RLI CORP
Form 10-Q
April 28, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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 (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 x No o

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 x No o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of April 15, 2011, the number of shares outstanding of the registrant s Common Stock was 21,056,305.

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, 2011**		**2010**	
Net premiums earned	$	116,051	$	116,264
Net investment income		16,303		16,600
Net realized investment gains		4,472		6,463
Other-than-temporary impairment (OTTI) losses on investments				
Consolidated revenue		136,826		139,327
Losses and settlement expenses		46,871		54,257
Policy acquisition costs		40,533		40,465
Insurance operating expenses		9,615		8,827
Interest expense on debt		1,512		1,512
General corporate expenses		2,005		1,717
Total expenses		100,536		106,778
Equity in earnings of unconsolidated investee		2,616		2,253
Earnings before income taxes		38,906		34,802
Income tax expense		12,445		10,581
Net earnings	$	26,461	$	24,221
Other comprehensive earnings, net of tax		5,248		9,275
Comprehensive earnings	$	31,709	$	33,496
Earnings per share:				
Basic:				
Basic net earnings per share	$	1.26	$	1.14
Basic comprehensive earnings per share	$	1.51	$	1.58
Diluted:				
Diluted net earnings per share	$	1.24	$	1.13
Diluted comprehensive earnings per share	$	1.49	$	1.57
Weighted average number of common shares outstanding				
Basic		21,025		21,176
Diluted		21,285		21,372
Cash dividends declared per common share	$	0.29	$	0.28

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

RLI Corp. and Subsidiaries Condensed Consolidated Balance Sheets

(in thousands, except share data)		**March 31, 2011 (unaudited)**		**December 31, 2010**
ASSETS				
Investments				
Fixed income				
Available-for-sale, at fair value	$	1,084,279	$	1,132,064
Held-to-maturity, at amortized cost		299,253		309,258
Trading, at fair value		10		15
Equity securities, at fair value		335,006		321,897
Short-term investments, at cost		111,872		39,787
Total investments		1,830,420		1,803,021
Accrued investment income		12,386		14,615
Premiums and reinsurance balances receivable		101,771		107,391
Ceded unearned premium		56,670		62,631
Reinsurance balances recoverable on unpaid losses		348,082		354,163
Deferred policy acquisition costs		72,744		74,435
Property and equipment		18,689		18,370
Investment in unconsolidated investees		46,368		43,358
Goodwill		26,214		26,214
Other assets		9,586		10,394
TOTAL ASSETS	$	2,522,930	$	2,514,592
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities:				
Unpaid losses and settlement expenses	$	1,173,849	$	1,173,943
Unearned premiums		292,159		301,537
Reinsurance balances payable		18,137		23,851
Income taxes-deferred		37,121		33,930
Bonds payable, long-term debt		100,000		100,000
Accrued expenses		27,182		42,436
Other liabilities		54,622		47,519
TOTAL LIABILITIES	$	1,703,070	$	1,723,216
Shareholders Equity				
Common stock ($1 par value)				
(32,408,296 shares issued at 3/31/11)				
(32,317,691 shares issued at 12/31/10)		32,408		32,318
Paid-in capital		217,855		215,066
Accumulated other comprehensive earnings		101,240		95,992
Retained earnings		854,732		834,375
Deferred compensation		8,376		6,474
Less: Treasury shares at cost				
(11,353,151 shares at 3/31/11)				
(11,353,151 shares at 12/31/10)		(394,751)		(392,849)
TOTAL SHAREHOLDERS EQUITY		819,860		791,376
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	2,522,930	$	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 Three-Month Periods Ended March 31, 2011	2010
Net cash provided by (used in) operating activities	$ 17,938	$ (2,448)
Cash Flows from Investing Activities		
Investments purchased	(60,240)	(168,823)
Investments sold	76,360	102,442
Investments called or matured	39,787	134,015
Net change in short-term investments	(69,590)	(48,847)
Net property and equipment purchased	(1,030)	(402)
Net cash (used in) provided by investing activities	$ (14,713)	$ 18,385
Cash Flows from Financing Activities		
Cash dividends paid	$ (6,104)	$ (5,954)
Stock option plan share issuance	918	370
Excess tax benefit from exercise of stock options	1,961	941
Treasury shares purchased		(11,294)
Net cash used in financing activities	$ (3,225)	$ (15,937)
Net increase in cash		
Cash at the beginning of the period		
Cash at March 31	$	$

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 March 31, 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, 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 are currently assessing the impact of adoption on our disclosures for our pending acquisition of Contractors Bonding and Insurance Company (CBIC). See further discussion on the acquisition in note 6 to the unaudited condensed consolidated interim financial statements, Subsequent Event.

