

RLI CORP
Form 10-Q
October 31, 2011

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 September 30, 2011

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)

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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

Smaller reporting company

(Do not check if a 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 October 15, 2011, the number of shares outstanding of the registrant's Common Stock was 21,081,400.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Three-Month Periods Ended September 30,	
	2011	2010
Net premiums earned	\$ 146,552	\$ 128,334
Net investment income	15,954	16,762
Net realized investment gains (losses)	80	4,527
Other-than-temporary impairment (OTTI) losses on investments	(257)	
Consolidated revenue	162,329	149,623
Losses and settlement expenses	64,802	55,823
Policy acquisition costs	46,712	40,624
Insurance operating expenses	10,302	10,161
Interest expense on debt	1,513	1,512
General corporate expenses	1,594	2,148
Total expenses	124,923	110,268
Equity in earnings of unconsolidated investee	713	1,648
Earnings before income taxes	38,119	41,003
Income tax expense	12,062	13,038
Net earnings	\$ 26,057	\$ 27,965
Other comprehensive earnings (loss), net of tax	(14,331)	30,476
Comprehensive earnings	\$ 11,726	\$ 58,441
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 1.24	\$ 1.34
Basic comprehensive earnings per share	\$ 0.56	\$ 2.79
Diluted:		
Diluted net earnings per share	\$ 1.22	\$ 1.33
Diluted comprehensive earnings per share	\$ 0.55	\$ 2.77
Weighted average number of common shares outstanding		
Basic	21,089	20,931
Diluted	21,335	21,090
Cash dividends declared per common share	\$ 0.30	\$ 0.29

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The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

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RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Nine-Month Periods Ended September 30,	
	2011	2010
Net premiums earned	\$ 393,429	\$ 366,356
Net investment income	47,437	50,127
Net realized investment gains	14,602	15,281
Other-than-temporary impairment (OTTI) losses on investments	(257)	
Consolidated revenue	455,211	431,764
Losses and settlement expenses	142,036	155,152
Policy acquisition costs	129,813	118,804
Insurance operating expenses	32,047	27,158
Interest expense on debt	4,537	4,537
General corporate expenses	5,563	5,406
Total expenses	313,996	311,057
Equity in earnings of unconsolidated investee	7,215	7,327
Earnings before income taxes	148,430	128,034
Income tax expense	48,531	40,854
Net earnings	\$ 99,899	\$ 87,180
Other comprehensive earnings (loss), net of tax	(6,323)	27,986
Comprehensive earnings	\$ 93,576	\$ 115,166
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 4.74	\$ 4.14
Basic comprehensive earnings per share	\$ 4.44	\$ 5.47
Diluted:		
Diluted net earnings per share	\$ 4.68	\$ 4.11
Diluted comprehensive earnings per share	\$ 4.39	\$ 5.42
Weighted average number of common shares outstanding		
Basic	21,063	21,043
Diluted	21,324	21,233
Cash dividends declared per common share	\$ 0.89	\$ 0.86

The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

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RLI Corp. and Subsidiaries Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)	September 30, 2011	December 31, 2010
ASSETS		
Investments		
Fixed income		
Available-for-sale, at fair value	\$ 1,211,759	\$ 1,132,064
Held-to-maturity, at amortized cost	318,428	309,258
Trading, at fair value	8	15
Equity securities, at fair value	331,301	321,897
Short-term investments, at cost	155,970	39,787
Total investments	2,017,466	1,803,021
Accrued investment income	12,144	14,615
Premiums and reinsurance balances receivable	119,771	107,391
Ceded unearned premium	59,298	62,631
Reinsurance balances recoverable on unpaid losses	341,986	354,163
Deferred policy acquisition costs	95,365	74,435
Property and equipment	19,502	18,370
Investment in unconsolidated investees	51,258	43,358
Goodwill and intangibles	60,733	26,214
Other assets	16,840	10,394
TOTAL ASSETS	\$ 2,794,363	\$ 2,514,592
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and settlement expenses	\$ 1,179,993	\$ 1,173,943
Unearned premiums	361,591	301,537
Reinsurance balances payable	22,687	23,851
Funds held	109,592	32,072
Income taxes-deferred	31,917	33,930
Bonds payable, long-term debt	100,000	100,000
Accrued expenses	55,165	42,436
Other liabilities	65,933	15,447
TOTAL LIABILITIES	\$ 1,926,878	\$ 1,723,216
Shareholders Equity		
Common stock (\$1 par value)		
(32,542,327 shares issued at 9/30/11)		
(32,317,691 shares issued at 12/31/10)	32,542	32,318
Paid-in capital	222,756	215,066
Accumulated other comprehensive earnings	89,669	95,992
Retained earnings	915,517	834,375
Deferred compensation	8,745	6,474
Less: Treasury shares at cost		
(11,465,107 shares at 9/30/11)		
(11,353,151 shares at 12/31/10)	(401,744)	(392,849)
TOTAL SHAREHOLDERS EQUITY	867,485	791,376
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 2,794,363	\$ 2,514,592

