RLI CORP
Form 10-K
February 26, 2016
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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, 2015

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)	37-0889946 (I.R.S. Employer Identification No.)
9025 North Lindbergh Drive, Peoria, Illinois (Address of principal executive offices)	61615 (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 No

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 No

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

Indicate by check mark whether the registrant (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 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.

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

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the Registrant as of June 30, 2015, based upon the closing sale price of the Common Stock on June 30, 2015 as reported on the New York Stock Exchange, was $1,942,913,293. 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 10, 2016 was 43,578,108.

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DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Registrant's definitive Proxy Statement for the 2016 annual meeting of shareholders to be held May 5, 2016, are incorporated herein by reference into Part III of this document, including: "Share Ownership of Certain Beneficial Owners," "Board Meetings and Compensation," "Compensation Discussion & Analysis," "Executive Compensation," "Equity Compensation Plan Information," "Executive Management," "Corporate Governance and Board Matters," "Audit Committee Report" and "Proposal Five: Ratification of Selection of Independent Registered Public Accounting Firm."

Exhibit index is located on pages 116-117 of this document, which lists documents filed as exhibits or incorporated by reference herein.

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RLI Corp.

Index to Annual Report on Form 10-K

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PART I

Item 1. Business

RLI Corp. is an Illinois corporation that was organized in 1965. We underwrite selected property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group. We conduct operations principally through three 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, 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. In 2015, we sold RLI Indemnity Company (RIC), a former subsidiary of Mt. Hawley, as a "shell." This transaction was essentially the sale of insurance licenses. All business and cash flows from the former subsidiary remain within the RLI Insurance Group. Each of our insurance companies is domiciled in Illinois. 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 specialty insurance company with a niche focus, we offer insurance coverages in both 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 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 admitted market. This typically results in coverages that are more restrictive and more expensive than coverages in the standard 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.

We distribute our property and casualty insurance through our wholly-owned branch offices that market to wholesale and retail producers. We offer limited coverages on a direct basis to select insureds, as well as various reinsurance coverages, which are distributed through brokers. 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.

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For the year ended December 31, 2015, the following table provides the geographic distribution of our risks insured as represented by direct premiums earned for all coverages.

State	Direct Premiums Earned (in thousands)	Percent of Total
California	$ 127,481	16.0 %
New York	108,937	13.7 %
Florida	83,566	10.5 %
Texas	59,475	7.5 %
Washington	30,563	3.8 %
New Jersey	26,265	3.3 %
Illinois	23,917	3.0 %
Arizona	23,081	2.9 %
Pennsylvania	21,290	2.7 %
Louisiana	20,617	2.6 %
Hawaii	16,358	2.1 %
Ohio	15,988	2.0 %
All Other	239,642	29.9 %
Total direct premiums earned	$ 797,180	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 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 the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

	Year Ended December 31,		
(in thousands)	2015	2014	2013
PREMIUMS WRITTEN			
Direct & Assumed	$ 853,586	$ 863,848	$ 843,195
Reinsurance ceded	(131,615)	(160,696)	(176,873)
Net	$ 721,971	$ 703,152	$ 666,322
PREMIUMS EARNED			
Direct & Assumed	$ 832,904	$ 854,518	$ 820,460

Reinsurance ceded	(132,743)	(167,143)	(189,658)
Net	$ 700,161	$ 687,375	$ 630,802

SPECIALTY INSURANCE MARKET OVERVIEW

The specialty insurance market differs significantly from the standard admitted market. In the standard admitted 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 admitted market counterparts, we manage these risks to achieve higher financial returns. To reach our financial and operational goals, we must have extensive knowledge of, and expertise in, our markets. Many 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 specialty admitted insurance market, the excess and surplus insurance market and the specialty property and casualty reinsurance markets.

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SPECIALTY ADMITTED INSURANCE MARKET

We write business in the specialty admitted market. Most of these risks are unique and hard to place in the standard admitted 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 2015, our specialty admitted operations produced gross premiums written of $560.2 million, representing approximately 66 percent of our total gross premiums for the year.

EXCESS AND SURPLUS INSURANCE MARKET

The excess and surplus market focuses on hard-to-place risks. Participating in this market allows us to underwrite non-standard 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 filter submission flow and match market opportunities to our expertise and appetite. According to the 2015 edition of A.M. Best Aggregate & Averages – Property/Casualty, United States & Canada, the excess and surplus market represented approximately $28 billion, or 5 percent, of the entire $570 billion domestic property and casualty industry in 2015, as measured by direct premiums written. Our excess and surplus operations wrote gross premiums of $259.9 million, or 30 percent, of our total gross premiums written in 2015.

SPECIALTY PROPERTY AND CASUALTY REINSURANCE MARKETS

We write business in the specialty property and casualty reinsurance markets. 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 clients, other (re)insurance companies. 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 2015, our specialty property and casualty reinsurance operations wrote gross premiums of $33.5 million, representing approximately 4 percent of our total gross premiums written for the year.

BUSINESS SEGMENT OVERVIEW

Our segment data is derived using the guidance set forth in Financial Accounting Standards Board 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 the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

CASUALTY SEGMENT

Commercial and Personal Umbrella

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. Net premiums earned from this business totaled $104.6 million, $100.4 million and $85.5 million, or 15 percent, 15 percent and 14 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

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 general liability business totaled $81.2 million, $80.8 million and $81.4 million, or 12 percent, 12 percent and 13 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

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Professional Services

We offer professional liability coverages focused on providing errors and omission coverage to small-to-medium sized design, technical, computer and miscellaneous professionals. Our product suite for these customers also includes 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 nationwide. Net premiums earned from the professional services group totaled $71.0 million, $58.3 million and $42.1 million, or 10 percent, 8 percent and 7 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Commercial Transportation

Our transportation insurance provides commercial automobile liability and physical damage insurance to local, intermediate and long haul truckers, public transportation entities and equipment dealers, along with other types of specialty commercial automobile risks. We also offer incidental, related insurance coverages including general liability, 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 $65.6 million, $58.9 million and $50.3 million, or 9 percent, 8 percent and 8 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

P&C Package Business

Our P&C package business offers property and casualty insurance coverages 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 inland marine coverages as well as commercial automobile, property and umbrella coverage. These products are predominantly marketed through retail agents. Net premiums earned from the P&C package business totaled $40.4 million, $35.4 million and $30.6 million, or 6 percent, 5 percent and 5 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Executive Products

We provide a suite of management liability coverages, such as directors and officers (D&O) liability insurance, fiduciary liability and fidelity coverages for a variety of low to moderate classes of risks. Our publicly traded D&O appetite generally focuses on offering excess "Side A" D&O coverage (where corporations cannot indemnify the individual directors and officers) as well as excess full coverage D&O. Additionally, we have had success rounding out our portfolio by writing fiduciary liability coverage, for both public and private entities, and primary and excess D&O coverage for private companies and non-profit organizations. We recently added representations and warranties coverage for companies involved in mergers and acquisitions, generally targeting private companies involved in transactions valued at $200 million or less. Net premiums earned from the executive products business totaled $17.9 million, $18.9 million and $19.1 million, or 3 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Medical Professional Liability

We offer medical professional liability insurance specializing in hard-to-place individuals and group physicians. In late 2014, we expanded into healthcare liability with a team focused on long-term care and hospital liability. Both businesses are marketed through wholesale brokers in the excess and surplus lines space. Net premiums earned from the medical professional liability business totaled $12.3 million, $15.9 million and $8.6 million, or 2 percent, 2 percent and 1 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Other Casualty

We offer a variety of other smaller products in our casualty segment, including coverage for security guards and 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. Effective January 1, 2014, we entered into a quota share reinsurance agreement with Prime Insurance Company and Prime Property and Casualty Insurance Inc., the two insurance subsidiaries of Prime Holdings Insurance Services, Inc. (Prime). We assume general liability, excess, commercial auto, property and professional liability coverages on hard-to-place risks that are primarily written in the excess and surplus insurance market, as well as certain coverages written on an admitted basis. Net premiums earned from these lines totaled $19.2 million, $13.4 million and $6.4 million, or 2 percent, 2 percent and 1 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

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PROPERTY SEGMENT

Commercial Property

Our commercial property coverage consists primarily of excess and surplus lines and specialty insurance such as fire, earthquake and difference in conditions (DIC), 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, builders’ risks and certain industrial and mercantile structures. Net premiums earned from the commercial property business totaled \$75.7 million, \$80.7 million and \$76.9 million, or 11 percent, 12 percent and 12 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Marine

Our marine coverages include cargo, hull, protection and indemnity (P&I), marine liability, as well as inland marine coverages including builders’ risks and contractors’ equipment. Although the predominant exposures are located within the United States, there is some incidental international exposure written within these coverages. Net premiums earned from the marine business totaled \$47.0 million, \$49.2 million and \$57.1 million, or 7 percent, 7 percent and 9 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Specialty Personal

We offer specialized homeowners insurance in select locations, including a limited amount of homeowners and dwelling fire insurance through retail agents in Hawaii and surplus lines homeowners insurance for high-valued homes in the Cape Cod, Massachusetts area. Additionally, we offer recreational vehicle insurance and jewelry insurance nationwide. Net premiums earned from specialty personal coverages totaled \$26.4 million, \$26.6 million and \$16.3 million, or 4 percent, 4 percent and 3 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Property Reinsurance

Our treaty division writes select specialty property treaties on a quota share or excess of loss basis targeting small, regional cedants and specialty risks. 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 perils.

The facultative unit, which specialized in excess and surplus property risks requiring underwriting expertise, was discontinued in 2015 as a result of challenging market conditions. Perils covered ranged from fire and mechanical breakdown to flood and other catastrophic events. The exposures written by this unit were predominantly located in the United States, but there was some incidental international exposure. Net premiums earned from the property reinsurance business totaled $12.3 million, $12.8 million and $15.8 million, or 2 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Crop Reinsurance

We provide quota share crop reinsurance for multi-peril crop (MPCI) and crop hail exposures for a single cedant. 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 between the U.S. Department of Agriculture (USDA) and a select number of primary insurers. 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. As noted in previous filings, our portion of assumed crop reinsurance was reduced for 2015 and will end with the 2015 crop year due to the acquisition of the cedant. Net premiums earned from the crop reinsurance business totaled $9.4 million, $28.3 million and $31.4 million, or 1 percent, 4 percent and 5 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Other Property

Our other property coverages consist of lines from which we have recently exited, including pet insurance and satellite insurance. Net premiums earned from other property coverages totaled less than $0.1 million, $0.1 million and $2.6 million, or less than 1 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

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SURETY SEGMENT

Miscellaneous

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. Net premiums earned from miscellaneous surety coverages totaled $42.4 million, $39.0 million and $38.1 million, or 6 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Commercial

We offer a large variety of commercial surety bonds for medium-to-large businesses across a broad spectrum of industries. These risks are underwritten on an account basis with the ability to write bonded aggregations up to $90 million. This coverage is marketed through a select number of regional and national brokers with surety expertise. Net premiums earned from commercial surety coverages totaled $29.5 million, $25.8 million and $23.1 million, or 4 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Contract

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. Net premiums earned from contract surety coverages totaled $28.3 million, $26.6 million and $27.2 million, or 4 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

Energy

Our energy surety coverages provide commercial surety bonds for the energy, petrochemical and refining industries both on and off shore. 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 energy coverages totaled $16.8

million, $16.1 million and $18.2 million, or 2 percent, 2 percent and 3 percent of total net premiums earned for 2015, 2014 and 2013, respectively.

MARKETING AND DISTRIBUTION

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

BROKERS

The largest volume of broker-generated premium is in our commercial property, general liability, commercial surety, commercial umbrella, commercial automobile, medical professional liability and specialty 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 target classes of insurance, such as home business and personal umbrella, through independent agents. Homeowners and dwelling fire is produced through independent agents in Hawaii. Several of these programs involve 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 systems.

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UNDERWRITING AGENTS

We contract with certain underwriting agencies, which 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.

ONLINE AND/OR DIRECT

We are actively employing online efforts to produce and efficiently process and service business including home businesses, jewelry, small commercial and personal umbrella risks and surety bonding. On a direct basis, we also assume premium on various reinsurance treaties.

COMPETITION

Our specialty property and casualty insurance subsidiaries are part of a very 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 the casualty segment include Arch, Aspen, Baldwin & Lyons, Chubb, CNA, Endurance, Great American, Great West, Hartford, Lancer, Markel, Navigators, RSUI, USLI, Travelers and Zurich. Primary competitors in the property segment include Arch, Aspen, Chubb, CNA, Crum & Forster, Endurance, Great American, Lexington, National Interstate and Travelers. Primary competitors in the surety segment are AIG, Arch, Chubb, CNA, Endurance, Great American, HCC, Navigators, Travelers and XL. 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 in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. In the casualty, property and surety areas, we have experienced underwriting specialists in our branch and home offices. We continue 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 programs where the opportunity exists to provide needed insurance coverage with exceptional service on a profitable basis.

FINANCIAL STRENGTH RATINGS

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

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

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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 compared to the standards they have established 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 specifically related to securities issued by the company.

At December 31, 2015, the following ratings were assigned to our insurance companies:

A.M. Best	
RLI Ins., Mt. Hawley and CBIC* (group-rated)	A+, Superior
Standard & Poor’s	
RLI Ins. and Mt. Hawley	A+, Strong
Moody’s	
RLI Ins. and Mt. Hawley	A2, Good

*CBIC is only rated by A.M. Best

For A.M. Best, Standard & Poor’s and Moody’s, the 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 2015, RLI Ins., Mt. Hawley and CBIC, 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, 2015, the policyholders’ statutory surplus of RLI Insurance Group totaled $865.3 million, which continues to result in A.M. Best’s financial size category “XI”.

