RLI CORP
Form 10-Q
July 24, 2015
Table of Contents

13

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2015

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number: 001-09463

RLI Corp.

(Exact name of registrant as specified in its charter)

ILLINOIS (State or other jurisdiction of incorporation or organization)	37-0889946 (I.R.S. Employer Identification Number)
9025 North Lindbergh Drive, Peoria, IL (Address of principal executive offices)	61615 (Zip Code)

(309) 692-1000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of July 13, 2015, the number of shares outstanding of the registrant's Common Stock was 43,232,625.

Table of Contents

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

	For the Three-Month Periods Ended June 30,	
(in thousands, except per share data)	2015	2014
Net premiums earned	$ 172,339	$ 168,604
Net investment income	13,431	13,982
Net realized investment gains	4,802	10,431
Consolidated revenue	$ 190,572	$ 193,017
Losses and settlement expenses	64,549	73,345
Policy acquisition costs	59,487	55,156
Insurance operating expenses	13,467	13,534
Interest expense on debt	1,857	1,874
General corporate expenses	2,748	2,549
Total expenses	$ 142,108	$ 146,458
Equity in earnings of unconsolidated investees	6,186	5,864
Earnings before income taxes	$ 54,650	$ 52,423
Income tax expense	17,465	16,698
Net earnings	$ 37,185	$ 35,725
Other comprehensive earnings (loss), net of tax	(24,932)	19,934
Comprehensive earnings	$ 12,253	$ 55,659
Earnings per share:		
Basic:		
Basic net earnings per share	$ 0.86	$ 0.83
Basic comprehensive earnings per share	$ 0.28	$ 1.29
Diluted:		

Diluted net earnings per share	$ 0.84	$ 0.82
Diluted comprehensive earnings per share	$ 0.28	$ 1.27
Weighted average number of common shares outstanding		
Basic	43,210	43,001
Diluted	44,019	43,688
Cash dividends paid per common share	$ 0.19	$ 0.18

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Six-Month Periods Ended June 30, 2015	2014
Net premiums earned	$ 341,342	$ 329,736
Net investment income	26,926	27,564
Net realized investment gains	18,088	16,932
Consolidated revenue	$ 386,356	$ 374,232
Losses and settlement expenses	145,410	144,361
Policy acquisition costs	118,460	110,207
Insurance operating expenses	24,998	26,067
Interest expense on debt	3,713	3,725
General corporate expenses	4,992	4,747
Total expenses	$ 297,573	$ 289,107
Equity in earnings of unconsolidated investees	10,380	9,289
Earnings before income taxes	$ 99,163	$ 94,414
Income tax expense	31,380	29,720
Net earnings	$ 67,783	$ 64,694
Other comprehensive earnings (loss), net of tax	(32,527)	37,671
Comprehensive earnings	$ 35,256	$ 102,365
Earnings per share:		
Basic:		
Basic net earnings per share	$ 1.57	$ 1.50
Basic comprehensive earnings per share	$ 0.82	$ 2.38
Diluted:		
Diluted net earnings per share	$ 1.54	$ 1.48
Diluted comprehensive earnings per share	$ 0.80	$ 2.34
Weighted average number of common shares outstanding		
Basic	43,176	42,993
Diluted	44,008	43,669
Cash dividends paid per common share	$ 0.37	$ 0.35

See accompanying notes to the unaudited condensed consolidated interim financial statements.

RLI Corp. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)	June 30, 2015	December 31, 2014
ASSETS		
Investments		
Fixed income		
Available-for-sale, at fair value	$ 1,537,365	$ 1,495,087
Equity securities, at fair value	391,152	410,642
Short-term investments, at cost	10,169	16,339
Other invested assets	11,069	11,597
Cash	27,087	30,620
Total investments and cash	$ 1,976,842	$ 1,964,285
Accrued investment income	15,052	14,629
Premiums and reinsurance balances receivable	174,584	154,573
Ceded unearned premium	52,603	53,961
Reinsurance balances recoverable on unpaid losses	328,030	335,106
Deferred policy acquisition costs	71,575	65,123
Property and equipment	43,407	42,549
Investment in unconsolidated investees	71,179	60,046
Goodwill and intangibles	72,249	72,695
Other assets	9,664	12,575
TOTAL ASSETS	$ 2,815,185	$ 2,775,542
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Unpaid losses and settlement expenses	$ 1,142,596	$ 1,121,040
Unearned premiums	430,632	401,412
Reinsurance balances payable	36,915	38,013
Funds held	54,055	51,481
Income taxes-deferred	68,462	82,285
Bonds payable, long-term debt	149,647	149,625
Accrued expenses	40,303	63,148
Other liabilities	24,677	23,476
TOTAL LIABILITIES	$ 1,947,287	$ 1,930,480
Shareholders' Equity		
Common stock ($1 par value, 100,000,000 shares authorized)		
(66,162,839 shares issued, 43,232,625 shares outstanding at 6/30/15)		