The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Nine-Month Periods Ended September 30,	
	2011	2010
Net cash provided by operating activities	\$ 115,922	\$ 87,867
Cash Flows from Investing Activities		
Investments purchased	(608,538)	(774,532)
Investments sold	353,781	218,083
Investments called or matured	340,321	512,650
Net change in short-term investments	(45,612)	(7,648)
Net property and equipment purchased	(2,507)	(1,297)
Investment in CBIC	(135,900)	
Net cash used in investing activities	\$ (98,455)	\$ (52,744)
Cash Flows from Financing Activities		
Cash dividends paid	\$ (18,757)	\$ (17,932)
Stock option plan share issuance	4,754	4,152
Excess tax benefit from exercise of stock options	3,160	2,515
Treasury shares purchased	(6,624)	(23,858)
Net cash used in financing activities	\$ (17,467)	\$ (35,123)
Net increase in cash		
Cash at the beginning of the period		
Cash at September 30	\$	\$

The accompanying notes are an integral part of the unaudited condensed consolidated interim financial statements.

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 2010 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 September 30, 2011 and the results of operations of RLI Corp. and Subsidiaries for all periods presented have been made. Certain reclassifications were made to the prior year's financial statements to conform to the classifications used in the current year. Specifically, on our balance sheet, the amount of funds held was broken out separately from other liabilities. Also, the fidelity division was reclassified to the casualty segment from the surety segment. See further discussion regarding the reclassification in note 5 to the unaudited condensed consolidated interim financial statements, Operating Segment Information. 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 from these estimates.

B. ADOPTED ACCOUNTING STANDARDS

ASU 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations

This Accounting Standards Update (ASU) specifies that if a public entity presents comparative financial statements, the entity (acquirer) should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year has occurred as of the beginning of the comparable prior annual reporting period. This ASU also expands the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings.

We adopted ASU 2010-29 on January 1, 2011. We have evaluated our recent acquisition of Contractors Bonding and Insurance Company (CBIC) under this guidance and, as the acquisition was not material as defined by the accounting guidance, pro forma disclosures were not required. See further discussion on

the acquisition in note 6 to the unaudited condensed consolidated interim financial statements, Acquisition.

ASU 2010-28, Intangibles – Goodwill and Other (Topic 350), When to Perform Step Two of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts

The amendments in this ASU modify Step One of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step Two of the goodwill impairment test if it is more-likely-than-not that a goodwill impairment exists. In determining whether it is more-likely-than-not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more-likely-than-not reduce the fair value of a reporting unit below its carrying amount.

Upon adoption of this ASU, if the carrying value of the reporting unit is zero or negative, the reporting entity must perform Step Two of the goodwill impairment test if it is more-likely-than-not that goodwill is impaired as of the date of adoption. Any resulting goodwill impairment should be presented as a cumulative-effect adjustment to beginning retained earnings of the period of adoption reflecting a change in accounting principle. No additional recurring disclosures are included as a result of this ASU.

