RLI CORP
Form 10-K
February 25, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

or

o 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	**37-0889946**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9025 North Lindbergh Drive, Peoria, Illinois	**61615**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **(309) 692-1000**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock $1.00 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

The aggregate market value of the registrant s common stock held by non-affiliates of the Registrant as of June 30, 2010, based upon the closing sale price of the Common Stock on June 30, 2010 as reported on the New York Stock Exchange, was $910,921,846. Shares of Common Stock held directly or indirectly by each reporting officer and director along with shares held by the Company ESOP have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant s Common Stock, $1.00 par value, on February 9, 2011 was 21,026,645.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the 2010 Financial Report to Shareholders for the year ended December 31, 2010, are incorporated by reference into Parts I and II of this document.

Portions of the Registrant s definitive Proxy Statement for the 2011 annual meeting of security holders to be held May 5, 2011, are incorporated herein by reference into Part III of this document.

Exhibit index is located on pages 61-62 of this document, which lists documents incorporated by reference herein.

PART I

Item 1. **Business**

RLI Corp. underwrites selected property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group. We conduct operations principally through three insurance companies. RLI Insurance Company, our principal subsidiary, writes multiple lines insurance on an admitted basis in all 50 states, the District of Columbia and Puerto Rico. Mt. Hawley Insurance Company, a subsidiary of RLI Insurance Company (RLI Ins.), writes surplus lines insurance in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. RLI Indemnity Company, a subsidiary of Mt. Hawley Insurance Company, has authority to write multiple lines of insurance on an admitted basis in 48 states and the District of Columbia. RIC has the authority to write fidelity and surety in North Carolina. We are an Illinois corporation that was organized in 1965. We have no material foreign operations.

We maintain an Internet website at http://www.rlicorp.com. We make available free of charge on our website our annual report on Form 10-K, our quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed with or furnished to the Securities and Exchange Commission as soon as reasonably practicable after such materials are filed or furnished. Information contained on our website is not intended to be incorporated by reference in this annual report and you should not consider that information a part of this annual report.

As a niche company, we offer specialty insurance coverages designed to meet specific insurance needs of targeted insured groups and underwrite for certain markets that are underserved by the insurance and reinsurance industry, such as our difference in conditions coverages or oil and gas surety bonds. We also provide types of coverages not generally offered by other companies, such as our stand-alone personal umbrella policy. The excess and surplus market, which unlike the standard admitted market is less regulated and more flexible in terms of policy forms and premium rates, provides an alternative for customers with hard-to-place risks. When we underwrite within the surplus lines market, we are selective in the line of business and type of risks we choose to write. Using our non-admitted status in this market allows us to tailor terms and conditions to manage these exposures more effectively than our admitted counterparts. Often the development of these specialty insurance coverages is generated through proposals brought to us by an agent or broker seeking coverage for a specific group of clients. Once a proposal is submitted, underwriters determine whether it would be a viable product based on our business objectives.

We distribute our property and casualty insurance through our wholly-owned branch offices that market to wholesale producers. We also market certain coverages to retail producers from several of our casualty, surety and property operations. We produce a limited amount of business under agreements with managing general agents under the direction of our product vice presidents. The majority of business is marketed through our branch offices located throughout the United States.

For the year ended December 31, 2010, the following table provides the geographic distribution of our risks insured as represented by direct premiums earned for all coverages. For the year ended December 31, 2010, no other state accounted for 1.5 percent or more of total direct premiums earned for all coverages.

State		Direct Premiums Earned (in thousands)	Percent of Total
California	$	107,690	18.0%
New York		83,080	13.9%
Florida		72,956	12.2%
Texas		53,631	8.9%
New Jersey		23,620	3.9%
Illinois		18,153	3.0%
Louisiana		17,067	2.8%
Pennsylvania		15,536	2.6%
Hawaii		15,020	2.5%
Ohio		11,166	1.9%
Massachusetts		10,472	1.7%
Washington		10,455	1.7%
All Other		160,823	26.9%
Total direct premiums	$	599,669	100.0%

In the ordinary course of business, we rely on other insurance companies to share risks through reinsurance. A large portion of the reinsurance is put into effect under contracts known as treaties and, in some instances, by negotiation on each individual risk (known as facultative reinsurance). We have quota share, excess of loss and catastrophe reinsurance contracts that protect against losses over stipulated amounts arising from any one occurrence or event. These arrangements allow us to pursue greater diversification of business and serve to limit the maximum net loss on catastrophes and large risks. Reinsurance is subject to certain risks, specifically market risk, which affects the cost of and the ability to secure these contracts, and credit risk, which is the risk that our reinsurers may not pay on losses in a timely fashion or at all. The following table illustrates, through premium volume, the degree to which we have utilized reinsurance during the past three years. For an expanded discussion of the impact of reinsurance on our operations, see Note 5 to our audited consolidated financial statements included in our 2010 Financial Report to Shareholders, attached as Exhibit 13 and incorporated by reference herein.

