

RLI CORP
Form 10-K
February 27, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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)

Illinois

(State or other jurisdiction of incorporation or organization)

9025 North Lindbergh Drive, Peoria, Illinois

37-0889946

(I.R.S. Employer Identification No.)

61615

Edgar Filing: RLI CORP - Form 10-K

(Address of principal executive offices)

(Zip Code)

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

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

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

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

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

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

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

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Edgar Filing: RLI CORP - Form 10-K

The aggregate market value of the registrant's common stock held by non-affiliates of the Registrant as of June 30, 2012, based upon the closing sale price of the Common Stock on June 30, 2012 as reported on the New York Stock Exchange, was \$1,282,418,887. Shares of Common Stock held directly or indirectly by each reporting officer and director along with shares held by the Company ESOP have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant's Common Stock, \$1.00 par value, on February 13, 2013 was 21,270,409.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the 2012 Annual Report to Shareholders for the year ended December 31, 2012, are incorporated by reference into Parts I and II of this document.

Portions of the Registrant's definitive Proxy Statement for the 2013 annual meeting of shareholders to be held May 2, 2013, are incorporated herein by reference into Part III of this document.

Exhibit index is located on pages 59-60 of this document, which lists documents filed as exhibits or incorporated by reference herein.

PART I

Item 1. **Business**

RLI Corp. underwrites selected property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group. We conduct operations principally through four insurance companies. These companies are organized in a vertical structure beneath RLI Corp. with RLI Insurance Company (RLI Ins.) as the first-level, or principal, insurance subsidiary. RLI Ins. writes multiple lines of insurance on an admitted basis in all 50 states, the District of Columbia and Puerto Rico. Mt. Hawley Insurance Company (Mt. Hawley), a subsidiary of RLI Ins., writes surplus lines insurance in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. RLI Indemnity Company (RIC), a subsidiary of Mt. Hawley, has authority to write multiple lines of insurance on an admitted basis in 48 states and the District of Columbia. Contractors Bonding and Insurance Company (CBIC), a subsidiary of RLI Ins., has authority to write multiple lines of insurance on an admitted basis in all 50 states and the District of Columbia. We are an Illinois corporation that was organized in 1965. We have no material foreign operations.

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

As a niche company with a specialty focus, we offer insurance coverages in both the specialty admitted and excess and surplus markets. Coverages in the specialty admitted market, such as our oil and gas 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 standard 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 standard 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.

We distribute our property and casualty insurance through our wholly-owned branch offices that market to wholesale producers. We also market certain coverages to retail producers from several of our casualty, surety and property operations. We also offer various reinsurance coverages which are distributed through brokers and on a direct basis. In addition, from time to time, we produce a limited amount of business under agreements with managing general agents under the direction of our product vice presidents.

For the year ended December 31, 2012, the following table provides the geographic distribution of our risks insured as represented by direct premiums earned for all coverages. For the year ended December 31, 2012, no other state accounted for 2 percent or more of total direct premiums earned for all coverages.

Edgar Filing: RLI CORP - Form 10-K

State	Direct Premiums Earned (in thousands)	Percent of Total
California	\$ 115,661	17.0%
New York	87,248	12.8%
Florida	71,980	10.6%
Texas	53,817	7.9%
Washington	28,849	4.2%
New Jersey	24,478	3.6%
Illinois	18,648	2.7%
Louisiana	16,960	2.5%
Arizona	16,587	2.4%
Hawaii	15,631	2.3%
Pennsylvania	15,036	2.2%
All Other	214,229	31.8%
Total direct premiums	\$ 679,124	100.0%

In the ordinary course of business, we rely on other insurance companies to share risks through reinsurance. A large portion of the reinsurance is put into effect under contracts known as treaties and, in some instances, by negotiation on each individual risk (known as facultative reinsurance). We have quota share, excess of loss and catastrophe (CAT) reinsurance contracts that protect against losses over stipulated amounts arising from any one occurrence or event. These arrangements allow us to pursue greater diversification of business and serve to limit the maximum net loss on catastrophes and large risks. Reinsurance is subject to certain risks, specifically market risk, which affects the cost of and the ability to secure these contracts, and credit risk, which is the risk that our reinsurers may not pay on losses in a timely fashion or at all. The following table illustrates, through premium volume, the degree to which we have utilized reinsurance during the past three years. For an expanded discussion of the impact of reinsurance on our operations, see Note 5 to our audited consolidated financial statements included in our 2012 Annual Report to Shareholders, attached as Exhibit 13 and incorporated by reference herein.