We adopted ASU 2010-28 on January 1, 2011. The adoption did not have an impact on our financial statements as the carrying value of the reporting unit related to our goodwill at the beginning of the reporting period is positive and there have been no triggering events that would suggest possible impairment. During 2011, we recognized additional goodwill related to our recent acquisition of CBIC.

C. PROSPECTIVE ACCOUNTING STANDARDS

ASU 2010-26, Financial Services – Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

Accounting guidance for deferred acquisition costs incurred by insurance entities changed under the ASU and was designed to eliminate inconsistent industry practices. The ASU requires costs to be incrementally or directly related to the successful acquisition of new or renewal insurance contracts in order to be capitalized as deferred acquisition costs.

Deferred acquisition costs may include agent and broker commissions, salaries of certain employees involved in underwriting and policy issuance, and medical and inspection fees. Previous accounting guidance described deferred acquisition costs as those that vary with and are primarily related to the acquisition of new and renewal insurance contracts. This resulted in some entities deferring only direct and incremental costs while others included certain indirect costs. Others deferred costs for all acquisition efforts, including rejected contracts.

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The new guidance limits the capitalization of contract acquisition costs to successful acquisition of insurance contracts in these four components:

- a. Incremental direct costs of contract acquisition;
- b. The portion of the employee's total compensation (excluding any compensation that is capitalized as incremental direct costs of contract acquisition) and payroll-related fringe benefits related directly to time spent performing any of the following acquisition activities for a contract that actually has been acquired:
 - Underwriting,
 - Policy issuance and processing,
 - Medical and inspection, and
 - Sales force contract selling;
- c. Other costs related directly to the insurers' acquisition activities in (b) that would not have been incurred by the insurance entity had the acquisition contract transaction(s) not occurred; and
- d. Advertising costs that meet the capitalization criteria.

Entities will not be required to capitalize costs that they had previously expensed as a result of applying the new guidance.

The effective date for the guidance will be interim and annual periods beginning after December 15, 2011. Early adoption is permitted but only at the beginning of an entity's annual reporting period.

Either prospective or retrospective application is permitted. If applied on a retrospective basis, the guidance does not require the disclosure of the effect of the change in accounting principle in the current period. However, if the prospective basis is applied, entities will be required to disclose either the effect of the change in the period of adoption or its effect in the period immediately preceding adoption.

We are currently assessing our estimate of the impact of adopting the ASU on our financial statements.

ASU 2011-08, Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment

On September 15, 2011, the FASB issued ASU 2011-08 which permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity can support the conclusion that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not need to perform the two-step impairment test for that reporting unit. Goodwill must be tested for impairment at least annually, and prior to this ASU, a two-step test was required to assess goodwill for impairment. In Step 1, the fair value of a reporting unit is compared to the reporting unit's carrying amount. If the fair value is less than the carrying amount, Step 2 is used to measure the amount of goodwill impairment, if any.

The ASU applies to both public and nonpublic entities and is effective for annual and interim goodwill impairment tests performed in fiscal years

beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. We have not early adopted this ASU and do not believe it will have a material effect on our financial statements.

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. The portion of goodwill which relates solely to our surety segment totaled \$26.2 million at September 30, 2011 and December 31, 2010 and is included in the total goodwill and intangibles on the balance sheet of \$60.7 million at September 30, 2011. Annual impairment testing was performed during the second quarter of 2011. Based upon this review, this asset was not impaired. In addition, as of September 30, 2011, there were no triggering events that had occurred that would suggest an updated review was necessary.

The remaining \$34.5 million of goodwill and intangibles relates to our purchase of CBIC in April 2011. Intangible assets with definite lives are amortized against future operating results. Amortization of intangible assets was \$0.2 million for the third quarter of 2011 and \$0.3 million since acquisition on April 28, 2011. We are still in the process of evaluating the acquisition under ASC Topic 805, Business Combinations. (See Note 6 to the unaudited condensed consolidated interim financial statements).

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.