	Year Ended December 31,					
(in thousands)		2010		2009		2008
PREMIUMS WRITTEN						
Direct & Assumed	$	636,316	$	631,200	$	681,169
Reinsurance ceded		(151,176)		(161,284)		(167,713)
Net	$	485,140	$	469,916	$	513,456
PREMIUMS EARNED						
Direct & Assumed	$	647,306	$	654,323	$	701,042
Reinsurance ceded		(153,924)		(162,362)		(172,278)
Net	$	493,382	$	491,961	$	528,764

Specialty Insurance Market Overview

The specialty insurance market differs significantly from the standard market. In the standard market, insurance rates and forms are highly regulated, products and coverage are largely uniform with relatively predictable exposures, and companies tend to compete for customers on the basis of price. In contrast, the specialty market provides coverage for risks that do not fit the underwriting criteria of the standard carriers. Competition tends to focus less on price and more on availability, service and other value-based considerations. While specialty market exposures may have higher insurance risks than their standard market counterparts, we manage these risks to achieve higher financial returns. To reach our financial and operational goals, we must have extensive knowledge and expertise in our markets. Most of our risks are underwritten on an individual basis and restricted limits, deductibles, exclusions and surcharges are employed in order to respond to distinctive risk characteristics. We operate in the excess and surplus insurance market, the specialty admitted insurance market and the specialty property reinsurance market.

Excess and Surplus Insurance Market

The excess and surplus market focuses on hard-to-place risks. Excess and surplus eligibility allows us to underwrite nonstandard market risks with more flexible policy forms and unregulated premium rates. This typically results in coverages that are more restrictive and more expensive than in the standard admitted market. The excess and surplus lines regulatory environment and production model also effectively filters submission flow and matches market opportunities to our expertise and appetite. In 2010, the excess and surplus market represented approximately $23 billion, or 5 percent, of the entire $478 billion domestic property and casualty industry, as measured by direct premiums written. Our excess and surplus operation wrote gross premiums of $232.4 million, or 36 percent, of our total gross premiums written.

Specialty Admitted Insurance Market

We also write business in the specialty admitted market. Most of these risks are unique and hard to place in the standard market, but for marketing and regulatory reasons, they must remain with an admitted insurance company. The specialty admitted market is subject to greater state regulation than the excess and surplus market, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as state guaranty funds and assigned risk plans. For 2010, our specialty admitted operations wrote gross premiums of $355.9 million, representing approximately 56 percent of our total gross premiums written for the year.

Specialty Property Reinsurance Market

We write business in the specialty property reinsurance market. This business can be written on an individual risk (facultative) basis or on a portfolio (treaty) basis. We write contracts on an excess of loss and a proportional basis. Contract provisions are written and agreed upon between the company and its client, another (re)insurance company. The business is typically more volatile as a result of unique underlying exposures and excess and aggregate attachments. This business requires specialized underwriting and technical modeling. For 2010, our specialty property reinsurance operations wrote gross written premiums of $48.0 million, representing about 8 percent of our total gross written premiums for the year.

Business Segment Overview

Our segment data is derived using the guidance set forth in FASB Accounting Standards Codification (ASC) 280, Segment Reporting. As prescribed by the guidance, reporting is based on the internal structure and reporting of information as it is used by management. The segments of our insurance operations are casualty, property and surety. For additional information, see Note 11 to our audited consolidated financial statements included in our 2010 Financial Report to Shareholders, attached as Exhibit 13 and incorporated by reference herein.

Casualty Segment

General Liability

Our general liability business consists primarily of coverage for third party liability of commercial insureds including manufacturers, contractors, apartments, real estate investment trusts (REITs) and mercantile. In 2009, we expanded into the specialized area of environmental liability for underground storage tanks, contractors and asbestos and environmental remediation specialists. Net premiums earned from our general liability business totaled $96.6 million, $115.4 million and $140.9 million, or 17 percent, 21 percent and 25 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Commercial and Personal Umbrella Liability

Our commercial umbrella coverage is principally written in excess of primary liability insurance provided by other carriers and in excess of primary liability written by us. The personal umbrella coverage is written in excess of the homeowners and automobile liability coverage provided by other carriers, except in Hawaii, where some underlying homeowners coverage is written by us. In 2010, we broadened eligibility guidelines and offered certain coverage enhancements in an effort to broaden our market reach. Net premiums earned from this business totaled $61.4 million, $62.4 million and $65.1 million, or 11 percent, 11 percent and 12 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Commercial Transportation