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 $132.7 million, $167.1 million and $189.7 million in 2015, 2014 and 2013, respectively. Insurance is ceded principally to reduce net liability on individual risks and to protect against catastrophic losses. We use reinsurance as an alternative to using our own capital to take risks and reduce volatility. Retention levels are evaluated 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 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 96 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. For more information regarding our largest reinsurers, see note 5 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

We utilize both treaty and facultative reinsurance coverage for our risks. Treaty coverage refers to a reinsurance contract under which the company agrees to cede all risks within a defined class of business to the reinsurer, who agrees to provide coverage on all risks ceded without individual underwriting. Facultative coverage is applied to individual risks at the company's discretion and is subject to underwriting by the reinsurer. 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

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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. Some property and surety treaties 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:

	(in millions)					
Product Line(s) Covered	Contract Type	Renewal Date	First-Dollar Retention	Per Risk Limit Purchased	Maximum Retention *	
General liability	Excess of Loss	1/1	$ 1.0	$ 4.0	$ 1.4	
Commercial umbrella and excess	Excess of Loss	1/1	1.0	9.0	1.9	
Personal umbrella and eXS	Excess of Loss	1/1	1.0	4.0	1.4	
Commercial transportation	Excess of Loss	1/1	0.5	4.5	1.0	
Executive products	Quota Share	7/1	N/A	25.0	8.8	
Professional services - professional liability	Excess of Loss	4/1	1.0	9.0	3.3	
Multi-line	Excess of Loss	1/1	0.5	10.5	1.6	
Multi-line workers comp	Excess of Loss	1/1	1.0	10.0	2.0	
Workers compensation catastrophe	Excess of Loss	1/1	11.0	14.0	11.0	
Medical professional liability	Excess of Loss	1/1	1.0	9.0	1.9	
Property	Excess of Loss	1/1	1.0	24.0	1.2	
Marine	Excess of Loss	6/1	2.0	28.0	2.0	
Surety	Excess of Loss	4/1	2.0	63.0	8.7	**

*Maximum retention includes first-dollar retention plus any co-participation we retain through the reinsurance tower.

**A limited number of commercial and energy surety accounts are permitted to exceed the $65.0 million limit. These accounts are subject to additional levels of review and are monitored on a monthly basis.

At each renewal, we consider any plans to change the underlying insurance coverage we offer, as well as updated loss activity, the level of RLI Insurance Group’s surplus, changes in our risk appetite and the cost and availability of reinsurance treaties. In the last renewal cycle, we maintained similar retentions on most lines of business.

PROPERTY REINSURANCE — CATASTROPHE COVERAGE

Our property CAT reinsurance reduces the financial impact of a CAT event involving multiple claims and policyholders. Reinsurance limits purchased fluctuate due to changes in the amount of exposure we insure, reinsurance costs, insurance company surplus levels and our risk appetite. In addition, we monitor the expected rate of return for each of our CAT lines of business. At high rates of return, we grow the book of business and may purchase additional reinsurance to increase our capacity. As the rate of return decreases, we shrink the book and may purchase less reinsurance as this capacity is unnecessary. Our reinsurance coverage for the last three years and for 2016 are shown in the following table:

Catastrophe Coverages

(in millions)

	2016		2015		2014		2013	
	First- Dollar Retention	Limit	First- Dollar Retention	Limit	First- Dollar Retention	Limit	First- Dollar Retention	Limit
California Earthquake	$ 25	300	$ 25	300	$ 25	300	$ 25	300
Non-California Earthquake	25	325	25	325	25	325	20	330
Other Perils	25	225	25	225	25	225	20	230

These CAT limits are in addition to the per-occurrence coverage provided by facultative and other treaty coverages. We have participated in the CAT layers purchased by retaining a percentage of each layer throughout this period. Our participation has varied based on price and the amount of risk transferred by each layer. Since 2014, all layers of the treaty have included one prepaid reinstatement.

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Our property CAT program continues to be applied on an excess of loss basis. It attaches after all other reinsurance has been considered. Although covered in one program, limits and attachment points differ for California earthquakes and all other perils. The following charts use information from our CAT modeling software to illustrate our pre-tax net retention resulting from particular events that would generate the gross losses shown in the tables:

Catastrophe - California Earthquake

(in millions)

Projected Gross Loss	2016 Ceded Losses	Net Losses	2015 Ceded Losses	Net Losses	2014 Ceded Losses	Net Losses
$ 50	$ 29	$ 21	$ 28	$ 22	$ 28	$ 22
100	73	27	72	28	70	30
200	163	37	163	37	160	40
350	302	48	302	48	298	52

Catastrophe - Other (Earthquake outside of California, Wind, Other)

(in millions)

Projected Gross Loss	2016 Ceded Losses	Net Losses	2015 Ceded Losses	Net Losses	2014 Ceded Losses	Net Losses
$ 25	$ 6	$ 19	$ 5	$ 20	$ 5	$ 20
50	22	28	21	29	19	31
100	63	37	60	40	56	44
250	198	52	192	58	188	62

In the above table, projected losses for 2016 were estimated based on our exposure as of December 31, 2015, utilizing the treaty structure in place as of January 1, 2016. All previous years were estimated similarly by utilizing the exposure at the end of each respective year and the treaty structure in place at the start of the following year.

The previous tables were generated using theoretical probabilities of events occurring in areas where our portfolio of currently in-force policies could generate the level of loss illustrated. Actual results could vary significantly from these tables as the actual nature or severity of a particular event cannot be predicted with any reasonable degree of accuracy. Reinsurance limits are purchased based on the anticipated losses from large events. The largest losses shown above are possible, but have a low probability of actually occurring. However, there is a remote chance that a larger event could occur. If the actual event losses are larger than anticipated, we could retain additional losses above the limit of our CAT reinsurance.

We continuously monitor and quantify our exposure to catastrophes including earthquakes, hurricanes, floods, convective storms, terrorist acts and other aggregating events. In the normal course of business, we manage our concentrations of exposures to catastrophic events, primarily by limiting concentrations of locations insured to acceptable levels and by purchasing reinsurance. Exposure and coverage detail is recorded for each risk location. We quantify and monitor the total policy limit insured in each geographical region. In addition, we use third-party CAT exposure models and an internally developed analysis to assess each risk to ensure we include an appropriate charge for assumed CAT risks. CAT exposure modeling is inherently uncertain due to the model's reliance on an infrequent observation of actual events and exposure data, increasing the importance of capturing accurate policy coverage data. The model results are used both in the underwriting analysis of individual risks and at a corporate level for the aggregate book of CAT-exposed business. From both perspectives, we consider the potential loss produced by individual events that represent moderate-to-high loss potential at varying probabilities and magnitudes. In calculating potential losses, we select appropriate assumptions including, but not limited to, loss amplification and loss adjustment expense. We establish risk tolerances at the portfolio level based on market conditions, the level of reinsurance available, changes to the assumptions in the CAT models, rating agency capital constraints, underwriting guidelines and coverages and internal preferences. Our risk tolerances for each type of CAT, and for all perils in aggregate, change over time as these internal and external conditions change. We are required to report to the rating agencies estimated loss to a single event that could include all potential earthquakes and hurricanes contemplated by the CAT modeling software. This reported loss includes the impact of insured losses based on the estimated frequency and severity of potential events, loss adjustment expense, reinstatements paid after the loss, reinsurance recoveries and taxes. Based on the CAT reinsurance treaty purchased on January 1, 2016, there is a 99.6 percent likelihood that the loss will be less than 8.2 percent of policyholders' surplus as of December 31, 2015. Our exposure to CAT losses has been relatively stable based on multiple views of risk including policy counts, policy limits insured and modeled losses based on multiple CAT models. The exposure levels are still well within our tolerances for this risk.

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LOSSES AND SETTLEMENT EXPENSES

OVERVIEW

Loss and loss adjustment expense (LAE) reserves represent our best estimate of ultimate payments for losses and related settlement expenses from claims that have been reported but not paid and losses that have been incurred but not yet reported to us (IBNR). Loss reserves do not represent an exact calculation of liability, but instead represent our estimates, generally utilizing individual claim estimates, actuarial expertise and estimation techniques at a given accounting date. The loss reserve estimates are expectations of what ultimate settlement and administration of claims will cost upon final resolution. These estimates are based on facts and circumstances then known to us, review of historical settlement patterns, estimates of trends in claims frequency and severity, projections of loss costs, expected interpretations of legal theories of liability and many other factors. In establishing reserves, we also take into account estimated recoveries from reinsurance, salvage and subrogation. The reserves are reviewed regularly by a team of actuaries we employ.

Net loss and loss adjustment reserves by product line at year-end 2015 and 2014 are illustrated in the following table. LAE is classified in the table as either allocated loss adjustment expense (ALAE) or unallocated loss adjustment expense (ULAE). ALAE refers to estimates of claim settlement expenses that can be identified with a specific claim or case, while ULAE cannot be identified with a specific claim. For a detailed discussion of loss reserves, refer to our critical accounting policy in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

(as of December 31, in thousands)	2015			2014		
Product Line	Case	IBNR	Total	Case	IBNR	Total
Casualty segment net loss and ALAE reserves						
Commercial umbrella	$ 9,349	$ 70,285	$ 79,634	$ 7,491	$ 56,167	$ 63,658
Personal umbrella	18,698	29,766	48,464	22,287	26,527	48,814
General liability	94,585	136,155	230,740	103,327	139,824	243,151
Professional services	18,392	64,473	82,865	11,034	49,380	60,414
Commercial transportation	52,962	21,769	74,731	53,620	19,060	72,680
P&C package business	10,551	26,118	36,669	10,243	25,910	36,153
Executive products	14,092	45,083	59,175	11,619	42,176	53,795
Medical professional liability	12,009	4,041	16,050	8,222	5,724	13,946
Other casualty	4,819	18,208	23,027	4,311	15,017	19,328
Property segment net loss and ALAE reserves						
Commercial property	4,240	2,901	7,141	4,216	2,982	7,198
Marine	13,181	16,017	29,198	14,436	19,076	33,512
Specialty personal	2,168	2,770	4,938	1,321	1,980	3,301

Property reinsurance	6,140	6,094	12,234	5,749	6,580	12,329
Crop reinsurance	56	7,542	7,598	276	23,809	24,085
Other property	105	750	855	60	929	989
Surety segment net loss and ALAE reserves						
Miscellaneous	392	4,417	4,809	535	4,654	5,189
Contract and commercial	1,753	12,613	14,366	(339)	16,684	16,345
Energy	492	2,230	2,722	947	2,673	3,620
Latent liability net loss and ALAE reserves	10,902	17,601	28,503	10,817	16,368	27,185
Total net loss and ALAE reserves	$ 274,886	$ 488,833	$ 763,719	$ 270,172	$ 475,520	$ 745,692
ULAE reserves	—	42,222	42,222	—	40,242	40,242
Total net loss and LAE reserves	$ 274,886	$ 531,055	$ 805,941	$ 270,172	$ 515,762	$ 785,934

Following is a table of significant risk factors involved in estimating losses grouped by major product line. We distinguish between loss ratio risk and reserve estimation risk. Loss ratio risk refers to the possible dispersion of loss ratios from year to year due to inherent volatility in the business, such as high severity or aggregating exposures. Reserve estimation risk recognizes the difficulty in estimating a given year's ultimate loss liability. As an example, our property CAT business (included below in "Other property") has significant variance in year-over-year results; however its reserving estimation risk is relatively moderate.

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Significant Risk Factors

Product line	Length of Reserve Tail	Emergence patterns relied upon	Other risk factors	Expected loss ratio variability	Reserve estimation variability
Commercial umbrella	Long	Internal	Low frequency High severity Loss trend volatility Rapid growth Unforeseen tort potential Exposure changes/mix	High	High
Personal umbrella	Medium	Internal	Low frequency High severity	Medium	Medium
General liability	Long	Internal	Exposure growth/mix Unforeseen tort potential	Medium	High
Medical professional liability	Long	External	High severity Exposure changes/mix Unforeseen tort potential/trends Small volume Loss trend volatility	High	High
Commercial transportation	Medium	Internal	High severity Exposure growth/mix	Medium	Medium
Executive products	Long	Internal & significant external	Low frequency High severity Loss trend volatility Economic volatility Unforeseen tort potential Small volume	High	High
Professional services	Long	External	Exposure growth Highly varied exposures Loss trend volatility Unforeseen tort potential	High	High

			Small volume		
P&C package business	Long	Internal	Exposure growth/mix Unforeseen tort potential Small volume	Medium	High
Other casualty	Medium	Internal & external	Small volume	Medium	Medium
Marine	Medium	Internal & external	Exposure changes/mix	High	High
Crop reinsurance	Short	External	Weather, yield and price volatility CAT aggregation exposure Unique inuring reinsurance features	Medium	Medium
Property reinsurance	Medium	External	New business CAT aggregation exposure Low frequency High severity Exposure growth/mix Reporting delay	High	Medium
Other property	Short	Internal	CAT aggregation exposure Low frequency High severity	High	Medium
Surety	Medium	Internal	Economic volatility Uniqueness of exposure	Medium	Medium
Runoff including asbestos & environmental	Long	Internal & external	Loss trend volatility Mass tort/latent exposure	High	High

A full analysis of our loss reserves takes place three times a year. The purpose of this analysis is to provide validation of our carried loss reserves. Estimates of the expected value of the unpaid loss and LAE are derived using actuarial methodologies. These estimates are then compared to the carried loss reserves to determine the appropriateness of the current reserve balance.

The methodologies we have chosen to incorporate are a function of data availability and are reflective of our own book of business. From time to time, we evaluate the need to add supplementary methodologies. New methods are incorporated if it is believed that they improve the estimate of our ultimate loss and LAE liability. All of the actuarial methods eventually converge to the same estimate as an accident year matures. Our core methodologies are listed below with a short description and their relative strengths and weaknesses:

Paid Loss Development — Historical payment patterns for prior claims are used to estimate future payment patterns for current claims. These patterns are applied to current payments by accident year to yield an expected ultimate loss.

