

RLI CORP
Form 10-Q
October 24, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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)

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

(309) 692-1000

(Registrant's telephone number, including area code)

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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As of October 12, 2016, the number of shares outstanding of the registrant's Common Stock was 43,906,953.

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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 September 30,	
	2016	2015
Net premiums earned	\$ 183,595	\$ 179,448
Net investment income	13,504	13,964
Net realized gains	9,347	7,534
Other-than-temporary impairment (OTTI) losses on investments	(95)	-
Consolidated revenue	\$ 206,351	\$ 200,946
Losses and settlement expenses	97,892	73,051
Policy acquisition costs	61,761	60,505
Insurance operating expenses	13,338	12,299
Interest expense on debt	1,857	1,857
General corporate expenses	2,242	1,958
Total expenses	\$ 177,090	\$ 149,670
Equity in earnings of unconsolidated investees	1,881	661
Earnings before income taxes	\$ 31,142	\$ 51,937
Income tax expense	8,879	16,029
Net earnings	\$ 22,263	\$ 35,908
Other comprehensive earnings (loss), net of tax	(6,931)	(16,136)
Comprehensive earnings	\$ 15,332	\$ 19,772
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 0.51	\$ 0.83
Basic comprehensive earnings per share	\$ 0.35	\$ 0.46
Diluted:		

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Diluted net earnings per share	\$ 0.50	\$ 0.81
Diluted comprehensive earnings per share	\$ 0.34	\$ 0.45
Weighted average number of common shares outstanding		
Basic	43,843	43,342
Diluted	44,492	44,153
Cash dividends paid per common share	\$ 0.20	\$ 0.19

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

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RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	For the Nine-Month Periods Ended September 30,	
	2016	2015
Net premiums earned	\$ 540,739	\$ 520,790
Net investment income	39,922	40,890
Net realized gains	23,457	25,622
Other-than-temporary impairment (OTTI) losses on investments	(95)	-
Consolidated revenue	\$ 604,023	\$ 587,302
Losses and settlement expenses	259,340	218,461
Policy acquisition costs	184,525	178,965
Insurance operating expenses	38,950	37,297
Interest expense on debt	5,570	5,570
General corporate expenses	7,385	6,950
Total expenses	\$ 495,770	\$ 447,243
Equity in earnings of unconsolidated investees	10,823	11,041
Earnings before income taxes	\$ 119,076	\$ 151,100
Income tax expense	36,343	47,409
Net earnings	\$ 82,733	\$ 103,691
Other comprehensive earnings (loss), net of tax	33,898	(48,663)
Comprehensive earnings	\$ 116,631	\$ 55,028
Earnings per share:		
Basic:		
Basic net earnings per share	\$ 1.89	\$ 2.40
Basic comprehensive earnings per share	\$ 2.67	\$ 1.27
Diluted:		
Diluted net earnings per share	\$ 1.86	\$ 2.35
Diluted comprehensive earnings per share	\$ 2.63	\$ 1.25
Weighted average number of common shares outstanding		
Basic	43,721	43,232
Diluted	44,416	44,031
Cash dividends paid per common share	\$ 0.59	\$ 0.56

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)	September 30, 2016	December 31, 2015
ASSETS		
Investments		
Fixed income		
Available-for-sale, at fair value (amortized cost - \$1,624,868 at 9/30/16 and \$1,518,156 at 12/31/15)	\$ 1,687,605	\$ 1,538,110
Equity securities available-for-sale, at fair value (cost - \$200,595 at 9/30/16 and \$202,437 at 12/31/15)	382,282	375,424
Short-term investments, at cost which approximates fair value	8,392	6,262
Other invested assets	24,502	20,666
Cash	13,970	11,081
Total investments and cash	\$ 2,116,751	\$ 1,951,543
Accrued investment income	13,311	14,878
Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of \$15,739 at 9/30/16 and \$14,898 at 12/31/15	136,214	143,662
Ceded unearned premium	54,014	52,833
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of \$10,956 at 9/30/16 and \$11,885 at 12/31/15	292,943	297,844
Deferred policy acquisition costs	75,805	69,829
Property and equipment, at cost, net of accumulated depreciation of \$43,011 at 9/30/16 and \$38,447 at 12/31/15	53,643	47,102
Investment in unconsolidated investees	82,276	70,784
Goodwill and intangibles	64,578	71,294
Other assets	23,999	15,696
TOTAL ASSETS	\$ 2,913,534	\$ 2,735,465
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Unpaid losses and settlement expenses	\$ 1,150,938	\$ 1,103,785
Unearned premiums	449,051	422,094
Reinsurance balances payable	17,425	37,556
Funds held	77,902	54,254
Income taxes-deferred	85,152	63,993
Bonds payable, long-term debt	148,694	148,554
Accrued expenses	40,029	55,742
Other liabilities	21,929	26,018
TOTAL LIABILITIES	\$ 1,991,120	\$ 1,911,996