(66,032,929 shares issued, 43,102,715 shares outstanding at 12/31/14)	$ 66,163	$ 66,033
Paid-in capital	217,165	213,737
Accumulated other comprehensive earnings	138,856	171,383
Retained earnings	838,713	786,908
Deferred compensation	14,042	13,769
Less: Treasury shares at cost		
(22,930,214 shares at 6/30/15 and 12/31/14)	(407,041)	(406,768)
TOTAL SHAREHOLDERS' EQUITY	$ 867,898	$ 845,062
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,815,185	$ 2,775,542

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Six-Month Periods Ended June 30, 2015	2014
Net cash provided by operating activities	$ 71,121	$ 38,528
Cash Flows from Investing Activities		
Investments purchased	$ (393,382)	$ (311,402)
Investments sold	250,602	217,403
Investments called or matured	81,680	49,932
Net change in short-term investments	3,866	15,462
Net property and equipment purchased	(3,289)	(4,921)
Investment in equity method investee	(1,711)	(5,301)
Net cash used in investing activities	$ (62,234)	$ (38,827)
Cash Flows from Financing Activities		
Cash dividends paid	$ (15,978)	$ (15,046)
Stock plan share issuance	1,779	2,760
Excess tax benefit from exercise of stock options	1,779	350
Net cash used in financing activities	$ (12,420)	$ (11,936)
Net decrease in cash	$ (3,533)	$ (12,235)
Cash at the beginning of the period	$ 30,620	$ 39,469
Cash at June 30	$ 27,087	$ 27,234

See accompanying notes to the unaudited condensed consolidated interim financial statements.

Table of Contents

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2014 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2015 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year.

The preparation of the unaudited condensed consolidated interim financial statements requires management to make estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated interim financial statements and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ significantly from these estimates.

B. ADOPTED ACCOUNTING STANDARDS

No new accounting standards have been adopted as no issued updates would impact our financial statements.

C. PROSPECTIVE ACCOUNTING STANDARDS

ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs

This ASU was issued to simplify the presentation of debt issuance costs by requiring them to be presented in the balance sheet as a direct deduction from the carrying amount of the related recognized debt liability, consistent with debt discounts. This ASU is effective for annual and interim reporting periods beginning after December 15, 2015. Early adoption is permitted. We have not early-adopted this ASU and do not believe adoption will have a material effect on our financial statements.

ASU 2015-09, Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts

This ASU was issued to enhance disclosures about an entity's insurance liabilities, including the nature, amount, timing and uncertainty of cash flows related to those liabilities. The new guidance requires the disclosure of the following information related to unpaid claims and claim adjustment expenses:

a. Net incurred and paid claims development information by accident year for the number of years for which claims incurred typically remain outstanding, but need not exceed 10 years;
b. A reconciliation of incurred and paid claims development information to the aggregate carrying amount of the liability for unpaid claims and claim adjustment expenses, with separate disclosure of reinsurance recoverable on unpaid claims for each period presented in the statement of financial position;
c. For each accident year presented, the total of incurred-but-not-reported liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses;
d. For each accident year presented, quantitative information about claim frequency accompanied by a qualitative description of methodologies used for determining claim frequency information; and
e. For all claims, the average annual percentage payout of incurred claims by age.

This ASU is effective for annual reporting periods beginning after December 15, 2015 and for interim periods beginning after December 15, 2016. Early adoption is permitted. We have not early-adopted this ASU and while disclosures will be increased, we do not believe adoption will have a material effect on our financial statements.

Table of Contents

D. INTANGIBLE ASSETS

In accordance with GAAP guidelines, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and intangible assets totaled $72.2 million at June 30, 2015.

Goodwill and intangible assets resulting from acquisitions completed prior to 2011 totaled $26.2 million and is attributable to our surety segment. Of this $26.2 million, $25.6 million relates to goodwill and $0.6 million relates to an indefinite-lived intangible asset. Goodwill and intangible assets resulting from the Contractors Bonding and Insurance Company (CBIC) acquisition in April 2011 totaled $30.3 million. The CBIC-related assets include goodwill attributable to our casualty and surety segments of $5.3 million and $15.1 million, respectively, and an indefinite-lived intangible asset in the amount of $7.5 million, which relates to state insurance licenses. Annual impairment testing was performed on each of these goodwill and indefinite-lived intangible assets during the second quarter of 2015. Based upon these reviews, none of the assets were impaired. In addition, as of June 30, 2015, there were no triggering events that occurred that would suggest further review was necessary. Definite-lived intangible assets related to the CBIC acquisition totaled $2.4 million, net of amortization, as of June 30, 2015.

The remaining $15.7 million of goodwill and intangibles relates to our purchase of Rockbridge Underwriting Agency (Rockbridge) in November 2012. Of this amount, $12.4 million is recorded as goodwill attributable to our casualty segment. The remaining $3.3 million relates to definite-lived intangible assets, net of amortization, as of June 30, 2015. Impairment testing is performed on this goodwill asset in the fourth quarter of each year. There were no triggering events that occurred during the first half of 2015 that would suggest further review was necessary.