Strengths: The method reflects only the claim dollars that have been paid and is not subject to case-basis reserve changes or changes in case reserve practices.

Weaknesses: External claims environment changes can impact the rate at which claims are settled and losses paid (e.g. increase in attorney involvement or legal precedent). Adjustments to reflect changes in payment patterns on a prospective basis are difficult to quantify. For losses that have occurred recently, payments can be minimal and thus early estimates are subject to significant instability.

Incurred Loss Development — Historical case-incurred patterns (paid losses plus case reserves) for past claims are used to estimate future case-incurred amounts for current claims. These patterns are applied to current case-incurred losses by accident year to yield an expected ultimate loss.

Strengths: Losses are reported more quickly than paid, therefore, the estimates stabilize sooner. The method reflects more information in the analysis than the paid loss development method.

Weaknesses: Method involves additional estimation risk if significant changes to case reserving practices have occurred.

Case Reserve Development — Patterns of historical development in reported losses relative to historical case reserves are determined. These patterns are applied to current case reserves by accident year and the result is combined with paid losses to yield an expected ultimate loss.

Strengths: Like the incurred development method, this method benefits from using the additional information available in case reserves that is not available from paid losses only. It also can provide a more reasonable estimate than other methods when the proportion of claims still open for an accident year is unusually high or low.

Weaknesses: It is subject to the risk of changes in case reserving practices or philosophy. It may provide unstable estimates when an accident year is immature and more of the IBNR is expected to come from unreported claims rather than development on reported claims and when accident years are very mature with infrequent case reserves.

Expected Loss Ratio — Historical loss ratios, in combination with projections of frequency and severity trends, as well as estimates of price and exposure changes, are analyzed to produce an estimate of the expected loss ratio for each accident year. The expected loss ratio is then applied to the earned premium for each year to estimate the expected ultimate losses. The current accident year expected loss ratio is also the prospective loss and ALAE ratio used in our initial IBNR generation process.

Strengths: Reflects an estimate independent of how losses are emerging on either a paid or a case reserve basis. This method is particularly useful in the absence of historical development patterns or where losses take a long time to emerge.

Weaknesses: Ignores how losses are actually emerging and thus produces the same estimate of ultimate loss regardless of favorable/unfavorable emergence.

Paid and Incurred Bornhuetter/Ferguson (BF) — This approach blends the expected loss ratio method with either the paid or incurred loss development method. In effect, the BF methods produce weighted average indications for each accident year. As an example, if the current accident year for commercial automobile liability is estimated to be 20 percent paid, then the paid loss development method would receive a weight of 20 percent and the expected loss ratio method would receive an 80 percent weight. Over time, this method will converge with the ultimate estimated by the respective loss development method.

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Strengths: Reflects actual emergence that is favorable/unfavorable, but assumes remaining emergence will continue as previously expected. Does not overreact to the early emergence (or lack of emergence) where patterns are most unstable.

Weaknesses: Could potentially understate favorable or unfavorable development by putting weight on the expected loss ratio.

In most cases, multiple estimation methods will be valid for the particular facts and circumstances of the claim liabilities being evaluated. Each estimation method has its own set of assumption variables and its own advantages and disadvantages, with no single estimation method being better than the others in all situations, and no one set of assumption variables being meaningful for all product line components. The relative strengths and weaknesses of the particular estimation methods, when applied to a particular group of claims, can also change over time. Therefore, the weight given to each estimation method will likely change by accident year and with each evaluation.

The actuarial central estimates typically follow a progression that places significant weight on the BF methods when accident years are younger and claims emergence is immature. As accident years mature and claims emerge over time, increasing weight is placed on the incurred development method, the paid development method and the case reserve development method. For product lines with faster loss emergence, the progression to greater weight on the incurred and paid development methods occurs more quickly.

For our long and medium-tail products, the BF methods are typically given the most weight for the first 36 months of evaluation. These methods are also predominant for the first 12 months of evaluation for short-tail lines. Beyond these time periods, our actuaries apply their professional judgment when weighting the estimates from the various methods deployed but place significant reliance on the expected stage of development in normal circumstances.

Judgment can supersede this natural progression if risk factors and assumptions change, or if a situation occurs that amplifies a particular strength or weakness of a methodology. Extreme projections are critically analyzed and may be adjusted, given less credence or discarded altogether. Internal documentation is maintained that records any substantial changes in methods or assumptions from one loss reserve study to another.

RESERVE SENSITIVITIES

There are three major parameters that have significant influence on our actuarial estimates of ultimate liabilities by product. They are the actual losses that are reported, the expected loss emergence pattern and the expected loss ratios used in the analyses. If the actual losses reported do not emerge as expected, it may cause us to challenge all or some of our previous assumptions. We may change expected loss emergence patterns, the expected loss ratios used in our analysis and/or the weights we place on a given actuarial method. The impact will be much greater and more leveraged for products with longer emergence patterns. Our general liability product is an example of a product with a relatively long emergence pattern. We have constructed a chart on the following page that illustrates the sensitivity of our general liability reserve estimates to these key parameters. We believe the scenarios to be reasonable as similar favorable variations have occurred in recent years. For example, while our general liability emergence has ranged from 6 percent to 29 percent favorable over the last three years, our emergence for all products combined, excluding general liability, has ranged from 15 percent to 23 percent favorable. The numbers below are the changes in estimated ultimate loss and ALAE in millions of dollars as of December 31, 2015, resulting from the change in the parameters shown. These parameters were applied to a general liability net loss and LAE reserve balance of $230.7 million at December 31, 2015, in addition to associated ULAE and latent liability reserves.

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(in millions)	Result from favorable change in parameter		Result from unfavorable change in the parameter	
+/-5 point change in expected loss ratio for all accident years	$	(7.7)	$	7.7
+/-10% change in expected emergence patterns	$	(5.5)	$	5.3
+/-30% change in actual loss emergence over a calendar year	$	(12.2)	$	12.2
Simultaneous change in expected loss ratio (5pts), expected emergence patterns (10%), and actual loss emergence (30%).	$	(24.9)	$	25.7

There are often significant inter-relationships between our reserving assumptions that have offsetting or compounding effects on the reserve estimate. Thus, in almost all cases, it is impossible to discretely measure the effect of a single assumption or construct a meaningful sensitivity expectation that holds true in all cases. The scenario above is representative of general liability, one of our largest and longest-tailed products. It is unlikely that all of our products would have variations as wide as illustrated in the example. It is also unlikely that all of our products would simultaneously experience favorable or unfavorable loss development in the same direction or at their extremes during a calendar year. Because our portfolio is made up of a diversified mix of products, there would ordinarily be some offsetting favorable and unfavorable emergence by product as actual losses start to emerge and our loss estimates become more reliable.

It is difficult for us to predict whether the favorable loss development observed in 2005 through 2015 will continue for any of our products in the future. We have reviewed historical data detailing the development of our total balance sheet reserves and changes in accident year loss ratios relative to original estimates. Based on this analysis and our understanding of loss reserve uncertainty, we believe fluctuations will occur in our estimate of ultimate reserve liabilities over time. Over the next calendar year, given our current exposure level and product mix, it would be reasonably likely for us to observe loss reserve development relating to prior years' estimates across all of our products ranging from approximately 10 percent ($80 million) favorable to 3 percent ($24 million) unfavorable.

HISTORICAL LOSS AND LAE DEVELOPMENT

The following table presents the development of our balance sheet reserves from 2005 through 2015. The top line of the table shows the net reserves at the balance sheet date for each of the indicated periods. This represents the estimated amount of net losses and settlement expenses arising in all prior years that are unpaid at the balance sheet date, including losses that had been incurred but not yet reported to us. The lower portion of the table shows the re-estimated amount of the previously recorded net reserves based on experience as of the end of each succeeding year, as well as the re-estimated previously recorded gross reserves as of December 31, 2015. The estimate changes as more information becomes known about the frequency and severity of claims for individual periods.

Favorable loss and LAE reserve development can be observed in the table for all years ending on both a net and gross basis. As the table displays, variations exist between our cumulative loss experience on a gross and net basis due to the application of reinsurance. On certain products, our net retention (after applying reinsurance) is significantly less than our gross retention (before applying reinsurance). These differences in retention can cause a significant (leveraged) difference between loss reserve development on a net and gross basis. As the relationship of our gross to net retention changes over time, re-estimation of loss reserves will result in variations between our cumulative loss experience on a gross and net basis.

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ear Ended December 31,									
05									
Prior	2006	2007	2008	2009	2010	2011	2012	2013	201
738,657	$ 793,106	$ 774,928	$ 809,027	$ 810,068	$ 819,780	$ 796,909	$ 798,599	$ 774,509	$ 7
154,446	162,450	161,484	160,460	147,677	177,862	200,169	226,361	219,876	2
270,210	275,322	267,453	269,740	259,456	308,702	339,847	363,884	354,872	
353,793	348,018	343,777	348,188	352,106	407,351	445,709	452,322		
399,811	394,812	393,157	404,112	421,176	479,641	505,653			
431,959	422,835	424,991	446,796	470,168	517,822				
447,415	443,091	453,587	480,534	497,731					
461,254	461,675	474,769	501,692						
475,620	477,611	491,703							
486,801	490,311								
496,824									
695,254	687,927	712,590	742,451	726,825	763,225	732,091	726,096	709,666	7
636,356	637,117	658,109	655,838	632,697	671,210	695,792	693,032	690,808	
599,420	601,939	605,111	596,476	608,260	644,663	680,458	681,342		
576,319	569,806	560,565	583,439	588,355	637,278	674,671			
556,836	540,895	552,558	570,613	582,805	637,656				
539,639	539,654	545,223	569,388	587,010					
540,298	533,551	547,113	575,820						
534,943	538,427	554,617							
539,427	546,485								
548,963									
189,694	$ 246,621	$ 220,311	$ 233,207	$ 223,058	$ 182,124	$ 122,238	$ 117,257	$ 83,701	$ 6
1,331,866	$ 1,318,777	$ 1,192,178	$ 1,159,311	$ 1,146,460	$ 1,173,943	$ 1,150,714	$ 1,158,483	$ 1,129,433	$ 1
(593,209)	(525,671)	(417,250)	(350,284)	(336,392)	(354,163)	(353,805)	(359,884)	(354,924)	(3
738,657	$ 793,106	$ 774,928	$ 809,027	$ 810,068	$ 819,780	$ 796,909	$ 798,599	$ 774,509	$ 7
991,387	$ 884,042	$ 864,629	$ 876,023	$ 894,147	$ 941,031	$ 986,548	$ 1,011,739	$ 1,003,540	$ 1
(442,424)	(337,557)	(310,012)	(300,203)	(307,137)	(303,375)	(311,877)	(330,397)	(312,732)	(2
548,963	$ 546,485	$ 554,617	$ 575,820	$ 587,010	$ 637,656	$ 674,671	$ 681,342	$ 690,808	$ 7
340,479	$ 434,735	$ 327,549	$ 283,288	$ 252,313	$ 232,912	$ 164,166	$ 146,744	$ 125,893	$ 1

OPERATING RATIOS

PREMIUMS TO SURPLUS RATIO

The following table shows, for the periods indicated, our insurance subsidiaries' statutory ratios of net premiums written to policyholders' surplus. While there is no statutory requirement applicable to us that establishes a permissible net premiums written to surplus ratio, guidelines established by the National Association of Insurance Commissioners (NAIC) provide that this ratio should generally be no greater than 3 to 1. While the NAIC provides this general guideline, rating agencies often require a more conservative ratio to maintain strong or superior ratings.

	Year Ended December 31,				
(dollars in thousands)	2015	2014	2013	2012	2011
Statutory net premiums written	$ 722,189	$ 703,152	$ 666,322	$ 593,086	$ 549,638
Policyholders' surplus	865,268	849,297	859,221	684,072	710,186
Ratio	0.8 to 1	0.8 to 1	0.8 to 1	0.9 to 1	0.8 to 1

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GAAP AND STATUTORY COMBINED RATIOS

Our underwriting experience is best indicated by our GAAP combined ratio, which is the sum of (a) the ratio of incurred losses and settlement expenses to net premiums earned (loss ratio) and (b) the ratio of policy acquisition costs and other operating expenses to net premiums earned (expense ratio). The difference between the combined ratio and 100 reflects the per-dollar rate of underwriting income or loss.

	Year Ended December 31,				
GAAP	2015	2014	2013	2012	2011
Loss ratio	42.7	43.2	41.2	47.1	37.2
Expense ratio	41.8	41.3	41.9	41.9	42.4
Combined ratio	84.5	84.5	83.1	89.0	79.6

We also calculate the statutory combined ratio, which is not indicative of GAAP underwriting income due to accounting for policy acquisition costs differently for statutory accounting purposes compared to GAAP. The statutory combined ratio is the sum of (a) the ratio of statutory loss and settlement expenses incurred to statutory net premiums earned (loss ratio) and (b) the ratio of statutory policy acquisition costs and other underwriting expenses to statutory net premiums written (expense ratio). The difference between the combined ratio and 100 reflects the per-dollar rate of underwriting income or loss.

	Year Ended December 31,				
Statutory	2015	2014	2013	2012	2011
Loss ratio	42.7	43.2	41.2	47.2	37.2
Expense ratio	41.2	40.9	41.0	40.8	41.9
Combined ratio	83.9	84.1	82.2	88.0	79.1
Industry combined ratio	95.2 (1)	97.2 (2)	95.8 (2)	103.1 (2)	108.2 (2)

(1) Source: Conning – Total Industry Forecast 2015Q4 – Commercial Lines. Estimated for the year ended December 31, 2015.
(2) Source: A.M. Best Aggregate & Averages — Property/Casualty, United States & Canada (2015 Edition) statutory basis.

