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 March 31, 2019

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)

Delaware (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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 12, 2019, the number of shares outstanding of the registrant's Common Stock was 44,554,256.

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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 March 31, 2019	2018
Net premiums earned	$ 204,689	$ 190,027
Net investment income	16,565	14,232
Net realized gains	9,068	8,460
Other-than-temporary impairment (OTTI) losses on investments	-	(56)
Net unrealized gains (losses) on equity securities	33,498	(26,772)
Consolidated revenue	$ 263,820	$ 185,891
Losses and settlement expenses	94,297	92,421
Policy acquisition costs	71,292	66,734
Insurance operating expenses	16,667	13,385
Interest expense on debt	1,861	1,856
General corporate expenses	3,276	2,283
Total expenses	$ 187,393	$ 176,679
Equity in earnings of unconsolidated investees	5,314	5,166
Earnings before income taxes	$ 81,741	$ 14,378
Income tax expense	16,268	2,162
Net earnings	$ 65,473	$ 12,216
Other comprehensive earnings (loss), net of tax	29,301	(26,398)
Comprehensive earnings (loss)	$ 94,774	$ (14,182)
Earnings per share:		
Basic:		
Basic net earnings per share	$ 1.47	$ 0.28
Basic comprehensive earnings (loss) per share	$ 2.13	$ (0.32)
Diluted:		
Diluted net earnings per share	$ 1.46	$ 0.27
Diluted comprehensive earnings (loss) per share	$ 2.11	$ (0.32)

Weighted average number of common shares outstanding:		
Basic	44,536	44,221
Diluted	44,887	44,650
Cash dividends paid per common share	$ 0.22	$ 0.21

See accompanying notes to 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)	March 31, 2019	December 31, 2018
ASSETS		
Investments and cash:		
Fixed income:		
Available-for-sale, at fair value (amortized cost - $1,772,097 at 3/31/19 and $1,776,465 at 12/31/18)	$ 1,793,343	$ 1,760,515
Equity securities, at fair value (cost - $234,428 at 3/31/19 and $220,373 at 12/31/18)	388,281	340,483
Short-term investments, at cost which approximates fair value	44,087	11,550
Other invested assets	54,262	51,542
Cash	25,181	30,140
Total investments and cash	$ 2,305,154	$ 2,194,230
Accrued investment income	14,080	14,033
Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of $17,055 at 3/31/19 and $16,967 at 12/31/18	139,487	152,576
Ceded unearned premium	71,011	71,174
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of $9,808 at 3/31/19 and $9,793 at 12/31/18	364,374	364,999
Deferred policy acquisition costs	82,893	84,934
Property and equipment, at cost, net of accumulated depreciation of $56,322 at 3/31/19 and $54,275 at 12/31/18	54,121	54,692
Investment in unconsolidated investees	100,174	94,967
Goodwill and intangibles	54,432	54,534
Other assets	51,149	18,926
TOTAL ASSETS	$ 3,236,875	$ 3,105,065
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Liabilities		
Unpaid losses and settlement expenses	$ 1,479,344	$ 1,461,348
Unearned premiums	482,325	496,505
Reinsurance balances payable	14,286	22,591
Funds held	74,043	72,309
Income taxes-deferred	39,672	24,238
Bonds payable, long-term debt	149,162	149,115
Accrued expenses	28,896	45,124
Other liabilities	74,442	26,993
TOTAL LIABILITIES	$ 2,342,170	$ 2,298,223
Shareholders’ Equity		

Common stock ($0.01 par value, 100,000,000 shares authorized)		
(67,484,470 shares issued, 44,554,256 shares outstanding at 3/31/19)		
(67,434,257 shares issued, 44,504,043 shares outstanding at 12/31/18)	$ 675	$ 674
Paid-in capital	308,551	305,660
Accumulated other comprehensive earnings	14,729	(14,572)
Retained earnings	963,749	908,079
Deferred compensation	7,315	8,354
Less: Treasury shares at cost		
(22,930,214 shares at 3/31/19 and 12/31/18)	(400,314)	(401,353)
TOTAL SHAREHOLDERS' EQUITY	$ 894,705	$ 806,842
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 3,236,875	$ 3,105,065

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

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Shareholders' Equity

(Unaudited)