Our transportation insurance facility in Atlanta provides automobile liability and physical damage insurance to local, intermediate and long haul truckers, public transportation risks and equipment dealers, along with other types of specialty commercial automobile risks. We also offer incidental, related insurance coverages, including general liability, commercial umbrella and excess liability and motor truck cargo. The facility is staffed by highly experienced transportation underwriters who produce business through independent agents and brokers nationwide. Net premiums earned from this business totaled

$40.3 million, $42.2 million and $46.7 million, or 7 percent, 8 percent and 8 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Executive Products

We provide a variety of professional liability coverages, such as directors and officers (D&O) liability insurance, employment practices liability and other miscellaneous professional liability coverages, for a variety of low to moderate classes of risks. We tend to focus on smaller accounts, avoiding the large account sector which is generally more sensitive to price competition. Our target accounts include publicly traded companies with market capitalization below $5 billion (where we are writing part of the traditional D&O program), Side A coverage (where corporations cannot indemnify the individual D&Os), private companies, nonprofit organizations and sole-sponsored and multi-employer fiduciary liability accounts. Our primary focus for publicly traded companies is on providing Side A coverage. Additionally, we have had success rounding out our portfolio by writing more fiduciary liability coverage, primary and excess D&O coverage for private companies and non-profit organizations. In 2009, we began offering coverage for select first and third party cyber liability exposures. Net premiums earned from the executive products business totaled $15.8 million, $15.6 million and $13.8 million, or 3 percent, 3 percent and 2 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Specialty Program Business

We offer program business in a variety of areas, which are typically multiple coverages combined into a package or portfolio policy. Our program coverages include: commercial property, general liability, inland marine and crime. We rely primarily on program administrators as sources for this business. In October 2010, we began offering pet insurance for domesticated animals. Net premiums earned from the specialty program business totaled $7.2 million, $21.6 million and $38.3 million, or 1 percent, 7 percent and 6 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Other

We offer a variety of other smaller programs in our casualty segment, including in-home business and employer s excess indemnity. In February 2009, we began a professional liability for design professionals coverage targeting small to medium-size risks. More recently, we have expanded our product suite to these same customers by offering a full array of multi-peril package products including worker s compensation coverage. Net premiums earned from these lines totaled $9.8 million, $7.9 million and $8.6 million, or 2 percent, 1 percent and 2 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Property Segment

Commercial

Our commercial property coverage consists primarily of excess and surplus lines and specialty insurance such as fire, earthquake and difference in conditions, which can include earthquake, wind, flood and collapse coverages and inland marine. We provide insurance for a wide range of commercial and industrial risks, such as office buildings, apartments, condominiums and certain industrial and mercantile structures. Net premiums earned from commercial property business totaled $80.5 million, $81.8 million and $85.3 million, or 14 percent, 15 percent and 15 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Marine

Our marine coverages include cargo, hull and protection and indemnity (P&I), marine liability, as well as inland marine coverages including builders risks, contractors equipment and other floater type coverages. In March 2008, the marine division added a yacht program. In 2010, 2009 and 2008, marine net premiums earned totaled $48.0 million, $52.5 million and $48.2 million, or 8 percent, 10 percent and 9 percent of consolidated revenues, respectively.

Crop Reinsurance

In January 2010, we added crop reinsurance to the property segment as we entered into a two-year agreement to become a quota share reinsurer of Producers Agricultural Insurance Company (ProAg). ProAg is a crop insurance company located in Amarillo, Texas. Under this agreement, we will reinsure a portion of ProAg s multi-peril crop insurance (MPCI) and crop hail premium and exposure. Crop insurance is purchased by agricultural producers for protection against crop-related losses due to natural disasters and other perils. The MPCI program is a partnership with the U.S. Department of Agriculture

(USDA). Crop insurers such as ProAg also issue policies that cover revenue shortfalls or production losses due to natural causes such as drought, excessive moisture, hail, wind, frost, insects, and disease. The new crop reinsurance agreement added $27.1 million in net premiums earned in 2010, or 5 percent of consolidated revenues.

Property Reinsurance

We offer facultative and other treaty reinsurance. These products were launched in 2007 for facultative coverages and expanded to treaty reinsurance in 2009. The division underwrites property facultative reinsurance for insurance companies utilizing reinsurance intermediaries. The facultative unit specializes in underground mining, power generation, and other technical risks requiring underwriting expertise. Perils covered range from fire, mechanical breakdown, flood, and other catastrophic events. Although the predominant exposures are located within the United States, there is some incidental international exposure written by this division. During 2009, we began opportunistically writing select specialty property treaties on a proportional basis. These treaties are portfolio underwritten using specialized actuarial models and cover catastrophic perils of earthquake, windstorm and other weather-related events, as well as some additional losses. This expanded in the second quarter of 2010 to include industry loss warranty (ILW) treaties. Under the ILW treaties, we provide reinsurance coverage for windstorm losses if two loss triggers (an industry loss limit trigger and a retention trigger) are met. Net premiums earned from property reinsurance business totaled $9.9 million, $7.8 million and $1.6 million, or 2 percent, 1 percent and less than 1 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Other