INVESTMENTS

Our investment portfolio serves as the primary resource for loss payments and secondly as a source of income to support operations. Our investment strategy is based on preservation of capital as the first priority, with a secondary focus on growing book value through total return. Investments of the highest quality and marketability are critical for preserving our claims-paying ability. Our portfolio contains no derivatives or off-balance sheet structured investments. In addition, we have a diversified investment portfolio which distributes credit risk across many issuers and a policy that limits aggregate credit exposure. Despite periodic fluctuations in market value, our equity portfolio is part of a long-term asset allocation strategy and has contributed significantly to our growth in book value.

Investment portfolios are managed both internally and externally by experienced portfolio managers. We follow an investment policy that is reviewed quarterly and revised periodically, with oversight conducted by our senior officers and board of directors.

Our investments include fixed income debt securities, common stock equity securities, exchange traded funds (ETFs) and a small number of limited partnership interests. During 2015, the majority of available cash flows were invested in fixed income securities. Our equity allocation decreased to 19 percent of the overall portfolio. During the year, we initiated an investment in a real estate fund, which is included in other invested assets. This investment together with low income housing tax credit partnerships and membership stock in the Federal Home Loan Bank of Chicago represented one percent of the total portfolio. As of December 31, 2015, 82 percent of the fixed income portfolio was rated A or better and 65 percent was rated AA or better.

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We classify all of the securities in our fixed income portfolio as available-for-sale, which are carried at fair value. The available-for-sale portfolio provides an additional source of liquidity and can be used to address potential future changes in our asset/liability structure.

Aggregate maturities for the fixed-income portfolio as of December 31, 2015, are as follows:

(in thousands)	Par Value	Amortized Cost	Fair Value	Carrying Value
2016	$ 9,390	$ 9,529	$ 9,643	$ 9,643
2017	29,369	29,943	29,943	29,943
2018	37,057	37,411	37,485	37,485
2019	82,431	85,107	86,822	86,822
2020	120,225	122,737	121,850	121,850
2021	136,782	142,640	143,848	143,848
2022	110,244	114,930	115,974	115,974
2023	68,608	74,166	76,083	76,083
2024	78,448	85,647	87,427	87,427
2025	136,037	148,094	149,343	149,343
2026	44,852	48,414	50,123	50,123
2027	64,849	73,265	77,266	77,266
2028	43,517	49,633	51,920	51,920
2029	50,845	58,268	58,434	58,434
2030	55,370	65,739	66,834	66,834
2031 and later	30,976	31,014	28,275	28,275
Total excluding Mtge/ABS/CMBS*	$ 1,099,000	$ 1,176,537	$ 1,191,270	$ 1,191,270
Mtge/ABS/CMBS*	$ 333,880	$ 341,619	$ 346,840	$ 346,840
Grand Total	$ 1,432,880	$ 1,518,156	$ 1,538,110	$ 1,538,110

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

We had cash, short-term investments and fixed income securities maturing within one year of $27.0 million at year-end 2015. This total represented 1 percent of cash and invested assets, down from 3 percent the prior year. Our short-term investments consist of investments with original maturities of 90 days or less, primarily AAA-rated prime and government money market funds.

REGULATION

STATE REGULATION

As an insurance holding company, we, as well as our insurance company subsidiaries, are subject to regulation by the states and territories in which the insurance subsidiaries are domiciled or transact business. Holding company registration in each insurer's state of domicile requires periodic reporting to the state regulatory authority of the financial, operational and management data of the insurers within the holding company system. All transactions within a holding company system affecting insurers must have fair and reasonable terms, and the insurer's policyholder surplus following any transaction must be both reasonable in relation to its outstanding liabilities and adequate for its needs. Notice to, and in some cases consent from, regulators are required prior to the consummation of certain transactions affecting insurance company subsidiaries of the holding company system. Each state and territory individually regulates the insurance operations of both insurance companies and insurance agents/brokers. Because our insurance companies operate in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam, we must comply with the individual insurance laws, regulations, rules and case law of each state and territory, including those regulating the filing of insurance rates and forms. Each of our three insurance company subsidiaries is domiciled in Illinois, with the Illinois Department of Insurance (IDOI) as their principal insurance regulator.

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The insurance holding company laws also require that ordinary dividends paid by an insurance company be reported to the insurer's domiciliary regulator prior to payment of the dividend and that extraordinary dividends may not be paid without such regulator's prior approval. An extraordinary dividend is generally defined under Illinois law as a dividend that, together with all other dividends made within the past 12 months, exceeds the greater of 100 percent of the insurer's statutory net income for the most recent calendar year or 10 percent of its statutory policyholders' surplus as of the preceding year end. Insurance regulators have broad powers to prevent the reduction of statutory surplus to inadequate levels, and there is no assurance that extraordinary dividend payments would be permitted.

Two primary focuses of state insurance regulation of insurance companies are financial solvency and market conduct practices. These regulations impose restrictions on the amount and type of investments our insurance company subsidiaries may have. Regulations designed to ensure financial solvency of insurers and require fair and adequate treatment and service for policyholders are enforced by various filing, reporting and examination requirements. Marketplace oversight is conducted by monitoring and periodically examining trade practices, approving policy forms, licensing of agents and brokers and requiring the filing and, in some cases, approval of premiums and commission rates to ensure they are fair and equitable. Financial solvency is monitored by minimum reserve and capital requirements (including risk-based capital requirements), periodic financial reporting procedures (annually, quarterly or more frequently if necessary) and periodic examinations.

The quarterly and annual financial reports to the states utilize statutory accounting principles that are different from GAAP, which present the business as a going concern. The statutory accounting principles used by insurance regulators, in keeping with the intent to assure policyholder protection, are generally based on a solvency concept.

Many jurisdictions have laws and regulations that limit an insurer's ability to withdraw from a particular market. For example, states may limit an insurer's ability to cancel or non-renew policies. Furthermore, certain states prohibit an insurer from withdrawing one or more lines of business from the state, except pursuant to a plan that is approved by the state insurance department. The state insurance department may disapprove a withdrawal plan that may lead to marketplace disruption. Laws and regulations that limit cancellation and non-renewal and that subject program withdrawals to prior approval requirements may restrict our ability to exit unprofitable marketplaces in a timely manner.

In addition, state-level changes to the insurance regulatory environment are frequent, including changes caused by state legislation, regulations by the state insurance regulators and court rulings. State insurance regulators are members of the National Association of Insurance Commissioners (NAIC). The NAIC is a non-governmental regulatory support organization that seeks to promote uniformity and to enhance state regulation of insurance through various activities, initiatives and programs. Among other regulatory and insurance company support activities, the NAIC maintains a state insurance department accreditation program and proposes model laws, regulations and guidelines for approval by state legislatures and insurance regulators. Such proposed laws and regulations cover areas including risk assessments, corporate governance and financial and accounting rules. To the extent such proposed model laws and regulations are adopted by states, they will apply to insurance carriers.

The Own Risk and Solvency Assessment ("ORSA") model act was developed by the NAIC and proposed for adoption by each state insurance regulatory department. In 2015, the Illinois legislature adopted the Risk Management and ORSA law, applicable to all Illinois-domiciled insurance companies, including ours. The ORSA program is a key component of an insurance company's overall enterprise risk management (ERM) framework, which is the process by which organizations identify, measure, monitor and manage key risks affecting the entire enterprise. An ORSA report, filed by us with the IDOI each year, is an internal identification, description and assessment of the risks associated with our business plan, and the sufficiency of capital resources to support those risks. Our ORSA report was filed with the IDOI in 2015, and will be updated and filed annually.

Virtually all states require licensed insurers to participate in various forms of guaranty associations in order to bear a portion of the loss suffered by the policyholders of insurance companies that become insolvent. Depending upon state law, licensed insurers can be assessed an amount that is generally equal to a small percentage of the annual premiums written for the relevant lines of insurance in that state to pay the claims of an insolvent insurer. These assessments may increase or decrease in the future, depending upon the rate of insolvencies of insurance companies. In some states, these assessments may be wholly or partially recovered through policy fees paid by insureds.

In addition, the insurance holding company laws require advance approval by state insurance commissioners of any change in control of an insurance company that is domiciled (or, in some cases, having such substantial business that it is deemed to be commercially domiciled) in that state. "Control" is generally presumed to exist through the ownership of 10 percent or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance

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company. In addition, insurance laws in many states contain provisions that require pre-notification to the insurance commissioners of a change in control of a non-domestic insurance company licensed in those states. Any future transactions that would constitute a change in control of our insurance company subsidiaries, including a change of control of us, would generally require the party acquiring control to obtain the prior approval by the insurance departments of the insurance company subsidiaries' state of domicile (Illinois) or commercial domicile, if any, and may require pre-acquisition notification in applicable states that have adopted pre-acquisition notification provisions. Obtaining these approvals could result in a material delay of, or deter, any such transaction.

In addition to monitoring our existing regulatory obligations, we are also monitoring developments in the following areas to determine the potential effect on our business and to comply with our legal obligations.

FEDERAL LEGISLATION / REGULATION

The U.S. insurance industry is not currently subject to any significant federal regulation and instead is regulated principally at the state level. However, the federal Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) and creation of the Federal Insurance Office (summarized below) include elements that affect the insurance industry, insurance companies and public companies such as ours.

The Sarbanes-Oxley Act established several significant corporate governance-related laws and Security and Exchange Commission (SEC) regulations applicable to public companies. The Dodd-Frank Act created significant changes in regulatory structures of banking and other financial institutions, created new governmental agencies (while merging and removing others), increased oversight of financial institutions and enhanced regulation of capital markets. The legislation also mandates new rules affecting executive compensation and corporate governance for public companies such as ours.

In addition, the Dodd-Frank Act contains insurance industry-specific provisions, including establishment of the Federal Insurance Office (FIO) and streamlining the regulation and taxation of surplus lines insurance and reinsurance among the states. The FIO, part of the U.S. Department of Treasury, has limited authority and no direct regulatory authority over the business of insurance. FIO's principal mandates include monitoring the insurance industry, collection of insurance industry information and data and representation of the U.S. with international insurance regulators. Although the FIO does not provide substantive regulation of the insurance industry at this time, we will monitor its activities carefully for any regulatory impact on our company. Many aspects of the Dodd-Frank Act affecting our company will be implemented over time by various federal agencies, including the SEC. Full implementation is expected to take several more years. We will continue to monitor, implement and comply with all Dodd-Frank Act-related changes to our regulatory environment, any FIO initiatives and any other federal legislation impacting our company.

As part of the passage of the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), in January 2015, the National Association of Registered Agents and Brokers (NARAB) was established by federal law, which is expected to streamline insurance agent/broker licensing.

Other federal laws and regulations apply to many aspects of our company and its business operations. This federal regulation includes, without limitation, laws affecting privacy and data security and credit reporting — examples of which include the Gramm-Leach-Bliley Act, Fair Credit Reporting Act and Fair and Accurate Credit Transactions Act; and international economic and trade sanctions — examples of which include the Office of Foreign Asset Control (OFAC), Foreign Account Tax Compliance Act and the Iran Threat Reduction and Syrian Human Rights Act (ITR/SHR). ITR/SHR generally prohibits U.S. companies from engaging in certain transactions with the government of Iran or certain Iranian businesses, including provision of insurance or reinsurance. Under ITR/SHR, we must disclose whether we or any of our affiliates knowingly engaged in certain specified activities identified in that law. For the year 2015, neither we nor our affiliates have knowingly engaged in any transaction or dealing reportable under Section 13(r) of the Exchange Act, as required by the ITR/SHR.

LICENSES AND TRADEMARKS

We enter into various license arrangements with third parties and vendors on a regular basis for various goods and services. For example, we have license agreements with third parties for a variety of services, including natural catastrophe modeling, policy management, claims processing, producer management and accounting/financial management.

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We hold a U.S. federal service mark registration of our corporate logo “RLI” and several other company service marks and trademarks with the U.S. Patent and Trademark Office. Such registrations protect our intellectual property nationwide from deceptively similar use. The duration of these registrations is 10 years, unless renewed. We monitor our trademarks and service marks and protect them from unauthorized use as necessary.

EMPLOYEES

As of December 31, 2015, we employed a total of 902 associates. Of the 902 total associates, 36 were part-time and 866 were full-time.

FORWARD LOOKING STATEMENTS

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 appear throughout this report. These statements relate to our current expectations, beliefs, intentions, goals or strategies regarding the future and are based on certain underlying assumptions by us. These forward looking statements generally include words such as “expect,” “predict,” “estimate,” “will,” “should,” “anticipate “believe” and similar expressions. Such assumptions are, in turn, based on information available and internal estimates and analyses of general economic conditions, competitive factors, conditions specific to the property and casualty insurance and reinsurance industries, claims development and the impact thereof on our loss reserves, the adequacy and financial security of our reinsurance programs, developments in the securities market and the impact on our investment portfolio, regulatory changes and conditions and other factors and are subject to various risks, uncertainties and other factors, including, without limitation those set forth below in “Item 1A Risk Factors.” Actual results could differ materially from those expressed in, or implied by, these forward looking statements. We assume no obligation to update any such statements. You should review the various risks, uncertainties and other factors listed from time to time in our Securities and Exchange Commission filings.

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Item 1A. Risk Factors

Our results of operations and revenues may fluctuate as a result of many factors, including cyclical changes in the insurance industry, which may cause the price of our securities to be volatile.

The results of operations of companies in the property and casualty insurance industry historically have been subject to significant fluctuations and uncertainties. Our profitability can be affected significantly by:

- Competitive pressures impacting our ability to retain business at an adequate rate,
- Rising levels of loss costs that we cannot anticipate at the time we price our coverages,
- Volatile and unpredictable developments, including man-made, weather-related and other natural CATs, terrorist attacks or significant price changes of the commodities we insure,
- Changes in the level of private and government-related reinsurance capacity,
- Changes in the amount of losses resulting from new types of claims and new or changing judicial interpretations relating to the scope of insurers' liabilities and
- The ability of our underwriters to accurately select and price risk and our claim personnel to appropriately deliver fair outcomes.