(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	Treas at Co
Balance, January 1, 2018	44,148,355	$ 853,598	$ 67,079	$ 233,077	$ 157,919	$ 788,522	$ 8,640	$ (40
Cumulative-effect adjustment from ASU 2016-01 and 2018-02	—	$ 86	$ —	$ —	$ (138,494)	$ 138,580	$ —	$ —
Net earnings	—	12,216	—	—	—	12,216	—	—
Other comprehensive earnings (loss), net of tax	—	(26,398)	—	—	(26,398)	—	—	—
Deferred compensation under Rabbi trust plans	—	—	—	—	—	—	(584)	584
Share-based compensation	104,771	2,721	104	2,617	—	—	—	—
Dividends and dividend equivalents ($0.21 per share)	—	(9,290)	—	—	—	(9,290)	—	—
Balance, March 31, 2018	44,253,126	$ 832,933	$ 67,183	$ 235,694	$ (6,973)	$ 930,028	$ 8,056	$ (40

(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	Treas at Co
Balance, January 1, 2019	44,504,043	$ 806,842	$ 674	$ 305,660	$ (14,572)	$ 908,079	$ 8,354	$ (40
Net earnings	—	$ 65,473	$ —	$ —	$ —	$ 65,473	$ —	$ —
	—	29,301	—	—	29,301	—	—	—

Other comprehensive earnings (loss), net of tax								
Deferred compensation under Rabbi trust plans	—	—	—	—	—	—	(1,039)	1,0
Share-based compensation	50,213	2,892	1	2,891	—	—	—	—
Dividends and dividend equivalents ($0.22 per share)	—	(9,803)	—	—	—	(9,803)	—	—
Balance, March 31, 2019	44,554,256	$ 894,705	$ 675	$ 308,551	$ 14,729	$ 963,749	$ 7,315	$ (40

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

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RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Three-Month Periods Ended March 31, 2019	2018
Net cash provided by operating activities	$ 30,787	$ 15,393
Cash Flows from Investing Activities		
Investments purchased	$ (132,080)	$ (177,324)
Investments sold	112,538	123,869
Investments called or matured	24,745	41,337
Net change in short-term investments	(32,537)	9,980
Net property and equipment purchased	(1,510)	(2,065)
Other	9	35
Net cash used in investing activities	$ (28,835)	$ (4,168)
Cash Flows from Financing Activities		
Cash dividends paid	$ (9,797)	$ (9,290)
Stock plan share issuance	2,886	2,721
Net cash used in financing activities	$ (6,911)	$ (6,569)
Net increase in cash	$ (4,959)	$ 4,656
Cash at the beginning of the period	$ 30,140	$ 24,271
Cash at March 31	$ 25,181	$ 28,927

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

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. DESCRIPTION OF BUSINESS

RLI Corp. (the “Company”) is an insurance holding company that was organized in 1965. As reported in previous SEC filings, RLI Corp. changed its state of incorporation from the State of Illinois to the State of Delaware on May 4, 2018 (the “Reincorporation”). The Reincorporation was effected by merging RLI Corp., an Illinois corporation (“RLI Illinois”) into RLI Corp., a Delaware corporation (“RLI Delaware”). Each outstanding share of RLI Illinois common stock, which had a par value of $1.00 per share, was automatically converted into one outstanding share of RLI Delaware common stock, with a par value of $0.01 per share. In order to reflect the new par value of common stock on the balance sheet, a $66.4 million reclassification from common stock to paid-in-capital was made during the second quarter of 2018. For more information on the Reincorporation, see RLI Corp.’s Form 8-K filed on May 7, 2018.

B. 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 2018 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 March 31, 2019 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. Certain reclassifications were made to 2018 to conform to the classifications used in the current 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.

C. ADOPTED ACCOUNTING STANDARDS

ASU 2016-02, Leases (Topic 842)

ASU 2016-02 was issued to improve the financial reporting of leasing transactions. Under previous guidance for lessees, leases were only included on the balance sheet if certain criteria, classifying the agreement as a capital lease, were met. This update requires the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months. For operating leases, the asset and liability are expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the statement of cash flows. For finance leases, interest on the lease liability is recognized separately from the amortization of the right-of-use asset in the statement of comprehensive income and the repayment of the principal portion of the lease liability is classified as a financing activity while the interest component is included in the operating section of the statement of cash flows.