The aforementioned definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets resulting from the acquisitions of CBIC and Rockbridge was $0.2 million for the second quarter of 2015 and $0.4 million for the six-month period ended June 30, 2015.

E. EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock or common stock equivalents were exercised or converted into common stock. When inclusion of common stock equivalents increases the earnings per share or reduces the loss per share, the effect on earnings is anti-dilutive. Under these circumstances, the diluted net earnings or net loss per share is computed excluding the common stock equivalents.

8

Table of Contents

The following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the unaudited condensed consolidated interim financial statements.

	For the Three-Month Period Ended June 30, 2015			For the Three-Month Period Ended June 30, 2014		
(in thousands, except per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	$ 37,185	43,210	$ 0.86	$ 35,725	43,001	$ 0.83
Effect of Dilutive Securities						
Stock options	-	809		-	687	
Diluted EPS						
Income available to common shareholders	$ 37,185	44,019	$ 0.84	$ 35,725	43,688	$ 0.82

	For the Six-Month Period Ended June 30, 2015			For the Six-Month Period Ended June 30, 2014		
(in thousands, except per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	$ 67,783	43,176	$ 1.57	$ 64,694	42,993	$ 1.50
Effect of Dilutive Securities						
Stock options	-	832		-	676	
Diluted EPS						
Income available to common shareholders	$ 67,783	44,008	$ 1.54	$ 64,694	43,669	$ 1.48

F. COMPREHENSIVE EARNINGS

Our comprehensive earnings include net earnings plus unrealized gains/losses on our available-for-sale investment securities, net of tax. In reporting comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 35 percent.

Unrealized losses for the first six months of 2015 were $32.5 million compared to unrealized gains of $37.7 million during the same period last year. Fixed income securities declined in market value during 2015 as interest rates rose and our conservative positioning in the equity portfolio underperformed the market over the same period. In 2014, both fixed income and equity securities experienced positive price movements.

The following table illustrates the changes in the balance of each component of accumulated other comprehensive earnings for each period presented in the unaudited condensed consolidated interim financial statements.

(in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
Unrealized Gains/Losses on Available-for-Sale Securities	2015	2014	2015	2014
Beginning balance	$ 163,788	$ 153,764	$ 171,383	$ 136,027
Other comprehensive earnings before reclassifications	(21,760)	26,714	(20,764)	48,674
Amounts reclassified from accumulated other comprehensive earnings	(3,172)	(6,780)	(11,763)	(11,003)
Net current-period other comprehensive earnings (loss)	$ (24,932)	$ 19,934	$ (32,527)	$ 37,671
Ending balance	$ 138,856	$ 173,698	$ 138,856	$ 173,698

Table of Contents

The sale or other-than-temporary impairment of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table.

(in thousands)	Amount Reclassified from Accumulated Other Comprehensive Earnings				
	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,		
Component of Accumulated Other Comprehensive Earnings	2015	2014	2015	2014	Affected line item in the Statement of Earnings
Unrealized gains and losses on available-for-sale securities	$ 4,880	$ 10,431	$ 18,097	$ 16,928	Net realized investment gains
	-	-	-	-	Other-than-temporary impairment (OTTI) losses on investments
	$ 4,880	$ 10,431	$ 18,097	$ 16,928	Earnings before income taxes
	(1,708)	(3,651)	(6,334)	(5,925)	Income tax expense
	$ 3,172	$ 6,780	$ 11,763	$ 11,003	Net earnings

2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2014 Annual Report on Form 10-K, we present all of our investments as available-for-sale, which are carried at fair value. During the fourth quarter of 2014, we sold our last remaining fixed income security that was classified as held-to-maturity. When available, we obtain quoted market prices to determine fair value for our investments. If a quoted market price is not available, fair value is estimated using a secondary pricing source or using quoted market prices of similar securities. We have no investment securities for which fair value is determined using Level 3 inputs as defined in note 3 to the unaudited condensed consolidated interim financial statements, "Fair Value Measurements."

