Section 1: 10-Q (10-Q)

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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, 2019

or

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

For the transition period from to

Commission File Number: 001-09463

RLI Corp.

(Exact name of registrant as specified in its charter)

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

(309) 692-1000

(Registrant’s telephone number, including area code)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock $0.01 par value	**RLI**	**New York Stock Exchange**

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of October 14, 2019, the number of shares outstanding of the registrant’s Common Stock was 44,836,488.

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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)

	For the Three-Month Periods Ended September 30,		For the Nine-Month Ended September	
(in thousands, except per share data)	**2019**	**2018**	**2019**	
Net premiums earned	$ 211,255	$ 200,815	$ 623,485	$
Net investment income	17,532	16,314	51,095	
Net realized gains	3,211	18,808	17,043	
Other-than-temporary impairment (OTTI) losses on investments	-	(161)	-	
Net unrealized gains (losses) on equity securities	4,906	4,848	47,214	
Consolidated revenue	$ 236,904	$ 240,624	$ 738,837	$
Losses and settlement expenses	108,990	110,231	307,206	
Policy acquisition costs	71,552	68,414	214,586	
Insurance operating expenses	16,982	14,408	50,597	
Interest expense on debt	1,861	1,862	5,583	
General corporate expenses	2,583	2,947	9,142	
Total expenses	$ 201,968	$ 197,862	$ 587,114	$
Equity in earnings of unconsolidated investees	4,011	3,587	17,793	
Earnings before income taxes	$ 38,947	$ 46,349	$ 169,516	$
Income tax expense	6,623	6,977	31,252	
Net earnings	$ 32,324	$ 39,372	$ 138,264	$
Other comprehensive earnings (loss), net of tax	15,341	(7,696)	72,506	
Comprehensive earnings	$ 47,665	$ 31,676	$ 210,770	$
Earnings per share:				
Basic:				
Basic net earnings per share	$ 0.72	$ 0.89	$ 3.09	$
Basic comprehensive earnings per share	$ 1.06	$ 0.71	$ 4.72	$
Diluted:				
Diluted net earnings per share	$ 0.71	$ 0.88	$ 3.06	$
Diluted comprehensive earnings per share	$ 1.05	$ 0.70	$ 4.66	$
Weighted average number of common shares outstanding:				
Basic	44,823	44,400	44,689	
Diluted	45,349	44,940	45,192	
Cash dividends paid per common share	$ 0.23	$ 0.22	$ 0.68	$

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, 2019		D
ASSETS				
Investments and cash:				
Fixed income:				
Available-for-sale, at fair value (amortized cost - $1,881,963 at 9/30/19 and $1,776,465 at 12/31/18)	$	1,957,025	$	
Equity securities, at fair value (cost - $260,883 at 9/30/19 and $220,373 at 12/31/18)		428,297		
Short-term investments, at cost which approximates fair value		5,534		
Other invested assets		59,577		
Cash		64,048		
Total investments and cash	$	2,514,481	$	
Accrued investment income		14,547		
Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of $16,860 at 9/30/19 and $16,967 at 12/31/18		157,111		
Ceded unearned premium		88,174		
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of $9,764 at 9/30/19 and $9,793 at 12/31/18		382,030		
Deferred policy acquisition costs		86,523		
Property and equipment, at cost, net of accumulated depreciation of $60,299 at 9/30/19 and $54,275 at 12/31/18		52,626		
Investment in unconsolidated investees		113,528		
Goodwill and intangibles		54,228		
Other assets		41,816		
TOTAL ASSETS	$	3,505,064	$	
LIABILITIES AND SHAREHOLDERS’ EQUITY				
Liabilities				
Unpaid losses and settlement expenses	$	1,557,358	$	
Unearned premiums		532,493		
Reinsurance balances payable		25,690		
Funds held		78,161		
Income taxes-deferred		55,910		
Bonds payable, long-term debt		149,255		
Accrued expenses		47,952		
Other liabilities		58,625		
TOTAL LIABILITIES	$	2,505,444	$	
Shareholders’ Equity				
Common stock ($0.01 par value, 100,000,000 shares authorized)				
(67,762,302 shares issued, 44,832,088 shares outstanding at 9/30/19)				
(67,434,257 shares issued, 44,504,043 shares outstanding at 12/31/18)	$	678	$	
Paid-in capital		318,092		
Accumulated other comprehensive earnings (loss)		57,934		
Retained earnings		1,015,915		
Deferred compensation		7,788		
Less: Treasury shares at cost				
(22,930,214 shares at 9/30/19 and 12/31/18)		(400,787)		
TOTAL SHAREHOLDERS’ EQUITY	$	999,620	$	
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$	3,505,064	$	

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

RLI Corp. and Subsidiaries
Condensed Consolidated Statements of Shareholders' Equity
(Unaudited)

(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	
Balance, January 1, 2018	44,148,355	$ 853,598	$ 67,079	$ 233,077	$ 157,919	$ 788,522	$ 8,640	$
Cumulative-effect adjustment from ASU 2016-01 and 2018-02	—	86	—	—	(138,494)	138,580	—	
Net earnings	—	12,216	—	—	—	12,216	—	
Other comprehensive earnings (loss), net of tax	—	(26,398)	—	—	(26,398)	—	—	
Deferred compensation	—	—	—	—	—	—	(584)	
Share-based compensation	104,771	2,721	104	2,617	—	—	—	
Dividends and dividend equivalents ($0.21 per share)	—	(9,290)	—	—	—	(9,290)	—	
Balance, March 31, 2018	44,253,126	$ 832,933	$ 67,183	$ 235,694	$ (6,973)	$ 930,028	$ 8,056	$
Par value conversion from $1.00 per share to $0.01 per share	—	—	(66,513)	66,513	—	—	—	
Net earnings	—	33,251	—	—	—	33,251	—	
Other comprehensive earnings (loss), net of tax	—	(7,675)	—	—	(7,675)	—	—	
Deferred compensation	—	—	—	—	—	—	(120)	
Share-based compensation	86,813	1,041	3	1,038	—	—	—	
Dividends and dividend equivalents ($0.22 per share)	—	(9,753)	—	—	—	(9,753)	—	
Balance, June 30, 2018	44,339,939	$ 849,797	$ 673	$ 303,245	$ (14,648)	$ 953,526	$ 7,936	$
Net earnings	—	39,372	—	—	—	39,372	—	
Other comprehensive earnings (loss), net of tax	—	(7,696)	—	—	(7,696)	—	—	
Deferred compensation	—	—	—	—	—	—	(171)	
Share-based compensation	144,715	155	1	154	—	—	—	
Dividends and dividend equivalents ($0.22 per share)	—	(9,772)	—	—	—	(9,772)	—	
Balance, September 30, 2018	44,484,654	$ 871,856	$ 674	$ 303,399	$ (22,344)	$ 983,126	$ 7,765	$

(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	
Balance, January 1, 2019	44,504,043	$ 806,842	$ 674	$ 305,660	$ (14,572)	$ 908,079	$ 8,354	$
Net earnings	—	65,473	—	—	—	65,473	—	
Other comprehensive earnings (loss), net of tax	—	29,301	—	—	29,301	—	—	
Deferred compensation	—	—	—	—	—	—	(1,039)	
Share-based compensation	50,213	2,892	1	2,891	—	—	—	
Dividends and dividend equivalents ($0.22 per share)	—	(9,803)	—	—	—	(9,803)	—	
Balance, March 31, 2019	44,554,256	$ 894,705	$ 675	$ 308,551	$ 14,729	$ 963,749	$ 7,315	$
Net earnings	—	40,467	—	—	—	40,467	—	
Other comprehensive earnings (loss), net of tax	—	27,864	—	—	27,864	—	—	
Deferred compensation	—	—	—	—	—	—	215	
Share-based compensation	232,941	7,217	2	7,215	—	—	—	
Dividends and dividend equivalents ($0.23 per share)	—	(10,305)	—	—	—	(10,305)	—	
Balance, June 30, 2019	44,787,197	$ 959,948	$ 677	$ 315,766	$ 42,593	$ 993,911	$ 7,530	$
Net earnings	—	32,324	—	—	—	32,324	—	
Other comprehensive earnings (loss), net of tax	—	15,341	—	—	15,341	—	—	
Deferred compensation	—	—	—	—	—	—	258	
Share-based compensation	44,891	2,327	1	2,326	—	—	—	
Dividends and dividend equivalents ($0.23 per share)	—	(10,320)	—	—	—	(10,320)	—	
Balance, September 30, 2019	44,832,088	$ 999,620	$ 678	$ 318,092	$ 57,934	$ 1,015,915	$ 7,788	$

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

RLI Corp. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(in thousands)	For the Nine-Month Periods Ended September 30, 2019		2	
Net cash provided by operating activities	$	186,762	$	
Cash Flows from Investing Activities				
Investments purchased	$	(466,039)	$	
Investments sold		222,893		
Investments called or matured		106,241		
Net change in short-term investments		6,016		
Net property and equipment purchased		(4,056)		
Other		83		
Net cash used in investing activities	$	(134,862)	$	
Cash Flows from Financing Activities				
Cash dividends paid	$	(30,428)	$	
Proceeds from stock option exercises		12,436		
Net cash used in financing activities	$	(17,992)	$	
Net increase in cash	$	33,908	$	
Cash at the beginning of the period	$	30,140	$	
Cash at September 30	$	64,048	$	

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. DESCRIPTION OF BUSINESS

RLI Corp. (the Company) is an insurance holding company that was organized in 1965. As reported in previous SEC filings, RLI Corp. changed its state of incorporation from the State of Illinois to the State of Delaware on May 4, 2018 (the Reincorporation). The Reincorporation was effected by merging RLI Corp., an Illinois corporation (RLI Illinois) into RLI Corp., a Delaware corporation (RLI Delaware). Each outstanding share of RLI Illinois common stock, which had a par value of $1.00 per share, was automatically converted into one outstanding share of RLI Delaware common stock, with a par value of $0.01 per share. In order to reflect the new par value of common stock on the balance sheet, a $66.5 million reclassification from common stock to paid-in-capital was made during the second quarter of 2018. For more information on the Reincorporation, see RLI Corp.'s Form 8-K filed on May 7, 2018.

B. BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2018 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at September 30, 2019 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year. Certain reclassifications were made to 2018 to conform to the classifications used in the current year.

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

C. ADOPTED ACCOUNTING STANDARDS

ASU 2016-02, Leases (Topic 842)

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

We adopted ASU 2016-02, ASU 2018-10 *Codification Improvements to Topic 842: Leases* and ASU 2018-11 *Leases (Topic 842): Targeted Improvements* on January 1, 2019. We applied the standards using the alternative transition method provided by ASU 2018-11 under which leases were recognized at the date of adoption and a cumulative-effect adjustment to the opening balance of retained earnings would have been recognized in the period of adoption. As the standard did not have an impact on our net earnings, no adjustment to the opening balance of retained earnings was required. As of September 30, 2019, $23.6 million of right-of-use assets and $25.8 million of lease liabilities were included in the other assets and other liabilities line items of the balance sheet, respectively, as a result of the adoption of this update. We implemented controls for the adoption of the standard and the ongoing monitoring of the right-of-use asset and lease liability, but they did not materially affect our internal control over financial reporting.