We adopted ASU 2016-02, ASU 2018-10 Codification Improvements to Topic 842: Leases and ASU 2018-11 Leases (Topic 842): Targeted Improvements on January 1, 2019. We applied the standards using the alternative transition method provided by ASU 2018-11 under which leases were recognized at the date of adoption and a cumulative-effective adjustment to the opening balance of retained earnings would have been recognized in the period of adoption. As the standard did not have an impact on our net earnings, no adjustment to the opening balance of retained earnings was required. As of March 31, 2019, $26.8 million of right-of-use assets and corresponding lease liabilities for operating leases were added to the other assets and other liabilities line items of the balance sheet, respectively, as a result of the adoption of this update. We implemented controls for the adoption of the standard and the ongoing monitoring of the right-of-use asset and lease liability, but they did not materially affect our internal control over financial reporting.

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ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities

Under previous guidance, the amortization period for callable debt securities held at a premium was generally the contractual life of the instrument. However, if an entity had a large number of similar loans, it could consider estimates of future principal prepayments. For those who chose to not incorporate an estimate of future prepayments, ASU 2017-08 shortens the amortization period for premium on debt securities to the earliest call date, rather than the maturity date, to align the amortization method with how the securities are quoted, priced and traded. After the earliest call date, if the call option is not exercised, the entity shall reset the effective yield using the payment terms of the debt security. Any excess of the amortized cost basis over the amount payable will be amortized to the next call date or to maturity if there are no other call dates. The method of accounting for a discount does not change and will continue to be amortized over the life of the bond.

We adopted ASU 2017-08 on January 1, 2019 using a modified retrospective approach. As we had been incorporating estimates of future principal prepayments when calculating the effective yield for bonds carrying a premium under the old guidance, the adoption of this update did not have a material impact on our financial statements.

ASU 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

ASU 2018-07 was issued to simplify the accounting for share-based transactions by expanding the scope of Topic 718 from only being applicable to share-based payments to employees to also include share-based payment transactions for acquiring goods and services from nonemployees. As a result, nonemployee share-based transactions will be measured by estimating the fair value of the equity instruments at the grant date, taking into consideration the probability of satisfying performance conditions. We adopted ASU 2018-07 on January 1, 2019. Our long term incentive plan limits the awards of share-based payments to employees and directors of the Company. As our share-based compensation expense to nonemployee directors was $0.1 million in the first three months of 2019, the standard did not have a material impact on our financial statements.

D. PROSPECTIVE ACCOUNTING STANDARDS

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

ASU 2016-13 was issued to provide more decision-useful information about the expected credit losses on financial instruments. Current GAAP delays the recognition of credit losses until it is probable a loss has been incurred. The update will require a financial asset measured at amortized cost, including reinsurance balances recoverable, to be presented at the net amount expected to be collected by means of an allowance for credit losses that runs through net earnings. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses. However, the amendments would limit the amount of the allowance to the amount by which fair value is below amortized cost. The measurement of credit losses on available-for-sale securities is similar under current GAAP, but the update requires the use of the allowance account through which amounts can be reversed, rather than through an irreversible write-down.

This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted beginning after December 15, 2018. Upon adoption, the update will be applied using the modified-retrospective approach, by which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is effective. This update will have the most impact on our available-for-sale fixed income portfolio and reinsurance balances recoverable. However, as our fixed income portfolio is weighted towards higher rated bonds (83.8 percent rated A or better at March 31, 2019) and we purchase reinsurance from financially strong reinsurers for which we already have an allowance for uncollectible reinsurance amounts, we do not expect that the effect of adoption will be material.

ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement

ASU 2018-13 modifies the disclosure requirements for assets and liabilities measured at fair value. The requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements have all been removed. However, the changes in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period must be disclosed along with the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements (or other quantitative information if it is more

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reasonable). Finally, for investments measured at net asset value, the requirements have been modified so that the timing of liquidation and the date when restrictions from redemption might lapse are only disclosed if the investee has communicated the timing to the entity or announced the timing publicly.