Available-for-Sale Securities

The amortized cost and fair value of available-for-sale securities at June 30, 2015 and December 31, 2014 were as follows:

Available-for-sale
(in thousands)

	6/30/2015			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	$ 30,281	$ 129	$ (10)	$ 30,400
U.S. agency	13,499	229	(84)	13,644
Non-U.S. govt. & agency	1,893	-	(53)	1,840
Agency MBS	232,883	7,680	(1,383)	239,180
ABS/CMBS*	87,214	1,429	(344)	88,299
Corporate	595,886	14,694	(8,620)	601,960
Municipal	553,346	11,746	(3,050)	562,042
Total Fixed Income	$ 1,515,002	$ 35,907	$ (13,544)	$ 1,537,365
Equity	$ 198,607	$ 193,648	$ (1,103)	$ 391,152

*Non-agency asset-backed and commercial mortgage-backed

Table of Contents

Available-for-sale
(in thousands)

	12/31/2014			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	$ 33,668	$ 131	$ (11)	$ 33,788
U.S. agency	6,385	362	-	6,747
Non-U.S. govt. & agency	9,862	803	-	10,665
Agency MBS	256,443	9,401	(1,376)	264,468
ABS/CMBS*	133,894	1,821	(411)	135,304
Corporate	543,183	23,697	(4,190)	562,690
Municipal	464,769	16,789	(133)	481,425
Total Fixed Income	$ 1,448,204	$ 53,004	$ (6,121)	$ 1,495,087
Equity	$ 193,535	$ 218,105	$ (998)	$ 410,642

*Non-agency asset-backed and commercial mortgage-backed

The following table presents the amortized cost and fair value of available-for-sale debt securities by contractual maturity dates as of June 30, 2015:

	6/30/2015	
Available-for-sale (in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 9,309	$ 9,391
Due after one year through five years	259,490	265,403
Due after five years through 10 years	599,500	608,967
Due after 10 years	326,606	326,125
Mtge/ABS/CMBS*	320,097	327,479
Total available-for-sale	$ 1,515,002	$ 1,537,365

*Mortgage-backed, asset-backed and commercial mortgage-backed

Unrealized Losses

We conduct and document periodic reviews of all securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of securities that were in an unrealized loss position as of June 30, 2015 and December 31, 2014. The tables segregate the securities based on type, noting the fair value, cost (or amortized cost) and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of June 30, 2015 unrealized losses, as shown in the following tables, were 0.7 percent of total invested assets. Unrealized losses increased in 2015, as interest rates increased during the first half of the year.

Table of Contents

(in thousands)	June 30, 2015 < 12 Mos.	12 Mos. & Greater	Total	December 31, 2014 < 12 Mos.	12 Mos. & Greater	Total
U.S. Government						
Fair value	$ 5,307	$ —	$ 5,307	$ 4,416	$ —	$ 4,416
Cost or amortized cost	5,317	—	5,317	4,427	—	4,427
Unrealized Loss	$ (10)	$ —	$ (10)	$ (11)	$ —	$ (11)
U.S. Agency						
Fair value	$ 7,026	$ —	$ 7,026	$ —	$ —	$ —
Cost or amortized cost	7,110	—	7,110	—	—	—
Unrealized Loss	$ (84)	$ —	$ (84)	$ —	$ —	$ —
Non-U.S. government						
Fair value	$ 1,840	$ —	$ 1,840	$ —	$ —	$ —
Cost or amortized cost	1,893	—	1,893	—	—	—
Unrealized Loss	$ (53)	$ —	$ (53)	$ —	$ —	$ —
Agency MBS						
Fair value	$ 60,153	$ 20,107	$ 80,260	$ 12,840	$ 61,534	$ 74,374
Cost or amortized cost	60,974	20,669	81,643	12,947	62,803	75,750
Unrealized Loss	$ (821)	$ (562)	$ (1,383)	$ (107)	$ (1,269)	$ (1,376)
ABS/CMBS*						
Fair value	$ 31,524	$ 4,157	$ 35,681	$ 63,782	$ 11,616	$ 75,398
Cost or amortized cost	31,845	4,180	36,025	64,084	11,725	75,809
Unrealized Loss	$ (321)	$ (23)	$ (344)	$ (302)	$ (109)	$ (411)
Corporate						
Fair value	$ 230,965	$ 9,825	$ 240,790	$ 123,617	$ 14,488	$ 138,105
Cost or amortized cost	239,010	10,400	249,410	127,634	14,661	142,295
Unrealized Loss	$ (8,045)	$ (575)	$ (8,620)	$ (4,017)	$ (173)	$ (4,190)
Municipal						
Fair value	$ 173,994	$ —	$ 173,994	$ 12,382	$ 19,019	$ 31,401
Cost or amortized cost	177,044	—	177,044	12,411	19,123	31,534
Unrealized Loss	$ (3,050)	$ —	$ (3,050)	$ (29)	$ (104)	$ (133)
Subtotal, fixed income						
Fair value	$ 510,809	$ 34,089	$ 544,898	$ 217,037	$ 106,657	$ 323,694
Cost or amortized cost	523,193	35,249	558,442	221,503	108,312	329,815
Unrealized Loss	$ (12,384)	$ (1,160)	$ (13,544)	$ (4,466)	$ (1,655)	$ (6,121)
Equity securities						
Fair value	$ 14,227	$ —	$ 14,227	$ 10,837	$ —	$ 10,837

Cost or amortized cost	15,330	—	15,330	11,835	—	11,835
Unrealized Loss	$ (1,103)	$ —	$ (1,103)	$ (998)	$ —	$ (998)
Total						
Fair value	$ 525,036	$ 34,089	$ 559,125	$ 227,874	$ 106,657	$ 334,531
Cost or amortized cost	538,523	35,249	573,772	233,338	108,312	341,650
Unrealized Loss	$ (13,487)	$ (1,160)	$ (14,647)	$ (5,464)	$ (1,655)	$ (7,119)

* Non-agency asset-backed and commercial mortgage-backed

12

Table of Contents

The following table shows the composition of the fixed income securities in unrealized loss positions at June 30, 2015 by the National Association of Insurance Commissioners (NAIC) rating and the generally equivalent Standard & Poor's (S&P) and Moody's ratings. The vast majority of the securities are rated by S&P and/or Moody's.