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

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

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

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

ASU 2018-07 was issued to simplify the accounting for share-based transactions by expanding the scope of Topic 718 from only being applicable to share-based payments to employees to include share-based payment transactions for acquiring goods and services from nonemployees. As a result, nonemployee share-based transactions will be measured by estimating the fair value of the equity instruments at the grant date, taking into consideration the probability of satisfying performance conditions. We adopted ASU 2018-07 on January 1, 2019. Our long-term incentive plan limits the awards of share-based payments to employees and directors of the Company. As our share-based compensation expense to nonemployee directors was $0.5 million in the first nine months of 2019, the standard did not have a material impact on our financial statements.

D. PROSPECTIVE ACCOUNTING STANDARDS

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

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

This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted beginning after December 15, 2018. Upon adoption, the update will be applied using the modified-retrospective approach, by which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is effective. This update will have the most impact on our available-for-sale fixed income portfolio and reinsurance balances recoverable. However, as our fixed income portfolio is weighted towards higher rated bonds (84.5 percent rated A or better at September 30, 2019) and we purchase reinsurance from financially strong reinsurers for which we already have an allowance for uncollectible reinsurance amounts, we do not expect that the effect of adoption will be material.

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

ASU 2018-13 modifies the disclosure requirements for assets and liabilities measured at fair value. The requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements have all been removed. However, the changes in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period must be disclosed along with the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements (or other quantitative information if it is more reasonable). Finally, for investments measured at net asset value, the requirements have been modified so that the timing of liquidation and the date when restrictions from redemption might lapse are only disclosed if the investee has communicated the timing to the entity or announced the timing publicly.

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

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

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

E. INTANGIBLE ASSETS

Goodwill and intangible assets totaled $54.2 million and $54.5 million at September 30, 2019 and December 31, 2018, respectively, as detailed in the following table:

Goodwill and Intangible Assets (in thousands)		**September 30, 2019**		**Dece 2**
Goodwill				
Energy surety	$	25,706	$	
Miscellaneous and contract surety		15,110		
Small commercial		5,246		
Total goodwill	$	46,062	$	
Intangibles				
State insurance licenses	$	7,500	$	
Definite-lived intangibles, net of accumulated amortization of $3,368 at 9/30/19 and $3,062 at 12/31/18		666		
Total intangibles	$	8,166	$	
Total goodwill and intangibles	$	54,228	$	

All definite-lived intangible assets are amortized based on their estimated useful lives. Amortization of intangible assets was $0.1 million for the third quarter of 2019 and $0.3 million for the nine-month period ended September 30, 2019, the same as for the comparable periods in 2018.

Annual impairment assessment was performed on our energy surety goodwill, miscellaneous and contract surety goodwill, small commercial goodwill and state insurance license indefinite-lived intangible asset during the second quarter of 2019. Based upon these reviews, none of the assets were impaired. In addition, as of September 30, 2019, there were no triggering events that would suggest an updated review was necessary on the above-mentioned goodwill and intangible assets.

Adverse loss experience triggered the need to test the medical professional liability reporting unit during the first quarter of 2018, which resulted in a $4.4 million non-cash impairment charge. A fair value for the medical professional liability reporting unit's agency relationships, carried as a definite-lived intangible, was determined by using a discounted cash flow valuation. The carrying value exceeded the fair value, resulting in a $0.8 million non-cash impairment charge. A fair value for the medical professional liability reporting unit's goodwill was determined by using a weighted average of a market approach and discounted cash flow valuation. The carrying value exceeded the fair value, resulting in a $3.6 million non-cash impairment charge. Subsequent to the first quarter 2018 impairment, the medical professional liability reporting unit had no remaining goodwill or intangible assets. All impairment charges were recorded as net realized losses in the consolidated statement of earnings.

F. EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock or common stock equivalents were exercised or converted into common stock. When inclusion of common stock equivalents increases the earnings per share or reduces the loss per share, the effect on earnings is anti-dilutive. Under these circumstances, the diluted net earnings or net loss per share is computed excluding the common stock equivalents. The following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the unaudited condensed consolidated interim financial statements:

	For the Three-Month Period Ended September 30, 2019			For the Three-Month Period Ended September 30, 2018	
(in thousands, except per share data)	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**	**Income (Numerator)**	**Shares (Denominator)**
Basic EPS					
Income available to common shareholders	$ 32,324	44,823	$ 0.72	$ 39,372	44,400
Effect of Dilutive Securities					
Stock options	-	526		-	540
Diluted EPS					
Income available to common shareholders	$ 32,324	45,349	$ 0.71	$ 39,372	44,940

	For the Nine-Month Period Ended September 30, 2019			For the Nine-Month Period Ended September 30, 2018	
(in thousands, except per share data)	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**	**Income (Numerator)**	**Shares (Denominator)**
Basic EPS					
Income available to common shareholders	$ 138,264	44,689	$ 3.09	$ 84,839	44,311
Effect of Dilutive Securities					
Stock options	-	503		-	449
Diluted EPS					
Income available to common shareholders	$ 138,264	45,192	$ 3.06	$ 84,839	44,760

G. COMPREHENSIVE EARNINGS

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

Unrealized gains, net of tax, on the fixed income portfolio for the first nine months of 2019 were $72.5 million, compared to $41.8 million of unrealized losses, net of tax, during the same period last year. Unrealized gains in the first nine months of 2019 were attributable to declining interest rates, which increased the fair value of securities held in the fixed income portfolio. In contrast, rising interest rates decreased the fair value of securities held in the fixed income portfolio in the first nine months of 2018.

The following table illustrates the changes in the balance of each component of accumulated other comprehensive earnings for each period presented in the unaudited condensed consolidated interim financial statements:

(in thousands) Unrealized Gains/Losses on Available-for-Sale Securities	For the Three-Month Periods Ended September 30, 2019	 2018	For the Nine-Month P Ended September 2019	
Beginning balance	$ 42,593	$ (14,648)	$ (14,572)	$
Cumulative effect adjustment of ASU 2016-01	-	-	-	
Adjusted beginning balance	$ 42,593	$ (14,648)	$ (14,572)	$
Other comprehensive earnings before reclassifications	16,231	(7,034)	74,414	
Amounts reclassified from accumulated other comprehensive earnings	(890)	(662)	(1,908)	
Net current-period other comprehensive earnings (loss)	$ 15,341	$ (7,696)	$ 72,506	$
Reclassification of stranded tax effect per ASU 2018-02	-	-	-	
Ending balance	$ 57,934	$ (22,344)	$ 57,934	$

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

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

The sale or other-than-temporary impairment of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table:

(in thousands)	Amount Reclassified from Accumulated Other Comprehensive Earnings				
Component of Accumulated Other Comprehensive Earnings	For the Three-Month Periods Ended September 30, 2019	 2018	For the Nine-Month Periods Ended September 30, 2019	 2018	Affected line item in the Statement of Earnings
Unrealized gains and losses on available-for-sale securities	$ 1,126	$ 999	$ 2,415	$ 141	Net realized gains (losses)
	-	(161)	-	(217)	Other-than-temporary impairment (OTTI) losses or
	$ 1,126	$ 838	$ 2,415	$ (76)	Earnings before income taxes
	(236)	(176)	(507)	16	Income tax benefit (expense)
	$ 890	$ 662	$ 1,908	$ (60)	Net earnings (loss)

2. INVESTMENTS

Our investments are primarily composed of fixed income debt securities and common stock equity securities. We carry our equity securities at fair value and categorize all of our debt securities as available-for-sale, which are carried at fair value. When available, we obtain quoted market prices to determine fair value for our investments. If a quoted market price is not available, fair value is estimated using a secondary pricing source or using quoted market prices of similar securities. We have no investment securities for which fair value is determined using Level 3 inputs as defined in note 3 to the unaudited condensed consolidated interim financial statements, "Fair Value Measurements."

Fixed Income Securities - Available-for-Sale

The amortized cost and fair value of available-for-sale securities at September 30, 2019 and December 31, 2018 were as follows:

Available-for-sale (in thousands) Asset Class	September 30, 2019 Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	F Va
U.S. government	$ 232,269	$ 8,705	$ (61)	$
U.S. agency	29,703	2,776	-	
Non-U.S. govt. & agency	9,241	290	(189)	
Agency MBS	421,448	10,632	(571)	
ABS/CMBS*	173,469	3,230	(144)	
Corporate	675,463	34,148	(1,509)	
Municipal	340,370	17,781	(26)	
Total Fixed Income	$ 1,881,963	$ 77,562	$ (2,500)	$

Available-for-sale (in thousands) Asset Class	December 31, 2018 Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	I V
U.S. government	$ 199,982	$ 1,232	$ (985)	$
U.S. agency	31,716	403	(215)	
Non-U.S. govt. & agency	8,170	-	(531)	
Agency MBS	402,992	1,709	(9,448)	
ABS/CMBS*	137,224	375	(876)	
Corporate	681,909	2,894	(16,124)	
Municipal	314,472	6,926	(1,310)	
Total Fixed Income	$ 1,776,465	$ 13,539	$ (29,489)	$

[redacted]l 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, 2019:

Available-for-sale (in thousands)	September 30, 2019 Amortized Cost	Fair Value
Due in one year or less	$ 87,635	$
Due after one year through five years	397,448	
Due after five years through 10 years	593,686	
Due after 10 years	208,277	
Mtge/ABS/CMBS*	594,917	
Total available-for-sale	$ 1,881,963	$

[redacted]mercial mortgage-backed

Unrealized Losses on Fixed Income Securities

We conduct and document periodic reviews of all fixed income securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of fixed income securities that were in an unrealized loss position as of September 30, 2019 and December 31, 2018. The tables segregate the securities based on type, noting the fair value, amortized cost and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of September 30, 2019, unrealized losses on fixed income securities, as shown in the following tables, were 0.1 percent of total invested assets. Unrealized losses decreased through the first nine months of 2019, as interest rates decreased from the end of 2018, increasing the fair value of securities held in the fixed income portfolio.

[redacted]

(in thousands)	September 30, 2019 < 12 Mos.	12 Mos. & Greater	Total	December 31, 2018 < 12 Mos.	12 Mos. & Greater	
U.S. government						
Fair value	$ 998	$ 15,717	$ 16,715	$ 7,249	$ 76,073	$
Amortized cost	999	15,777	16,776	7,270	77,037	
Unrealized Loss	$ (1)	$ (60)	$ (61)	$ (21)	$ (964)	$
U.S. agency						
Fair value	$ —	$ —	$ —	$ —	$ 8,843	$
Amortized cost	—	—	—	—	9,058	
Unrealized Loss	$ —	$ —	$ —	$ —	$ (215)	$
Non-U.S. government						
Fair value	$ —	$ 1,710	$ 1,710	$ 5,432	$ 2,207	$
Amortized cost	—	1,899	1,899	5,571	2,599	
Unrealized Loss	$ —	$ (189)	$ (189)	$ (139)	$ (392)	$
Agency MBS						
Fair value	$ 6,209	$ 49,352	$ 55,561	$ 25,345	$ 261,325	$
Amortized cost	6,215	49,917	56,132	25,486	270,632	
Unrealized Loss	$ (6)	$ (565)	$ (571)	$ (141)	$ (9,307)	$
ABS/CMBS*						
Fair value	$ 26,521	$ 8,101	$ 34,622	$ 46,918	$ 32,137	$
Amortized cost	26,600	8,166	34,766	47,146	32,785	
Unrealized Loss	$ (79)	$ (65)	$ (144)	$ (228)	$ (648)	$
Corporate						
Fair value	$ 32,584	$ 16,226	$ 48,810	$ 306,177	$ 147,751	$
Amortized cost	33,341	16,978	50,319	315,428	154,624	
Unrealized Loss	$ (757)	$ (752)	$ (1,509)	$ (9,251)	$ (6,873)	$
Municipal						
Fair value	$ 8,579	$ —	$ 8,579	$ 6,036	$ 55,681	$
Amortized cost	8,605	—	8,605	6,052	56,975	
Unrealized Loss	$ (26)	$ —	$ (26)	$ (16)	$ (1,294)	$
Total fixed income						
Fair value	$ 74,891	$ 91,106	$ 165,997	$ 397,157	$ 584,017	$
Amortized cost	75,760	92,737	168,497	406,953	603,710	
Unrealized Loss	$ (869)	$ (1,631)	$ (2,500)	$ (9,796)	$ (19,693)	$

[redacted]al mortgage-backed

The following table shows the composition of the fixed income securities in unrealized loss positions at September 30, 2019 by the National Association of Insurance Commissioners (NAIC) rating and the generally equivalent Standard & Poor's (S&P) and Moody's ratings. The vast majority of the securities are rated by S&P and/or Moody's.