In addition, the demand for property and casualty insurance, both admitted and excess and surplus lines, can vary significantly, rising as the overall level of economic activity increases and falling as that activity decreases, causing our revenues to fluctuate. These fluctuations in results of operations and revenues may cause the price of our securities to be volatile.

Adverse changes in the economy could lower the demand for our insurance products and could have an adverse effect on the revenue and profitability of our operations.

Factors such as business revenue, construction spending, government spending, the volatility and strength of the capital markets and inflation can all affect the business and economic environment. These same factors affect our ability to generate revenue and profits. Insurance premiums in our markets are heavily dependent on our customer revenues, values transported, miles traveled and number of new projects initiated. In an economic downturn that is characterized by higher unemployment, declines in construction spending and reduced corporate revenues, the demand for insurance products is adversely affected. Adverse changes in the economy may lead our customers to have less need for insurance coverage, to cancel existing insurance policies, to modify coverage or to not renew with us, all of which affect our ability to generate revenue.

Catastrophic losses, including those caused by natural disasters, such as earthquakes and hurricanes, or man-made events such as terrorist attacks, are inherently unpredictable and could cause us to suffer material financial losses.

We face the risk of property damage resulting from catastrophic events, particularly earthquakes on the West Coast and hurricanes and tropical storms affecting the continental U.S. or Hawaii. Since the Northridge, California earthquake in 1994, most of our CAT-related claims have resulted from hurricanes and other seasonal storms such as tornadoes and hail storms.

The incidence and severity of CATs are inherently unpredictable. The extent of losses from a CAT is a function of both the total amount of insured values in the area affected by the event and the severity of the event. Most CATs are restricted to fairly specific geographic areas. However, hurricanes and earthquakes may produce significant damage in large, heavily populated areas. In addition to hurricanes and earthquakes, CAT losses can be due to windstorms, severe winter weather and fires and may include terrorist events. In addition, climate change could have an impact on longer-term natural CAT trends. Extreme weather events that are linked to rising temperatures, changing global weather patterns, sea, land and air temperatures, as well as sea levels, rain and snow could result in increased occurrence and severity of CATs. CATs can cause losses in a variety of our property and casualty segments, and it is possible that a catastrophic event or multiple catastrophic events could cause us to suffer material financial losses. In addition, CAT claims costs may be higher than we originally estimate and could cause substantial volatility in our financial results for any fiscal quarter or year. Our ability to write new business could also be affected. We believe that increases in the value and geographic concentration of insured property, the effects of inflation and the growth of our workers compensation business could also increase the severity of claims from CAT events in the future.

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Since the model cannot contemplate all possible CAT scenarios and includes underlying assumptions based on a limited set of actual CAT events, the losses we might incur from an actual catastrophe could be higher than our expectation of losses generated from modeled catastrophe scenarios, and our results of operations and financial condition could be materially and adversely affected.

Actual insured losses may be greater than our loss reserves, which would negatively impact our profitability.

Significant periods of time often elapse between the occurrence of an insured loss, the reporting of the loss to us and our payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and the related loss adjustment expenses. Loss reserves are just an estimate of the ultimate costs of claims and do not represent an exact calculation of liability. Estimating loss reserves is a difficult and complex process involving many variables and subjective judgments. As part of the reserving process, we review historical data and consider the impact of various factors such as:

- Loss emergence and cedant reporting patterns,
- Underlying policy terms and conditions,
- Business and exposure mix,
- Trends in claim frequency and severity,
- Changes in operations,
- Emerging economic and social trends,
- Inflation and
- Changes in the regulatory and litigation environments.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. It also assumes that adequate historical or other data exists upon which to make these judgments. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves and actual results are likely to differ from original estimates. If the actual amount of insured losses is greater than the amount we have reserved for these losses, our profitability could suffer.

We may suffer losses from litigation, which could materially and adversely affect our financial condition and business operations.

As is typical in our industry, we continually face risks associated with litigation of various types, including disputes relating to insurance claims under our policies as well as other general commercial and corporate litigation. We are party to a variety of litigation matters throughout the year. Litigation is subject to inherent uncertainties, and if there were an outcome unfavorable to us, there exists the possibility of a material adverse impact on our results of operations and financial position in the period in which the outcome occurs. And even if an unfavorable outcome does not materialize, we still may face substantial expense and disruption associated with the litigation.

Our reinsurers may not pay on losses in a timely fashion, or at all, which may increase our costs.

We purchase reinsurance by transferring part of the risk we have assumed (known as ceding) to a reinsurance company in exchange for part of the premium we receive in connection with the risk. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the reinsured) of our liability to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. That is, our reinsurers may not pay claims made by us on a timely basis, or they may not pay some or all of these claims for a variety of reasons. Either of these events would increase our costs and could have a materially adverse effect on our business.

If we cannot obtain adequate reinsurance protection for the risks we have underwritten, we may be exposed to greater losses from these risks or we may reduce the amount of business we underwrite, which will reduce our revenues.

Market conditions beyond our control determine the availability and cost of the reinsurance protection that we purchase. In addition, the historical results of reinsurance programs and the availability of capital also affect the availability of reinsurance. Our reinsurance facilities are generally subject to annual renewal. We cannot be sure that we can maintain our current reinsurance facilities, that we can obtain other reinsurance facilities in adequate amounts and at favorable rates, or that we can diversify our exposure among an adequate number of high quality reinsurance partners. If we are unable to renew our expiring facilities or to obtain new reinsurance facilities on terms we deem acceptable, either our net exposures would increase—which could increase the volatility of our results—or, if we were unwilling to bear an increase in net exposures, we would have to reduce the level of our underwriting commitments, which would reduce our revenues.

Our investment results and, therefore, our financial condition may be impacted by changes in the business, financial condition or operating results of the entities in which we invest, as well as changes in interest rates, government monetary policies, general economic conditions, liquidity and overall market conditions.

We invest the premiums we receive from customers until they are needed to pay expenses or policyholder claims. Funds remaining after paying expenses and claims remain invested and are included in retained earnings. The value of our investment portfolio can fluctuate as a result of changes in the business, financial condition or operating results of the entities in which we invest. In addition, fluctuations can result from changes in interest rates, credit risk, government monetary policies, liquidity of holdings and general economic conditions. The equity portfolio will fluctuate with movements in the overall stock market. While the equity portfolio has been constructed to have lower downside risk than the market, the portfolio is positively correlated with movements in domestic stocks. The bond portfolio is affected by interest rate changes and movement in credit spreads. We attempt to mitigate our interest rate and credit risks by constructing a well-diversified portfolio of high-quality securities with varied maturities. These fluctuations may, however, negatively impact our financial condition and impair our ability to raise capital, if needed. However, we attempt to manage this risk through asset allocation, duration and security selection.

We compete with a large number of companies in the insurance industry for underwriting revenues.

We compete with a large number of other companies in our selected lines of business. During periods of intense competition for premium (soft markets), we are vulnerable to the actions of other companies who may seek to write business without the appropriate regard for ultimate profitability. During these times, it is very difficult to grow or maintain premium volume without sacrificing underwriting discipline and income.

We face competition both from specialty insurance companies, underwriting agencies and intermediaries, as well as diversified financial services companies that are significantly larger than we are and that have significantly greater financial, marketing, management and other resources. We may also face competition from new sources of capital such as institutional investors seeking access to the insurance market, sometimes referred to as alternative capital, which may depress pricing or limit our opportunities to write business. Some of these competitors also have greater experience and market recognition than we do. We may incur increased costs in competing for underwriting revenues. If we are unable to compete effectively in the markets in which we operate or expand our operations into new markets, our underwriting revenues may decline, as well as overall business results.

A number of new, proposed or potential legislative or industry developments could further increase competition in our industry. These developments include:

- An increase in capital-raising by companies in our lines of business, which could result in new entrants to our markets and an excess of capital in the industry,
- The deregulation of commercial insurance lines in certain states and the possibility of federal regulatory reform of the insurance industry, which could increase competition from standard carriers for our excess and surplus lines of insurance business,
- Programs in which state-sponsored entities provide property insurance in CAT-prone areas or other “alternative markets” types of coverage and
- Changing practices caused by the Internet, which may lead to greater competition in the insurance business.

New competition from these developments could cause the supply and/or demand for insurance or reinsurance to change, which could affect our ability to price our coverages at attractive rates and thereby adversely affect our underwriting results.

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A downgrade in our ratings from A.M. Best, Standard & Poor’s, or Moody’s could negatively affect our business.

Financial strength ratings are a critical factor in establishing the competitive position of insurance companies. Our insurance companies are rated for overall financial strength by A.M. Best, Standard & Poor’s and Moody’s. A.M. Best, Standard & Poor’s and Moody’s ratings reflect their opinions of an insurance company’s and an insurance holding company’s financial strength, operating performance, strategic position and ability to meet its obligations to policyholders, and are not evaluations directed to investors. Our ratings are subject to periodic review by such firms, and we cannot assure the continued maintenance of our current ratings. All of our ratings were reviewed during 2015. A.M. Best reaffirmed its “A+, Superior” rating for the combined entity of RLI Ins., Mt. Hawley and CBIC (group-rated). Standard & Poor’s reaffirmed our “A+, Strong” rating for the group of RLI Ins. and Mt. Hawley. Moody’s reaffirmed our group rating of “A2, Good” for RLI Ins. and Mt. Hawley. Because these ratings have become an increasingly important factor in establishing the competitive position of insurance companies, if our ratings are reduced from their current levels by A.M. Best, Standard & Poor’s or Moody’s, our competitive position in the industry, and therefore our business, could be adversely affected. A significant downgrade could result in a substantial loss of business, as policyholders might move to other companies with higher claims-paying and financial strength ratings.

We are subject to extensive governmental regulation, which may adversely affect our ability to achieve our business objectives. Moreover, if we fail to comply with these regulations, we may be subject to penalties, including fines and suspensions, which may adversely affect our financial condition and results of operations.

As an insurance company, we are subject to extensive governmental regulation and supervision. Most insurance regulations are designed to protect the interests of policyholders rather than shareholders and other investors. These regulations, generally administered by a department of insurance in each state in which we do business, relate to, among other things:

- Approval of policy forms and premium rates,
- Standards of solvency, including risk-based capital measurements,
- Licensing of insurers and their producers,
- Restrictions on agreements with our large revenue-producing agents,
- Cancellation and non-renewal of policies,
- Restrictions on the nature, quality and concentration of investments,
- Restrictions on the ability of our insurance company subsidiaries to pay dividends to us,
- Restrictions on transactions between insurance company subsidiaries and their affiliates,
- Restrictions on the size of risks insurable under a single policy,
- Requiring deposits for the benefit of policyholders,
- Requiring certain methods of accounting,
- Periodic examinations of our operations and finances,
- Prescribing the form and content of records of financial condition required to be filed and
- Requiring reserves for unearned premium, losses and other purposes.

State insurance departments also conduct periodic examinations of the conduct and affairs of insurance companies and require the filing of annual, quarterly and other reports relating to financial condition, holding company issues and other matters. These regulatory requirements may adversely affect or inhibit our ability to achieve some or all of our business objectives.

In addition, regulatory authorities have relatively broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, we follow practices based on our interpretations of regulations or practices that we believe may be generally followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, insurance regulatory authorities could fine us, preclude or temporarily suspend us from carrying on

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some or all of our activities or otherwise penalize us. This could adversely affect our ability to operate our business. Further, changes in the level of regulation of the insurance industry or changes in laws or regulations themselves or interpretations by regulatory authorities could adversely affect our ability to operate our business as currently conducted.

In addition to regulations specific to the insurance industry, including the insurance laws of our principal state regulator (Illinois), as a public company we are also subject to the rules and regulations of the U.S. Securities and Exchange Commission and the New York Stock Exchange (NYSE), each of which regulate many areas such as financial and business disclosures, corporate governance and shareholder matters. We are also subject to the corporation laws of Illinois, where we and our three insurance company subsidiaries are incorporated. At the federal level, among other laws, we are subject to the Sarbanes-Oxley Act and the Dodd-Frank Act, each of which regulate corporate governance, executive compensation and other areas, as well as laws relating to federal trade restrictions, privacy/data security, crop insurance and terrorism risk insurance laws. We monitor these laws, regulations and rules on an ongoing basis to ensure compliance and make appropriate changes as necessary. Implementing such changes may require adjustments to our business methods, increases to our costs and other changes that could cause us to be less competitive in our industry.

We may be unable to attract and retain qualified key employees.

We depend on our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. Providing suitable succession planning for such positions is also important. If we cannot attract or retain top-performing executive officers, underwriters and other employees, if the quality of their performance decreases, or if we fail to implement succession plans for our key staff, we may be unable to maintain our current competitive position in the markets in which we operate and be unable to expand our operations into new markets.

We are an insurance holding company and, therefore, may not be able to receive adequate or timely dividends from our insurance subsidiaries.

RLI Corp. is the holding company for our three insurance operating companies. At the holding company level, our principal assets are the shares of capital stock of our insurance company subsidiaries. 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. 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. Ordinary dividends, which may be paid by our principal insurance subsidiary without prior regulatory approval, are subject to certain limitations based upon 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. Because the limitations are based upon a rolling 12-month period, the presence, amount and impact of these restrictions vary over time.

Anti-takeover provisions affecting us could prevent or delay a change of control that is beneficial to you.

Provisions of our articles of incorporation and by-laws, as well as applicable Illinois law, federal and state regulations and insurance company regulations may discourage, delay or prevent a merger, tender offer or other change of control that holders of our securities may consider favorable. Some of these provisions impose various procedural and other requirements that could make it more difficult for shareholders to effect certain corporate actions. These provisions could:

- Have the effect of delaying, deferring or preventing a change in control of us,
- Discourage bids for our securities at a premium over the market price,
- Adversely affect the market price of, and the voting and other rights of the holders of, our securities or
- Impede the ability of the holders of our securities to change our management.