NAIC Rating	Equivalent S&P Rating	Equivalent Moody's Rating	(dollars in thousands) Amortized Cost	Fair Value	Unrealized Loss	Percent to Total
1	AAA/AA/A	Aaa/Aa/A	$ 422,894	$ 414,108	$ (8,786)	64.9 %
2	BBB	Baa	90,037	86,789	(3,248)	24.0 %
3	BB	Ba	26,131	25,368	(763)	5.6 %
4	B	B	19,243	18,512	(731)	5.4 %
5	CCC or lower	Caa or lower	137	121	(16)	0.1 %
6			—	—	—	—
		Total	$ 558,442	$ 544,898	$ (13,544)	100.0 %

Evaluating Investments for OTTI

The fixed income portfolio contained 355 securities in an unrealized loss position as of June 30, 2015. The $13.5 million in associated unrealized losses for these 355 securities represents 0.9 percent of the fixed income portfolio's cost basis. Of these 355 securities, 33 have been in an unrealized loss position for 12 consecutive months or longer. All fixed income securities in the investment portfolio continue to pay the expected coupon payments under the contractual terms of the securities. Any credit-related impairment related to fixed income securities we do not plan to sell and for which we are not more likely than not to be required to sell is recognized in net earnings, with the non-credit related impairment recognized in comprehensive earnings. Based on our analysis, our fixed income portfolio is of high credit quality and we believe we will recover the amortized cost basis of our fixed income securities. We continually monitor the credit quality of our fixed income investments to assess if it is probable that we will receive our contractual or estimated cash flows in the form of principal and interest. There were no other-than-temporary impairment (OTTI) losses recognized in net earnings or other comprehensive earnings in the periods presented on the fixed income portfolio.

As of June 30, 2015, we held five common stock securities that were in an unrealized loss position. The unrealized loss on these securities was $1.1 million. Based on our analysis, we believe each security will recover in a reasonable period of time and we have the intent and ability to hold them until recovery. No equity securities have been in an unrealized loss position for 12 consecutive months or longer. There were no OTTI losses recognized in the periods presented on the equity portfolio.

Other Invested Assets

Other invested assets include an investment in a low income housing tax credit partnership, carried at amortized cost, and membership in the Federal Home Loan Bank Chicago (FHLBC), carried at cost. Our interest in a low income housing tax credit partnership had a balance of $9.5 million at June 30, 2015 compared to $9.8 million at December 31, 2014 and recognized a total tax benefit of $0.2 million during the second quarter of 2015 and $0.5 million during the six-month period ended June 30, 2015. Our investment in FHLBC stock totaled $1.6 million at June 30, 2015 compared to $1.8 million at December 31, 2014.

Cash and Short-term Investments

Cash consists of uninvested balances in bank accounts. We had a cash balance of $27.1 million at the end of the second quarter of 2015, compared to $30.6 million at the end of 2014. Short-term investments are carried at cost, which approximates fair value. The balance at June 30, 2015 was $10.2 million compared to $16.3 million at December 31, 2014.

3. FAIR VALUE MEASUREMENTS

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Fair value is defined as the price in the principal market that would be received for an asset to facilitate an orderly transaction between market participants on the measurement date.

Table of Contents

We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. GAAP guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also describes three levels of inputs that may be used to measure fair value.

Financial assets are classified based upon the lowest level of significant input that is used to determine fair value. The following are the levels of the fair value hierarchy and a brief description of the type of valuation inputs that are used to establish each level:

Pricing Level 1 is applied to valuations based on readily available, unadjusted quoted prices in active markets for identical assets.

Pricing Level 2 is applied to valuations based upon quoted prices for similar assets in active markets, quoted prices for identical or similar assets in inactive markets; or valuations based on models where the significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities) or can be corroborated by observable market data.

Pricing Level 3 is applied to valuations that are derived from techniques in which one or more of the significant inputs are unobservable.

As a part of management’s process to determine fair value, we utilize widely recognized, third-party pricing sources to determine our fair values. We have obtained an understanding of the third-party pricing sources’ valuation methodologies and inputs. The following is a description of the valuation techniques used for financial assets that are measured at fair value, including the general classification of such assets pursuant to the fair value hierarchy.