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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 is positive and there have been no triggering events that would suggest possible impairment.

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 will 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.

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;

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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 assessing our estimate of the impact of adopting the ASU 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. Goodwill, which relates to our surety segment, is listed separately on the balance sheet and totaled $26.2 million at March 31, 2011 and December 31, 2010. Annual impairment testing was performed during the second quarter of 2010. Based upon this review, this asset was not impaired. In addition, as of March 31, 2011, there were no triggering events that had occurred that would suggest an updated review was necessary.

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.

(in thousands, except per share data)	For the Three-Month Period Ended March 31, 2011 Income (Numerator)	Shares (Denominator)	Per Share Amount	For the Three-Month Period Ended March 31, 2010 Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	$ 26,461	21,025	$ 1.26	$ 24,221	21,176	$ 1.14
Effect of Dilutive Securities						
Stock options		260			196	
Diluted EPS						
Income available to common shareholders	$ 26,461	21,285	$ 1.24	$ 24,221	21,372	$ 1.13

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 March 31, 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 March 31, 2011 and December 31, 2010, unrealized losses, as shown in the following tables, were less than 1% of total invested assets. Unrealized losses have increased in 2011, as interest rates increased during the first quarter.

Investment Positions with Unrealized Losses

Segmented by Type and Period of Continuous

Unrealized Loss at March 31, 2011

(dollars in thousands)	< 12 Mos.	12 Mos. & Greater	Total
U.S Government			
Fair value	$ 8,071	$	$ 8,071
Cost or Amortized Cost	8,339		8,339
Unrealized Loss	(268)		(268)
U.S Agency			
Fair value	$ 328,860	$	$ 328,860
Cost or Amortized Cost	338,798		338,798
Unrealized Loss	(9,938)		(9,938)
Mortgage-backed			
Fair value	$ 55,647	$	$ 55,647
Cost or Amortized Cost	56,936		56,936
Unrealized Loss	(1,289)		(1,289)
ABS/CMO*			
Fair value	$ 12,685	$	$ 12,685
Cost or Amortized Cost	12,778		12,778
Unrealized Loss	(93)		(93)
Corporate			
Fair value	$ 108,170	$ 503	$ 108,673
Cost or Amortized Cost	111,503	515	112,018
Unrealized Loss	(3,333)	(12)	(3,345)
States, political subdivisions & revenues			
Fair value	$ 74,328	$ 2,012	$ 76,340
Cost or Amortized Cost	76,313	2,094	78,407
Unrealized Loss	(1,985)	(82)	(2,067)
Subtotal, debt securities			
Fair value	$ 587,761	$ 2,515	$ 590,276
Cost or Amortized Cost	604,667	2,609	607,276
Unrealized Loss	(16,906)	(94)	(17,000)
Common Stock			
Fair value	$ 11,233	$	$ 11,233
Cost or Amortized Cost	11,840		11,840
Unrealized Loss	(607)		(607)
Total			
Fair value	$ 598,994	$ 2,515	$ 601,509
Cost or Amortized Cost	616,507	2,609	619,116
Unrealized Loss	(17,513)	(94)	(17,607)

* 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**
U.S Government			
Fair value	$ 5,689	$	$ 5,689
Cost or Amortized Cost	5,880		5,880
Unrealized Loss	(191)		(191)
U.S Agency			
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)
States, political subdivisions & revenues			
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 less than $0.1 million classified as trading.

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 March 31, 2011 and December 31, 2010 were as follows:

Available-for-sale

(in thousands)

	3/31/2011			
Asset Class	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Agencies	$ 96,017	$ 638	$ (2,335)	$ 94,320
Corporates	423,034	23,748	(2,820)	443,962
Mortgage-backed	245,467	10,284	(1,289)	254,462
ABS/CMO*	62,519	2,152	(93)	64,578
Treasuries	15,718	182	(268)	15,632
Munis	209,823	3,569	(2,067)	211,325
Total Fixed Income	**$ 1,052,578**	**$ 40,573**	**$ (8,872)**	**$ 1,084,279**

Available-for-sale

(in thousands)

	12/31/2010			
Asset Class	**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
Munis	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