We offer a variety of other smaller programs in our property segment, including a limited amount of homeowners and dwelling fire insurance in Hawaii. Net premiums earned from other property coverages totaled $16.1 million, $13.2 million and $11.8 million, or 3 percent, 2 percent and 2 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Surety Segment

Our surety segment specializes in writing small-to-large commercial and small contract surety coverages, as well as those for the energy (plugging and abandonment of oil wells), petrochemical and refining industries. We offer miscellaneous bonds, including license and permit, notary and court bonds. In September 2008, we launched a fidelity division focusing on fidelity and crime coverage for commercial insureds and select financial institutions. These bonds are written through independent agencies as well as regional and national brokers. Net earned premium from the surety segment totaled $80.7 million, $71.6 million and $68.4 million, or 14 percent, 13 percent and 12 percent of consolidated revenues for 2010, 2009 and 2008, respectively.

Marketing and Distribution

We distribute our coverages primarily through branch offices throughout the country that market to wholesale and retail brokers and through independent agents. We also market through agencies and more recently through e-commerce channels.

Brokers

The largest volume of broker-generated premium is in our commercial property, general liability, commercial surety, commercial umbrella, commercial automobile, and specialty facultative and treaty reinsurance coverages. This business is produced through wholesale, retail, and reinsurance brokers who are not affiliated with us.

Independent Agents

Our surety segment offers its business through a variety of independent agents. Additionally, we write program business, such as at-home business and personal umbrella, through independent agents. Homeowners and dwelling fire is produced through independent agents in Hawaii. Each of these programs involves detailed eligibility criteria, which are incorporated into strict underwriting guidelines, and prequalification of each risk using a system accessible by the independent agent. The independent agent cannot bind the risk unless they receive approval through our system.

Underwriting Agents

We contract with certain underwriting agencies who have limited authority to bind or underwrite business on our behalf. The underwriting agreements involve strict underwriting guidelines and the agents are subject to audits upon request. These agencies may receive some compensation through contingent profit commission.

E-commerce and/or Direct

We are actively employing e-commerce to produce and efficiently process and service business, including, at-home businesses, small commercial and personal umbrella risks surety bonding, and pet insurance. Our largest assumed reinsurance treaty is on a direct basis with ProAg.

Competition

Our specialty property and casualty insurance subsidiaries are part of an extremely competitive industry that is cyclical and historically characterized by periods of high premium rates and shortages of underwriting capacity followed by periods of severe competition and excess underwriting capacity. Within the United States alone, approximately 2,400 companies, both stock and mutual, actively market property and casualty coverages. Our primary competitors in our casualty segment are, among others, Ace, Arch, James River, Landmark, Navigators, USLI, Great West, Lancer, National Interstate, Chubb, Philadelphia, Great American, Travelers and CNA. Our primary competitors in our property segment are, among others, Ace, Lexington, Arch, Crum & Forster, Travelers and Markel. Our primary competitors in our surety segment are, among others, Ace, Arch, HCC, CNA, Safeco, North American Specialty, Travelers and Hartford. The combination of coverages, service, pricing and other methods of competition vary from line to line. Our principal methods of meeting this competition are innovative coverages, marketing structure and quality service to the agents and policyholders at a fair price. We compete favorably in part because of our sound financial base and reputation, as well as our broad geographic penetration into all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. In the casualty, property and surety areas, we have acquired experienced underwriting specialists in our branch and home offices. We have continued to maintain our underwriting and marketing standards by not seeking market share at the expense of earnings. We have a track record of withdrawing from markets when conditions become overly adverse and we offer new coverages and new programs where the opportunity exists to provide needed insurance coverage with exceptional service on a profitable basis.

Financial Strength Ratings

A.M. Best ratings for the industry range from A++ (Superior) to F (In Liquidation) with some companies not being rated. Standard & Poor s ratings for the industry range from AAA (Extremely strong) to R (Regulatory Action). Moody s ratings for the industry range from Aaa (Exceptional) to C (Lowest). The following table illustrates the range of ratings assigned by each of the three major rating companies that has issued a financial strength rating on our insurance companies:

A.M. Best		**Standard & Poor s**		**Moody s**	
SECURE		SECURE		STRONG	
A++, A+	Superior	AAA	Extremely strong	Aaa	Exceptional
A,A-	Excellent	AA	Very strong	Aa	Excellent
B++, B+	Very good	A	Strong	A	Good
		BBB			