[redacted]

NAIC Rating	Equivalent S&P Rating	Equivalent Moody's Rating	Amortized Cost (dollars in thousands)	Fair Value (dollars in thousands)	Unrealized Loss (dollars in thousands)	Pe to
1	AAA/AA/A	Aaa/Aa/A	$ 122,495	$ 121,660	$ (835)	
2	BBB	Baa	12,031	11,683	(348)	
3	BB	Ba	12,481	11,981	(500)	
4	B	B	20,977	20,245	(732)	
5	CCC	Caa	513	428	(85)	
6	CC or lower	Ca or lower	-	-	-	
		Total	$ 168,497	$ 165,997	$ (2,500)	

Evaluating Fixed Income Securities for OTTI

The fixed income portfolio contained 171 securities in an unrealized loss position as of September 30, 2019. The $2.5 million in associated unrealized losses represents 0.1 percent of the fixed income portfolio's cost basis. Of these 171 securities, 79 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 on fixed income securities we do not plan to sell and for which we are not more likely than not to be required to sell is recognized in net earnings, with the non-credit related impairment recognized in comprehensive earnings. Based on our analysis, our fixed income portfolio is of high credit quality and we believe we will recover the amortized cost basis of our fixed income securities. We continually monitor the credit quality of our fixed income investments to assess if it is probable that we will receive our contractual or estimated cash flows in the form of principal and interest. We did not recognize any other-than-temporary impairment (OTTI) losses in earnings on the fixed income portfolio in the first nine months of 2019. Comparatively, we recognized $0.2 million in OTTI losses in earnings on two fixed income securities that we no longer had the intent to hold in the same period in 2018. There were no OTTI losses recognized in other comprehensive earnings on the fixed income portfolio for the periods presented.

Unrealized Gains and Losses on Equity Securities

Unrealized gains recognized on equity securities still held as of September 30, 2019 were $6.9 million during the third quarter and $61.7 million during the first nine months of 2019. Comparatively, unrealized gains recognized on equity securities still held as of September 30, 2018 were $22.8 million during the third quarter, while unrealized losses were $18.2 million during the first nine months of 2018.

Other Invested Assets

We had $59.6 million of other invested assets at September 30, 2019, compared to $51.5 million at the end of 2018. Other invested assets include investments in low income housing tax credit partnerships (LIHTC), membership in the Federal Home Loan Bank of Chicago (FHLBC) and investments in private funds. Our LIHTC investments are carried at amortized cost and our investment in FHLBC stock is carried at cost. Due to the nature of the LIHTC and our membership in the FHLBC, their carrying amounts approximate fair value. The private funds are carried at fair value, using each investment's net asset value.

Our LIHTC interests had a balance of $18.8 million at September 30, 2019, compared to $20.3 million at December 31, 2018 and recognized a total tax benefit of $0.6 million during the third quarter of 2019, the same as the prior year. For the nine-month periods ended September 30, 2019 and 2018, our LIHTC interests recognized a total benefit of $1.9 million and $1.7 million, respectively. Our unfunded commitment for our LIHTC investments totaled $7.1 million at September 30, 2019 and will be paid out in installments through 2035.

As of September 30, 2019, $16.2 million of investments were pledged as collateral with the FHLBC to ensure timely access to the secured lending facility that ownership of FHLBC stock provides. As of and during the nine-month period ending September 30, 2019, there were no outstanding borrowings with the FHLBC.

We had $7.4 million of unfunded commitments related to our investments in private funds at September 30, 2019. Additionally, our interest in these investments is generally restricted from being transferred or otherwise redeemed without prior consent by the respective entities. An IPO would allow for the transfer of interest in some situations, while the timed dissolution of the partnership would trigger redemption in others.

Cash and Short-term Investments

Cash consists of uninvested balances in bank accounts. We had a cash balance of $64.0 million at September 30, 2019, compared to $30.1 million at the end of 2018. As of September 30, 2019, we had $5.5 million of short-term investments that were carried at cost and approximated fair value, compared to $11.6 million at December 31, 2018.

3. FAIR VALUE MEASUREMENTS

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Fair value is defined as the price in the principal market that would be received for an asset to facilitate an orderly transaction between market participants on the measurement date. We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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

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

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

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

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

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

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

For all of our fixed income securities classified as Level 2, as described above, we periodically conduct a review to assess the reasonableness of the fair values provided by our pricing services. Our review consists of a two-pronged approach. First, we compare prices provided by our pricing services to those provided by an additional source. In some cases, we obtain prices from securities brokers and compare them to the prices provided by our pricing services. In both comparisons, if discrepancies are found, we compare our prices to actual reported trade data for like securities. No changes to the fair values supplied by our pricing services have occurred as a result of our reviews. Based on these assessments, we have determined that the fair values of our Level 2 securities provided by our pricing services are reasonable.

Common Stock: As of September 30, 2019, all of our common stock holdings are traded on an exchange. Exchange traded equities have readily observable price levels and are classified as Level 1 (fair value based on quoted market prices). Pricing for the equity security not traded on an exchange in 2018 was provided by a third-party pricing source and was classified as Level 2.

Due to the relatively short-term nature of cash, short-term investments, accounts receivable and accounts payable, their carrying amounts are reasonable estimates of fair value. Our investments in private funds, classified as other invested assets, are measured using the investment's net asset value per share and are not categorized within the fair value hierarchy.

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

	As of September 30, 2019			
	Fair Value Measurements Using			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fixed income securities - available-for-sale				
U.S. government	$ —	$ 240,913	$ —	$
U.S. agency	—	32,479	—	
Non-U.S. govt. & agency	—	9,342	—	
Agency MBS	—	431,509	—	
ABS/CMBS*	—	176,555	—	
Corporate	—	708,102	—	
Municipal	—	358,125	—	
Total fixed income securities - available-for-sale	$ —	$ 1,957,025	$ —	$
Equity securities	428,297	—	—	
Total	$ 428,297	$ 1,957,025	$ —	$

	As of December 31, 2018			
	Fair Value Measurements Using			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	T
Fixed income securities - available-for-sale				
U.S. government	$ —	$ 200,229	$ —	$
U.S. agency	—	31,904	—	
Non-U.S. govt. & agency	—	7,639	—	
Agency MBS	—	395,253	—	
ABS/CMBS*	—	136,723	—	
Corporate	—	668,679	—	
Municipal	—	320,088	—	
Total fixed income securities - available-for-sale	$ —	$ 1,760,515	$ —	$
Equity securities	339,985	498	—	
Total	$ 339,985	$ 1,761,013	$ —	$

[redacted]al 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, 2019.

[redacted]

4. HISTORICAL LOSS AND LAE DEVELOPMENT

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

(in thousands)	For the Nine-Month Peri Ended September 30, 2019		2
Unpaid losses and LAE at beginning of year			
Gross	$	1,461,348	$
Ceded		(364,999)	
Net	$	1,096,349	$
Increase (decrease) in incurred losses and LAE			
Current accident year	$	362,395	$
Prior accident years		(55,189)	
Total incurred	$	307,206	$
Loss and LAE payments for claims incurred			
Current accident year	$	(51,270)	$
Prior accident years		(176,957)	
Total paid	$	(228,227)	$
Net unpaid losses and LAE at September 30	$	1,175,328	$
Unpaid losses and LAE at September 30			
Gross	$	1,557,358	$
Ceded		(382,030)	
Net	$	1,175,328	$

For the first nine months of 2019, incurred losses and LAE included $55.2 million of favorable development on prior years' loss reserves. The majority of products experienced modest amounts of favorable development on prior accident years, with notable contributions from transportation, general liability, commercial excess and personal umbrella, professional services, small commercial and surety. Executive products and medical professional liability were the exceptions and experienced adverse development.

For the first nine months of 2018, incurred losses and LAE included $38.5 million of favorable development on prior years' loss reserves. Commercial excess and personal umbrella, general liability, marine and surety were drivers of the favorable development. Executive products, transportation and medical professional liability experienced adverse development.

5. INCOME TAXES

Our effective tax rate for the three and nine-month periods ended September 30, 2019 was 17.0 percent and 18.4 percent, respectively, compared to 15.1 percent and 15.4 percent, respectively, for the same periods in 2018. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was reduced for the three and nine-month period in 2018 by an increased level of tax exempt securities and stock option exercises and the corresponding tax benefits. Additionally, the effective rate was higher for the first nine months of 2019 due to higher levels of pre-tax earnings, which caused the tax-favored adjustments to be smaller on a percentage basis in 2019 compared to the prior year.

Income tax expense attributable to income from operations for the three and nine-month periods ended September 30, 2019 and 2018 differed from the amounts computed by applying the U.S. federal tax rate of 21 percent to pretax income by the items detailed in the below table. In interim periods, income taxes are adjusted to reflect the effective tax rate we anticipate for the year, with adjustments flowing through the other items line.

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(in thousands)	For the Three-Month Periods Ended September 30, 2019 Amount	%	2018 Amount	%	For the Nine-Month Periods Ended Septembe 2019 Amount	%	2018 Amount
Provision for income taxes at the statutory rate of 21%	$ 8,179	21.0 %	$ 9,733	21.0 %	$ 35,598	21.0 %	$ 21,061
Increase (reduction) in taxes resulting from:							
Excess tax benefit on share-based compensation	(614)	(1.6)%	(2,273)	(4.9)%	(3,546)	(2.1)%	(4,340)
Tax exempt interest income	(276)	(0.7)%	(375)	(0.8)%	(930)	(0.6)%	(1,460)
Dividends received deduction	(218)	(0.6)%	(150)	(0.3)%	(635)	(0.4)%	(516)
ESOP dividends paid deduction	(136)	(0.3)%	(139)	(0.3)%	(413)	(0.2)%	(423)
Other items, net	(312)	(0.8)%	181	0.4 %	1,178	0.7 %	1,128
Total tax expense	$ 6,623	17.0 %	$ 6,977	15.1 %	$ 31,252	18.4 %	$ 15,450

6. STOCK BASED COMPENSATION

Our RLI Corp. Long-Term Incentive Plan (2010 LTIP) was in place from 2010 to 2015. The 2010 LTIP provided for equity-based compensation, including stock options, up to a maximum of 4,000,000 shares of common stock (subject to adjustment for changes in our capitalization and other events). Between 2010 and 2015, we granted 2,878,000 stock options under the 2010 LTIP. The 2010 LTIP was replaced in 2015.