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Shareholders' Equity		
Common stock (\$1 par value, 100,000,000 shares authorized)		
(66,837,167 shares issued, 43,906,953 shares outstanding at 9/30/16)		
(66,474,342 shares issued, 43,544,128 shares outstanding at 12/31/15)	\$ 66,837	\$ 66,474
Paid-in capital	229,107	221,345
Accumulated other comprehensive earnings	157,672	123,774
Retained earnings	861,797	804,875
Deferred compensation	10,395	10,647
Less: Treasury shares at cost		
(22,930,214 shares at 9/30/16 and 12/31/15)	(403,394)	(403,646)
TOTAL SHAREHOLDERS' EQUITY	\$ 922,414	\$ 823,469
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 2,913,534	\$ 2,735,465

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 Nine-Month Periods Ended September 30,	
	2016	2015
Net cash provided by operating activities	\$ 123,000	\$ 121,367
Cash Flows from Investing Activities		
Investments purchased	\$ (434,505)	\$ (540,159)
Investments sold	243,506	349,411
Investments called or matured	102,752	135,750
Net change in short-term investments	(1,476)	(43,745)
Net property and equipment purchased	(11,852)	(6,405)
Investment in equity method investee	-	(1,711)
Acquisition of agency	(850)	-
Net cash used in investing activities	\$ (102,425)	\$ (106,859)
Cash Flows from Financing Activities		
Cash dividends paid	\$ (25,811)	\$ (24,221)
Stock plan share issuance	(357)	39
Excess tax benefit from exercise of stock options	8,482	7,242
Net cash used in financing activities	\$ (17,686)	\$ (16,940)
Net increase (decrease) in cash	\$ 2,889	\$ (2,432)
Cash at the beginning of the period	\$ 11,081	\$ 30,620
Cash at September 30	\$ 13,970	\$ 28,188

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. 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 2015 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at September 30, 2016 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year.

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

B. ADOPTED ACCOUNTING STANDARDS

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

This ASU was issued to simplify the presentation of debt issuance costs by requiring them to be presented in the balance sheet as a direct deduction from the carrying amount of the related recognized debt liability, consistent with debt discounts. We adopted ASU 2015-03 on January 1, 2016 on a retrospective basis. Our adoption of the new standard resulted in a \$1.1 million decrease to long-term debt and other assets at December 31, 2015.

C. PROSPECTIVE ACCOUNTING STANDARDS

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

This ASU was issued to enhance disclosures about an entity's insurance liabilities, including the nature, amount, timing and uncertainty of cash flows related to those liabilities. The new guidance requires the following information related to unpaid claims and claim adjustment expenses be disclosed using an appropriate level of disaggregation so as not to obscure useful information:

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

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

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ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

This ASU was issued to improve the recognition and measurement of financial instruments. The new guidance makes targeted improvements to GAAP as follows:

- a. Requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income;
- b. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment;
- c. Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet;
- d. Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes;
- e. Requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments;
- f. Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and
- g. Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

This ASU is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is only permitted for provision (e) above. Upon adoption, a cumulative-effect adjustment to the balance sheet will be made as of the beginning of the fiscal year of adoption. We have not yet completed the analysis of how adopting this ASU will affect our financial statements.

ASU 2016-02, Leases (Topic 842)

ASU 2016-02 was issued to improve the financial reporting of leasing transactions. Under current guidance for lessees, leases are only included on the balance sheet if certain criteria, classifying the agreement as a capital lease, are met. This update will require 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 will be 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 will be 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 will be classified as a financing activity while the interest component will be included in the operating section of the statement of cash flows.