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Any significant interruption in the operation of our facilities, systems and business functions or breach in our data security infrastructure could adversely affect our financial condition and results of operations.

We rely on multiple computer systems to issue policies, pay claims, run modeling functions, assess insurance risks and complete various important internal processes including accounting and bookkeeping. Our business is highly dependent on our ability to access these systems to perform necessary business functions. Additionally, some of these systems may include or rely upon third-party systems not located on RLI premises. Any of these systems may be exposed to unplanned interruption, unreliability, intrusion and data breaches from a variety of causes, including among others, storms and other natural disasters, terrorist attacks, utility outages or complications encountered as existing systems are replaced or upgraded.

Any such issues could materially impact our company including the impairment of information availability, compromise of system integrity/accuracy, misappropriation of confidential information, reduction of our volume of transactions and interruption of our general business. Although we believe our computer systems are securely protected and continue to take steps to ensure they are protected against cyber-security risks, we cannot guarantee that such problems will never occur. If they do, interruption to our business and damage to our reputation, and related costs, could be significant, which could impair our profitability.

We may not be able to effectively start up or integrate new product opportunities.

Our ability to grow our business depends, in part, on our creation, implementation and acquisition of new insurance products that are profitable and fit within our business model. New product launches as well as resources to integrate business acquisitions are subject to many obstacles, including ensuring we have sufficient business and systems processes, determining appropriate pricing, obtaining reinsurance, assessing opportunity costs and regulatory burdens and planning for internal infrastructure needs. If we cannot accurately assess and overcome these obstacles or we improperly implement new insurance products, our ability to grow profitably will be impaired.

Access to capital and market liquidity may adversely affect our ability to take advantage of business opportunities as they arise.

Our ability to grow our business depends in part on our ability to access capital when needed. We cannot predict capital market liquidity or the availability of capital. We also cannot predict the extent and duration of future economic and market disruptions, the impact of government interventions into the market to address these disruptions and their combined impact on our industry, business and investment portfolios. If our company needs capital but cannot raise it, our business and future growth could be adversely affected.

Our success will depend on our ability to maintain and enhance effective operating procedures and manage risks on an enterprise wide basis.

Operational risk and losses can result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures or external events. We continue to enhance our operating procedures and internal controls to effectively support our business and our regulatory and reporting requirements. The NAIC and state legislatures have increased their focus on risks within an insurer's holding company system that may pose enterprise risk to insurers. In 2015, the Illinois legislature adopted the Risk Management and Own Risk and Solvency Assessment Law ("ORSA"), which requires domestic insurers to maintain a risk management framework and establishes a legal requirement for domestic insurers to conduct an ORSA in accordance with the NAIC's ORSA Guidance Manual. The ORSA law also provides that, no less than annually, an insurer must submit an ORSA summary report. We operate within an ERM framework designed to assess and monitor our risks. However, assurance that we can effectively review and monitor all risks or that all of our employees will operate within the ERM framework cannot be guaranteed. Assurances that our ERM framework will result in us accurately identifying all risks and accurately limiting our exposures based on our assessments also cannot be guaranteed.

We may not be able to, or might not choose to, continue paying dividends on our common stock.

We have a history of paying regular, quarterly dividends and in recent years have paid special dividends. Any determination to pay either type of dividend to our stockholders in the future will be at the discretion of our board of directors and will depend on our results of operations, financial condition and other factors deemed relevant by our board of directors. Our ability to pay dividends depends largely on our subsidiaries' earnings and operating capital requirements and is subject to the regulatory, contractual, rating agency and other constraints of our subsidiaries, including the effect of any such dividends or

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distributions on the A.M. Best rating or other ratings of our insurance subsidiaries. In addition, we may choose to retain capital to support growth or further mitigate risk, as opposed to returning excess capital to our shareholders.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own five commercial buildings on our 23 acre corporate campus in Peoria, Illinois. Our primary building is a two-story 84,000 square foot office building, which serves as our corporate headquarters. Located on the same campus is a 24,000 square foot building, which is used by two branch offices of RLI Ins., and is being replaced by a 41,000 square foot building currently in the course of construction and projected to be completed in the third quarter of 2016. In addition, we own a 15,000 square foot office building, a 26,000 square foot multi-story building used for record storage and a 12,000 square foot building used for furniture and equipment storage.

Most of our branch offices and other company operations lease office space throughout the country. Management considers our office facilities suitable and adequate for our current levels of operations.

Item 3. Legal Proceedings

We are party to numerous claims, losses and litigation matters that arise in the normal course of our business. Many of such claims, losses or litigation matters involve claims under policies that we underwrite as an insurer. We believe that the resolution of these claims and losses will not have a material adverse effect on our financial condition, results of operations or cash flows.

We are also involved in various other legal proceedings and litigation unrelated to our insurance business from time to time that arise in the ordinary course of business operations. Management believes that any liabilities that may arise as a result of these legal matters will not have a material adverse effect on our financial condition, results of operations or cash flows.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Investor Information:

TRADING AND DIVIDEND INFORMATION

	Closing Stock Price			Dividends
2015	High	Low	Ending	Declared
1st Quarter	$ 53.25	$ 46.91	$ 52.41	$ 0.18
2nd Quarter	53.28	48.55	51.39	0.19
3rd Quarter	56.61	51.45	53.53	0.19
4th Quarter	63.02	53.15	61.75	2.19

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2014	Closing Stock Price High	Low	Ending	Dividends Declared
1st Quarter	$ 47.76	$ 40.31	$ 44.24	$ 0.17
2nd Quarter	46.17	42.20	45.78	0.18
3rd Quarter	46.53	42.74	43.29	0.18
4th Quarter	50.54	42.98	49.40	3.18

RLI common stock trades on the New York Stock Exchange under the symbol RLI. RLI has paid dividends for 158 consecutive quarters and increased dividends in each of the last 40 years. In December 2015 and 2014, RLI paid special cash dividends of $2.00 and $3.00 per share, respectively, to shareholders as of the record date. As of February 10, 2016, there were 818 registered holders of the Company's common stock.

The following graph provides a five-year comparison of RLI's total return to shareholders compared to that of the S&P 500 and S&P P&C Index.

		2010	2011	2012	2013	2014	2015
RLI	--------------	$ 100	151	147	232	255	334
S&P 500	•••••••••••••••	$ 100	102	118	157	178	181
S&P 500 P&C Index	— — —	$ 100	100	120	166	192	210

Assumes $100 invested on December 31, 2010, in RLI, S&P 500 and S&P 500 P&C Index, with reinvestment of dividends. Comparison of five-year annualized total return — RLI: 27.3%, S&P 500: 12.5%, and S&P 500 P&C Index: 16.0%.

Refer to Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," of this document for information on securities authorized for issuance under our equity compensation plan.

(b) Not applicable.

(c) In 2010, our Board of Directors implemented a $100 million share repurchase program. We did not repurchase any shares during 2015. 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.

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Item 6. Selected Financial Data

The following is selected financial data of RLI Corp. and Subsidiaries for the 5 years ended December 31, 2015.

(amounts in thousands, except per share data and ratios)	2015	2014	2013	2012	2011
OPERATING RESULTS					
Gross premiums written	$ 853,586	863,848	843,195	784,799	702,107
Consolidated revenue	$ 794,634	775,165	705,601	660,774	619,169
Net earnings	$ 137,544	135,445	126,255	103,346	126,598
Comprehensive earnings(1)	$ 89,935	170,801	119,112	129,191	147,931
Net cash provided from operating activities	$ 152,586	123,085	134,966	36,240 (8)	117,991 (8)
FINANCIAL CONDITION					
Total investments and cash	$ 1,951,543	1,964,285	1,922,058	1,840,881	1,900,288
Total assets	$ 2,736,579	2,775,542	2,740,310	2,644,632	2,654,834
Unpaid losses and settlement expenses	$ 1,103,785	1,121,040	1,129,433	1,158,483	1,150,714
Total debt	$ 149,668	149,625	149,582 (7)	100,000	100,000
Total shareholders' equity	$ 823,469	845,062	828,966	796,363	792,634
Statutory surplus(2)	$ 865,268	849,297	859,221	684,072	710,186
SHARE INFORMATION(3)					
Net earnings per share:					
Basic	$ 3.18	3.15	2.95	2.44	3.00
Diluted	$ 3.12	3.09	2.90	2.39	2.95
Comprehensive earnings per share:(1)					
Basic	$ 2.08	3.97	2.79	3.04	3.51
Diluted	$ 2.04	3.90	2.74	2.99	3.45
Cash dividends declared per share:					
Ordinary	$ 0.75	0.71	0.67	0.63	0.60
Special(4)	$ 2.00	3.00	1.50	2.50	2.50
Book value per share(4)	$ 18.91	19.61	19.29	18.73	18.73
Closing stock price(4)	$ 61.75	49.40	48.69	32.33	36.43
Stock Split			200 % (3)		
Weighted average shares outstanding:					
Basic	43,299	43,020	42,744	42,431	42,156
Diluted	44,131	43,819	43,514	43,160	42,869
Common shares outstanding	43,544	43,103	42,982	42,525	42,324

OTHER NON-GAAP FINANCIAL INFORMATION(5)(6)										
Net premiums written to statutory surplus(2)	83	%	83	%	78	%	87	%	77	%
GAAP combined ratio(6)	84.5		84.5		83.1		89.0		79.6	
Statutory combined ratio(2)(6)	83.9		84.1		82.2		88.0		79.1	(9)

(1) See note 1.P to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

(2) Ratios and surplus information are presented on a statutory basis. As discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, statutory accounting principles differ from GAAP and are generally based on a solvency concept. Further discussion is included in note 9 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data. Reporting of statutory surplus is a required disclosure under GAAP.

(3) On January 15, 2014, our stock split on a 2-for-1 basis. All share and per share data has been retroactively stated to reflect this split.

(4) In 2015, RLI Corp. declared and paid a special cash dividend of $2.00 per share, which totaled $87.1 million. Special dividends were also declared and paid in each of the previous four years, totaling $129.3 million, $64.5 million, $106.3 million, and $105.8 million for 2014, 2013, 2012 and 2011, respectively. The special dividends produced corresponding decreases to book value per share and our stock price.
(5) See page 36 for information regarding non-GAAP financial measures.
(6) The GAAP and statutory combined ratios are impacted by favorable development on prior accident years' loss reserves. For further discussion, see note 6 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.
(7) On October 2, 2013, we successfully completed a public debt offering, issuing $150.0 million in senior notes maturing September 15, 2023. This offering generated proceeds, net of discount and commission, of $148.6 million. In December 2013, we redeemed $100.0 million in senior notes that were issued in 2003 and were set to mature in January 2014.
(8) Operating cash flow for 2011 includes a $50.0 million cash deposit that we received from a commercial surety customer in lieu of credit. The return of this $50.0 million deposit is reflected in operating cash flow for 2012.
(9) Includes statutory results of CBIC post-acquisition.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

RLI Corp. underwrites select property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group. As a specialty insurance company with a niche focus, we offer insurance coverages in both 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 achieved this for the 20th consecutive year in 2015, averaging an 87.3 combined ratio over that period of time. This foundation 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 E&S insurance company, has also enhanced returns. 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 certain measures of 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 casualty portion of our business consists largely of general liability, personal umbrella, transportation, executive products and commercial umbrella coverages, as well as package business and other specialty coverages, such as professional liability and workers compensation for office-based professionals. We offer fidelity and crime coverage for commercial insureds and select financial institutions and recently expanded our casualty offerings to include medical and healthcare professional liability coverage in the excess and surplus market. We also assume select casualty business for excess and surplus accounts through our quota share reinsurance agreement with Prime. 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, marine and facultative and treaty reinsurance including crop. We also offer select personal lines policies, such as recreational vehicle, jewelry and Hawaii homeowners coverages. While our marine and facultative reinsurance coverages are predominantly domestic risks, these portfolios do contain a relatively small portion of foreign risks. Property insurance and reinsurance 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

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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. Our assumed multi-peril crop and hail treaty reinsurance business covers revenue shortfalls or production losses due to natural causes such as drought, excessive moisture, hail, wind, frost, insects and disease. Significant aggregation of these losses is mitigated by the U.S. Federal Government reinsurance program that provides stop loss protection inuring to our benefit. As noted in previous filings, our portion of assumed crop reinsurance was reduced for 2015 and will end with the 2015 crop year due to the acquisition of the cedant. Additionally, we discontinued offering facultative reinsurance at the end of the third quarter of 2015 as a result of challenging market conditions.

The surety segment specializes in writing small-to-large commercial and contract surety coverages, as well as those for the energy, petrochemical and refining industries. We 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 insureds. 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.

While rates generally improved in more recent years, many of our coverages experienced flat or declining prices in 2014 and 2015. Excess capital in the market impacted the rate environment, and 2015 represented the third consecutive year without a natural catastrophe significant to the industry. As a result, the insurance marketplace remains very competitive. Despite these challenges, we believe that our business model is geared 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.

BUSINESS DEVELOPMENT

On November 3, 2015, we completed the sale of RLI Indemnity Company (RIC) to Clear Blue Financial Holdings, LLC for net sale proceeds of $7.5 million, primarily generated from the transfer of insurance licenses. RIC was sold as a “shell,” with all business and cash flows from the company being retained by RLI Insurance Group. At the time of the sale, RIC had minimal assets and written premium and was transferring all premium and loss cash flows to RLI Ins. through a 100 percent quota share reinsurance agreement. RLI Ins. will continue to reinsure all RIC bond and insurance liabilities that existed at the date of sale, adjust claims and service the remaining in-force polices and bonds until they terminate or are moved into RLI Ins.