This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. As the amendments are only disclosure related and we do not currently have any assets or liabilities that are measured based on Level 3 inputs, our financial statements will not be materially impacted by this update.

ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract

ASU 2018-15 requires a customer in a cloud computing arrangement (i.e. hosting arrangement) that is a service contract to follow the internal-use software guidance to determine which implementation costs to capitalize as assets or expense as incurred. Relevant implementation costs in the development stage are capitalized, while costs incurred during the preliminary project and post-implementation stages are expensed as the activities are performed. Capitalized costs are expensed over the term of the hosting arrangement. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted. This update can either be applied retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently evaluating how the adoption of this ASU will affect our financial statements.

E. INTANGIBLE ASSETS

Goodwill and intangible assets totaled $54.4 million and $54.5 million at March 31, 2019 and December 31, 2018, respectively, as detailed in the following table.

Goodwill and Intangible Assets (in thousands)	March 31, 2019	December 31, 2018
Goodwill		
Energy surety	$ 25,706	$ 25,706
Miscellaneous and contract surety	15,110	15,110
Small commercial	5,246	5,246
Total goodwill	$ 46,062	$ 46,062
Intangibles		
State insurance licenses	$ 7,500	$ 7,500
	870	972

Definite-lived intangibles, net of accumulated amortization of $3,164 at 3/31/19 and $3,062 at 12/31/18		
Total intangibles	$ 8,370	$ 8,472
Total goodwill and intangibles	$ 54,432	$ 54,534

All definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets was $0.1 million for the first quarter of 2019 and 2018.

Annual impairment testing was performed on our energy surety goodwill, miscellaneous and contract surety goodwill, small commercial goodwill and state insurance license indefinite-lived intangible asset during 2018. Based upon these reviews, none of the assets were impaired. In addition, as of March 31, 2019, there were no triggering events that would suggest an updated review was necessary on the above mentioned goodwill and intangible assets.

As previously disclosed, adverse loss experience triggered the need to test the medical professional liability reporting unit during the first quarter of 2018, which resulted in a $4.4 million non-cash impairment charge. A fair value for the medical professional liability reporting unit's agency relationships, carried as a definite-lived intangible, was determined by using a discounted cash flow valuation. The carrying value exceeded the fair value, resulting in a $0.8 million non-cash impairment charge. A fair value for the medical professional liability reporting unit's goodwill was determined by using a weighted average of a market approach and discounted cash flow valuation. The carrying value exceeded the fair value, resulting in a

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$3.6 million non-cash impairment charge. Subsequent to the first quarter 2018 impairment, the medical professional liability reporting unit had no remaining goodwill or intangible assets. All impairment charges were recorded as net realized losses in the consolidated statement of earnings.

F. 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 interim financial statements.

	For the Three-Month Period Ended March 31, 2019			For the Three-Month Period Ended March 31, 2018		
(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	$ 65,473	44,536	$ 1.47	$ 12,216	44,221	$ 0.28
Effect of Dilutive Securities						
Stock options	-	351		-	429	
Diluted EPS						
Income available to common shareholders	$ 65,473	44,887	$ 1.46	$ 12,216	44,650	$ 0.27

G. COMPREHENSIVE EARNINGS

Our comprehensive earnings include net earnings plus after-tax unrealized gains and losses on our fixed income portfolio. In reporting other comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 21 percent.

Unrealized gains, net of tax, on the fixed income portfolio for the first three months of 2019 were $29.3 million, compared to $26.4 million of unrealized losses, net of tax, during the same period last year. Unrealized gains in the first three months of 2019 were attributable to declining interest rates, which increased the fair value of securities held in the fixed income portfolio. In contrast, rising interest rates decreased the fair value of securities held in the fixed income portfolio in the first three months of 2018.