Corporate, Agencies, Government and Municipal Bonds: The pricing vendor employs a multi-dimensional model which uses standard inputs including (listed in approximate order of priority for use) benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, market bids/offers and other reference data. The pricing vendor also monitors market indicators, as well as industry and economic events. All bonds valued using these techniques are classified as Level 2. All corporate, agency, government and municipal securities were deemed Level 2.

Mortgage-backed Securities (MBS)/Commercial Mortgage-backed Securities (CMBS) and Asset-backed Securities (ABS): The pricing vendor evaluation methodology includes principally interest rate movements and new issue data. Evaluation of the tranches (non-volatile, volatile or credit sensitivity) is based on the pricing vendors’ interpretation of accepted modeling and pricing conventions. This information is then used to determine the cash flows for each tranche, benchmark yields, prepayment assumptions and to incorporate collateral performance. To evaluate MBS and CMBS volatility, an option adjusted spread model is used in combination with models that simulate interest rate paths to determine market price information. This process allows the pricing vendor to obtain evaluations of a broad universe of securities in a way that reflects changes in yield curve, index rates, implied volatility, mortgage rates and recent trade activity. MBS/CMBS and ABS with corroborated, observable inputs are classified as Level 2. All of our MBS/CMBS and ABS are deemed Level 2.

Common Stock: Exchange traded equities have readily observable price levels and are classified as Level 1 (fair value based on quoted market prices). All of our common stock holdings are deemed Level 1.

For the Level 2 securities, as described above, we periodically conduct a review to assess the reasonableness of the fair values provided by our pricing services. Our review consists of a two pronged approach. First, we compare prices provided by our pricing services to those provided by an additional source. Second, we obtain prices from securities brokers and compare them to the prices provided by our pricing services. In both comparisons, when discrepancies are found, we compare our prices to actual reported trade data for like securities. Based on this assessment, we determined that the fair values of our Level 2 securities provided by our pricing services are reasonable.

For common stock, we receive prices from a nationally recognized pricing service. Prices are based on observable inputs in an active market and are therefore disclosed as Level 1. Based on this assessment, we determined that the fair values of our Level 1 securities provided by our pricing service are reasonable.

Due to the relatively short-term nature of cash, short-term investments, accounts receivable and accounts payable, their carrying amounts are reasonable estimates of fair value.

Table of Contents

Assets measured at fair value in the accompanying unaudited condensed consolidated interim financial statements on a recurring basis are summarized below:

	As of June 30, 2015			
	Fair Value Measurements Using			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Available-for-sale securities				
U.S. government	$ —	$ 30,400	$ —	$ 30,400
U.S. agency	—	13,644	—	13,644
Non-U.S. govt. & agency	—	1,840	—	1,840
Agency MBS	—	239,180	—	239,180
ABS/CMBS*	—	88,299	—	88,299
Corporate	—	601,960	—	601,960
Municipal	—	562,042	—	562,042
Equity	391,152	—	—	391,152
Total available-for-sale securities	$ 391,152	$ 1,537,365	$ —	$ 1,928,517

*Non-agency asset-backed and commercial mortgage-backed

	As of December 31, 2014			
	Fair Value Measurements Using			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Available-for-sale securities				
U.S. government	$ —	$ 33,788	$ —	$ 33,788
U.S. agency	—	6,747	—	6,747
Non-U.S. govt. & agency	—	10,665	—	10,665
Agency MBS	—	264,468	—	264,468
ABS/CMBS*	—	135,304	—	135,304
Corporate	—	562,690	—	562,690
Municipal	—	481,425	—	481,425
Equity	410,642	—	—	410,642
Total available-for-sale securities	$ 410,642	$ 1,495,087	$ —	$ 1,905,729

* Non-agency asset-backed and commercial mortgage-backed

As noted in the above table, we did not have any assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period. Additionally, there were no securities transferred in or out of levels 1 or 2 during the six-month period ended June 30, 2015.

4. INCOME TAXES

Our effective tax rate for the three and six-month periods ended June 30, 2015 was 32 percent compared to 31 percent for the same periods in 2014. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher for the three and six-month periods ended June 30, 2015 due to an increase in underwriting income compared to the same periods in 2014.