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

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(in thousands, except per share data)	For the Three-Month Period Ended September 30, 2011			For the Three-Month Period Ended September 30, 2010		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	\$ 26,057	21,089	\$ 1.24	\$ 27,965	20,931	\$ 1.34
Effect of Dilutive Securities						
Stock Options		246			159	
Diluted EPS						
Income available to common shareholders	\$ 26,057	21,335	\$ 1.22	\$ 27,965	21,090	\$ 1.33

(in thousands, except per share data)	For the Nine-Month Period Ended September 30, 2011			For the Nine-Month Period Ended September 30, 2010		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	\$ 99,899	21,063	\$ 4.74	\$ 87,180	21,043	\$ 4.14
Effect of Dilutive Securities						
Stock options		261			190	
Diluted EPS						
Income available to common shareholders	\$ 99,899	21,324	\$ 4.68	\$ 87,180	21,233	\$ 4.11

2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2010 Annual Report on Form 10-K, we present our investments in these classes as available-for-sale, held-to-maturity, or trading securities. 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.

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 September 30, 2011 and December 31, 2010. 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 September 30, 2011 and December 31, 2010, unrealized losses, as shown in the following tables, were less than 1% of total invested assets. Unrealized losses have decreased in 2011, as the market value of fixed income securities have increased as a result of lower interest rates which have offset the decline in equity markets.

Investment Positions with Unrealized Losses
Segmented by Type and Period of Continuous
Unrealized Loss at September 30, 2011

(dollars in thousands)	< 12 Mos.	12 Mos. & Greater	Total
Treasuries			
Fair value	\$ 6,317	\$	\$ 6,317
Cost or Amortized Cost	6,339		6,339
Unrealized Loss	(22)		(22)
Agencies			
Fair value	\$ 35,364	\$ 17,997	\$ 53,361
Cost or Amortized Cost	35,489	18,039	53,528
Unrealized Loss	(125)	(42)	(167)
Mortgage-backed			
Fair value	\$	\$	\$
Cost or Amortized Cost			
Unrealized Loss			
ABS/CMO*			
Fair value	\$ 2,305	\$	\$ 2,305
Cost or Amortized Cost	2,341		2,341
Unrealized Loss	(36)		(36)
Corporate			
Fair value	\$ 83,711	\$ 20,383	\$ 104,094
Cost or Amortized Cost	86,809	21,155	107,964
Unrealized Loss	(3,098)	(772)	(3,870)
Municipals			
Fair value	\$ 17,132	\$ 1,862	\$ 18,994
Cost or Amortized Cost	17,266	1,872	19,138
Unrealized Loss	(134)	(10)	(144)
Subtotal, debt securities			
Fair value	\$ 144,829	\$ 40,242	\$ 185,071
Cost or Amortized Cost	148,244	41,066	189,310
Unrealized Loss	(3,415)	(824)	(4,239)
Common Stock			
Fair value	\$ 42,769	\$	\$ 42,769
Cost or Amortized Cost	50,013		50,013
Unrealized Loss	(7,244)		(7,244)
Total			
Fair value	\$ 187,598	\$ 40,242	\$ 227,840
Cost or Amortized Cost	198,257	41,066	239,323
Unrealized Loss	(10,659)	(824)	(11,483)

* Asset-backed & collateralized mortgage obligations.

This table excludes securities with a fair value of less than \$0.1 million classified as trading.

Investment Positions with Unrealized Losses
Segmented by Type and Period of Continuous
Unrealized Loss at December 31, 2010