This ASU is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. Upon adoption, leases will be recognized and measured at the beginning of the earliest period presented

using a modified retrospective approach. We have not yet completed the analysis of how adopting this ASU will affect our financial statements.

ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

ASU 2016-09 was issued to simplify the accounting for share-based payment awards. The guidance requires that, prospectively, all tax effects related to share-based payments be made through the income statement at the time of settlement as opposed to excess tax benefits being recognized in additional paid-in-capital under the current guidance. The ASU also removes the requirement to delay recognition of a tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis, with a cumulative-effect adjustment to opening retained earnings. Additionally, all tax related cash flows resulting from share-based payments are to be reported as operating activities on the statement of cash flows, a change from the current requirement to present tax benefits as an inflow from financing activities and an outflow from operating activities. Finally, entities will be allowed to withhold an amount up to the employees' maximum individual tax rate (as opposed to the minimum statutory tax rate) in the relevant jurisdiction without resulting in liability classification of the award. The change in withholding requirements will be applied on a modified retrospective approach.

This ASU is effective for annual and interim reporting periods beginning after December 15, 2016. Early adoption is permitted with any adjustments reflected as of the beginning of the fiscal year of adoption. The primary impact this guidance

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will have on our financial statements relates to the provision concerning the recognition of tax effects through the income statement. The impact to our income statement will vary depending upon the level of intrinsic value associated with option exercises in a particular period.

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326)

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 to be presented at the net amount expected to be collected by means of an allowance for credit losses that runs through net income. 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 presented. We have not yet completed the analysis of how adopting this ASU will affect our financial statements.

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments

ASU 2016-15 was issued to reduce the diversity in practice of how certain cash receipts and payments, for which current guidance is silent, are classified in the statement of cash flows. The update addresses eight specific issues, including contingent consideration payments made after a business combination, distributions received from equity method investees and the classification of cash receipts and payments that have aspects of more than one class of cash flows. This ASU is effective for annual and interim reporting periods beginning after December 15, 2017. Early adoption is permitted. Upon adoption, the update will be applied using the retrospective transition method. We have not yet completed the analysis of how adopting this ASU will affect our financial statements, but do not expect a material impact on our statement of cash flows.

D. INTANGIBLE ASSETS

In accordance with GAAP guidelines, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and intangible assets totaled \$64.6 million and \$71.3 million at September 30, 2016 and December 31, 2015, respectively, as detailed in the following table.

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Goodwill and Intangible Assets	September	December
(in thousands)	30,	31,
Reporting Unit	2016	2015
Goodwill		
Energy surety	\$ 25,706	\$ 25,706
Miscellaneous and contract surety	15,110	15,110
P&C package business	5,246	5,246
Medical professional liability *	5,208	12,434
Total goodwill	\$ 51,270	\$ 58,496
Intangibles		
State insurance licenses	\$ 7,500	\$ 7,500
Definite-lived intangibles, net of accumulated amortization of \$5,339 at 9/30/16 and \$4,678 at 12/31/15	5,808	5,298
Total intangibles	\$ 13,308	\$ 12,798
Total goodwill and intangibles	\$ 64,578	\$ 71,294

* The September 30, 2016 medical professional liability goodwill balance reflects a \$7.2 million non-cash impairment charge recorded in the second quarter of 2016.

All definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets was \$0.2 million for the third quarter of 2016 and \$0.7 million for the nine-month period ended September 30, 2016, compared to \$0.2 million for the third quarter of 2015 and \$0.7 million for the nine-month period ended September 30, 2015. Definite-lived intangibles increased during 2016 as a result of the asset acquisition from an insurance agency. Separately identifiable assets of the agency totaled \$1.2 million and related primarily to acquired software, trade name and agency relationships.

Annual impairment testing was performed on our energy surety goodwill, miscellaneous and contract surety goodwill, P&C package business goodwill and state insurance license indefinite-lived intangible asset during the second quarter of 2016. Based upon these reviews, none of the assets were impaired. In addition, as of September 30, 2016, there were no triggering events that occurred on the above mentioned goodwill and intangible assets that would suggest an updated review was necessary.