On February 5, 2014, we invested $5.3 million for a 20 percent equity ownership interest in Prime Holdings Insurance Services, Inc. (Prime). On March 4, 2015, we invested an additional $1.7 million, increasing our total equity ownership to 27 percent. Prime writes business through two Illinois domiciled insurance carriers, Prime Insurance Company, an excess and surplus lines company, and Prime Property and Casualty Insurance Inc., an admitted insurance company.

A more detailed discussion of the impact of these acquisitions and disposals is provided in note 13 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

GAAP AND NON-GAAP FINANCIAL PERFORMANCE METRICS

Throughout this annual report, we present our operations in the way we believe will be most meaningful, useful and transparent to anyone using this financial information to evaluate our performance. In addition to the generally accepted accounting principles in the United States of America (GAAP) presentation of net income, we show certain statutory reporting information and other non-GAAP financial measures that we believe are valuable in managing our business and drawing comparisons to our peers. These non-GAAP measures are underwriting income, combined ratios and net unpaid loss and settlement expenses.

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

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premiums earned. Each of these captions is presented in the statements of earnings but not subtotaled. However, this information is available in total and by segment in note 11 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data. 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 on investments, general corporate expenses, debt costs and unconsolidated investee earnings.

Combined Ratio

This ratio is a common industry measure of profitability for any underwriting operation 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. For example, a combined ratio of 85 implies that for every $100 of premium we earn, we record $15 of underwriting income.

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 consolidated 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 consolidated 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 other-than-temporary impairment (OTTI), recoverability of reinsurance balances, deferred policy acquisition costs and deferred taxes.

LOSSES AND SETTLEMENT EXPENSES

Overview

Loss and loss adjustment expense (LAE) reserves represent our best estimate of ultimate payments for losses and related settlement expenses from claims that have been reported but not paid and those losses that have occurred but have not yet been reported to us. Loss reserves do not represent an exact calculation of liability, but instead represent our estimates, generally utilizing individual claim estimates, actuarial expertise and estimation techniques at a given accounting date. The loss reserve estimates are expectations of what ultimate settlement and administration of claims will cost upon final resolution. These estimates are based on facts and circumstances then known to us, review of historical settlement patterns, estimates of trends in claims frequency and severity, projections of loss costs, expected interpretations of legal theories of liability and many other factors. In establishing reserves, we also take into account estimated recoveries from reinsurance, salvage and subrogation. The reserves are reviewed regularly by a team of actuaries we employ.

The process of estimating loss reserves involves a high degree of judgment and is subject to a number of variables. These variables can be affected by both internal and external events, such as changes in claims handling procedures, claim personnel, economic inflation, legal trends and legislative changes, among others. The impact of many of these items on ultimate costs for loss and LAE is difficult to estimate. Loss reserve estimations also differ significantly by coverage due to differences in claim complexity, the volume of claims, the policy limits written, the terms and conditions of the underlying policies, the potential severity of individual claims, the determination of occurrence date for a claim and reporting lags (the time between the occurrence of the policyholder event and when it is actually reported to the insurer). Informed judgment is applied throughout the process. We continually refine our loss reserve estimates as historical loss experience develops and additional claims are reported and settled. We rigorously attempt to consider all significant facts and circumstances known at the time loss reserves are established.

Due to inherent uncertainty underlying loss reserve estimates, including, but not limited to, the future settlement environment, final resolution of the estimated liability may be different from that anticipated at the reporting date. Therefore, actual paid losses in the future may yield a significantly different amount than currently reserved — favorable or unfavorable.

The amount by which estimated losses differ from those originally reported for a period is known as “development.” Development is unfavorable when the losses ultimately settle for more than the levels at which they were reserved or subsequent estimates indicate a basis for reserve increases on unresolved claims. Development is favorable when losses ultimately settle for less than the amount reserved or subsequent estimates indicate a basis for reducing loss reserves on unresolved claims. We reflect favorable or unfavorable developments of loss reserves in the results of operations in the period the estimates are changed.

We record two categories of loss and LAE reserves — case-specific reserves and IBNR reserves.

Within a reasonable period of time after a claim is reported, our claim department completes an initial investigation and establishes a case reserve. This case-specific reserve is an estimate of the ultimate amount we will have to pay for the claim, including related legal expenses and other costs associated with resolving and settling it. The estimate reflects all of the current information available regarding the claim, the informed judgment of our professional claim personnel regarding the nature and value of the specific type of claim and our reserving practices. During the life cycle of a particular claim, as more information becomes available, we may revise the estimate of the ultimate value of the claim either upward or downward. We may determine that it is appropriate to pay portions of the reserve to the claimant or related settlement expenses before final resolution of the claim. The amount of the individual claim reserve will be adjusted accordingly and is based on the most recent information available.

We establish IBNR reserves to estimate the amount we will have to pay for claims that have occurred, but have not yet been reported to us, claims that have been reported to us that may ultimately be paid out differently than reflected in our case-specific reserves and claims that have been closed but may reopen and require future payment.

Our IBNR reserving process involves three steps: (1) an initial IBNR generation process that is prospective in nature, (2) a loss and LAE reserve estimation process that occurs retrospectively and (3) a subsequent discussion and reconciliation between our prospective and retrospective IBNR estimates, which includes changes in our provisions for IBNR where deemed appropriate. These three processes are discussed in more detail in the following sections.

LAE represents the cost involved in adjusting and administering losses from policies we issued. The LAE reserves are frequently separated into two components: allocated and unallocated. Allocated loss adjustment expense (ALAE) reserves represent an estimate of claims settlement expenses that can be identified with a specific claim or case. Examples of ALAE would be the hiring of an outside adjuster to investigate a claim or an outside attorney to defend our insured. The claim professional typically estimates this cost separately from the loss component in the case reserve. Unallocated loss adjustment expense (ULAE) reserves represent an estimate of claims settlement expenses that cannot be identified with a specific claim. An example of ULAE would be the cost of an internal claim examiner to manage or investigate claims.

Our best estimate of ultimate loss and LAE reserves are proposed by our lead reserving actuary and approved by our Loss Reserve Committee (LRC). The LRC is made up of various members of the management team including the lead reserving actuary, chief executive officer, chief operating officer, chief financial officer, general counsel and other selected executives. We do not use discounting (recognition of the time value of money) in reporting our estimated reserves for losses and settlement expenses. Based on current assumptions used in calculating reserves, we believe that our reserve levels at December 31, 2015, make a reasonable provision to meet our future obligations.

Initial IBNR Generation Process

Initial carried IBNR reserves are determined through a reserve generation process. The intent of this process is to establish an initial total reserve that will provide a reasonable provision for the ultimate value of all unpaid loss and ALAE liabilities. For most casualty and surety products, this process involves the use of an initial loss and ALAE ratio that is applied to the earned premium for a given period. The result is our best initial estimate of the expected amount of ultimate loss and ALAE for the period by product. Payments and case reserves are subtracted from this initial estimate of ultimate loss and ALAE to determine a carried IBNR reserve.

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For most property products, we use an alternative method of determining an appropriate provision for initial IBNR. Since this segment is characterized by a shorter period of time between claim occurrence and claim settlement, the IBNR reserves are determined by IBNR percentages applied to premium earned. The percentages are determined based on historical reporting patterns and are updated periodically. In addition, for assumed property reinsurance, consideration is given to data compiled for a sizable sample of reinsurers. No deductions for paid or case reserves are made. This alternative method of determining initial IBNR allows incurred losses and ALAE to react more rapidly to the actual emergence and is more appropriate for our property products where final claim resolution occurs over a shorter period of time.

Our crop reinsurance business is unique and is subject to an inherently higher degree of estimation risk during interim periods. As a result, the interim reports and professional judgments of our ceding company’s actuaries and crop business experts provide important information which assists us in estimating our carried reserves.

We do not reserve for natural or man-made catastrophes until an event has occurred. Shortly after such occurrence, we review insured locations exposed to the event, catastrophe model loss estimates based on our own exposures and industry loss estimates of the event. We also consider our knowledge of frequency and severity from early claim reports to determine an appropriate reserve for the catastrophe. These reserves are reviewed frequently to consider actual losses reported and appropriate changes to our estimates are made to reflect the new information.

The initial loss and ALAE ratios that are applied to earned premium are reviewed at least semi-annually. Prospective estimates are made based on historical loss experience adjusted for exposure mix, price change and loss cost trends. The initial loss and ALAE ratios also reflect our judgment as to estimation risk. We consider estimation risk by product and coverage within product, if applicable. A product with greater volatility and uncertainty has greater estimation risk. Products or coverages with higher estimation risk include, but are not limited to, the following characteristics:

- Significant changes in underlying policy terms and conditions,
- A new business or one experiencing significant growth and/or high turnover,
- Small volume or lacking internal data requiring significant utilization of external data,
- Unique reinsurance features including those with aggregate stop-loss, reinstatement clauses, commutation provisions or clash protection,
- Longer emergence patterns with exposures to latent unforeseen mass tort,
- Assumed reinsurance businesses where there is an extended reporting lag and/or a heavier utilization of ceding company data and claims and product expertise,
- High severity and/or low frequency,
- Operational processes undergoing significant change and/or
- High sensitivity to significant swings in loss trends, economic change or judicial change.

The historical and prospective loss and ALAE estimates, along with the risks listed, are the basis for determining our initial and subsequent carried reserves. Adjustments in the initial loss ratio by product and segment are made where necessary and reflect updated assumptions regarding loss experience, loss trends, price changes and prevailing risk factors. The LRC approves all final decisions regarding changes in the initial loss and ALAE ratios.

Loss and LAE Reserve Estimation Process

A full analysis of our loss reserves takes place three times a year. The purpose of this analysis is to provide validation of our carried loss reserves. Estimates of the expected value of the unpaid loss and LAE are derived using actuarial methodologies. These estimates are then compared to the carried loss reserves to determine the appropriateness of the current reserve balance.

The process of estimating ultimate payment for claims and claim expenses begins with the collection and analysis of current and historical claim data. Data on individual reported claims, including paid amounts and individual claim adjuster estimates, are grouped by common characteristics. There is judgment involved in this grouping. Considerations when grouping data include the volume of the data available, the credibility of the data available, the homogeneity of the risks in each cohort

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and both settlement and payment pattern consistency. We use this data to determine historical claim reporting and payment patterns, which are used in the analysis of ultimate claim liabilities. For portions of the business without sufficiently large numbers of policies or that have not accumulated sufficient historical statistics, our own data is supplemented with external or industry average data as available and when appropriate. For our newer products such as crop reinsurance, as well as for executive products, professional services and marine, we utilize external data extensively.

In addition to the review of historical claim reporting and payment patterns, we also incorporate estimated losses relative to premium (loss ratios) by year into the analysis. The expected loss ratios are based on a review of historical loss performance, trends in frequency and severity and price level changes. The estimates are subject to judgment including consideration given to available internal and industry data, growth and policy turnover, changes in policy limits, changes in underlying policy provisions, changes in legal and regulatory interpretations of policy provisions and changes in reinsurance structure. For the most current year, these are equivalent with the ratios used in the initial IBNR generation process. Increased recognition is given to actual emergence as the years age.

We use historical development patterns, expected loss ratios and standard actuarial methods to derive an estimate of the ultimate level of loss and LAE payments necessary to settle all the claims occurring as of the end of the evaluation period.

Our reserve processes include multiple standard actuarial methods for determining estimates of IBNR reserves. Other supplementary methodologies are incorporated as necessary. Mass tort and latent liabilities are examples of exposures for which supplementary methodologies are used. Each method produces an estimate of ultimate loss by accident year. We review all of these various estimates and assign weights to each based on the characteristics of the product being reviewed.

Our estimates of ultimate loss and LAE reserves are subject to change as additional data emerges. This could occur as a result of change in loss development patterns, a revision in expected loss ratios, the emergence of exceptional loss activity, a change in weightings between actuarial methods, the addition of new actuarial methodologies, new information that merits inclusion or the emergence of internal variables or external factors that would alter our view.

There is uncertainty in the estimates of ultimate losses. Significant risk factors to the reserve estimate include, but are not limited to, unforeseen or unquantifiable changes in:

- Loss payment patterns,
- Loss reporting patterns,
- Frequency and severity trends,
- Underlying policy terms and conditions,

- Business or exposure mix,
- Operational or internal processes affecting the timing of loss and LAE transactions,
- Regulatory and legal environment and/or
- Economic environment.

Our actuaries engage in discussions with senior management, underwriting and the claim department on a regular basis to ascertain any substantial changes in operations or other assumptions that are necessary to consider in the reserving analysis.

A considerable degree of judgment in the evaluation of all these factors is involved in the analysis of reserves. The human element in the application of judgment is unavoidable when faced with uncertainty. Different experts will choose different assumptions based on their individual backgrounds, professional experiences and areas of focus. Hence, the estimates selected by various qualified experts may differ significantly from each other. We consider this uncertainty by examining our historic reserve accuracy and through an internal peer review process.

Given the substantial impact of the reserve estimates on our financial statements, we subject the reserving process to significant diagnostic testing and reasonability checks. In addition, there are data validity checks and balances in our front-end processes. Data anomalies are researched and explained to reach a comfort level with the data and results. Leading indicators such as actual versus expected emergence and other diagnostics are also incorporated into the reserving processes.

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Determination of Our Best Estimate

Upon completion of our full loss and LAE estimation analysis, the results are discussed with the LRC. As part of this discussion, the analysis supporting the actuarial central estimate of the IBNR reserve by product is reviewed. The actuaries also present explanations supporting any changes to the underlying assumptions used to calculate the indicated central estimate. A review of the resulting variance between the indicated reserves and the carried reserves takes place. Quarterly, we also consider the most recent actual loss emergence compared to the expected loss emergence derived using the last full loss and ALAE analyses. Our actuaries make a recommendation to management in regards to booked reserves that reflect their analytical assessment and view of estimation risk. After discussion of these analyses and all relevant risk factors, the LRC determines whether the reserve balances require adjustment. Resulting reserve balances have always fallen within our actuaries' reasonable range of estimates.