In 2015, our shareholders approved the 2015 RLI Corp. Long-Term Incentive Plan (2015 LTIP), which provides for equity-based compensation and replaced the 2010 LTIP. In conjunction with the adoption of the 2015 LTIP, effective May 7, 2015, options were no longer granted under the 2010 LTIP. Awards under the 2015 LTIP may be in the form of restricted stock, restricted stock units, stock options (non-qualified only), stock appreciation rights, performance units as well as other stock-based awards. Eligibility under the 2015 LTIP is limited to employees and directors of the Company or any affiliate. The granting of awards under the 2015 LTIP is solely at the discretion of the board of directors. The maximum number of shares of common stock available for distribution under the 2015 LTIP is 4,000,000 shares (subject to adjustment for changes in our capitalization and other events). Since the plan's approval in 2015, we have granted 2,250,085 awards under the 2015 LTIP, including 346,455 thus far in 2019.

Stock Options

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

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

The following tables summarize option activity for the nine-month periods ended September 30, 2019 and 2018:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag In (in
Outstanding options at January 1, 2019	1,964,880	$ 54.24		
Options granted	324,525	$ 81.27		
Options exercised	(493,615)	$ 45.61		$
Options canceled/forfeited	(59,050)	$ 60.92		
Outstanding options at September 30, 2019	1,736,740	$ 61.52	5.43	$
Exercisable options at September 30, 2019	622,290	$ 52.78	4.03	$

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Ag In (in
Outstanding options at January 1, 2018	2,257,015	$ 46.80		
Options granted	401,250	$ 64.31		
Options exercised	(685,810)	$ 36.72		$
Options canceled/forfeited	(15,600)	$ 61.44		
Outstanding options at September 30, 2018	1,956,855	$ 53.81	5.50	$
Exercisable options at September 30, 2018	678,905	$ 45.60	4.03	$

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 2019, 324,525 stock options were granted with a weighted average exercise price of $81.27 and a weighted average fair value of $13.47. We recognized $1.2 million of expense in the third quarter of 2019 and $3.6 million in the first nine months of 2019 related to options vesting. Since options granted under our 2015 LTIP are non-qualified, we recorded a tax benefit of $0.2 million in the third quarter of 2019 and $0.7 million in the first nine months of 2019 related to this compensation expense. Total unrecognized compensation expense relating to outstanding and unvested options was $5.8 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized $1.2 million of compensation expense in the third quarter of 2018 and $3.4 million in the first nine months of 2018. We recorded a tax benefit of $0.2 million in the third quarter of 2018 and $0.7 million in the first nine months of 2018 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:

	2019	2018
Weighted-average fair value of grants	$ 13.47	$ 10.38
Risk-free interest rates	2.41 %	2.69 %
Dividend yield	2.69 %	3.15 %
Expected volatility	22.71 %	22.88 %
Expected option life	4.95 years	5.06 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 determined based on the average annualized quarterly dividends paid during the most recent five-year period and incorporated a consideration for special dividends paid in recent history. 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.

Restricted Stock Units

In addition to stock options, restricted stock units (RSUs) are granted with a value equal to the closing stock price of the Company's stock on the dates the units are granted. These units generally have a three-year cliff vesting, but have an accelerated vesting feature for participants who are retirement eligible, defined by the plan as those individuals whose age and years of service equals 75. In addition, the RSUs have dividend participation, which accrue as additional units and are settled with granted stock units at the end of the vesting period.

As of September 30, 2019, 45,350 RSUs have been granted to employees under the 2015 LTIP, including 15,275 in 2019, and 43,530 remain outstanding. We recognized $0.3 million of expense on these units in the third quarter of 2019 and $0.6 million in the first nine months of 2019. Total unrecognized compensation expense relating to outstanding and unvested RSUs was $1.2 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized $0.2 million of expense in the third quarter of 2018 and $0.4 million in the first nine months of 2018.

In 2018 and 2019, each outside director received RSUs with a fair market value of $50,000 on the date of grant as part of annual director compensation. Director RSUs vest one year from the date of grant. As of September 30, 2019, 15,085 restricted stock units have been granted to directors under the 2015 LTIP, including 6,655 in 2019, and 6,081 remain outstanding. We recognized $0.1 million of compensation expense on these units in the third quarter of 2019 and $0.5 million in the first nine months of 2019. Total unrecognized compensation expense relating to outstanding and unvested director RSUs was $0.3 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized $0.1 million of compensation expense in the third quarter of 2018 and $0.2 million in the first nine months of 2018.

7. 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, 2019**	**2018**	**For the Nine-Month Per Ended September 30 2019**	
Casualty	$ 140,423	$ 131,605	$ 415,667	$
Property	41,476	39,067	120,194	
Surety	29,356	30,143	87,624	
Net premiums earned	$ 211,255	$ 200,815	$ 623,485	$
Net investment income	17,532	16,314	51,095	
Net realized gains	3,211	18,647	17,043	
Net unrealized gains (losses) on equity securities	4,906	4,848	47,214	
Total consolidated revenue	$ 236,904	$ 240,624	$ 738,837	$

NET EARNINGS (in thousands)	**2019**	**2018**	**2019**	
Casualty	$ 2,370	$ (1,974)	$ 14,652	$
Property	6,202	2,621	14,012	
Surety	5,159	7,115	22,432	
Net underwriting income	$ 13,731	$ 7,762	$ 51,096	$
Net investment income	17,532	16,314	51,095	
Net realized gains	3,211	18,647	17,043	
Net unrealized gains (losses) on equity securities	4,906	4,848	47,214	
General corporate expense and interest on debt	(4,444)	(4,809)	(14,725)	
Equity in earnings of unconsolidated investees	4,011	3,587	17,793	
Total earnings before income taxes	$ 38,947	$ 46,349	$ 169,516	$
Income tax expense	6,623	6,977	31,252	
Total net earnings	$ 32,324	$ 39,372	$ 138,264	$

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, 2019	2018	For the Nine-Month Periods Ended September 30, 2019	20
Casualty				
Commercial excess and personal umbrella	$ 35,959	$ 31,244	$ 102,580	$
General liability	25,005	22,485	74,240	
Commercial transportation	21,067	20,747	61,979	
Professional services	20,816	19,890	60,390	
Small commercial	13,927	12,883	40,430	
Executive products	7,026	5,352	19,476	
Other casualty	16,623	19,004	56,572	
Total	$ 140,423	$ 131,605	$ 415,667	$
Property				
Marine	$ 19,033	$ 16,068	$ 54,633	$
Commercial property	17,098	18,489	50,248	
Specialty personal	4,948	4,228	14,324	
Other property	397	282	989	
Total	$ 41,476	$ 39,067	$ 120,194	$
Surety				
Miscellaneous	$ 10,998	$ 11,822	$ 33,880	$
Contract	7,507	7,474	21,106	
Commercial	7,209	6,863	21,020	
Energy	3,642	3,984	11,618	
Total	$ 29,356	$ 30,143	$ 87,624	$
Grand Total	$ 211,255	$ 200,815	$ 623,485	$

8. LEASES

We adopted ASU 2016-02, Leases on January 1, 2019, which resulted in the recognition of operating leases on the balance sheet in 2019 and forward. See note 1c for more information on the adoption of the ASU. Right-of-use assets are included in the other assets line item and lease liabilities are included in the other liabilities line item of the consolidated balance sheet. We determine if a contract contains a lease at inception and recognize operating lease right-of-use assets and operating lease liabilities based on the present value of the future minimum lease payments at the commencement date. As our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at the commencement date in determining the present value of future payments. Lease agreements may include options to extend or terminate. The options are exercised at our discretion and are included in operating lease liabilities if it is reasonably certain the option will be exercised. Lease agreements have lease and non-lease components, which are accounted for as a single lease component. Lease expense is recognized on a straight-line basis over the lease term.

The Company’s operating lease obligations are for branch office facilities. Our leases have remaining lease terms of 1 to 16 years. Expenses associated with leases totaled $6.9 million in 2018, $6.8 million in 2017 and $6.4 million in 2016. The components of lease expense and other lease information as of and during the three and nine-month period ended September 30, 2019 are as follows:

(in thousands)	For the Three-Month Period Ended September 30, 2019	For the Nine-Mon Ended September
Operating lease cost	$ 1,423	$
Cash paid for amounts included in measurement of lease liabilities		
Operating cash flows from operating leases	$ 1,438	$
Right-of-use assets obtained in exchange for new operating lease liabilities	$ 427	$
Reduction to right-of-use assets resulting from reduction to lease liabilities	$ -	$

(in thousands)	September 30, 2019
Operating lease right-of-use assets	$ 23,604
Operating lease liabilities	$ 25,787
Weighted-average remaining lease term - operating leases	4.91 years
Weighted-average discount rate - operating leases	2.33 %

Future minimum lease payments under non-cancellable leases as of September 30, 2019 and December 31, 2018 were as follows:

(in thousands)	September 30, 2019	December 31, 2
2019	$ 1,477	$
2020	5,975	
2021	5,967	
2022	5,904	
2023	4,386	
Thereafter	3,699	
Total future minimum lease payments	$ 27,408	$
Less imputed interest	(1,621)	
Total operating lease liability	$ 25,787	

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

"SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: This discussion and analysis may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Various risk factors that could affect future results are listed in our filings with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the year ended December 31, 2018.

OVERVIEW

RLI Corp. (the Company) was founded in 1965. We underwrite specialty property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group (the Group). We conduct operations principally through three insurance companies. RLI Insurance Company (RLI Ins.), a subsidiary of RLI Corp. and our principal insurance subsidiary, writes multiple lines of insurance on an admitted basis in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. Mt. Hawley Insurance Company (Mt. Hawley), a subsidiary of RLI Ins., writes excess and surplus lines insurance on a non-admitted basis in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. Contractors Bonding and Insurance Company (CBIC), a subsidiary of RLI Ins., writes multiple lines of insurance on an admitted basis in all 50 states and the District of Columbia. Each of our insurance companies is domiciled in Illinois.

As a specialty insurance company with a niche focus, we offer insurance coverages in the specialty admitted and excess and surplus markets. Coverages in the specialty admitted market such as our energy surety bonds, are for risks that are unique or hard-to-place in the standard market, but must remain with an admitted insurance company for regulatory or marketing reasons. In addition, our coverages in the specialty admitted market may be designed to meet specific insurance needs of targeted insured groups, such as our professional liability and package coverages for design professionals and our stand-alone personal umbrella policy. The specialty admitted market is subject to more state regulation than the excess and surplus market, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as state guaranty funds and assigned risk plans. We also underwrite coverages in the excess and surplus market. The excess and surplus market, unlike the admitted market, is less regulated and more flexible in terms of policy forms and premium rates. This market provides an alternative for customers with risks or loss exposures that generally cannot be written in the standard market. This typically results in coverages that are more restrictive and more expensive than coverages in the admitted market. When we underwrite within the excess and surplus market, we are selective in the lines of business and type of risks we choose to write. Using our non-admitted status in this market allows us to tailor terms and conditions to manage these exposures effectively. Often, the development of these coverages is generated through proposals brought to us by an agent or broker seeking coverage for a specific group of clients or loss exposures. Once a proposal is submitted, our underwriters determine whether it would be a viable product based on our business objectives.