As disclosed in previous SEC filings, premium declines have decreased the fair value of our medical professional liability business in recent periods. Continuing rate and volume declines coupled with recent adverse loss experience resulted in a triggering event during the second quarter of 2016. A fair value was determined by using a weighted average of a market approach valuation and income approach (or discounted cash flow method) valuation. It was determined that the carrying cost of our medical professional liability goodwill exceeded the fair value. As a result, we recorded a \$7.2 million non-cash impairment charge included as a net realized loss in the consolidated statement of

earnings for the nine-month period ending September 30, 2016. There have been no additional triggering events subsequent to the second quarter 2016 impairment. As an additional consequence of the premium declines and adverse loss experience, the remaining portion of the contingent earn-out agreement associated with our acquisition of this medical professional liability business was eliminated, resulting in a \$1.5 million reduction to expenses for the nine-month period ending September 30, 2016.

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.

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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.

(in thousands, except per share data)	For the Three-Month Period Ended September 30, 2016			For the Three-Month Period Ended September 30, 2015		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	\$ 22,263	43,843	\$ 0.51	\$ 35,908	43,342	\$ 0.83
Effect of Dilutive Securities						
Stock options	-	649		-	811	
Diluted EPS						
Income available to common shareholders	\$ 22,263	44,492	\$ 0.50	\$ 35,908	44,153	\$ 0.81
For the Nine-Month Period						
(in thousands, except per share data)	Ended September 30, 2016			Ended September 30, 2015		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	\$ 82,733	43,721	\$ 1.89	\$ 103,691	43,232	\$ 2.40
Effect of Dilutive Securities						
Stock options	-	695		-	799	
Diluted EPS						
Income available to common shareholders	\$ 82,733	44,416	\$ 1.86	\$ 103,691	44,031	\$ 2.35

F. COMPREHENSIVE EARNINGS

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

Unrealized gains, net of tax, for the first nine months of 2016 were \$33.9 million, compared to unrealized losses, net of tax, of \$48.7 million during the same period last year. Unrealized gains in the first nine months of 2016 were primarily due to a decline in interest rates, increasing the value of the fixed income portfolio, and were aided by positive pricing movements for equity securities. In 2015, unrealized losses were the result of rising interest rates and an underperforming equity market.

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 September 30,		For the Nine-Month Periods Ended September 30,	
	2016	2015	2016	2015
Unrealized Gains/Losses on Available-for-Sale Securities				
Beginning balance	\$ 164,603	\$ 138,856	\$ 123,774	\$ 171,383
Other comprehensive earnings before reclassifications	(572)	(11,257)	54,159	(32,020)
Amounts reclassified from accumulated other comprehensive earnings	(6,359)	(4,879)	(20,261)	(16,643)
Net current-period other comprehensive earnings (loss)	\$ (6,931)	\$ (16,136)	\$ 33,898	\$ (48,663)
Ending balance	\$ 157,672	\$ 122,720	\$ 157,672	\$ 122,720

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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				Affected line item in the Statement of Earnings
	For the Three-Month Periods Ended September 30, 2016		For the Nine-Month Periods Ended September 30, 2015		
Component of Accumulated Other Comprehensive Earnings	2016	2015	2016	2015	
Unrealized gains and losses on available-for-sale securities	\$ 9,878	\$ 7,507	\$ 31,266	\$ 25,604	Net realized gains
	(95)	-	(95)	-	Other-than-temporary impairment (OTTI) losses on investments
	\$ 9,783	\$ 7,507	\$ 31,171	\$ 25,604	Earnings before income taxes
	(3,424)	(2,628)	(10,910)	(8,961)	Income tax expense
	\$ 6,359	\$ 4,879	\$ 20,261	\$ 16,643	Net earnings

2. INVESTMENTS

Our investments are primarily composed of fixed income debt securities and common stock equity securities. As disclosed in our 2015 Annual Report on Form 10-K, we present all of our investments 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."