(in thousands)	Year Ended December 31,		
	2012	2011	2010
PREMIUMS WRITTEN			
Direct & Assumed	\$ 784,799	\$ 702,107	\$ 636,316
Reinsurance ceded	(191,713)	(152,469)	(151,176)
Net	\$ 593,086	\$ 549,638	\$ 485,140
PREMIUMS EARNED			
Direct & Assumed	\$ 756,721	\$ 692,947	\$ 647,306
Reinsurance ceded	(180,150)	(154,495)	(153,924)
Net	\$ 576,571	\$ 538,452	\$ 493,382

Specialty Insurance Market Overview

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

Excess and Surplus Insurance Market

The excess and surplus market focuses on hard-to-place risks. Excess and surplus eligibility allows us to underwrite nonstandard market risks with more flexible policy forms and unregulated premium rates. This typically results in coverages that are more restrictive and more expensive than in the standard admitted market. The excess and surplus lines regulatory

environment and production model also effectively filters submission flow and matches market opportunities to our expertise and appetite. In 2012, the excess and surplus market represented approximately \$22 billion, or 4 percent, of the entire \$501 billion domestic property and casualty industry, as measured by direct premiums written. Our excess and surplus operations wrote gross premiums of \$242.5 million, or 31 percent, of our total gross premiums written in 2012.

Specialty Admitted Insurance Market

We also write business in the specialty admitted market. Most of these risks are unique and hard to place in the standard market, but for marketing and regulatory reasons, they must remain with an admitted insurance company. The specialty admitted market is subject to greater state regulation than the excess and surplus market, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as state guaranty funds and assigned risk plans. For 2012, our specialty admitted operations wrote gross premiums of \$468.9 million, representing approximately 60 percent of our total gross premiums written for the year.

Specialty Property Reinsurance Market

We write business in the specialty property reinsurance market. This business can be written on an individual risk (facultative) basis or on a portfolio (treaty) basis. We write contracts on an excess of loss and a proportional basis. Contract provisions are written and agreed upon between the company and its client, another (re)insurance company. The business is typically more volatile as a result of unique underlying exposures and excess and aggregate attachments. This business requires specialized underwriting and technical modeling. For 2012, our specialty property reinsurance operations wrote gross premiums of \$73.4 million, representing approximately 9 percent of our total gross written premiums for the year.

Business Segment Overview

Our segment data is derived using the guidance set forth in FASB Accounting Standards Codification (ASC) 280, Segment Reporting. As prescribed by the guidance, reporting is based on the internal structure and reporting of information as it is used by management. The segments of our insurance operations are casualty, property and surety. For additional information, see Note 11 to our audited consolidated financial statements included in our 2012 Annual Report to Shareholders, attached as Exhibit 13 and incorporated by reference herein.

Casualty Segment

General Liability

Our general liability business consists primarily of coverage for third party liability of commercial insureds including manufacturers, contractors, apartments, real estate investment trusts (REITs) and mercantile. We also offer coverages in the specialized area of environmental liability for underground storage tanks, contractors and asbestos and environmental remediation specialists. Net premiums earned from our

Edgar Filing: RLI CORP - Form 10-K

general liability business totaled \$85.0 million, \$85.0 million and \$96.6 million, or 13 percent, 14 percent and 17 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Commercial and Personal Umbrella Liability

Our commercial umbrella coverage is principally written in excess of primary liability insurance provided by other carriers and in excess of primary liability written by us. The personal umbrella coverage is written in excess of the homeowners and automobile liability coverage provided by other carriers, except in Hawaii, where some underlying homeowners coverage is written by us. In 2010, we broadened eligibility guidelines and offered certain coverage enhancements in an effort to broaden our market reach. In 2012, we experienced significant growth in sales of our commercial product to contractors, particularly in the eastern region of the country. Net premiums earned from this business totaled \$68.3 million, \$63.0 million and \$61.4 million, or 10 percent, 10 percent and 11 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Commercial Transportation

Our transportation insurance provides automobile liability and physical damage insurance to local, intermediate and long haul truckers, public transportation risks and equipment dealers, along with other types of specialty commercial automobile risks. We also offer incidental, related insurance coverages, including general liability and excess liability and motor truck cargo. Our highly experienced transportation underwriters produce business through independent agents and brokers nationwide. Net premiums earned from this business totaled \$34.7 million, \$34.1 million and \$40.3 million, or 5 percent, 6 percent and 7 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

CBIC Package Business

In April 2011, we acquired CBIC and affiliated companies. Approximately half of the business written by CBIC is admitted property and casualty packages offered to small contractors (ContracPac) and other small-to-medium sized Main Street retail businesses. The coverages included in these packages are predominantly general liability, but also have some property/inland marine coverages as well as automobile and excess/umbrella coverage. These products are predominantly marketed through retail agents. Net premiums earned from the CBIC package business totaled \$28.5 million and \$16.4 million, or 4 percent and 3 percent of consolidated revenues for 2012 and 2011, respectively.