The foundation of our overall business strategy is to underwrite for profit in all market conditions and we have achieved this for 23 consecutive years, averaging an 88.1 combined ratio over that period of time. This drives our ability to provide shareholder returns in three different ways: the underwriting income itself, net investment income from our investment portfolio and long-term appreciation in our equity portfolio. Our investment strategy is based on preservation of capital as the first priority, with a secondary focus on generating total return. The fixed income portfolio consists primarily of highly-rated, diversified, liquid, investment-grade securities. Consistent underwriting income allows a portion of our investment portfolio to be invested in equity securities and other risk asset classes. Our equity portfolio consists of a core stock portfolio weighted toward dividend-paying stocks, as well as exchange traded funds (ETFs). Our minority equity ownership interests in Maui Jim, Inc. (Maui Jim), a manufacturer of high-quality sunglasses, and Prime Holdings Insurance Services, Inc. (Prime), a specialty insurance company, have also enhanced financial results. We have a diversified investment portfolio and closely monitor our investment risks. Despite periodic fluctuations in market value, our equity portfolio is part of a long-term asset allocation strategy and has contributed significantly to our historic growth in book value.

We measure the results of our insurance operations by monitoring growth and profitability across three distinct business segments: casualty, property and surety. Growth is measured in terms of gross premiums written and profitability is analyzed through combined ratios, which are further subdivided into their respective loss and expense components.

The property and casualty insurance business is cyclical and influenced by many factors, including price competition, economic conditions, natural or man-made disasters (for example, earthquakes, hurricanes and terrorism), interest rates, state regulations, court decisions and changes in the law.

One of the unique and challenging features of the property and casualty insurance business is that coverages must be priced before costs have fully developed, because premiums are charged before claims are incurred. This requires that liabilities be estimated and recorded in recognition of future loss and settlement obligations. Due to the inherent uncertainty in estimating these liabilities, there can be no assurance that actual liabilities will not be more or less than recorded amounts; if actual liabilities differ from recorded amounts, there will be an adverse or favorable effect on net earnings. In evaluating the objective performance measures previously mentioned, it is important to consider the following individual characteristics of each major insurance segment.

The casualty portion of our business consists largely of commercial excess, personal umbrella, general liability, transportation and executive products coverages, as well as package business and other specialty coverages, such as professional liability and workers' compensation for office-based professionals. We also offer fidelity and crime coverage for commercial insureds and select financial institutions. We exited the medical professional liability business in 2019 as losses had exceeded our expectations and our assessment of the competitive environment did not support a conclusion that an underwriting profit could be achieved in the near term. The casualty business is subject to the risk of estimating losses and related loss reserves because the ultimate settlement of a casualty claim may take several years to fully develop. The casualty segment is also subject to inflation risk and may be affected by evolving legislation and court decisions that define the extent of coverage and the amount of compensation due for injuries or losses.

Our property segment is comprised primarily of commercial fire, earthquake, difference in conditions and marine coverages. We also offer select personal lines policies, including homeowners' coverages. Property insurance results are subject to the variability introduced by perils such as earthquakes, fires and hurricanes. Our major catastrophe exposure is to losses caused by earthquakes, primarily on the West Coast. Our second largest catastrophe exposure is to losses caused by wind storms to commercial properties throughout the Gulf and East Coast, as well as to homes we insure in Hawaii. We limit our net aggregate exposure to a catastrophic event by minimizing the total policy limits written in a particular region, purchasing reinsurance and maintaining policy terms and conditions throughout market cycles. We also use computer-assisted modeling techniques to provide estimates that help us carefully manage the concentration of risks exposed to catastrophic events.

The surety segment specializes in writing small to large-sized commercial and contract surety coverages, as well as those for the energy, petrochemical and refining industries. We also offer miscellaneous bonds including license and permit, notary and court bonds. Often, our surety coverages involve a statutory requirement for bonds. While these bonds typically maintain a relatively low loss ratio, losses may fluctuate due to adverse economic conditions affecting the financial viability of our principals. The contract surety product guarantees the construction work of a commercial contractor for a specific project. Generally, losses occur due to the deterioration of a contractor's financial condition. This line has historically produced marginally higher loss ratios than other surety lines during economic downturns.

The insurance marketplace is intensely competitive across all of our segments. Despite challenges that exist in today's marketplace, we believe that our business model is built to create underwriting income by focusing on sound risk selection and discipline. Our primary focus will continue to be on underwriting profitability, with a secondary focus on premium growth where we believe underwriting profit exists, as opposed to general premium growth or market share measurements.

GAAP, non-GAAP and Performance Measures

Throughout this quarterly report, we include certain non-generally accepted accounting principles (non-GAAP) financial measures. Management believes that these non-GAAP measures better explain the Company's results of operations and allow for a more complete understanding of the underlying trends in the Company's business. These measures should not be viewed as a substitute for those determined in accordance with generally accepted accounting principles in the United States of America (GAAP). In addition, our definitions of these items may not be comparable to the definitions used by other companies.

Following is a list of non-GAAP measures found throughout this report with their definitions, relationships to GAAP measures and explanations of their importance to our operations.

Underwriting Income

Underwriting income or profit represents one measure of the pretax profitability of our insurance operations and is derived by subtracting losses and settlement expenses, policy acquisition costs and insurance operating expenses from net premiums earned, which are all GAAP financial measures. Each of these captions is presented in the statements of earnings but is not subtotaled. However, this information is available in total and by segment on page 20 of this quarterly report on Form 10-Q and in note 11 to the consolidated financial statements in our 2018 Annual Report on Form 10-K, regarding operating segment information. The nearest comparable GAAP measure is earnings before income taxes which, in addition to underwriting income, includes net investment income, net realized gains or losses, net unrealized gain or losses on equity securities, general corporate expenses, debt costs and our portion of earnings from unconsolidated investees.

Combined Ratio

The combined ratio, which is derived from components of underwriting income, is a common industry performance measure of profitability for underwriting operations and is calculated in two components. First, the loss ratio is losses and settlement expenses divided by net premiums earned. The second component, the expense ratio, reflects the sum of policy acquisition costs and insurance operating expenses divided by net premiums earned. All items included in these components of the combined ratio are presented in our GAAP consolidated financial statements. The sum of the loss and expense ratios is the combined ratio. The difference between the combined ratio and 100 reflects the per-dollar rate of underwriting income or loss.

Net Unpaid Loss and Settlement Expenses

Unpaid losses and settlement expenses, as shown in the liabilities section of our balance sheets, represents the total obligations to claimants for both estimates of known claims and estimates for incurred but not reported (IBNR) claims. The related asset item, reinsurance balances recoverable on unpaid losses and settlement expense, is the estimate of known claims and estimates of IBNR that we expect to recover from reinsurers. The net of these two items is generally referred to as net unpaid loss and settlement expenses and is commonly used in our disclosures regarding the process of establishing these various estimated amounts.

Critical Accounting Policies

In preparing the unaudited condensed consolidated interim financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ significantly from those estimates.

The most critical accounting policies involve significant estimates and include those used in determining the liability for unpaid losses and settlement expenses, investment valuation and OTTI, recoverability of reinsurance balances, deferred policy acquisition costs and deferred taxes. For a detailed discussion of each of these policies, refer to our 2018 Annual Report on Form 10-K. There have been no significant changes to any of these policies during the current year.

RESULTS OF OPERATIONS

Nine Months Ended September 30, 2019 Compared to Nine Months Ended September 30, 2018

Consolidated revenue for the first nine months of 2019 increased $93.0 million, or 14 percent, from the same period in 2018. Net premiums earned for the Group increased 6 percent, driven by growth from our casualty and property segments. Investment income increased 13 percent due to an increased asset base relative to the prior year. Realized gains during the first nine months of 2019 were $17.0 million and were comprised of $14.4 million of realized gains on equity securities, $2.4 million of realized gains on the fixed income portfolio and $0.2 million of miscellaneous realized gains. This compares to realized gains of $52.5 million on equity securities from rebalancing the portfolio, which were partially offset by $0.1 million of realized losses on fixed income securities and $4.6 million in miscellaneous losses, primarily from a non-cash impairment charge on goodwill and definite-lived intangibles for the same period in 2018. Additionally, $47.2 million of net unrealized gains on equity securities were recognized in the first nine months of 2019 compared to $34.5 million of net unrealized losses in the same period in 2018.

	For the Nine-Month Periods Ended September 30,			
	2019		2018	
Consolidated revenues (in thousands)				
Net premiums earned	$	623,485	$	587,364
Net investment income		51,095		45,123
Net realized gains		17,043		47,900
Net unrealized gains (losses) on equity securities		47,214		(34,535)
Total consolidated revenue	$	738,837	$	645,852

Net after-tax earnings for the first nine months of 2019 totaled $138.3 million, compared to $84.8 million for the same period last year. The increase in earnings for 2019 was influenced by $37.3 million of after-tax unrealized gains on equity securities compared to $27.3 million of after-tax unrealized losses on equity securities in 2018. Underwriting results for both periods reflect profitable current accident year results and favorable development from prior years' loss reserves. Favorable development on prior years' loss reserves provided additional pretax earnings of $55.2 million in the first nine months of 2019 and $38.5 million in 2018. Pretax storm losses were $8.0 million in the first nine months of 2019, compared to $17.5 million of hurricane, other storm and volcanic activity losses for the same period in 2018. Pretax bonus and profit sharing-related expenses associated with the net impact of prior years' reserve development and catastrophe losses totaled $7.0 million in 2019, compared to $3.5 million in 2018. These performance-related expenses affected policy acquisition, insurance operating and general corporate expenses. Bonus and profit-sharing amounts earned by executives, managers and associates are predominately influenced by corporate performance including operating earnings, combined ratio and return on capital. These performance-related expenses were further increased in the first nine months of 2019 based on the overall growth in earnings and book value.

During the first nine months of 2019, equity in earnings of unconsolidated investees totaled $17.8 million. This amount includes $12.9 million from Maui Jim and $4.9 million from Prime. Comparatively, the first nine months of 2018 reflected $15.9 million of earnings, including $13.3 million from Maui Jim and $2.6 million from Prime.

Comprehensive earnings totaled $210.8 million for the first nine months of 2019, compared to $43.1 million for the same period in 2018. Other comprehensive earnings primarily included after-tax unrealized gains and losses from the fixed income portfolio. In 2019, declining interest rates resulted in unrealized gains on the fixed income portfolio and $72.5 million of other comprehensive earnings in the first nine months. This compares to $41.8 million of other comprehensive loss for the same period in 2018, primarily attributable to increasing interest rates during the period.

Premium

Gross premiums written for the Group increased $65.4 million, or 9 percent, for the first nine months of 2019 when compared to 2018. Products in our casualty and property segments drove the growth. Net premiums earned increased $36.1 million, or 6 percent, also driven by products in our casualty and property segments.