Available-for-Sale Securities

The amortized cost and fair value of available-for-sale securities at September 30, 2016 and December 31, 2015 were as follows:

Available-for-sale
(in thousands)

Asset Class	September 30, 2016			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	\$ 82,796	\$ 1,523	\$ (6)	\$ 84,313
U.S. agency	11,493	807	-	12,300
Non-U.S. govt. & agency	6,037	153	(190)	6,000
Agency MBS	302,761	9,603	(279)	312,085
ABS/CMBS*	116,156	2,322	(242)	118,236
Corporate	563,045	22,093	(4,464)	580,674
Municipal	542,580	31,647	(230)	573,997
Total Fixed Income	\$ 1,624,868	\$ 68,148	\$ (5,411)	\$ 1,687,605
Equity	\$ 200,595	\$ 182,616	\$ (929)	\$ 382,282

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(in thousands)

Asset Class	December 31, 2015			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	\$ 43,597	\$ 58	\$ (112)	\$ 43,543
U.S. agency	15,481	306	(47)	15,740
Non-U.S. govt. & agency	5,035	-	(557)	4,478
Agency MBS	250,060	6,451	(1,619)	254,892
ABS/CMBS*	91,559	995	(606)	91,948
Corporate	523,351	8,565	(14,807)	517,109
Municipal	589,073	21,375	(48)	610,400
Total Fixed Income	\$ 1,518,156	\$ 37,750	\$ (17,796)	\$ 1,538,110
Equity	\$ 202,437	\$ 174,443	\$ (1,456)	\$ 375,424

*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 September 30, 2016:

Available-for-sale (in thousands)	September 30, 2016	
	Amortized Cost	Fair Value
Due in one year or less	\$ 29,101	\$ 29,173
Due after one year through five years	357,543	365,930
Due after five years through 10 years	544,117	571,544
Due after 10 years	275,190	290,637
Mtge/ABS/CMBS*	418,917	430,321
Total available-for-sale	\$ 1,624,868	\$ 1,687,605

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

Unrealized Losses

We conduct and document periodic reviews of all securities with unrealized losses to evaluate whether the impairment

is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of securities that were in an unrealized loss position as of September 30, 2016 and December 31, 2015. The tables segregate the securities based on type, noting the fair value, cost (or amortized cost) and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of September 30, 2016 unrealized losses, as shown in the following tables, were 0.3 percent of total invested assets. Unrealized losses decreased in 2016, due largely to interest rates declines from the end of 2015, which increased the fair value of securities held in the fixed income portfolio.

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(in thousands)	September 30, 2016			December 31, 2015		
	< 12 Mos.	12 Mos. & Greater	Total	< 12 Mos.	12 Mos. & Greater	Total
U.S. Government						
Fair value	\$ 2,021	\$ —	\$ 2,021	\$ 36,000	\$ —	\$ 36,000
Cost or amortized cost	2,027	—	2,027	36,112	—	36,112
Unrealized Loss	\$ (6)	\$ —	\$ (6)	\$ (112)	\$ —	\$ (112)
U.S. Agency						
Fair value	\$ —	\$ —	\$ —	\$ 8,070	\$ —	\$ 8,070
Cost or amortized cost	—	—	—	8,117	—	8,117
Unrealized Loss	\$ —	\$ —	\$ —	\$ (47)	\$ —	\$ (47)
Non-U.S. government						
Fair value	\$ 3,849	\$ —	\$ 3,849	\$ 4,478	\$ —	\$ 4,478
Cost or amortized cost	4,039	—	4,039	5,035	—	5,035
Unrealized Loss	\$ (190)	\$ —	\$ (190)	\$ (557)	\$ —	\$ (557)
Agency MBS						
Fair value	\$ 42,710	\$ 9,028	\$ 51,738	\$ 100,424	\$ 18,520	\$ 118,944
Cost or amortized cost	42,789	9,228	52,017	101,473	19,090	120,563
Unrealized Loss	\$ (79)	\$ (200)	\$ (279)	\$ (1,049)	\$ (570)	\$ (1,619)
ABS/CMBS*						
Fair value	\$ 31,680	\$ 6,540	\$ 38,220	\$ 51,091	\$ 8,364	\$ 59,455
Cost or amortized cost	31,848	6,614	38,462	51,562	8,499	60,061
Unrealized Loss	\$ (168)	\$ (74)	\$ (242)	\$ (471)	\$ (135)	\$ (606)
Corporate						
Fair value	\$ 23,768	\$ 24,065	\$ 47,833	\$ 275,404	\$ 15,174	\$ 290,578
Cost or amortized cost	23,927	28,370	52,297	285,515	19,870	305,385
Unrealized Loss	\$ (159)	\$ (4,305)	\$ (4,464)	\$ (10,111)	\$ (4,696)	\$ (14,807)
Municipal						
Fair value	\$ 30,266	\$ —	\$ 30,266	\$ 8,462	\$ 2,418	\$ 10,880
Cost or amortized cost	30,496	—	30,496	8,504	2,424	10,928
Unrealized Loss	\$ (230)	\$ —	\$ (230)	\$ (42)	\$ (6)	\$ (48)
Subtotal, fixed income						
Fair value	\$ 134,294	\$ 39,633	\$ 173,927	\$ 483,929	\$ 44,476	\$ 528,405
Cost or amortized cost	135,126	44,212	179,338	496,318	49,883	546,201
Unrealized Loss	\$ (832)	\$ (4,579)	\$ (5,411)	\$ (12,389)	\$ (5,407)	\$ (17,796)
Equity securities						
Fair value	\$ 4,071	\$ 2,225	\$ 6,296	\$ 16,476	\$ —	\$ 16,476