Executive Products

We provide a variety of management professional liability coverages, such as directors and officers (D&O) liability insurance, employment practices liability, fiduciary liability, and fidelity coverages for a variety of low to moderate classes of risks. We tend to focus more on smaller accounts, as opposed to the large account sector which is generally more sensitive to price competition. Our target accounts include publicly traded companies with market capitalization below \$5 billion (where we are writing part of the traditional D&O program), Side A coverage (where corporations cannot indemnify the individual D&Os), private companies, nonprofit organizations and sole-sponsored and multi-employer fiduciary liability accounts. Our primary focus for publicly traded companies is on providing Side A coverage. Additionally, we have had success rounding out our portfolio by writing more fiduciary liability coverage, primary and excess D&O coverage for private companies and non-profit organizations. In 2011, we moved our miscellaneous professional liability business to our professional services group and combined our fidelity operation with our executive products group. Net premiums earned from the executive products business totaled \$17.2 million, \$15.5 million and \$14.5 million, or 3 percent, 3 percent and 2 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Professional Services

We offer professional liability coverages focused on providing errors and omission coverage to small-to-medium size design professionals. In 2011, we combined our miscellaneous professional liability business into our design professionals group to form the professional services group. This group has focused on small-to-medium sized computer, technical, design and miscellaneous professionals. We have recently expanded our product suite to these same customers by offering a full array of multi-peril package products including general liability, property, automobile, excess liability, and worker's compensation coverages. This business primarily markets its products through specialty retail agents throughout the country. Net premiums earned from the professional services group totaled \$28.0 million, \$13.2 million and \$6.2 million, or 4 percent, 2 percent and 1 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Other

We offer a variety of other smaller products in our casualty segment, including in-home business insurance which provides limited liability and property coverage, on and off-site, for a variety of small business owners who work from their own home. We also have a number of programs that provide multiple, specialized coverages to a segmented customer base. We rely on program administrators to source these types of programs. In 2012, we expanded our offerings within the casualty segment through our newly launched security guards program. We also began offering medical malpractice coverage in 2012 with our acquisition of Rockbridge Underwriting Agency. Net premiums earned from these lines totaled \$6.0 million, \$9.0 million and \$13.0 million, or 1 percent, 1 percent and 2 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Property Segment

Commercial

Our commercial property coverage consists primarily of excess and surplus lines and specialty insurance such as fire, earthquake and difference in conditions, which can include earthquake, wind, flood and collapse coverages. We provide insurance for a wide range of commercial and industrial risks, such as office buildings, apartments, condominiums and certain industrial and mercantile structures. Net premiums earned from the commercial property business totaled \$74.2 million, \$80.7 million and \$80.5 million, or 11 percent, 13 percent and 14 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Marine

Our marine coverages include cargo, hull and protection and indemnity (P&I), marine liability, as well as inland marine coverages including builders risks, contractors equipment and other floater type coverages. Although the predominant exposures are located within the United States, there is some incidental international exposure written by this division. Net premiums earned from the marine business totaled \$56.4 million, \$51.7 million and \$48.0 million, or 9 percent, 8 percent and 8 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Crop Reinsurance

We offer quota share crop reinsurance to crop insurers on multi-peril crop insurance (MPCI) and crop hail premium and exposure. Crop insurance is purchased by agricultural producers for protection against crop-related losses due to natural disasters and other perils. The MPCI program is a partnership with the U.S. Department of Agriculture (USDA). Crop insurers also issue policies that cover revenue shortfalls or production losses due to natural causes such as drought, excessive moisture, hail, wind, frost, insects, and disease. Net premiums earned from the crop reinsurance business totaled \$24.5 million, \$34.9 million and \$27.1 million, or 4 percent, 6 percent and 5 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Property Reinsurance