	Gross Premiums Written			Net Premiums Earned	
	For the Nine-Month Periods Ended September 30,			For the Nine-Month Periods Ended September 30,	
(in thousands)	2019	2018	% Change	2019	2018
Casualty					
Commercial excess and personal umbrella	$ 135,814	$ 116,116	17.0 %	$ 102,580	$ 91,84
General liability	75,818	69,516	9.1 %	74,240	68,98
Commercial transportation	79,716	72,639	9.7 %	61,979	60,57
Professional services	68,076	66,265	2.7 %	60,390	59,55
Small commercial	46,904	41,197	13.9 %	40,430	38,67
Executive products	67,917	45,865	48.1 %	19,476	15,54
Other casualty	50,405	64,931	(22.4) %	56,572	51,88
Total	$ 524,650	$ 476,529	10.1 %	$ 415,667	$ 387,06
Property					
Marine	$ 68,658	$ 54,145	26.8 %	$ 54,633	$ 44,86
Commercial property	90,035	85,884	4.8 %	50,248	53,29
Specialty personal	16,460	14,024	17.4 %	14,324	12,49
Other property	1,634	1,042	56.8 %	989	77
Total	$ 176,787	$ 155,095	14.0 %	$ 120,194	$ 111,43
Surety					
Miscellaneous	$ 33,267	$ 37,680	(11.7) %	$ 33,880	$ 35,18
Contract	22,616	23,320	(3.0) %	21,106	20,83
Commercial	22,211	20,956	6.0 %	21,020	20,33
Energy	11,641	12,233	(4.8) %	11,618	12,50
Total	$ 89,735	$ 94,189	(4.7) %	$ 87,624	$ 88,85
Grand Total	$ 791,172	$ 725,813	9.0 %	$ 623,485	$ 587,36

Casualty

Gross premiums written for the casualty segment in the first nine months of 2019 were up 10 percent, or $48.1 million, as mid-single digit rate increases were experienced. Premiums from commercial excess and personal umbrella increased $19.7 million, due in part to an expanded distribution base in personal umbrella and larger scale in the energy casualty space. Our executive products group grew $22.1 million as substantial rate increases were achieved and newer initiatives gained traction. General liability, transportation, small commercial and professional services also contributed to the growth during the first nine months of the year. As previously announced, we reduced our quota share reinsurance agreement with Prime from 25 percent to 6 percent at the beginning of 2019 and exited from our medical professional liability lines due to unfavorable market conditions and poor underwriting performance. The actions on these programs account for the decline in other casualty and offset continued growth in our general binding authority and mortgage reinsurance lines.

Property

Gross premiums written for the Group's property segment totaled $176.8 million for the first nine months of 2019, up 14 percent from the same period last year. Market disruption has provided opportunity for our marine product and, along with rate increases, led to a 27 percent increase in premiums written over the first nine months of 2018. Hawaii homeowners, within the specialty personal group, benefited from continued investment in relationships and distribution with growth of 12 percent. Commercial property is up 5 percent as rates are up and an improving market has allowed our underwriters to find more opportunities.

Surety

The surety segment recorded gross premiums written of $89.7 million for the first nine months of 2019, a decrease of $4.5 million from the same period last year. Competitive market conditions led to a reduction in miscellaneous, contract and energy surety production, which was partially offset by growth within our commercial lines. Selectively reducing exposures on high risk accounts, given the current stage in the credit cycle, and restructuring one program in the miscellaneous surety book also resulted in a decline in premium for the first nine months of the year.

Underwriting Income

Underwriting income for the Group totaled $51.1 million for the first nine months of 2019, compared to $39.4 million in the same period last year. Both periods reflect positive underwriting results for the current accident year and favorable reserve development on prior accident years, with 2019 experiencing a larger benefit. The combined ratio for the Group totaled 91.8 in 2019, compared to 93.3 in 2018. The loss ratio decreased to 49.3 from 51.8, due to the increased level of favorable development and lower catastrophe losses in 2019. The Group's expense ratio increased to 42.5 from 41.5 as strong growth in earnings and book value led to increased bonus and profit-sharing expenses.

	For the Nine-Month Periods Ended September 30, 2019	2018
Underwriting income (in thousands)		
Casualty	$ 14,652	$ 2,441
Property	14,012	12,150
Surety	22,432	24,804
Total	$ 51,096	$ 39,395
Combined ratio		
Casualty	96.5	99.4
Property	88.3	89.1
Surety	74.4	72.1
Total	91.8	93.3

Casualty

The casualty segment recorded underwriting income of $14.7 million in the first nine months of 2019, compared to $2.4 million for the same period last year. Reserve releases reduced loss and settlement expenses for the casualty segment by $43.2 million, primarily on accident years 2015 through 2018. Transportation, general liability, professional services, commercial excess and personal umbrella and small commercial all contributed to the favorable development, while executive products and medical professional liability experienced adverse development. In comparison, $20.5 million of reserves were released in the first nine months of 2018, largely driven by commercial excess, personal umbrella and general liability. A majority of the difference between the reserve releases in 2019 and 2018 can be attributed to the contrast between the favorable development in 2019 and adverse development in 2018 within our transportation business.

The combined ratio for the casualty segment was 96.5 in 2019, compared to 99.4 in 2018. The segment's loss ratio was 59.5 in 2019, down from 63.7 in 2018. The loss ratio decreased in 2019 as a result of more favorable development on prior years' reserves. The expense ratio for the casualty segment was 37.0, up from 35.7 for the same period last year, due to investments in technology and a larger amount of bonus and profit-sharing expenses.

Property

The property segment recorded underwriting income of $14.0 million for the first nine months of 2019, compared to $12.2 million for the same period last year. Loss and settlement expenses for 2019 included $3.8 million of favorable development on prior years' loss and catastrophe reserves and $7.6 million of storm losses. Comparatively, the 2018 underwriting results included $10.1 million of favorable development on prior years' loss and catastrophe reserves, primarily from the marine business, $7.2 million of loss from Hurricane Florence, $6.5 million of losses from the volcanic activity in Hawaii and $2.8 million of other storm losses.

The combined ratio for the property segment was 88.3, compared to 89.1 for the same period last year. The segment's loss ratio was 44.0 in 2019, down from 45.2 in 2018 due to lower levels of catastrophe losses than in the prior year. The segment's expense ratio was 44.3 in 2019, up modestly from 43.9 in 2018, as strong growth in overall earnings and book value led to an increase in bonus and profit-sharing expenses.

Surety

The surety segment recorded underwriting income of $22.4 million for the first nine months of 2019, compared to $24.8 million for the same period last year. Both periods reflected positive current accident year underwriting performance and benefited from favorable development on prior years' loss reserves. Results for 2019 included favorable development on prior accident years' reserves across most surety lines, which decreased loss and settlement expenses for the segment by $8.1 million. Comparatively, 2018 results included favorable development on prior accident years' loss reserves across all products, which decreased the segment's loss and settlement expenses by $8.0 million.

The combined ratio for the surety segment totaled 74.4 for the first nine months of 2019, compared to 72.1 for the same period in 2018. The segment's loss ratio was 8.1 for 2019, compared to 8.5 for 2018. The expense ratio was 66.3, up from 63.6 in the prior year, due to increased investments in technology and higher bonus and profit-sharing expenses on a slightly lower premium base.

Investment Income and Realized Capital Gains

Our investment portfolio generated net investment income of $51.1 million during the first nine months of 2019, an increase of 13.2 percent from that reported for the same period in 2018. The increase in investment income was due to an increased asset base relative to the prior year.

Yields on our fixed income investments for the first nine months of 2019 and 2018 were as follows:

	2019	2018
Pretax Yield		
Taxable	3.42 %	3.27 %
Tax-Exempt	2.82 %	2.70 %
After-Tax Yield		
Taxable	2.70 %	2.58 %
Tax-Exempt	2.67 %	2.56 %

We recognized $17.0 million of realized gains in the first nine months of 2019, which were comprised of $14.4 million of realized gains on equity securities, $2.4 million of realized gains on the fixed income portfolio and $0.2 million of miscellaneous realized gains. This compares to realized gains of $52.5 million on equity securities from rebalancing the portfolio that were partially offset by $0.1 million of realized losses in the fixed income portfolio as well as realized losses related to a non-cash impairment charge on goodwill and definite-lived intangibles for the same period in 2018.

The following table depicts the composition of our investment portfolio at September 30, 2019 as compared to December 31, 2018:

	September 30, 2019		December 31, 2018	
(in thousands)	Financial Stmt Value	%	Financial Stmt Value	%
Fixed income	$ 1,957,025	77.8 %	$ 1,760,515	
Equity securities	428,297	17.0 %	340,483	
Other invested assets	59,577	2.4 %	51,542	
Cash and short-term investments	69,582	2.8 %	41,690	
Total	$ 2,514,481	100.0 %	$ 2,194,230	

We believe our overall asset allocation best meets our strategy to preserve capital for policyholders, provide sufficient income to support insurance operations, and to effectively grow book value over a long-term investment horizon.

The fixed income portfolio increased by $196.5 million in the first nine months of 2019. The increase was due to cash flows being allocated to the fixed income portfolio as well as the decline in interest rates during the year, increasing the fair value of securities in the fixed income portfolio. Average fixed income duration was 4.8 years at September 30, 2019, reflecting our current liability structure and sound capital position. The equity portfolio increased by $87.8 million during the first nine months of 2019 due largely to strong equity market returns.

Income Taxes

Our effective tax rate for the first nine months of 2019 was 18.4 percent, compared to 15.4 percent for the same period in 2018. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher for the first nine months of 2019 due to higher levels of pre-tax earnings, which caused the tax-favored adjustments to be smaller on a percentage basis in 2019 compared to the prior year. Additionally, the effective rate was reduced in 2018 by an increased level of tax exempt securities and stock option exercises and the corresponding tax benefits.

Three Months Ended September 30, 2019 Compared to Three Months Ended September 30, 2018

Consolidated revenue for the third quarter of 2019 decreased $3.7 million, or 2 percent, from the same period in 2018. Net premiums earned for the Group increased 5 percent, driven by growth from our casualty and property segments. Investment income increased 7 percent due to an increased asset base relative to the prior year. Realized gains during the quarter were $3.2 million and were comprised of $2.1 million of realized gains on equity securities and $1.1 million of realized gains on the fixed income portfolio. This compares to $18.0 million of realized gains on the equity portfolio from rebalancing and $0.8 million of realized losses on the fixed income portfolio for the same period in 2018. Additionally, $4.9 million of net unrealized gains on equity securities were recognized in the third quarter of 2019, compared to $4.8 million in the same period in 2018.

	For the Three-Month Periods Ended September 30,	
	2019	2018
Consolidated revenues (in thousands)		
Net premiums earned	$ 211,255	$ 200,815
Net investment income	17,532	16,314
Net realized gains	3,211	18,647
Net unrealized gains (losses) on equity securities	4,906	4,848
Total consolidated revenue	$ 236,904	$ 240,624

Net after-tax earnings for the third quarter of 2019 totaled $32.3 million, compared to $39.4 million for the same period last year. The decrease in earnings for 2019 was influenced by $5.5 million of net after-tax realized and unrealized gains on equity securities compared to $18.0 million in 2018. Underwriting results for both periods reflect profitable current accident year results and favorable development from prior years' loss reserves. Favorable development on prior years' loss reserves provided additional pretax earnings of $14.4 million in the third quarter of 2019 compared to $10.5 million in 2018. Catastrophe activity consisted of $3.0 million of pretax storm losses in the third quarter of 2019, compared to $7.5 million of losses from Hurricane Florence for the same period in the 2018. Pretax bonus and profit sharing-related expenses associated with the net impact of prior years' reserve development and catastrophe losses totaled $1.7 million in 2019, compared to $0.6 million in 2018. These performance-related expenses affected policy acquisition, insurance operating and general corporate expenses. Bonus and profit-sharing amounts earned by executives, managers and associates are predominately influenced by corporate performance including operating earnings, combined ratio and return on capital. These performance-related expenses were further increased in the third quarter of 2019 based on the overall growth in earnings and book value.

During the third quarter of 2019, equity in earnings of unconsolidated investees totaled $4.0 million. This amount includes $2.8 million from Maui Jim and $1.2 million from Prime. Comparatively, the third quarter of 2018 reflected $3.6 million of earnings, including $2.6 million from Maui Jim and $1.0 million from Prime.