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Cost or amortized cost	4,577	2,648	7,225	17,932	—	17,932
Unrealized Loss	\$ (506)	\$ (423)	\$ (929)	\$ (1,456)	\$ —	\$ (1,456)
Total						
Fair value	\$ 138,365	\$ 41,858	\$ 180,223	\$ 500,405	\$ 44,476	\$ 544,881
Cost or amortized cost	139,703	46,860	186,563	514,250	49,883	564,133
Unrealized Loss	\$ (1,338)	\$ (5,002)	\$ (6,340)	\$ (13,845)	\$ (5,407)	\$ (19,252)

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

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The following table shows the composition of the fixed income securities in unrealized loss positions at September 30, 2016 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)		Unrealized Loss	Percent to Total	
			Amortized Cost	Fair Value			
1	AAA/AA/A	Aaa/Aa/A	\$ 143,545	\$ 142,648	\$ (897)	16.6	%
2	BBB	Baa	11,779	11,499	(280)	5.2	%
3	BB	Ba	1,796	1,719	(77)	1.4	%
4	B	B	17,186	14,594	(2,592)	47.9	%
5	CCC or lower	Caa or lower	5,032	3,467	(1,565)	28.9	%
6			—	—	—	—	
		Total	\$ 179,338	\$ 173,927	\$ (5,411)	100.0	%

Evaluating Investments for OTTI

The fixed income portfolio contained 130 securities in an unrealized loss position as of September 30, 2016. The \$5.4 million in associated unrealized losses for these 130 securities represents 0.3 percent of the fixed income portfolio's cost basis. Of these 130 securities, 58 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. In the third quarter of 2016, we recognized \$0.1 million in other-than-temporary impairment (OTTI) charges in earnings on a fixed income security that we no longer had the intent to hold. Comparatively, we did not recognize any OTTI losses in earnings on the fixed income portfolio in 2015. There were no OTTI losses recognized in other comprehensive earnings on the fixed income portfolio for the periods presented.

As of September 30, 2016, we held three common stock securities that were in an unrealized loss position. The unrealized loss on these securities was \$0.9 million. Based on our analysis, we believe each security will recover in a reasonable period of time and we have the intent and ability to hold them until recovery. One equity security has been in an unrealized loss position for 12 consecutive months or longer. There were no OTTI losses recognized in the periods presented on the equity portfolio.

Other Invested Assets

Other invested assets include investments in three low income housing tax credit partnerships (LIHTC), carried at amortized cost, membership in the Federal Home Loan Bank of Chicago (FHLBC), carried at cost, and an investment in a real estate fund, carried at cost. Due to the nature of the LIHTC and our membership in the FHLBC, their carrying amounts approximate fair value. Our LIHTC interests had a balance of \$17.9 million at September 30, 2016, compared to \$14.0 million at December 31, 2015 and recognized a total tax benefit of \$0.4 million during the third quarter of 2016 compared to \$0.3 million during the third quarter of 2015. For the nine-month periods ended September 30, 2016 and 2015, our LIHTC interests recognized a total tax benefit of \$1.2 and \$0.8, respectively. Our investment in FHLBC stock totaled \$1.6 million at September 30, 2016 and December 31, 2015. Our investment in the real estate fund was carried at \$5.0 million and had a fair value of \$5.1 million at September 30, 2016, compared to a carrying value of \$5.0 million, which approximated fair value, at December 31, 2015.