We offer facultative and other treaty property reinsurance. The division underwrites property facultative reinsurance for insurance companies utilizing reinsurance intermediaries. The facultative unit specializes in buffer-layer carve-outs, excess and surplus property risks and other technical risks, such as power generation, requiring unique underwriting expertise. Perils covered range from fire and mechanical breakdown to flood and other catastrophic events. Although the predominant exposures are located within the United States, there is some incidental international exposure written by this division. This division also writes select specialty property treaties on a proportional basis. These treaties are portfolio underwritten using specialized actuarial models and cover catastrophic perils of earthquake, windstorm and other weather-related events, as well as some additional losses. In 2011, we expanded our treaty offerings by adding a specialty treaty unit that focuses on writing quota share and excess of loss treaties for small, regional companies. From time-to-time we have participated on a limited basis in capital market vehicles (Industry Loss Warranties/CAT bonds) to add narrowly defined, diversifying CAT risk. Net premiums earned from the property reinsurance business totaled \$27.0 million, \$19.9 million and \$14.7 million, or 4 percent, 3 percent and 3 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Other

We offer a variety of other smaller programs in our property segment, including a limited amount of homeowners and dwelling fire insurance in Hawaii. In 2012, we expanded our offerings within the property segment through our newly launched recreational vehicles program. Net premiums earned from other property coverages totaled \$20.3 million, \$16.4 million and \$11.4 million, or 3 percent, 3 percent and 2 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Surety Segment

Miscellaneous Surety

Our miscellaneous surety coverage includes small bonds for businesses and individuals written through approximately 10,000 independent insurance agencies throughout the United States. Examples of these types of bonds are license and permit, notary, and court bonds. These bonds are usually individually underwritten and utilize extensive automation tools for the underwriting and bond delivery to our agents. In April 2011, we acquired CBIC and affiliated entities. This acquisition added \$11.4 million and \$8.3 million of net premiums earned to miscellaneous surety in 2012 and 2011, respectively. Net premiums earned from miscellaneous surety coverages totaled \$39.3 million, \$34.8 million and \$24.8 million, or 6 percent, 6 percent and 4 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Contract Surety

We offer bonds for small-to-medium sized contractors throughout the United States, underwritten on an account basis. Typically, these are Performance and Payment bonds for individual construction contracts. These bonds are marketed through a select number of insurance agencies that have surety and construction expertise. We also offer bonds for small and emerging contractors that are reinsured through the federal small business administration. In April 2011, we acquired CBIC and affiliated entities. This acquisition added \$8.7 million and \$7.2 million of net premiums earned to contract surety in 2012 and 2011,

respectively. Net premiums earned from contract surety coverages totaled \$26.3 million, \$24.4 million and \$19.0 million, or 4 percent, 4 percent and 3 percent of consolidated revenues for 2012, 2011 and 2010, respectively.

Commercial Surety

We offer a large variety of commercial surety bonds for medium-to-large businesses. These risks are underwritten on an account basis and typically are for publicly traded corporations or their equivalent-sized private companies. This coverage is marketed through a select number of regional and national brokers with surety expertise. Net premiums earned from commercial surety coverages totaled \$22.1 million, \$21.3 million and \$18.9 million, or 3 percent of consolidated revenues for 2012, 2011 and 2010.

Oil and Gas Surety

Our oil and gas surety coverages provide commercial surety bonds for the energy, petrochemical and refining industries. These risks are primarily underwritten on an account basis and are primarily marketed through insurance producers with expertise in these industries. Net premiums earned from oil and gas surety coverages totaled \$18.7 million, \$18.1 million and \$17.0 million, or 3 percent of consolidated revenues for 2012, 2011 and 2010.

Marketing and Distribution

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

Brokers

The largest volume of broker-generated premium is in our commercial property, general liability, commercial surety, commercial umbrella, commercial automobile and specialty facultative and treaty reinsurance coverages. This business is produced through independent wholesale, retail and reinsurance brokers.

Independent Agents

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

underwriters or through our automated system.

Underwriting Agents

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

E-commerce and/or Direct

We are actively employing e-commerce to produce and efficiently process and service business, including, at-home businesses, small commercial and personal umbrella risks and surety bonding. On a direct basis we also assume premium on our crop reinsurance treaties.