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

AFS (in thousands)	3/31/2011 Amortized Cost	3/31/2011 Fair Value	12/31/2010 Amortized Cost	12/31/2010 Fair Value
Agencies				
Due within 1 year	$	$	$ 2,004	$ 2,021
After 1 but within 5 years	4,773	4,960	4,796	5,026
After 5 but within 10 years	35,993	35,305	39,988	39,712
After 10 years*	55,251	54,055	56,345	55,454
Total	96,017	94,320	103,133	102,213
Corporates				
Due within 1 year	$	$	$ 1,001	$ 1,010
After 1 but within 5 years	107,673	113,748	96,768	101,864
After 5 but within 10 years	299,534	314,331	327,171	345,049
After 10 years	15,827	15,883	24,711	25,010
Total	423,034	443,962	449,651	472,933
Mortgage-backed				
Due within 1 year	$	$	$	$
After 1 but within 5 years				
After 5 but within 10 years	4,253	4,518	2,521	2,677
After 10 years*	241,214	249,944	240,843	251,464
Total	245,467	254,462	243,364	254,141
Asset-backed				
Due within 1 year	$	$	$	$
After 1 but within 5 years	4,487	4,690	4,882	5,137
After 5 but within 10 years	7,898	8,304	4,099	4,567
After 10 years*	50,134	51,584	38,513	40,211
Total	62,519	64,578	47,494	49,915
Treasuries				
Due within 1 year	$ 1,858	$ 1,883	$ 3,865	$ 3,915
After 1 but within 5 years	8,964	9,083	7,012	7,192
After 5 but within 10 years	4,896	4,666	4,894	4,717
After 10 years*				
Total	15,718	15,632	15,771	15,824
Munis				
Due within 1 year	$ 10,902	$ 11,030	$ 14,004	$ 14,113
After 1 but within 5 years	15,813	16,451	25,177	26,303
After 5 but within 10 years	69,063	70,679	74,770	77,028
After 10 years*	114,045	113,165	120,505	119,594
Total	209,823	211,325	234,456	237,038
TOTAL	$ 1,052,578	$ 1,084,279	$ 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.

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Held-to-Maturity Debt Securities

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

Held-to-maturity

(in thousands)

	3/31/2011							
Asset Class		**Amortized Cost/ Carrying Value****		**Gross Unrecognized Gains**		**Gross Unrecognized Losses**		**Fair Value**
Agencies	$	278,403	$	448	$	(7,603)	$	271,248
Corporates		15,000				(525)		14,475
Mortgage-backed								
ABS/CMO*								
Treasuries								
Munis		5,850		199				6,049
Total Fixed Income	**$**	**299,253**	**$**	**647**	**$**	**(8,128)**	**$**	**291,772**

Held-to-maturity

(in thousands)

	12/31/2010							
Asset Class		**Amortized Cost/ Carrying Value****		**Gross Unrecognized Gains**		**Gross Unrecognized Losses**		**Fair Value**
Agencies	$	288,407	$	607	$	(6,688)	$	282,326
Corporates		15,000		100		(125)		14,975
Mortgage-backed								
ABS/CMO*								
Treasuries								
Munis		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 interim 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.

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

HTM (in thousands)	3/31/2011 Amortized Cost	3/31/2011 Fair Value	12/31/2010 Amortized Cost	12/31/2010 Fair Value
Agencies				
Due within 1 year	$	$	$ 4,086	$ 4,117
After 1 but within 5 years	3,964	4,304	3,960	4,351
After 5 but within 10 years	13,996	13,716	18,994	18,812
After 10 years*	260,443	253,228	261,367	255,046
Total	278,403	271,248	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	14,475	15,000	14,975
Total	15,000	14,475	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				
Munis				
Due within 1 year	$ 2,630	$ 2,665	$ 2,631	$ 2,685
After 1 but within 5 years	3,220	3,384	3,220	3,398
After 5 but within 10 years				
After 10 years*				
Total	5,850	6,049	5,851	6,083
TOTAL	$ 299,253	$ 291,772	$ 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 March 31, 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) Book Value	Fair Value	Unrealized Loss	Percent to Total
1	AAA/AA/A	Aaa/Aa/A	$ 596,265	$ 579,618	$ (16,647)	97.9%
2	BBB	Baa	11,011	10,658	(353)	2.1%
3	BB	Ba				
4	B	B				
5	CCC or lower	Caa or lower				
6						
		Total	$ 607,276	$ 590,276	$ (17,000)	100.0%

Evaluating Investments for OTTI

The fixed income portfolio contained 170 unrealized loss positions as of March 31, 2011. The $17.0 million in associated unrealized losses for these 170 securities represents 1.3% of the fixed income portfolio s cost basis. Of these 170 securities, three have been in an unrealized loss position for 12 consecutive months or longer and these collectively represent less than $0.1 million in unrealized losses. The unrealized losses on these three 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. The fixed income unrealized losses can primarily be attributed to changes in interest rates. 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 March 31, 2011, we held four common stock positions that were in unrealized loss positions. Unrealized losses on these securities totaled $0.6 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 four 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 March 31, 2011, there were no impairment charges for equity securities. Comparatively, we did not recognize any OTTI losses on equity securities during the first three 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.