Cash and Short-term Investments

Cash consists of uninvested balances in bank accounts. We had a cash balance of \$14.0 million at the end of the third quarter of 2016, compared to \$11.1 million at the end of 2015. Short-term investments of \$8.4 million and \$6.3 million at September 30, 2016 and December 31, 2015, respectively, are carried at cost, which approximates fair value.

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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. GAAP guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also describes three levels of inputs that may be used to measure fair value.

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

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

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

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

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

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

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

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

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

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

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

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

(in thousands)	As of September 30, 2016			Total
	Fair Value Measurements Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Available-for-sale securities				
U.S. government	\$ —	\$ 84,313	\$ —	\$ 84,313
U.S. agency	—	12,300	—	12,300
Non-U.S. govt. & agency	—	6,000	—	6,000
Agency MBS	—	312,085	—	312,085
ABS/CMBS*	—	118,236	—	118,236
Corporate	—	580,674	—	580,674
Municipal	—	573,997	—	573,997
Equity	382,282	—	—	382,282
Total available-for-sale securities	\$ 382,282	\$ 1,687,605	\$ —	\$ 2,069,887

(in thousands)	As of December 31, 2015			Total
	Fair Value Measurements Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Available-for-sale securities				
U.S. government	\$ —	\$ 43,543	\$ —	\$ 43,543
U.S. agency	—	15,740	—	15,740
Non-U.S. govt. & agency	—	4,478	—	4,478
Agency MBS	—	254,892	—	254,892

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ABS/CMBS*	—	91,948	—	91,948
Corporate	—	517,109	—	517,109
Municipal	—	610,400	—	610,400
Equity	375,424	—	—	375,424
Total available-for-sale securities	\$ 375,424	\$ 1,538,110	\$ —	\$ 1,913,534

* 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 nine-month period ended September 30, 2016.

4. INCOME TAXES

Our effective tax rate for the three and nine-month periods ended September 30, 2016 was 28.5 percent and 30.5 percent, respectively, compared to 30.9 percent and 31.4 percent, respectively, for the same periods in 2015. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was slightly lower for the three and nine-month periods ended September 30, 2016. While the dollar amount of tax favored adjustments were similar year over year, they were slightly larger on a percentage basis due to lower levels of pre-tax earnings.

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Income tax expense attributable to income from operations for the three and nine-month periods ended September 30, 2016 and 2015 differed from the amounts computed by applying the U.S. federal tax rate of 35 percent to pretax income as a result of the following:

(in thousands)	For the Three-Month Periods Ended September 30,				For the Nine-Month Periods Ended September 30,			
	2016 Amount	%	2015 Amount	%	2016 Amount	%	2015 Amount	%
Provision for income taxes at the statutory rate of 35%	\$ 10,900	35.0 %	\$ 18,178	35.0 %	\$ 41,677	35.0 %	\$ 52,885	35.0 %
Increase (reduction) in taxes resulting from:								
Tax exempt interest income	(1,020)	(3.2) %	(1,082)	(2.1) %	(3,149)	(2.6) %	(3,098)	(2.0) %
Dividends received deduction	(626)	(2.0) %	(603)	(1.2) %	(1,676)	(1.4) %	(1,715)	(1.1) %
ESOP dividends paid deduction	(238)	(0.8) %	(234)	(0.4) %	(714)	(0.6) %	(693)	(0.5) %
Other items, net	(137)	(0.5) %	(230)	(0.4) %	205	0.1 %	30	0.0 %
Total tax expense	\$ 8,879	28.5 %	\$ 16,029	30.9 %	\$ 36,343	30.5 %	\$ 47,409	31.4 %

5. STOCK BASED COMPENSATION

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

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

options under the 2010 LTIP. 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, 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 2015, we have granted 920,250 stock options under the 2015 LTIP, including 410,250 thus far in 2016.