Income tax expense attributable to income from operations for the three and six-month periods ended June 30, 2015 and 2014 differed from the amounts computed by applying the U.S. federal tax rate of 35 percent to pretax income as a result of the following:

Table of Contents

	For the Three-Month Periods Ended June 30,						For the Six-Month Periods Ended June 30,					
	2015			2014			2015			2014		
(in thousands)	Amount	%		Amount	%		Amount	%		Amount	%	
Provision for income taxes at the statutory rate of 35%	$ 19,127	35	%	$ 18,348	35	%	$ 34,707	35	%	$ 33,045	35	%
Increase (reduction) in taxes resulting from:												
Tax exempt interest income	(1,054)	(2)	%	(1,048)	(2)	%	(2,016)	(2)	%	(2,082)	(2)	%
Dividends received deduction	(535)	(1)	%	(533)	(1)	%	(1,112)	(1)	%	(1,131)	(1)	%
ESOP dividends paid deduction	(238)	—	%	(220)	(1)	%	(458)	—	%	(421)	(1)	%
Other items, net	165	—	%	151	—	%	259	—	%	309	—	%
Total tax expense	$ 17,465	32	%	$ 16,698	31	%	$ 31,380	32	%	$ 29,720	31	%

5. STOCK BASED COMPENSATION

Our RLI Corp. Omnibus Stock Plan (omnibus plan) was in place from 2005 to 2010. The omnibus plan provided for equity-based compensation, including stock options, up to a maximum of 3,000,000 shares of common stock (subject to adjustment for changes in our capitalization and other events). Between 2005 and 2010, we granted 2,458,059 stock options under this plan, including incentive stock options (ISOs), which were adjusted as part of the special dividends paid in 2014 and prior years. The omnibus plan was replaced in 2010.

In 2010, our shareholders approved the RLI Corp. Long-Term Incentive Plan (2010 LTIP), which provides for equity-based compensation and replaced the omnibus plan. In conjunction with the adoption of the 2010 LTIP, effective May 6, 2010, options were no longer granted under the omnibus plan. The 2010 LTIP provided for equity-based compensation, including stock options, up to a maximum of 4,000,000 shares of common stock (subject to adjustment for changes in our capitalization and other events). Between 2010 and 2015, we granted 2,878,000 stock options under the 2010 LTIP, including 53,500 in the first quarter of 2015. The 2010 LTIP was replaced in the second quarter of 2015.

During the second quarter of 2015, our shareholders approved the 2015 RLI Corp. Long-Term Incentive Plan (2015 LTIP), which provides for equity-based compensation and replaced the 2010 LTIP. In conjunction with the adoption of the 2015 LTIP, effective May 7, 2015, options were no longer granted under the 2010 LTIP. Awards under the 2015 LTIP may be in the form of restricted stock, stock options (non-qualified only), stock appreciation rights, performance units as well as other stock-based awards. Eligibility under the 2015 LTIP is limited to employees or directors of the company or any affiliate. The granting of awards under the 2015 LTIP is solely at the discretion of the board of directors. The maximum number of shares of common stock available for distribution under the 2015 LTIP is 4,000,000 shares (subject to adjustment for changes in our capitalization and other events). Thus far in 2015, we have granted 412,000 stock options under the 2015 LTIP.

Under the 2015 LTIP, as under the 2010 LTIP and omnibus plan, we grant stock options for shares with an exercise price equal to the fair market value of the shares at the date of grant (subject to adjustments for changes in our capitalization, special dividends and other events as set forth in such plans). Options generally vest and become exercisable ratably over a five-year period and expire eight years after grant.

For most participants, the requisite service period and vesting period will be the same. For participants who are retirement eligible, defined by the plan as those individuals whose age and years of service equals 75, the requisite service period is deemed to be met and options are immediately expensed on the date of grant. For participants who will become retirement eligible during the vesting period, the requisite service period over which expense is recognized is the period between the grant date and the attainment of retirement eligibility. Shares issued upon option exercise are newly issued shares.

Table of Contents

The following tables summarize option activity for the periods ended June 30, 2015 and 2014:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2015	2,892,717	$ 26.65		
Options granted	465,500	$ 49.52		
Options exercised	(215,617)	$ 18.97		$ 6,620
Options canceled/forfeited	(4,560)	$ 31.87		
Outstanding options at June 30, 2015	3,138,040	$ 30.56	5.28	$ 65,356
Exercisable options at June 30, 2015	1,441,660	$ 22.48	4.02	$ 41,674

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2014	2,595,084	$ 26.04		
Options granted	420,000	$ 42.88		
Options exercised	(43,872)	$ 18.31		$ 1,139
Options canceled/forfeited	(740)	$ 16.51		
Outstanding options at June 30, 2014	2,970,472	$ 28.53	5.47	$ 51,232
Exercisable options at June 30, 2014	1,300,292	$ 22.02	4.21	$ 30,894

The majority of our stock options are granted annually at our regular board meeting in May. In addition, options are approved at the May meeting for quarterly grants to certain retirement eligible employees. Since stock option grants to retirement eligible employees are fully expensed when issued, the approach allows for a more even expense distribution throughout the year.

Thus far in 2015, 465,500 stock options were granted with a weighted average exercise price of $49.52 and a weighted average fair value of $8.94. We recognized $1.1 million of expense in the second quarter of 2015 and $2.0 million in the first six months of 2015 related to options vesting. Since options granted under 2010 LTIP and 2015 LTIP are non-qualified, we recorded a tax benefit of $0.4 million in the second quarter of 2015 and $0.7 million in the first six months of 2015 related to this compensation expense. Total unrecognized compensation expense relating to outstanding and unvested options was $6.8 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized $1.2 million of expense in the second quarter of 2014 and $2.1 million of expense in the first six months of 2014. We recorded a tax benefit of $0.4 million in the second quarter of 2014 and $0.7 million in the first six months of 2014 related to this compensation expense.