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 March 31,	
Unrealized Gains/Losses on Available-for-Sale Securities	2019	2018
Beginning balance	$ (14,572)	$ 157,919
Cumulative effect adjustment of ASU 2016-01	-	(142,219)
Adjusted beginning balance	$ (14,572)	$ 15,700
Other comprehensive earnings before reclassifications	29,795	(26,410)
Amounts reclassified from accumulated other comprehensive earnings	(494)	12
Net current-period other comprehensive earnings (loss)	$ 29,301	$ (26,398)
Reclassification of stranded tax effect per ASU 2018-02	-	3,725
Ending balance	$ 14,729	$ (6,973)

In 2018, the adoption of accounting standards resulted in adjustments to accumulated other comprehensive earnings. ASU 2016-01 required equity investments to be measured at fair value with changes in fair value recognized in net earnings. A cumulative-effect adjustment was made as of the beginning of 2018, which moved $142.2 million of net unrealized gains and losses on equity securities from accumulated other comprehensive earnings to retained earnings. ASU 2018-02 addressed

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issues arising from the enactment of the Tax Cuts and Jobs Act of 2017. Accounting guidance required deferred tax items to be revalued based on the new tax laws with the changes included in net earnings. Since other comprehensive earnings was not affected by the revaluation of the deferred tax items, the accumulated other comprehensive earnings balance was reflective of the historic tax rate instead of the newly enacted rate, which created a stranded tax effect. ASU 2018-02 allowed for the reclassification of our $3.7 million stranded tax effect out of accumulated other comprehensive earnings into retained earnings.

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 March 31,		
Component of Accumulated Other Comprehensive Earnings	2019	2018	Affected line item in the Statement of Earnings
Unrealized gains and losses on available-for-sale securities	$ 625	$ 41	Net realized gains (losses)
	-	(56)	Other-than-temporary impairment (OTTI) losses on investments
	$ 625	$ (15)	Earnings before income taxes
	(131)	3	Income tax benefit (expense)
	$ 494	$ (12)	Net earnings (loss)

2. INVESTMENTS

Our investments are primarily composed of fixed income debt securities and common stock equity securities. We carry our equity securities at fair value and categorize all of our debt securities as available-for-sale, which are carried at fair value. 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.”

Fixed Income Securities - Available-for-Sale

The amortized cost and fair value of available-for-sale securities at March 31, 2019 and December 31, 2018 were as follows:

Available-for-sale
(in thousands)

	March 31, 2019			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	$ 192,148	$ 2,964	$ (384)	$ 194,728
U.S. agency	31,712	1,043	(17)	32,738
Non-U.S. govt. & agency	8,162	74	(293)	7,943
Agency MBS	396,248	3,211	(5,493)	393,966
ABS/CMBS*	146,164	983	(341)	146,806
Corporate	684,492	12,934	(3,910)	693,516
Municipal	313,171	10,664	(189)	323,646
Total Fixed Income	$ 1,772,097	$ 31,873	$ (10,627)	$ 1,793,343

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

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Available-for-sale
(in thousands)

	December 31, 2018			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	$ 199,982	$ 1,232	$ (985)	$ 200,229
U.S. agency	31,716	403	(215)	31,904
Non-U.S. govt. & agency	8,170	-	(531)	7,639
Agency MBS	402,992	1,709	(9,448)	395,253
ABS/CMBS*	137,224	375	(876)	136,723
Corporate	681,909	2,894	(16,124)	668,679
Municipal	314,472	6,926	(1,310)	320,088
Total Fixed Income	$ 1,776,465	$ 13,539	$ (29,489)	$ 1,760,515

*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 March 31, 2019:

	March 31, 2019	
Available-for-sale (in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 42,428	$ 42,477
Due after one year through five years	390,764	395,761
Due after five years through 10 years	615,405	627,475
Due after 10 years	181,088	186,858
Mtge/ABS/CMBS*	542,412	540,772
Total available-for-sale	$ 1,772,097	$ 1,793,343

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

Unrealized Losses on Fixed Income Securities

We conduct and document periodic reviews of all fixed income 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 fixed income securities that were in an unrealized loss position as of March 31, 2019 and December

31, 2018. The tables segregate the securities based on type, noting the fair value, 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 March 31, 2019, unrealized losses on fixed income securities, as shown in the following tables, were 0.5 percent of total invested assets. Unrealized losses decreased through the first three months of 2019, as interest rates decreased from the end of 2018, increasing the fair value of securities held in the fixed income portfolio.