Competition

Our specialty property and casualty insurance subsidiaries are part of an extremely competitive industry that is cyclical and historically characterized by periods of high premium rates and shortages of underwriting capacity followed by periods of severe competition and excess underwriting capacity. Within the United States alone, approximately 2,700 companies actively market property and casualty coverages. Our primary competitors in our casualty segment are, among others, Ace, Arch, James River, Meadowbrook, Navigators, USLI, Great West, Lancer, Baldwin & Lyons, Chubb, Philadelphia, Great American, Travelers and CNA. Our primary competitors in our property segment are, among others, ACE, Lexington, Arch, Endurance, Crum & Forster, Travelers and Markel. Our primary competitors in our surety segment are, among others, ACE, Arch, HCC, CNA, Safeco,

North American Specialty, Travelers and Hartford. The combination of coverages, service, pricing and other methods of competition vary from line to line. Our principal methods of meeting this competition are innovative coverages, marketing structure and quality service to the agents and policyholders at a fair price. We compete favorably, in part, because of our sound financial base and reputation, as well as our broad geographic penetration into all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. In the casualty, property and surety areas, we have acquired experienced underwriting specialists in our branch and home offices. We have continued to maintain our underwriting and marketing standards by not seeking market share at the expense of earnings. We have a track record of withdrawing from markets when conditions become overly adverse and we offer new coverages and new programs where the opportunity exists to provide needed insurance coverage with exceptional service on a profitable basis.

Financial Strength Ratings

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

A.M. Best SECURE		Standard & Poor's SECURE		Moody's STRONG	
A++, A+	Superior	AAA	Extremely strong	Aaa	Exceptional
A,A-	Excellent	AA	Very strong	Aa	Excellent
B++, B+	Very good	A	Strong	A	Good
		BBB	Good	Baa	Adequate
VULNERABLE		VULNERABLE		WEAK	
B,B-	Fair	BB	Marginal	Ba	Questionable
C++,C+	Marginal	B	Weak	B	Poor
C,C-	Weak	CCC	Very weak	Caa	Very poor
D	Poor	CC	Extremely weak	Ca	Extremely poor
E	Under regulatory supervision	R	Regulatory action	C	Lowest
F	In liquidation				
S	Rating suspended				
Within-category modifiers		+, -		1,2,3 (1 high, 3 low)	

Publications of A.M. Best, Standard & Poor's and Moody's indicate that A and A+ ratings are assigned to those companies that, in their opinion, have achieved excellent overall performance when compared to the standards established by these firms and have a strong ability to meet their obligations to policyholders over a long period of time. In evaluating a company's financial and operating performance, each of the firms review the company's profitability, leverage and liquidity, as well as the company's spread of risk, the quality and appropriateness of its reinsurance, the quality and diversification of its assets, the adequacy of its policy and loss reserves, the adequacy of its surplus, its capital structure, its risk management practices and the experience and objectives of its management. These ratings are based on factors relevant to policyholders, agents, insurance brokers and intermediaries and are not directed to the protection of investors.

At December 31, 2012, the following ratings were assigned to our insurance companies:

A.M. Best

RLI Insurance, Mt. Hawley Insurance and	
RLI Indemnity (group-rated)	A+, Superior
Contractors Bonding and Insurance Company **	A+, Superior

Standard & Poor's*

RLI Insurance and Mt. Hawley Insurance	A+, Strong
----------------------------------------	------------

Moody's

RLI Insurance, Mt. Hawley Insurance and	
RLI Indemnity	A2, Good

* Standard & Poor's does not rate RLI Indemnity

** CBIC is only rated by A.M. Best

A.M. Best upgraded the financial strength rating for CBIC from A, Excellent in 2011 to A+, Superior in 2012. For each of our other insurance companies, the A.M. Best, Standard & Poor's and Moody's financial strength ratings represented above are affirmations of previously assigned ratings. A.M. Best, in addition to assigning a financial strength rating, also assigns financial size categories. In June 2012, RLI Ins., Mt. Hawley and RIC, which are collectively rated as a group, were assigned a financial size category of XI (adjusted policyholders' surplus of between \$750 million and \$1 billion). As of December 31, 2012, the policyholders' statutory surplus of RLI Insurance Group totaled \$684.1 million. This would put the group in A.M. Best's financial size category X (adjusted policyholders' surplus of between \$500 million and \$750 million).

Reinsurance

We reinsure a portion of our insurance exposure, paying or ceding to the reinsurer a portion of the premiums received on such policies. Earned premiums ceded to non-affiliated reinsurers totaled \$180.2 million, \$154.5 million and \$153.9 million in 2012, 2011, and 2010, respectively. Insurance is ceded principally to reduce net liability on individual risks and to protect against catastrophic losses. While reinsurance does not relieve us of our legal liability to our policyholders, we use reinsurance as an alternative to using our own capital to fund losses. Retention levels are adjusted each year to maintain a balance between the growth in surplus and the cost of reinsurance. Although reinsurance does not legally discharge an insurer from its primary liability for the full amount of the policies, it does make the assuming reinsurer liable to the insurer to the extent of the insurance ceded.