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

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

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The following tables summarize option activity for the periods ended September 30, 2016 and 2015:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2016	2,582,220	\$ 32.42		
Options granted	410,250	\$ 64.15		
Options exercised	(638,675)	\$ 23.67		\$ 27,704
Options canceled/forfeited	(8,940)	\$ 41.90		
Outstanding options at September 30, 2016	2,344,855	\$ 40.32	5.12	\$ 65,748
Exercisable options at September 30, 2016	939,785	\$ 31.10	3.58	\$ 35,016

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2015	2,892,717	\$ 26.65		
Options granted	517,000	\$ 50.09		
Options exercised	(511,187)	\$ 18.27		\$ 17,845
Options canceled/forfeited	(4,560)	\$ 31.87		
Outstanding options at September 30, 2015	2,893,970	\$ 32.31	5.29	\$ 61,522
Exercisable options at September 30, 2015	1,197,470	\$ 23.89	4.01	\$ 35,497

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

Thus far in 2016, 410,250 stock options were granted with a weighted average exercise price of \$64.15 and a weighted average fair value of \$11.47. We recognized \$1.0 million of expense in the third quarter of 2016 and \$3.2 million in the first nine months of 2016 related to options vesting. Since options granted under our 2010 LTIP and 2015 LTIP are non-qualified, we recorded a tax benefit of \$0.4 million in the third quarter of 2016 and \$1.1 million in the first nine months of 2016 related to this compensation expense. Total unrecognized compensation expense relating to outstanding and unvested options was \$7.1 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized \$1.1 million of expense in the third quarter of 2015 and \$3.0 million of expense in the first nine months of 2015. We recorded a tax benefit of \$0.4 million in the third quarter of 2015 and \$1.1 million in the first nine months of 2015 related to this compensation expense.

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

	2016	2015
Weighted-average fair value of grants	\$ 11.47	\$ 9.04
Risk-free interest rates	1.21 %	1.53 %
Dividend yield	1.61 %	1.81 %
Expected volatility	23.06 %	22.89 %
Expected option life	5.04 years	5.21 years

The risk-free rate was determined based on U.S. treasury yields that most closely approximated the option's expected life. The dividend yield was calculated based on the average annualized ordinary dividends paid during the most recent five-year period. It excluded the special dividends paid in the fourth quarters of 2015 and prior years. The expected volatility was calculated based on the median of the rolling volatilities for the expected life of the options. The expected option life was determined based on historical exercise behavior and the assumption that all outstanding options will be exercised at the midpoint of the current date and remaining contractual term, adjusted for the demographics of the current year's grant.

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6. OPERATING SEGMENT INFORMATION

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

REVENUES (in thousands)	For the Three-Month Periods Ended September 30,		For the Nine-Month Periods Ended September 30,	
	2016	2015	2016	2015
Casualty	\$ 115,619	\$ 105,160	\$ 336,572	\$ 305,842
Property	37,532	44,685	114,011	128,084
Surety	30,444	29,603	90,156	86,864
Net premiums earned	\$ 183,595	\$ 179,448	\$ 540,739	\$ 520,790
Net investment income	13,504	13,964	39,922	40,890
Net realized gains	9,252	7,534	23,362	25,622
Total consolidated revenue	\$ 206,351	\$ 200,946	\$ 604,023	\$ 587,302
NET EARNINGS (in thousands)	2016	2015	2016	2015
Casualty	\$ 259	\$ 13,651	\$ 20,490	\$ 38,124
Property	468	9,216	13,911	22,220
Surety	9,877	10,726	23,523	25,723
Net underwriting income	\$ 10,604	\$ 33,593	\$ 57,924	\$ 86,067
Net investment income	13,504	13,964	39,922	40,890
Net realized gains	9,252	7,534	23,362	25,622
General corporate expense and interest on debt	(4,099)	(3,815)	(12,955)	(12,520)
Equity in earnings of unconsolidated investees	1,881	661	10,823	11,041
Total earnings before income taxes	\$ 31,142	\$ 51,937	\$ 119,076	\$ 151,100
Income tax expense	8,879	16,029	36,343	47,409
Total net earnings	\$ 22,263	\$ 35,908	\$ 82,733	\$ 103,691

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

NET PREMIUMS EARNED (in thousands)	For the Three-Month Periods Ended September 30,		For the Nine-Month Periods Ended September 30,	
	2016	2015	2016	2015