Comprehensive earnings totaled $47.7 million for the third quarter of 2019, compared to $31.7 million for the third quarter of 2018. Other comprehensive earnings primarily included after-tax unrealized gains and losses from the fixed income portfolio. The third quarter's $15.3 million of other comprehensive earnings was due to unrealized gains on the fixed income portfolio as interest rates declined. This compares to $7.7 million of other comprehensive loss for the same period in 2018, primarily attributable to increasing interest rates during the period.

Premium

Gross premiums written for the Group increased $37.9 million, or 16 percent, for the third quarter of 2019 when compared to 2018. Products in our casualty and property segments drove the growth. Net premiums earned increased $10.4 million, or 5 percent, also driven by products in our casualty and property segments.

	Gross Premiums Written			Net Premiums Earned	
	For the Three-Month Periods Ended September 30,			For the Three-Month Periods Ended September 30,	
(in thousands)	2019	2018	% Change	2019	2018
Casualty					
Commercial excess and personal umbrella	$ 45,392	$ 39,589	14.7 %	$ 35,959	$ 31,24
General liability	21,045	20,021	5.1 %	25,005	22,48
Commercial transportation	31,325	25,449	23.1 %	21,067	20,74
Professional services	23,092	21,754	6.2 %	20,816	19,89
Small commercial	16,696	13,178	26.7 %	13,927	12,88
Executive products	30,268	16,340	85.2 %	7,026	5,35
Other casualty	15,602	21,222	(26.5) %	16,623	19,00
Total	$ 183,420	$ 157,553	16.4 %	$ 140,423	$ 131,60
Property					
Marine	$ 24,508	$ 19,765	24.0 %	$ 19,033	$ 16,06
Commercial property	32,585	25,667	27.0 %	17,098	18,48
Specialty personal	5,503	5,066	8.6 %	4,948	4,22
Other property	810	435	86.2 %	397	28
Total	$ 63,406	$ 50,933	24.5 %	$ 41,476	$ 39,06
Surety					
Miscellaneous	$ 10,867	$ 12,722	(14.6) %	$ 10,998	$ 11,82
Contract	7,667	7,677	(0.1) %	7,507	7,47
Commercial	8,114	7,031	15.4 %	7,209	6,86
Energy	3,515	3,218	9.2 %	3,642	3,98
Total	$ 30,163	$ 30,648	(1.6) %	$ 29,356	$ 30,14
Grand Total	$ 276,989	$ 239,134	15.8 %	$ 211,255	$ 200,81

Casualty

Gross premiums written for the casualty segment were up 16 percent, or $25.9 million, in the third quarter of 2019. Our executive products group grew significantly during the quarter, as sizeable rate increases were achieved and exposure growth was experienced with both mature and newer product offerings. Transportation also experienced rate and exposure growth, leading to a $5.9 million increase over the third quarter of 2018. Premiums from commercial excess and personal umbrella increased $5.8 million, due in part to an expanded distribution base in personal umbrella and larger scale in the energy casualty space. Other casualty, which includes assumed premiums from Prime and our medical professional liability lines, decreased $5.6 million, despite growth from our general binding authority and mortgage reinsurance business. As previously announced, we reduced our quota share reinsurance agreement with Prime from 25 percent to 6 percent at the beginning of 2019 and exited from our medical professional liability lines due to unfavorable market conditions and poor underwriting performance.

Property

Gross premiums written for the property segment totaled $63.4 million for the third quarter of 2019, up 24 percent from the same period last year. Our commercial property business accounted for a large portion of the increase, up $6.9 million, as changes to the market have allowed our high underwriting standards to become more competitive. Marine premiums written were up 24 percent as market disruption provided new opportunities.

Surety

The surety segment recorded gross premiums written of $30.2 million for the third quarter of 2019, a decrease of $0.5 million from the same period last year. Restructuring of one program resulted in a decline of miscellaneous surety premium in the third quarter, which was partially offset by growth within our commercial and energy lines.

Underwriting Income

Underwriting income for the Group totaled $13.7 million for the third quarter of 2019, compared to $7.8 million in the same period last year. Both periods reflect positive underwriting results for the current accident year and favorable reserve development on prior accident years, with 2019 experiencing a larger benefit. The combined ratio for the Group totaled 93.5 in 2019, compared to 96.1 in 2018. The loss ratio decreased to 51.6 from 54.9, due to the increased level of favorable development in 2019. The Group’s expense ratio increased to 41.9 from 41.2 as strong growth in earnings and book value led to increased bonus and profit-sharing expenses.

	For the Three-Month Periods Ended September 30,	
	2019	**2018**
Underwriting income (in thousands)		
Casualty	$ 2,370	$ (1,974)
Property	6,202	2,621
Surety	5,159	7,115
Total	$ 13,731	$ 7,762
Combined ratio		
Casualty	98.3	101.5
Property	85.0	93.3
Surety	82.4	76.4
Total	93.5	96.1

Casualty

The casualty segment recorded underwriting income of $2.4 million in the third quarter of 2019, compared to $2.0 million of underwriting loss for the same period last year. Reserve releases reduced loss and settlement expenses for the casualty segment by $12.4 million, primarily on accident years 2016 through 2018. Transportation, professional services, commercial excess, general liability, and small commercial all contributed to the favorable development, while executive products and medical professional liability experienced adverse development. In comparison, $6.0 million of reserves were released in the third quarter of 2018. Commercial excess, personal umbrella and professional services developed favorably, while small commercial and medical professional liability developed adversely.

The combined ratio for the casualty segment was 98.3 in 2019, compared to 101.5 in 2018. The segment’s loss ratio was 61.7 in 2019, down from 65.3 in 2018. The loss ratio decreased in 2019 as a result of more favorable development on prior years’ reserves. The expense ratio for the casualty segment was 36.6, up from 36.2 for the same period last year, due to higher bonus and profit-sharing expenses and investments in technology.

Property

The property segment recorded underwriting income of $6.2 million for the third quarter of 2019, compared to $2.6 million for the same period last year. Underwriting results for 2019 included $1.8 million of favorable development on prior years' loss and catastrophe reserves and $3.0 million of storm losses. Comparatively, the 2018 underwriting results included $3.6 million of favorable development on prior years' loss and catastrophe reserves and $7.2 million of losses from Hurricane Florence.

Underwriting results for the third quarter of 2019 translated into a combined ratio of 85.0, compared to 93.3 for the same period last year. The segment's loss ratio was 42.0 in 2019, down from 51.6 in 2018 due to a combination of decreased current accident year catastrophe and non-catastrophe losses. The segment's expense ratio increased to 43.0 in 2019 from 41.7 in the prior year, as strong growth in overall earnings and book value led to an increase in bonus and profit-sharing expenses.

Surety

The surety segment recorded underwriting income of $5.2 million for the third quarter of 2019, compared to $7.1 million for the same period last year. Both periods reflected positive current accident year underwriting performance and benefited from favorable development on prior years' loss reserves. Results for 2019 included favorable development on prior accident years' reserves, which decreased loss and settlement expenses for the segment by $0.1 million. Comparatively, 2018 results included favorable development on prior accident years' loss reserves across most products, which decreased the segment's loss and settlement expenses by $1.0 million.

The combined ratio for the surety segment totaled 82.4 for the third quarter of 2019, compared to 76.4 for the same period in 2018. The segment's loss ratio was 17.0 in 2019, up from 13.6 in 2018. The loss ratio increase was the result of a lower amount of favorable development on prior accident years' reserves. The expense ratio was 65.4, up from 62.8 in the prior year, due to increased investments in technology and higher bonus and profit-sharing expenses on a slightly lower premium base.

Investment Income and Realized Capital Gains

Our investment portfolio generated net investment income of $17.5 million during the third quarter of 2019, an increase of 7.5 percent from that reported for the same period in 2018. The increase in investment income was largely due to an increased asset base relative to the prior year.

Yields on our fixed income investments for the third quarter of 2019 and 2018 were as follows:

	3Q 2019	3Q 2018
Pretax Yield		
Taxable	3.38 %	3.28 %
Tax-Exempt	2.80 %	2.93 %
After-Tax Yield		
Taxable	2.67 %	2.59 %
Tax-Exempt	2.65 %	2.77 %

We recognized $3.2 million of realized gains in the third quarter of 2019, which were comprised of $2.1 million of realized gains on equity securities from rebalancing the portfolio and $1.1 million of realized gains on the fixed income portfolio. This compares to realized gains of $18.6 million in the third quarter of 2018, which were comprised of $18.0 million of realized gains on the equity portfolio and $0.8 million of realized gains on the fixed income portfolio.

Income Taxes

Our effective tax rate for the third quarter of 2019 was 17.0 percent, compared to 15.1 percent for the same period in 2018. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher for the third quarter of 2019 due to lower levels of tax exempt interest income and tax benefits from stock option exercises.

LIQUIDITY AND CAPITAL RESOURCES

We have three primary types of cash flows: (1) cash flows from operating activities, which consist mainly of cash generated by our underwriting operations and income earned on our investment portfolio, (2) cash flows from investing activities related to the purchase, sale and maturity of investments, and (3) cash flows from financing activities that impact our capital structure, such as shareholder dividend payments and changes in debt and shares outstanding.

The following table summarizes cash flows provided by (used in) our activities for the nine-month periods ended September 30, 2019 and 2018:

(in thousands)	2019	2018
Operating cash flows	$ 186,762	$ 163,369
Investing cash flows	(134,862)	(103,273)
Financing cash flows	(17,992)	(24,898)
Total	$ 33,908	$ 35,198

Operating activities generated positive cash flows of $186.8 million in the first nine months of 2019, compared to $163.4 million in the same period last year. The increase in operating cash flows was due to increased premium receipts and investment income, which were partially offset by a larger amount of paid loss and loss adjustment expense during the period.

We have $149.3 million in debt outstanding. On October 2, 2013, we completed a public debt offering, issuing $150.0 million in senior notes maturing September 15, 2023 (a 10-year maturity), and paying interest semi-annually at the rate of 4.875 percent per annum. The notes were issued at a discount resulting in proceeds, net of discount and commission, of $148.6 million. The estimated fair value for the senior note at September 30, 2019 was $162.5 million. The fair value of our debt is estimated based on the limited observable prices that reflect thinly traded securities.

As of September 30, 2019, we had cash and other investments maturing within one year of approximately $157.4 million and an additional $408.7 million maturing between one to five years. Whereas our strategy is to be fully invested at all times, short-term investments in excess of demand deposit balances are considered a component of investment activities, and thus are classified as investments in our consolidated balance sheets.

We also maintain a revolving line of credit with JP Morgan Chase Bank N.A., which permits us to borrow up to an aggregate principal amount of $50.0 million. This facility was entered into during the second quarter of 2018 and replaced the previous $40.0 million facility which expired on May 28, 2018. Under certain conditions, the line may be increased up to an aggregate principal amount of $75.0 million. The facility has a two-year term that expires on May 24, 2020. As of and during the nine-month period ended September 30, 2019, no amounts were outstanding on this facility.

Additionally, two of our insurance companies, RLI Ins. and Mt. Hawley, are members of the Federal Home Loan Bank of Chicago (FHLBC). Membership in the Federal Home Loan Bank System provides both companies access to an additional source of liquidity via a secured lending facility. Our membership allows each insurance subsidiary to determine tenor and structure at the time of borrowing. As of and during the nine-month period ended September 30, 2019, there were no outstanding borrowing amounts with the FHLBC.