(dollars in thousands)	< 12 Mos.	12 Mos. & Greater	Total
Treasuries			
Fair value	\$ 5,689	\$	\$ 5,689
Cost or Amortized Cost	5,880		5,880
Unrealized Loss	(191)		(191)
Agencies			
Fair value	\$ 295,897	\$	\$ 295,897
Cost or Amortized Cost	304,374		304,374
Unrealized Loss	(8,477)		(8,477)
Mortgage-backed			
Fair value	\$ 43,852	\$	\$ 43,852
Cost or Amortized Cost	44,659		44,659
Unrealized Loss	(807)		(807)
ABS/CMO *			
Fair value	\$ 2,160	\$	\$ 2,160
Cost or Amortized Cost	2,196		2,196
Unrealized Loss	(36)		(36)
Corporate			
Fair value	\$ 110,772	\$ 1,951	\$ 112,723
Cost or Amortized Cost	113,813	2,012	115,825
Unrealized Loss	(3,041)	(61)	(3,102)
Municipals			
Fair value	\$ 80,465	\$ 996	\$ 81,461
Cost or Amortized Cost	82,652	1,050	83,702
Unrealized Loss	(2,187)	(54)	(2,241)
Subtotal, debt securities			
Fair value	\$ 538,835	\$ 2,947	\$ 541,782
Cost or Amortized Cost	553,574	3,062	556,636
Unrealized Loss	(14,739)	(115)	(14,854)
Common Stock			
Fair value	\$ 6,078	\$	\$ 6,078
Cost or Amortized Cost	6,372		6,372
Unrealized Loss	(294)		(294)
Total			
Fair value	\$ 544,913	\$ 2,947	\$ 547,860
Cost or Amortized Cost	559,946	3,062	563,008
Unrealized Loss	(15,033)	(115)	(15,148)

* Asset-backed & collateralized mortgage obligations.

This table excludes securities with a fair value of \$0.1 million, classified as trading.

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The following tables show the amortized cost, unrealized gains/losses, fair value and contractual maturities for our available-for-sale and held-to-maturity securities.

Available-for-Sale Securities

The amortized cost and fair value of securities available-for-sale at September 30, 2011 and December 31, 2010 were as follows:

Available-for-sale

(in thousands)

Asset Class	9/30/2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Agencies	\$ 165,399	\$ 1,274	\$ (56)	\$ 166,617
Corporates	433,662	30,167	(3,470)	460,359
Mortgage-backed	239,596	16,477		256,073
ABS/CMO*	60,598	2,022	(36)	62,584
Treasuries	21,511	486	(22)	21,975
Municipals	234,459	9,836	(144)	244,151
Total Fixed Income	\$ 1,155,225	\$ 60,262	\$ (3,728)	\$ 1,211,759

Available-for-sale

(in thousands)

Asset Class	12/31/2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Agencies	\$ 103,133	\$ 869	\$ (1,789)	\$ 102,213
Corporates	449,651	26,259	(2,977)	472,933
Mortgage-backed	243,364	11,584	(807)	254,141
ABS/CMO*	47,494	2,457	(36)	49,915
Treasuries	15,771	244	(191)	15,824
Municipals	234,456	4,823	(2,241)	237,038
Total Fixed Income	\$ 1,093,869	\$ 46,236	\$ (8,041)	\$ 1,132,064

*Asset-backed and collateralized mortgage obligations

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The following table presents the amortized cost and fair value of available-for-sale debt securities by contractual maturity dates as of September 30, 2011, and December 31, 2010:

AFS (in thousands)	9/30/2011		12/31/2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Agencies				
Due within 1 year	\$ 503	\$ 503	\$ 2,004	\$ 2,021
After 1 but within 5 years	4,728	4,981	4,796	5,026
After 5 but within 10 years	93,295	93,756	39,988	39,712
After 10 years*	66,873	67,377	56,345	55,454
Total	165,399	166,617	103,133	102,213
Corporates				
Due within 1 year	\$	\$	\$ 1,001	\$ 1,010
After 1 but within 5 years	101,114	107,229	96,768	101,864
After 5 but within 10 years	311,732	332,629	327,171	345,049
After 10 years	20,816	20,501	24,711	25,010
Total	433,662	460,359	449,651	472,933
Mortgage-backed				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years				
After 5 but within 10 years	3,402	3,645	2,521	2,677
After 10 years*	236,194	252,428	240,843	251,464
Total	239,596	256,073	243,364	254,141
Asset-backed				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years	3,147	3,262	4,882	5,137
After 5 but within 10 years	4,099	4,584	4,099	4,567
After 10 years*	53,352	54,738	38,513	40,211
Total	60,598	62,584	47,494	49,915
Treasuries				
Due within 1 year	\$ 6,097	\$ 6,143	\$ 3,865	\$ 3,915
After 1 but within 5 years	15,414	15,832	7,012	7,192
After 5 but within 10 years			4,894	4,717
After 10 years*				
Total	21,511	21,975	15,771	15,824
Municipals				
Due within 1 year	\$ 8,336	\$ 8,470	\$ 14,004	\$ 14,113
After 1 but within 5 years	18,607	19,334	25,177	26,303
After 5 but within 10 years	100,602	105,654	74,770	77,028
After 10 years*	106,914	110,693	120,505	119,594
Total	234,459	244,151	234,456	237,038
TOTAL	\$ 1,155,225	\$ 1,211,759	\$ 1,093,869	\$ 1,132,064