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(in thousands)	March 31, 2019 < 12 Mos.	March 31, 2019 12 Mos. & Greater	March 31, 2019 Total	December 31, 2018 < 12 Mos.	December 31, 2018 12 Mos. & Greater	December 31, 2018 Total
U.S. Government						
Fair value	$ —	$ 46,641	$ 46,641	$ 7,249	$ 76,073	$ 83,322
Amortized cost	—	47,025	47,025	7,270	77,037	84,307
Unrealized Loss	$ —	$ (384)	$ (384)	$ (21)	$ (964)	$ (985)
U.S. Agency						
Fair value	$ —	$ 3,988	$ 3,988	$ —	$ 8,843	$ 8,843
Amortized cost	—	4,005	4,005	—	9,058	9,058
Unrealized Loss	$ —	$ (17)	$ (17)	$ —	$ (215)	$ (215)
Non-U.S. government						
Fair value	$ —	$ 3,669	$ 3,669	$ 5,432	$ 2,207	$ 7,639
Amortized cost	—	3,962	3,962	5,571	2,599	8,170
Unrealized Loss	$ —	$ (293)	$ (293)	$ (139)	$ (392)	$ (531)
Agency MBS						
Fair value	$ 1,388	$ 239,998	$ 241,386	$ 25,345	$ 261,325	$ 286,670
Amortized cost	1,389	245,490	246,879	25,486	270,632	296,118
Unrealized Loss	$ (1)	$ (5,492)	$ (5,493)	$ (141)	$ (9,307)	$ (9,448)
ABS/CMBS*						
Fair value	$ 20,570	$ 30,341	$ 50,911	$ 46,918	$ 32,137	$ 79,055
Amortized cost	20,689	30,563	51,252	47,146	32,785	79,931
Unrealized Loss	$ (119)	$ (222)	$ (341)	$ (228)	$ (648)	$ (876)
Corporate						
Fair value	$ 70,935	$ 120,782	$ 191,717	$ 306,177	$ 147,751	$ 453,928
Amortized cost	72,528	123,099	195,627	315,428	154,624	470,052
Unrealized Loss	$ (1,593)	$ (2,317)	$ (3,910)	$ (9,251)	$ (6,873)	$ (16,124)
Municipal						
Fair value	$ —	$ 18,229	$ 18,229	$ 6,036	$ 55,681	$ 61,717
Amortized cost	—	18,418	18,418	6,052	56,975	63,027
Unrealized Loss	$ —	$ (189)	$ (189)	$ (16)	$ (1,294)	$ (1,310)
Total fixed income						
Fair value	$ 92,893	$ 463,648	$ 556,541	$ 397,157	$ 584,017	$ 981,174
Amortized cost	94,606	472,562	567,168	406,953	603,710	1,010,663
Unrealized Loss	$ (1,713)	$ (8,914)	$ (10,627)	$ (9,796)	$ (19,693)	$ (29,489)

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

The following table shows the composition of the fixed income securities in unrealized loss positions at March 31, 2019 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.

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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	$ 434,824	$ 427,442	$ (7,382)	69.5	%
2	BBB	Baa	59,320	57,548	(1,772)	16.7	%
3	BB	Ba	34,925	34,375	(550)	5.2	%
4	B	B	36,178	35,408	(770)	7.2	%
5	CCC	Caa	1,921	1,768	(153)	1.4	%
6	CC or lower	Ca or lower	-	-	-	-	%
		Total	$ 567,168	$ 556,541	$ (10,627)	100.0	%

Evaluating Fixed Income Securities for OTTI

The fixed income portfolio contained 481 securities in an unrealized loss position as of March 31, 2019. The $10.6 million in associated unrealized losses for these 481 securities represents 0.6 percent of the fixed income portfolio's cost basis. Of these 481 securities, 259 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. We did not recognize any other-than-temporary impairment (OTTI) losses in earnings on the fixed income portfolio in the first quarter of 2019. Comparatively, we recognized $0.1 million in OTTI losses in earnings on one fixed income security that we no longer had the intent to hold in the same period in 2018. There were no OTTI losses recognized in other comprehensive earnings on the fixed income portfolio for the periods presented.

Unrealized Gains and Losses on Equity Securities

Unrealized gains recognized during the first quarter of 2019 on equity securities still held as of March 31, 2019 were $41.9 million. Unrealized losses recognized during the first quarter of 2018 on equity securities still held as of March 31, 2018 were $12.3 million.