Reinsurance is subject to certain risks, specifically market risk (which affects the cost and ability to secure reinsurance contracts) and credit risk (which relates to the ability to collect from the reinsurer on our claims). We purchase reinsurance from a number of financially strong reinsurers. We evaluate reinsurers' ability to pay based on their financial results, level of surplus, financial strength ratings and other risk characteristics. A reinsurance committee, comprised of senior management, approves our security guidelines and reinsurer usage. More than 95 percent of our reinsurance recoverables are due from companies with financial strength ratings of A or better by A.M. Best and Standard & Poor's rating services.

Edgar Filing: RLI CORP - Form 10-K

The following table sets forth the 10 largest reinsurers in terms of amounts recoverable, net of collateral we are holding from such reinsurers, as of December 31, 2012. These reinsurers all have financial strength ratings of A or better by A.M. Best and Standard and Poor's rating services. Also shown are the amounts of written premium ceded to these reinsurers during the calendar year 2012.

Edgar Filing: RLI CORP - Form 10-K

(dollars in thousands)	A.M. Best Rating	S & P Rating	Net Reinsurer Exposure as of 12/31/2012	Percent of Total	Ceded Premiums Written	Percent of Total
Endurance Re	A	A	\$ 64,615	16.6%	\$ 20,955	10.9%
Munich Re America / HSB	A+	AA-	61,321	15.7%	31,814	16.6%
Aspen UK Ltd.	A	A	34,624	8.9%	15,863	8.3%
Axis Re	A	A+	29,376	7.5%	5,571	2.9%
Transatlantic Re	A	A+	28,575	7.3%	11,636	6.1%
Berkley Insurance Co.	A+	A+	22,205	5.7%	7,400	3.9%
Swiss Re / Westport Ins. Corp.	A+	AA-	21,932	5.6%	7,873	4.1%
Toa-Re	A+	A+	17,077	4.4%	3,367	1.8%
Alterra Re USA	A	A	13,983	3.6%	6,286	3.3%
Allied World Re - US	A	A	13,956	3.6%	5,501	2.9%
All other reinsurers*			82,447	21.1%	75,447	39.2%
Total ceded exposure			\$ 390,111	100.0%	\$ 191,713	100.0%

* All other reinsurance balances recoverable, when considered by individual reinsurer, are less than 2 percent of shareholders' equity.

We utilize both treaty and facultative reinsurance coverage for our risks. Treaty coverage refers to a reinsurance contract that is applied to a group or class of business where all the risks written meet the criteria for that class. Facultative coverage is applied to individual risks as opposed to a group or class of business. It is used for a variety of reasons, including supplementing the limits provided by the treaty coverage or covering risks or perils excluded from treaty reinsurance.

Much of our reinsurance is purchased on an excess of loss basis. Under an excess of loss arrangement, we retain losses on a risk up to a specified amount and the reinsurers assume any losses above that amount. We may choose to participate in the reinsurance layers purchased by retaining a percentage of the layer. It is common to find conditions in excess of loss covers such as occurrence limits, aggregate limits and reinstatement premium charges. Occurrence limits cap our recovery for multiple losses caused by the same event. Aggregate limits cap our recovery for all losses ceded during the contract term. We may be required to pay additional premium to reinstate or have access to use the reinsurance limits for potential future recoveries during the same contract year. Our property and surety treaties tend to include reinstatement provisions which require us, in certain circumstances, to pay reinstatement premiums after a loss has occurred in order to preserve coverage.

Excluding CAT reinsurance, the following table summarizes the reinsurance treaty coverage currently in effect:

Product Line(s) Covered	Contract Type	Renewal Date	First-Dollar Retention	(in millions) Per Risk Limit Purchased	Maximum Retention
General liability	Excess of Loss	1/1	\$ 1.0	\$ 5.0	\$ 1.75
Commercial umbrella and excess	Excess of Loss/ Quota Share	1/1	1.0	9.0	1.6
Personal umbrella and eXS	Excess of Loss	1/1	1.0	5.0	1.75
Transportation	Excess of Loss/ Quota Share	1/1	0.5	4.5	0.58
Executive products	Quota Share	7/1	N/A	25.0	8.75
Professional Services - professional liability	Excess of Loss	4/1			