The fair value of options was estimated using a Black-Scholes based option pricing model with the following weighted average grant-date assumptions and weighted average fair values as of June 30:

	2015	2014
Weighted-average fair value of grants	$ 8.94	$ 7.76
Risk-free interest rates	1.54 %	1.70 %
Dividend yield	1.81 %	1.94 %
Expected volatility	22.89 %	23.22 %
Expected option life	5.21 years	5.18 years

The risk-free rate was determined based on U.S. treasury yields that most closely approximated the option's expected life. The dividend yield was calculated based on the average annualized ordinary dividends paid during the most recent five-year period. It excluded the special dividends paid in the fourth quarters of 2014 and prior years. The expected volatility was calculated based on the median of the rolling volatilities for the expected life of the options. The expected option life was determined based on historical exercise behavior and the assumption that all outstanding options will be exercised at the midpoint of the current date and remaining contractual term, adjusted for the demographics of the current year's grant.

Table of Contents

During the first quarter of 2014, each outside director received $10,000 worth of restricted common shares from the 2010 LTIP as part of director compensation. The shares were directly owned by each director on the date of issuance and included a one-year restriction on the sale or transfer of such shares. In the first quarter of 2014, we issued a total of 2,097 restricted shares and recognized $0.1 million of compensation expense. This restricted share program was terminated in 2014.

6. OPERATING SEGMENT INFORMATION

Selected information by operating segment is presented in the table below. Additionally, the table reconciles segment totals to total earnings and total revenues.

	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
REVENUES				
(in thousands)	2015	2014	2015	2014
Net premiums earned:				
Casualty	$ 101,914	$ 94,360	$ 200,682	$ 185,337
Property	41,281	48,791	83,399	92,109
Surety	29,144	25,453	57,261	52,290
Segment totals before income taxes	$ 172,339	$ 168,604	$ 341,342	$ 329,736
Net investment income	13,431	13,982	26,926	27,564
Net realized gains	4,802	10,431	18,088	16,932
Total consolidated revenue	$ 190,572	$ 193,017	$ 386,356	$ 374,232
NET EARNINGS				
(in thousands)	2015	2014	2015	2014
Casualty	$ 19,201	$ 16,467	$ 24,473	$ 22,545
Property	4,828	2,293	13,004	11,971
Surety	10,807	7,809	14,997	14,585
Net underwriting income	$ 34,836	$ 26,569	$ 52,474	$ 49,101
Net investment income	13,431	13,982	26,926	27,564
Net realized gains	4,802	10,431	18,088	16,932
General corporate expense and interest on debt	(4,605)	(4,423)	(8,705)	(8,472)
Equity in earnings of unconsolidated investees	6,186	5,864	10,380	9,289
Total earnings before income taxes	$ 54,650	$ 52,423	$ 99,163	$ 94,414
Income tax expense	17,465	16,698	31,380	29,720

Total net earnings	$ 37,185	$ 35,725	$ 67,783	$ 64,694

18

Table of Contents

The following table further summarizes revenues by major product type within each operating segment:

NET PREMIUMS EARNED (in thousands)	For the Three-Month Periods Ended June 30, 2015	2014	For the Six-Month Periods Ended June 30, 2015	2014
Casualty				
Commercial and personal umbrella	$ 26,012	$ 25,024	$ 51,309	$ 49,780
General liability	20,607	20,523	40,579	40,455
Professional services	17,641	13,839	34,721	26,700
Commercial transportation	15,117	15,005	29,798	29,516
P&C package business	9,909	8,495	19,558	16,778
Executive products	4,601	4,721	9,286	9,405
Medical professional liability	3,032	3,724	6,136	7,424
Other casualty	4,995	3,029	9,295	5,279
Total	$ 101,914	$ 94,360	$ 200,682	$ 185,337
Property				
Commercial property	$ 19,049	$ 20,054	$ 38,952	$ 40,487
Marine	10,984	12,962	22,901	25,163
Specialty personal	6,657	6,709	13,447	12,817
Property reinsurance	3,342	3,387	6,359	6,748
Crop reinsurance	1,222	5,683	1,687	6,869
Other property	27	(4)	53	25
Total	$ 41,281	$ 48,791	$ 83,399	$ 92,109
Surety				
Miscellaneous	$ 10,489	$ 9,598	$ 20,657	$ 19,080
Commercial	7,592	6,313	14,493	12,447
Contract	6,789	6,256	13,619	13,017
Oil and Gas	4,274	3,286	8,492	7,746
Total	$ 29,144	$ 25,453	$ 57,261	$ 52,290