Other Invested Assets

We had $54.3 million of other invested assets at March 31, 2019, compared to $51.5 million at the end of 2018. Other invested assets include investments in low income housing tax credit partnerships (LIHTC), membership in the Federal Home Loan Bank of Chicago (FHLBC) and investments in private funds. Our LIHTC investments are carried at amortized cost and our investment in FHLBC stock is carried at cost. Due to the nature of the LIHTC and our membership in the FHLBC, their carrying amounts approximate fair value. The private funds are carried at fair value, using each investment's net asset value.

Our LIHTC interests had a balance of $19.7 million at March 31, 2019, compared to $20.3 million at December 31, 2018 and recognized a total tax benefit of $0.6 million during the first quarter of 2019, the same as the prior year. Our unfunded commitment for our LIHTC investments totaled $7.0 million at March 31, 2019 and will be paid out in installments through 2025.

As of March 31, 2019, $16.0 million of investments were pledged as collateral with the FHLBC to ensure timely access to the secured lending facility that ownership of FHLBC stock provides. As of and during the three month period ending March 31, 2019, there were no outstanding borrowings with the FHLBC.

We had $15.1 million of unfunded commitments related to our investments in private funds at March 31, 2019. Additionally, our interest in these investments is generally restricted from being transferred or otherwise redeemed without prior consent by the respective entities. An IPO would allow for the transfer of interest in some situations, while the timed dissolution of the partnership would trigger redemption in others.

Cash and Short-term Investments

Cash consists of uninvested balances in bank accounts. We had a cash balance of $25.2 million at March 31, 2019, compared to $30.1 million at the end of 2018. As of March 31, 2019, we had $44.1 million of short-term investments that were carried at cost and approximated fair value, compared to $11.6 million at December 31, 2018.

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. We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring 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. Financial assets are classified based upon the lowest level of significant input that is used to determine fair value.

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/CMO and ABS are deemed Level 2.

For all of our fixed income securities classified as Level 2, 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. In some cases, we obtain prices from securities brokers and compare them to the prices provided by our pricing services. In both comparisons, if discrepancies are found, we compare our prices to actual reported trade data for like securities. No changes to the fair values supplied by our pricing services have occurred as a result of our reviews. Based on these assessments, we have determined that the fair values of our Level 2 securities provided by our pricing services are reasonable.

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Common Stock: All but one of our common stock holdings are traded on an exchange. Exchange traded equities have readily observable price levels and are classified as Level 1 (fair value based on quoted market prices). Pricing for the equity security not traded on an exchange is provided by a third-party pricing source and is classified as Level 2.

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. Our investments in private funds, classified as other invested assets, are measured using the investment's net asset value per share and are not categorized within the fair value hierarchy.

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

	As of March 31, 2019 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
Fixed income securities - available-for-sale				
U.S. government	$ —	$ 194,728	$ —	$ 194,728
U.S. agency	—	32,738	—	32,738
Non-U.S. govt. & agency	—	7,943	—	7,943
Agency MBS	—	393,966	—	393,966
ABS/CMBS*	—	146,806	—	146,806
Corporate	—	693,516	—	693,516
Municipal	—	323,646	—	323,646
Total fixed income securities - available-for-sale	$ —	$ 1,793,343	$ —	$ 1,793,343
Equity securities	387,778	503	—	388,281
Total	$ 387,778	$ 1,793,846	$ —	$ 2,181,624

	As of December 31, 2018 Fair Value Measurements Using		
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

(in thousands)	(Level 1)	(Level 2)	(Level 3)	Total
Fixed income securities - available-for-sale				
U.S. government	$ —	$ 200,229	$ —	$ 200,229
U.S. agency	—	31,904	—	31,904
Non-U.S. govt. & agency	—	7,639	—	7,639
Agency MBS	—	395,253	—	395,253
ABS/CMBS*	—	136,723	—	136,723
Corporate	—	668,679	—	668,679
Municipal	—	320,088	—	320,088
Total fixed income securities - available-for-sale	$ —	$ 1,760,515	$ —	$ 1,760,515
Equity securities	339,985	498	—	340,483
Total	$ 339,985	$ 1,761,013	$ —	$ 2,100,998

* 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 three-month period ended March 31, 2019.