* Investments with no stated maturities are included as contractual maturities of greater than 10 years. Actual maturities may differ due to call or prepayment rights.

Held-to-Maturity Debt Securities

The carrying value and fair value of held-to-maturity securities at September 30, 2011 and December 31, 2010 were as follows:

Held-to-maturity

(in thousands)

Asset Class	Amortized Cost/ Carrying Value**	9/30/2011		Fair Value
		Gross Unrecognized Gains	Gross Unrecognized Losses	
Agencies	\$ 299,554	\$ 1,137	\$ (111)	\$ 300,580
Corporates	15,000		(400)	14,600
Mortgage-backed ABS/CMO*				
Treasuries				
Municipals	3,874	160		4,034
Total Fixed Income	\$ 318,428	\$ 1,297	\$ (511)	\$ 319,214

Held-to-maturity

(in thousands)

Asset Class	Amortized Cost/ Carrying Value**	12/31/2010		Fair Value
		Gross Unrecognized Gains	Gross Unrecognized Losses	
Agencies	\$ 288,407	\$ 607	\$ (6,688)	\$ 282,326
Corporates	15,000	100	(125)	14,975
Mortgage-backed ABS/CMO*				
Treasuries				
Municipals	5,851	232		6,083
Total Fixed Income	\$ 309,258	\$ 939	\$ (6,813)	\$ 303,384

*Asset-backed and collateralized mortgage obligations

** Held-to-maturity securities are carried on the unaudited condensed consolidated balance sheets at amortized cost and changes in the fair value of these securities, other than impairment charges, are not reported on the financial statements.

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The following table presents the carrying value and fair value of debt securities held-to-maturity by contractual maturity dates as of September 30, 2011 and December 31, 2010:

HTM (in thousands)	9/30/2011		12/31/2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Agencies				
Due within 1 year	\$ 2,001	\$ 2,078	\$ 4,086	\$ 4,117
After 1 but within 5 years	1,972	2,158	3,960	4,351
After 5 but within 10 years	35,771	35,924	18,994	18,812
After 10 years*	259,810	260,420	261,367	255,046
Total	299,554	300,580	288,407	282,326
Corporates				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years				
After 5 but within 10 years				
After 10 years	15,000	14,600	15,000	14,975
Total	15,000	14,600	15,000	14,975
Mortgage-backed				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years				
After 5 but within 10 years				
After 10 years*				
Total				
Asset-backed				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years				
After 5 but within 10 years				
After 10 years*				
Total				
Treasuries				
Due within 1 year	\$	\$	\$	\$
After 1 but within 5 years				
After 5 but within 10 years				
After 10 years*				
Total				
Municipals				
Due within 1 year	\$ 800	\$ 803	\$ 2,631	\$ 2,685
After 1 but within 5 years	3,074	3,231	3,220	3,398
After 5 but within 10 years				
After 10 years*				
Total	3,874	4,034	5,851	6,083
TOTAL	\$ 318,428	\$ 319,214	\$ 309,258	\$ 303,384

*Investments with no stated maturities are included as contractual maturities of greater than 10 years. Actual maturities may differ due to call or prepayment rights.