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.

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.

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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:

	As of March 31, 2011 Fair Value Measurements Using							
($ in 000s) Description		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Total**
Trading securities								
Mortgage-backed	$		$	10	$		$	10
ABS/CMO*								
Treasuries								
Total trading securities	$		$	10	$		$	10
Available-for-sale securities								
Agencies	$		$	94,320	$		$	94,320
Corporates				443,962				443,962
Mortgage-backed				254,462				254,462
ABS/CMO*				64,578				64,578
Treasuries				15,632				15,632
Municipals				211,325				211,325
Equity		335,006						335,006
Total available-for-sale securities	$	335,006	$	1,084,279	$		$	1,419,285
Total	$	335,006	$	1,084,289	$		$	1,419,295

*Asset-backed & collateralized mortgage obligations

($ in 000s) Description	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Total	
	As of December 31, 2010 Fair Value Measurements Using							
Trading securities								
Corporate	$		$		$		$	
Mortgage-backed				15				15
ABS/CMO*								
Treasuries								
Total trading securities	$		$	15	$		$	15
Available-for-sale securities								
Agencies	$		$	102,213	$		$	102,213
Corporates				472,933				472,933
Mortgage-backed				254,141				254,141
ABS/CMO*				49,915				49,915
Treasuries				15,824				15,824
Municipals				237,038				237,038
Equity		321,897						321,897
Total available-for-sale securities	$	321,897	$	1,132,064	$		$	1,453,961
Total	$	321,897	$	1,132,079	$		$	1,453,976

*Asset-backed & collateralized mortgage obligations

As noted in the above table, we do 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.

4. STOCK BASED COMPENSATION

Our shareholder-approved RLI Corp. Omnibus Stock Plan (omnibus plan) was in place from 2005 to 2010. The omnibus plan provided for grants of up to 1,500,000 shares (subject to adjustment for changes in our capitalization). Since 2005, we have granted 1,227,445 stock options under this plan.

During the second quarter of 2010, our shareholders approved the RLI Corp. Long-Term Incentive Plan (LTIP), which replaces the omnibus plan and which was filed with the Securities and Exchange Commission via a Form 8-K Current Report on May 6, 2010. In conjunction with the adoption of the LTIP, effective May 6, 2010, options will no longer be granted under the omnibus plan. Awards under the LTIP may be in the form of restricted stock, stock options (nonqualified only), stock appreciation rights, performance units, as well as other stock based awards. Eligibility under the LTIP is limited to employees or directors of the company or any affiliate. The granting of awards under the LTIP is solely at the discretion of the executive resources committee of the board of directors. The total number of shares of common stock available for distribution under the LTIP may not exceed 2,000,000 shares (subject to adjustment for changes in our capitalization). Since 2010, we have granted 227,000 stock options under the LTIP, including 19,950 thus far in 2011.

Under the LTIP, as under the omnibus plan, we grant stock options for shares with an exercise price equal to the fair market value of the shares at the date of grant. Options generally vest and become exercisable ratably over a five-year period. Beginning with the annual grant in May 2009, options granted under both plans have an eight-year life. Prior to that grant, options were granted with a ten-year life. The related compensation expense is recognized over the requisite service period.

In most instances, 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.

The following tables summarize option activity for the periods ended March 31, 2011 and 2010:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000 s)
Outstanding options at January 1, 2011	1,524,982	$ 41.32		
Options granted	19,950	$ 55.28		
Options exercised	(177,857)	$ 28.00		$ 4,711
Options canceled/forfeited	(7,130)	$ 44.59		
Outstanding options at March 31, 2011	1,359,945	$ 43.25	5.89	$ 19,583
Exercisable options at March 31, 2011	668,875	$ 40.79	5.07	$ 11,274

	Number of	Weighted Average	Weighted Average Remaining	Aggregate