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4. HISTORICAL LOSS AND LAE DEVELOPMENT

The following table is a reconciliation of our unpaid losses and settlement expenses (LAE) for the first three months of 2019 and 2018.

	For the Three-Month Periods Ended March 31,	
(in thousands)	2019	2018
Unpaid losses and LAE at beginning of year		
Gross	$ 1,461,348	$ 1,271,503
Ceded	(364,999)	(301,991)
Net	$ 1,096,349	$ 969,512
Increase (decrease) in incurred losses and LAE		
Current accident year	$ 113,930	$ 107,011
Prior accident years	(19,633)	(14,590)
Total incurred	$ 94,297	$ 92,421
Loss and LAE payments for claims incurred		
Current accident year	$ (5,531)	$ (3,384)
Prior accident year	(70,145)	(64,121)
Total paid	$ (75,676)	$ (67,505)
Net unpaid losses and LAE at March 31,	$ 1,114,970	$ 994,428
Unpaid losses and LAE at March 31,		
Gross	$ 1,479,344	$ 1,303,131
Ceded	(364,374)	(308,703)
Net	$ 1,114,970	$ 994,428

For the first three months of 2019, incurred losses and LAE included $19.6 million of favorable development on prior years' loss reserves. The majority of products experienced modest amounts of favorable development on prior accident years, with notable contributions from general liability, commercial excess and personal umbrella, professional services and surety. Executive products was the exception and experienced adverse development.

For the first three months of 2018, incurred losses and LAE included $14.6 million of favorable development on prior years' loss reserves. Commercial excess and personal umbrella, general liability and small commercial were drivers of the favorable development within the casualty segment. Property and surety segments also developed favorably, contributing to the decrease in incurred losses on prior accident years.

5. INCOME TAXES

Our effective tax rate for the three-month period ended March 31, 2019 was 19.9 percent, compared to 15.0 percent for the same period in 2018. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher for the first quarter of 2019 due largely to higher levels of pre-tax earnings, which caused the tax favored adjustments to be smaller on a percentage basis in 2019 compared to the prior year.

Income tax expense attributable to income from operations for the three-month periods ended March 31, 2019 and 2018 differed from the amounts computed by applying the U.S. federal tax rate of 21 percent to pretax income by the items detailed in the below table. In interim periods, income taxes are adjusted to reflect the effective tax rate we anticipate for the year, with adjustments flowing through the other items line.

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	For the Three-Month Periods Ended March 31,			
	2019		2018	
(in thousands)	Amount	%	Amount	%
Provision for income taxes at the statutory rate of 21%	$ 17,166	21.0 %	$ 3,019	21.0 %
Increase (reduction) in taxes resulting from:				
Excess tax benefit on share-based compensation	(741)	(0.9) %	(1,143)	(7.9) %
Tax exempt interest income	(345)	(0.4) %	(581)	(4.0) %
Dividends received deduction	(203)	(0.2) %	(196)	(1.4) %
ESOP dividends paid deduction	(137)	(0.2) %	(139)	(1.0) %
Other items, net	528	0.6 %	1,202	8.3 %
Total tax expense	$ 16,268	19.9 %	$ 2,162	15.0 %

6. STOCK BASED COMPENSATION

Our RLI Corp. Long-Term Incentive Plan (2010 LTIP) was in place from 2010 to 2015. 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. The 2010 LTIP was replaced in 2015.

In 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, restricted stock units, 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 and 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). Since the plan’s approval in 2015, we have granted 1,944,380 awards under the 2015 LTIP, including 40,750 thus far in 2019.

Stock Options

Under the 2015 LTIP, as under the 2010 LTIP, 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.

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The following tables summarize option activity for the periods ended March 31, 2019 and 2018:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2019	1,964,880	$ 54.24		
Options granted	40,750	$ 66.16		
Options exercised	(50,580)	$ 33.71		$ 1,795
Options canceled/forfeited	(19,100)	$ 57.28		
Outstanding options at March 31, 2019	1,935,950	$ 55.00	5.14	$ 32,589
Exercisable options at March 31, 2019	702,250	$ 47.84	3.73	$ 16,794

Weighted