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The following table shows the composition of the fixed income securities in unrealized loss positions at September 30, 2011 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)			Percent to Total
			Book Value	Fair Value	Unrealized Loss	
1	AAA/AA/A	Aaa/Aa/A	\$ 168,065	\$ 164,460	\$ (3,605)	85.0%
2	BBB	Baa	21,245	20,611	(634)	15.0%
3	BB	Ba				
4	B	B				
5	CCC or lower	Caa or lower				
6						
		Total	\$ 189,310	\$ 185,071	\$ (4,239)	100.0%

Short-term Investments

Short-term investments are carried at cost, which approximates fair value. The balance at September 30, 2011 was \$156.0 million compared to \$39.8 million at December 31, 2010. The increase was primarily due to a \$50.0 million cash deposit that was received from a commercial surety customer in lieu of a letter of credit. In addition, another \$12.0 million of collateral was received from another surety customer in the third quarter of 2011. Related increases can be seen in funds held on the balance sheet, as well as in our operating cash flows for the year. These are timing issues and will flow out of cash when the customer provides the customary letter of credit and the collateral is released, respectively.

Evaluating Investments for OTTI

The fixed income portfolio contained 69 unrealized loss positions as of September 30, 2011. The \$4.2 million in associated unrealized losses for these 69 securities represents 0.3% of the fixed income portfolio's cost basis. Of these 69 securities, ten have been in an unrealized loss position for 12 consecutive months or longer and these collectively represent \$0.8 million in unrealized losses. The unrealized losses on these ten securities are due to changes in interest rates, and are not credit-specific issues. All fixed income securities in the investment portfolio continue to pay the expected coupon payments under the contractual terms of the securities. In 2009, we adopted GAAP guidance on the recognition and presentation of other-than-temporary impairment (OTTI). Accordingly, 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 a 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 OTTI losses recognized in net earnings or other comprehensive earnings in the periods presented.

As of September 30, 2011, we held 46 common stock positions that were in unrealized loss positions. Unrealized losses on these securities totaled \$7.2 million. Based on our analysis, we believe these securities will recover in a reasonable period of time and we have the intent and ability to hold these securities until recovery. Of the 46 common stock positions that were in an unrealized loss position, none have been in an unrealized loss position for 12 consecutive months or longer.

Through September 30, 2011, we recognized \$0.3 million in other-than-temporary impairment charges for equity securities. All charges were in our equity portfolio on securities we no longer had the intent to hold. Comparatively, we did not recognize any OTTI losses on equity securities during the first nine months of 2010.

3. FAIR VALUE MEASUREMENTS

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

We determined the fair values of certain financial instruments based on the fair value hierarchy. 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.

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. These valuations are based on quoted prices that are readily and regularly available in an active market.

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. Financial assets are classified based upon the lowest level of significant input that is used to determine fair value.

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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. As a part of management's process to determine fair value, we utilize widely recognized, third party pricing sources to determine our fair values.

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Corporate, Agencies, Treasuries and Municipal Bonds: The pricing vendor uses a generic model which uses standard inputs, including (listed in 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. Further, the model uses Option Adjusted Spread (OAS) and is a multidimensional relational model. All bonds valued using these techniques are classified as Level 2. All corporate, agencies, treasuries and municipal securities were deemed Level 2.

Mortgage-backed Securities (MBS)/Collateralized Mortgage Obligations (CMO) and Asset-backed Securities (ABS): The pricing vendor evaluation methodology includes interest rate movements, new issue data and other pertinent 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 CMO volatility, an OAS 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/CMO and ABS with corroborated, observable inputs are classified as Level 2. All of our MBS/CMO 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.

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

(\$ in 000s) Description	As of September 30, 2011 Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Trading securities				
Mortgage-backed ABS/CMO*	\$	\$ 8	\$	\$ 8
Treasuries				
Total trading securities	\$	\$ 8	\$	\$ 8
Available-for-sale securities				
Agencies	\$	\$ 166,617	\$	\$ 166,617
Corporates		460,359		460,359
Mortgage-backed ABS/CMO*		256,073		256,073
Treasuries		62,584		62,584
Municipals		21,975		21,975
Equity		244,151		244,151
Total available-for-sale securities	\$	331,301		331,301