We believe that cash generated by operations and investments will provide sufficient sources of liquidity to meet our anticipated needs over the next 12 to 24 months. In the event they are not sufficient, we believe cash available from financing activities and other sources will provide sufficient additional liquidity.

We have not had any liquidity issues affecting our operations as we have sufficient cash flow to support operations. In addition to our bank credit facility and FHLBC membership, our highly liquid investment portfolio provides an additional source of liquidity.

We maintain a diversified investment portfolio representing policyholder funds that have not yet been paid out as claims, as well as the capital we hold for our shareholders. As of September 30, 2019, our investment portfolio had a balance sheet value of $2.5 billion. Invested assets at September 30, 2019 have increased $320.3 million from December 31, 2018.

As of September 30, 2019, our investment portfolio had the following asset allocation breakdown:

Portfolio Allocation
(in thousands)

Asset class	Cost or Amortized Cost	Fair Value	Unrealized Gain/(Loss)	% of Total Fair Value	Quali
U.S. government	$ 232,269	$ 240,913	$ 8,644	9.6 %	AA
U.S. agency	29,703	32,479	2,776	1.3 %	AA
Non-U.S. govt. & agency	9,241	9,342	101	0.4 %	BB
Agency MBS	421,448	431,509	10,061	17.2 %	AA
ABS/CMBS**	173,469	176,555	3,086	7.0 %	AA
Corporate	675,463	708,102	32,639	28.1 %	BBB
Municipal	340,370	358,125	17,755	14.2 %	AA
Total Fixed Income	**$ 1,881,963**	**$ 1,957,025**	**$ 75,062**	**77.8 %**	**AA**
Equity	**$ 260,883**	**$ 428,297**	**$ 167,414**	**17.0 %**	
Other Invested Assets	**$ 59,493**	**$ 59,577**	**$ 84**	**2.4 %**	
Cash and Short-Term Investments	**$ 69,582**	**$ 69,582**	**$ —**	**2.8 %**	
Total Portfolio	**$ 2,271,921**	**$ 2,514,481**	**$ 242,560**	**100.0 %**	

[redacted]P and Fitch
**Asset-backed and commercial mortgage-backed securities

Quality is an average of each bond’s credit rating, adjusted for its relative weighting in the portfolio. As of September 30, 2019, our fixed income portfolio had the following rating distribution:

AAA	**50.6 %**
AA	**14.7 %**
A	**19.2 %**
BBB	**9.5 %**
BB	**3.5 %**
B	**2.4 %**
CCC	**0.0 %**
NR	**0.1 %**
Total	**100.0 %**

As of September 30, 2019, the duration of the fixed income portfolio was 4.8 years. Our fixed income portfolio remained well diversified, with 1,194 individual issues.

Our investment portfolio has limited exposure to structured asset-backed securities (ABS). As of September 30, 2019, we had $114.4 million in ABS which are pools of assets collateralized by cash flows from several types of loans, including home equity, credit cards, autos and structured bank loans in the form of collateralized loan obligations (CLOs).

As of September 30, 2019, we had $62.2 million in commercial mortgage backed securities (CMBS) and $431.5 million in mortgage backed securities backed by government sponsored enterprises (GSEs - Freddie Mac, Fannie Mae and Ginnie Mae). Excluding the GSE backed MBS, our exposure to ABS and CMBS was 7.0 percent of our investment portfolio at quarter end.

We had $708.1 million in corporate fixed income securities as of September 30, 2019, which includes $83.8 million invested in a high yield credit strategy. This high-yield portfolio consists of floating rate bank loans and bonds that are below investment grade in credit quality and offer incremental yield over our core fixed income portfolio.

We also maintain an allocation to municipal fixed income securities. As of September 30, 2019, we had $358.1 million in municipal securities. The municipal portfolio includes approximately 80 percent tax-exempt securities and 20 percent taxable

[redacted]

securities. Approximately 84 percent of our municipal bond portfolio maintains an 'AA' or better rating, while 99 percent of the municipal bond portfolio is rated 'A' or better.

Our equity portfolio had a fair value of $428.3 million as of September 30, 2019 and is also a source of liquidity. The securities within the equity portfolio remain primarily invested in large-cap issues with a focus on dividend income. In the equity portfolio, the strategy remains one of value investing, with security selection taking precedence over market timing.

As of September 30, 2019, our equity portfolio had a dividend yield of 2.4 percent, compared to 2.0 percent for the S&P 500 index. Because of the corporate dividend-received-deduction applicable to our dividend income, we pay an effective tax rate of 13.1 percent on dividends, compared to 21.0 percent on taxable interest and 5.3 percent on municipal bond interest income. The equity portfolio is managed in a diversified and granular manner, with 232 individual securities and three ETF positions. No single stock exposure is greater than 2 percent of the equity portfolio.

We had $59.6 million of other invested assets at September 30, 2019, including investments in low income housing tax credit partnerships, membership in the Federal Home Loan Bank of Chicago (FHLBC) and investments in private funds. As of September 30, 2019, $16.2 million of investments were pledged as collateral with the FHLBC to ensure timely access to the secured lending facility that ownership of FHLBC stock provides. As of and during the nine-month period ending September 30, 2019, there were no outstanding borrowings with the FHLBC.

Our investment portfolio does not have any exposure to derivatives.

Our capital structure is comprised of equity and debt outstanding. As of September 30, 2019, our capital structure consisted of $149.3 million in 10-year maturity senior notes maturing in 2023 (debt) and $999.6 million of shareholders' equity. Debt outstanding comprised 13.0 percent of total capital as of September 30, 2019. Interest and fees on debt obligations totaled $5.6 million during the first nine months of 2019, the same amount as the previous year. We have incurred interest expense on debt at an average annual interest rate of 4.91 percent for the nine-month periods ended September 30, 2019 and 2018.

We paid a regular quarterly cash dividend of $0.23 per share on September 20, 2019, the same as the prior quarter. We have increased dividends in each of the last 44 years.

Our three insurance subsidiaries are subsidiaries of RLI Corp, with RLI Ins. as the first-level, or principal, insurance subsidiary. At the holding company (RLI Corp.) level, we rely largely on dividends from our insurance company subsidiaries to meet our obligations for paying principal and interest on outstanding debt, corporate expenses and dividends to RLI Corp. shareholders. As discussed further below, dividend payments to RLI Corp. from our principal insurance subsidiary are restricted by state insurance laws as to the amount that may be paid without prior approval of the insurance regulatory authorities of Illinois. As a result, we may not be able to receive dividends from such subsidiary at times and in amounts necessary to pay desired dividends to RLI Corp. shareholders. On a GAAP basis, as of September 30, 2019, our holding company had $999.6 million in equity. This includes amounts related to the equity of our insurance subsidiaries, which is subject to regulatory restrictions under state insurance laws. The unrestricted portion of holding company net assets is comprised primarily of investments and cash, including $46.5 million in liquid assets, which approximates annual holding company expenditures. Unrestricted funds at the holding company are available to fund debt interest, general corporate obligations and dividend payments to our shareholders. If necessary, the holding company also has other potential sources of liquidity that could provide for additional funding to meet corporate obligations or pay shareholder dividends, which include a revolving line of credit, as well as access to capital markets.

Ordinary dividends, which may be paid by our principal insurance subsidiary without prior regulatory approval, are subject to certain limitations based upon statutory income, surplus and earned surplus. The maximum ordinary dividend distribution from our principal insurance subsidiary in a rolling 12-month period is limited by Illinois law to the greater of 10 percent of RLI Ins. policyholder surplus, as of December 31 of the preceding year, or the net income of RLI Ins. for the 12-month period ending December 31 of the preceding year. Ordinary dividends are further restricted by the requirement that they be paid from earned surplus. Any dividend distribution in excess of the ordinary dividend limits is deemed extraordinary and requires prior approval from the Illinois Department of Insurance (IDOI). In the first nine months of 2019, RLI Ins. paid $14.0 million in ordinary dividends to RLI Corp. In 2018, our principal insurance subsidiary paid ordinary dividends totaling $13.0 million and extraordinary dividends totaling $110.0 million. Given the amount of dividends paid during the prior rolling 12-month period, the net assets of our principal insurance subsidiary are restricted until the middle of the fourth quarter of 2019 and cannot be distributed to RLI Corp. without prior approval from the IDOI. In addition to restrictions from our principal subsidiary's insurance regulator, we also consider internal models and how capital adequacy is defined by our rating agencies in determining amounts available for distribution. However, as discussed above, RLI Corp. had the necessary amount of unrestricted liquid net assets on hand at September 30, 2019 to cover normal annual holding company expenditures as they are incurred and become payable.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of economic losses due to adverse changes in the estimated fair value of a financial instrument as the result of changes in equity prices, interest rates, foreign currency exchange rates and commodity prices. Historically, our primary market risks have been equity price risk associated with investments in equity securities and interest rate risk associated with investments in fixed maturities. We have limited exposure to both foreign currency risk and commodity risk.

Credit risk is the potential loss resulting from adverse changes in an issuer's ability to repay its debt obligations. We monitor our portfolio to ensure that credit risk does not exceed prudent levels. We have consistently invested in high credit quality, investment grade securities. Our fixed maturity portfolio has an average rating of "AA-," with 85 percent rated "A" or better by at least two nationally recognized rating organizations.

On an overall basis, our exposure to market risk has not significantly changed from that reported in our December 31, 2018 Annual Report on Form 10-K.

ITEM 4. Controls and Procedures

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was performed, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective, as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objective, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We believe that our disclosure controls and procedures provide such reasonable assurance.

No changes were made to our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. **Legal Proceedings** – There were no material changes to report.

Item 1A. **Risk Factors -** There were no material changes to report.

Item 2. **Unregistered Sales of Equity Securities and Use of Proceeds** -

Items 2(a) and (b) are not applicable.

In 2010, our Board of Directors implemented a $100 million share repurchase program. We did not repurchase any shares during 2019. We have $87.5 million of remaining capacity from the repurchase program. The repurchase program may be suspended or discontinued at any time without prior notice.

Item 3. **Defaults Upon Senior Securities** - Not Applicable.

Item 4. **Mine Safety Disclosures -** Not Applicable.

Item 5. **Other Information** - Not Applicable.

Item 6. Exhibits

Exhibit 31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101	iXBRL-Related Documents

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RLI Corp.

/s/ Todd W. Bryant
Todd W. Bryant
Vice President, Chief Financial Officer
(Principal Financial and Chief Accounting Officer)

Date: October 24, 2019

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Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATION

Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jonathan E. Michael, certify that:

I have reviewed this quarterly report on Form 10-Q of RLI Corp.;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 24, 2019

/s/ Jonathan E. Michael

Jonathan E. Michael
Chairman & CEO

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Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATION

Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Todd W. Bryant, certify that:

I have reviewed this quarterly report on Form 10-Q of RLI Corp.;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 24, 2019

/s/ Todd W. Bryant

Todd W. Bryant
Vice President, Chief Financial Officer

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Section 4: EX-32.1 (EX-32.1)

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of RLI Corp. (the “Company”) on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jonathan E. Michael, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jonathan E. Michael

Jonathan E. Michael
Chairman & CEO
October 24, 2019

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Section 5: EX-32.2 (EX-32.2)

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of RLI Corp. (the "Company") on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Todd W. Bryant, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Todd W. Bryant

Todd W. Bryant
Vice President, Chief Financial Officer
October 24, 2019

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