As a predominantly excess and surplus lines and specialty insurer serving niche markets, we believe there are several reasons to carry, on an overall basis, reserves above the actuarial central estimate. We believe we are subject to above-average variation in estimates and that this variation is not symmetrical around the actuarial central estimate.

One reason for the variation is the above-average policyholder turnover and changes in the underlying mix of exposures typical of an excess and surplus lines business. This constant change can cause estimates based on prior experience to be less reliable than estimates for more stable, admitted books of business. Also, as a niche market insurer, there is little industry-level information for direct comparisons of current and prior experience and other reserving parameters. These unknowns create greater-than-average variation in the actuarial central estimates.

Actuarial methods attempt to quantify future outcomes. However, insurance companies are subject to unique exposures that are difficult to foresee at the point coverage is initiated and, often, many years subsequent. Judicial and regulatory bodies involved in interpretation of insurance contracts have increasingly found opportunities to expand coverage beyond that which was intended or contemplated at the time the policy was issued. Many of these policies are issued on an "all risk" and occurrence basis. Aggressive plaintiff attorneys have often sought coverage beyond the insurer's original intent. Some examples would be the industry's ongoing asbestos and environmental litigation, court interpretations of exclusionary language for mold and construction defect and debates over wind versus flood as the cause of loss from major hurricane events.

We believe that because of the inherent variation and the likelihood that there are unforeseen and under-quantified liabilities absent from the actuarial estimate, it is prudent to carry loss reserves above the actuarial central estimate. Most of our variance between the carried reserve and the actuarial central estimate is in the most recent accident years for our casualty segment, where the most significant estimation risks reside. These estimation risks are considered when setting the initial loss ratios. In the cases where these risks fail to materialize, favorable loss development will likely occur over subsequent accounting periods. It is also possible that the risks materialize above the amount we considered when booking our initial loss reserves. In this case, unfavorable loss development is likely to occur over subsequent accounting periods.

Our best estimate of loss and LAE reserves may change as a result of a revision in the actuarial central estimate, the actuary’s certainty in the estimates and processes and our overall view of the underlying risks. From time to time, we benchmark our reserving policies and procedures and refine them by adopting industry best practices where appropriate. A detailed, ground-up analysis of the actuarial estimation risks associated with each of our products and segments, including an assessment of industry information, is performed annually. This information is used when determining management’s best estimate of booked reserves.

Loss reserve estimates are subject to a high degree of variability due to the inherent uncertainty of ultimate settlement values. Periodic adjustments to these estimates will likely occur as the actual loss emergence reveals itself over time. Our loss reserving processes reflect accepted actuarial practices and our methodologies result in a reasonable provision for reserves as of December 31, 2015.

INVESTMENT VALUATION AND OTTI

Throughout each year, we and our investment managers buy and sell securities to achieve investment objectives in accordance with investment policies established and monitored by our board of directors and executive officers.

We classify our investments in debt and equity securities into one of three categories. Available-for-sale securities are carried at fair value with unrealized gains/losses recorded as a component of comprehensive earnings and shareholders’ equity, net of deferred income taxes. During 2014, we sold our remaining debt securities classified as held-to-maturity. During 2013, we sold our remaining debt securities classified as trading.

Fair value is defined as the price in the principal market that would be received for an asset to facilitate an orderly transaction between market participants on the measurement date.

We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. GAAP guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also describes three pricing categories that are used to classify fair value.

We regularly evaluate our fixed income and equity securities using both quantitative and qualitative criteria to determine impairment losses for other-than-temporary declines in the fair value of the investments. The following are some of the key factors we consider for determining if a security is other-than-temporarily impaired:

- The length of time and the extent to which the fair value has been less than cost,
- The probability of significant adverse changes to the cash flows on a fixed income investment,
- The occurrence of a discrete credit event resulting in the issuer defaulting on a material obligation, the issuer seeking protection from creditors under the bankruptcy laws, or the issuer proposing a voluntary reorganization under which creditors are asked to exchange their claims for cash or securities having a fair value substantially lower than par value of their claims,
- The probability that we will recover the entire amortized cost basis of our fixed income securities prior to maturity or
- For our equity securities, our expectation of recovery to cost within a reasonable period of time.

Quantitative criteria considered during this process include, but are not limited to: the degree and duration of current fair value as compared to the cost (amortized, in certain cases) of the security, degree and duration of the security's fair value being below cost and, for fixed maturities, whether the issuer is in compliance with the terms and covenants of the security. Qualitative criteria include the credit quality, current economic conditions, the anticipated speed of cost recovery, the financial health of and specific prospects for the issuer, as well as the absence of intent to sell or requirement to sell fixed income securities prior to recovery. In addition, we consider price declines of fixed income securities in our OTTI analysis where such price declines provide evidence of declining credit quality, and we distinguish between price changes caused by credit deterioration as opposed to rising interest rates.

Key factors that we consider in the evaluation of credit quality include:

- Changes in technology that may impair the earnings potential of the investment,
- The discontinuance of a segment of business that may affect future earnings potential,
- Reduction or elimination of dividends,
- Specific concerns related to the issuer's industry or geographic area of operation,
- Significant or recurring operating losses, poor cash flows and/or deteriorating liquidity ratios and
- A downgrade in credit quality by a major rating agency.

For mortgage-backed securities and asset-backed securities that have significant unrealized loss positions and major rating agency downgrades, credit impairment is assessed using a cash flow model that estimates likely payments using security-specific collateral and transaction structure. All of our mortgage-backed and asset-backed securities remain AAA-rated by one of the major rating agencies and the fair value is not significantly less than amortized cost.

Under current accounting standards, an OTTI write-down of debt securities, where fair value is below amortized cost, is triggered by circumstances where (1) an entity has the intent to sell a security, (2) it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis or (3) the entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the difference between the security's amortized cost and its fair value. If an entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income.

Part of our evaluation of whether particular securities are other-than-temporarily impaired involves assessing whether we have both the intent and ability to continue to hold equity securities in an unrealized loss position. For fixed income securities, we consider our intent to sell a security (which is determined on a security-by-security basis) and whether it is more likely than not we will be required to sell the security before the recovery of our amortized cost basis. Significant changes in these factors could result in a charge to net earnings for impairment losses. Impairment losses result in a reduction of the underlying investment's cost basis.

RECOVERABILITY OF REINSURANCE BALANCES

Ceded unearned premiums and reinsurance balances recoverable on paid and unpaid losses and settlement expenses are reported separately as assets, rather than being netted with the related liabilities, since reinsurance does not relieve us of our liability to policyholders. Such balances are subject to the credit risk associated with the individual reinsurer. Additionally, the same uncertainties associated with estimating unpaid losses and settlement expenses impact the estimates for the ceded portion of such liabilities. We continually monitor the financial condition of our reinsurers. As part of our monitoring efforts, we review their annual financial statements, Securities and Exchange Commission filings for those reinsurers that are publicly traded, A.M. Best and S&P rating developments and insurance industry developments that may impact the financial condition of our reinsurers. In addition, we subject our reinsurance recoverables to detailed recoverability tests, including one based on average default by S&P rating. Based upon our review and testing, our policy is to charge to earnings, in the form of an allowance, an estimate of unrecoverable amounts from reinsurers. This allowance is reviewed on an ongoing basis to ensure that the amount makes a reasonable provision for reinsurance balances that we may be unable to recover.

DEFERRED POLICY ACQUISITION COSTS

We defer commissions, premium taxes and certain other costs that are incrementally or directly related to the successful acquisition of new or renewal insurance contracts. Acquisition-related costs may be deemed ineligible for deferral when they are based on contingent or performance criteria beyond the basic acquisition of the insurance contract, or when efforts to obtain or renew the insurance contract are unsuccessful. All eligible costs are capitalized and charged to expense in proportion to premium revenue recognized. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value. This would also give effect to the premiums to be earned and anticipated losses and settlement expenses, as well as certain other costs expected to be incurred as the premiums are earned. Judgments as to the ultimate recoverability of such deferred costs are reviewed on a segment basis and are highly dependent upon estimated future loss costs associated with the premiums written. This deferral methodology applies to both gross and ceded premiums and acquisition costs.

DEFERRED TAXES

We record net deferred tax assets to the extent that temporary differences representing future deductible items exceed future taxable items. A significant amount of our deferred tax assets relate to expected future tax deductions arising from claim reserves and future taxable income related to changes in our unearned premium.

Periodically, management reviews our deferred tax positions to determine if it is more likely than not that the assets will be realized. These reviews include, among other things, the nature and amount of the taxable income and expense items, the expected timing of when assets will be used or liabilities will be required to be reported, as well as the reliability of historical profitability of businesses expected to provide future earnings. Furthermore, management considers tax-planning strategies it can use to increase the likelihood that the tax assets will be realized. After conducting the periodic review, if management determines that the realization of the tax asset does not meet the more likely than not criteria, an offsetting valuation allowance is recorded, thereby reducing net earnings and the deferred tax asset in that period. In addition, management must make estimates of the tax rates expected to apply in the periods in which future taxable items are realized. Such estimates include determinations and judgments as to the expected manner in which certain temporary differences, including deferred amounts related to our equity method investment, will be recovered. These estimates enter into the determination of the applicable tax rates and are subject to change based on the circumstances.

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We consider uncertainties in income taxes and recognize those in our financial statements as required. As it relates to uncertainties in income taxes, our unrecognized tax benefits, including interest and penalty accruals, are not considered material to the consolidated financial statements. Also, no tax uncertainties are expected to result in significant increases or decreases to unrecognized tax benefits within the next 12-month period. Penalties and interest related to income tax uncertainties, should they occur, would be included in income tax expense in the period in which they are incurred.

Additional discussion of other significant accounting policies may be found in note 1 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

RESULTS OF OPERATIONS

Consolidated revenue, as displayed in the table that follows, totaled $794.6 million for 2015, compared to $775.2 million for 2014 and $705.6 million in 2013.

CONSOLIDATED REVENUE	Year ended December 31,		
(in thousands)	2015	2014	2013
Net premiums earned	$ 700,161	$ 687,375	$ 630,802
Net investment income	54,644	55,608	52,763
Net realized investment gains	39,829	32,182	22,036
Total consolidated revenue	$ 794,634	$ 775,165	$ 705,601

Consolidated revenue increased 3 percent in 2015, following a 10 percent increase in 2014 and a 7 percent increase in 2013. Premiums earned from insurance operations improved for each of the past three years, while investment income declined slightly during 2015, after posting a 5 percent increase in the prior year. Net premiums earned increased 2 percent in 2015, after advancing 9 percent in both 2014 and 2013. Excluding the impact of our exit from crop, net premiums earned increased 5 percent in 2015. Increased retentions and reduced reinsurance costs have each contributed to the improved results. We have a diverse portfolio of products, and a number of those have contributed to the growth in premium. Growth has been balanced between more mature product lines with a longstanding presence in our portfolio and newer product initiatives which have been rolled out in recent years. The bulk of the growth during 2015 was attributable to our casualty and surety segments. On an overall basis, our businesses continue to operate in challenging market conditions. Excess capital remained in the marketplace during 2015, and yet another year of light catastrophe activity translated into lower rates and increased competition, in particular for excess and surplus (E&S) catastrophe coverages. While the pressure on pricing for primary coverages has challenged top line production, we have been able to offset this somewhat during our annual reinsurance renewals, through cost savings realized on all major casualty and property reinsurance treaties in each of the past three years. From an investment income perspective, revenues decreased by 2 percent in 2015. The decrease was primarily due to a smaller invested asset base for most of the year. Additionally, an increased allocation to municipal securities contributed to the decline. While yields are lower on a pretax basis, municipals often exhibit higher after-tax yields versus taxable alternatives.

We recorded net realized investment gains on our investment portfolio in each of the past three years. The majority of gains realized over this period related to sales activities versus calls or maturities. Sales activity was largely due to normal portfolio rebalancing, as well as raising cash to support special dividends paid in each of the last three years. Realized gains for 2015 also reflect a $6.7 million gain related to the sale of RIC, which occurred in the fourth quarter.

NET EARNINGS	Year ended December 31,		
(in thousands)	2015	2014	2013
Underwriting income	$ 108,558	$ 107,019	$ 106,793
Net investment income	54,644	55,608	52,763
Net realized gains	39,829	32,182	22,036
Debt interest	(7,426)	(7,438)	(8,095)
Corporate expenses	(9,837)	(10,222)	(8,746)
Investees earnings	10,914	12,338	10,915
Pretax earnings	$ 196,682	$ 189,487	$ 175,666
Income tax expense	(59,138)	(54,042)	(49,411)
Net earnings	$ 137,544	$ 135,445	$ 126,255

Net earnings increased for the third consecutive year in 2015. Results for 2015 reflected both positive underwriting results for the current accident year and favorable loss reserve development on prior accident years. Catastrophe losses were relatively light in 2015, with the absence of significant earthquake or hurricane activity benefiting earnings, much like in 2014

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and 2013. Catastrophe losses over the past three years related primarily to spring and winter storms totaling $12.1 million, $7.2 million and $10.0 million, respectively. In total, underwriting income was $108.6 million in 2015, compared to $107.0 million in 2014 and $106.8 million in 2013. Results for each of these years reflect combined ratios below 85. Our ability to continue to produce underwriting income, at margins which have consistently outperformed the broader industry, is a testament to our underwriters' discipline throughout the insurance cycle and our continued commitment to underwriting for a profit. We believe our underwriting discipline can differentiate us from the broader insurance market by ensuring appropriate risk selection and pricing of both new and renewal business and can serve to slow the pace of deterioration in underwriting results. Since our products must be priced before the ultimate loss costs are known, it may take several years to know if pricing was adequate. Inadequate pricing may lead to adverse loss development in future periods. In 2015, we experienced $65.4 million in favorable development in prior accident years' reserves, compared to favorable development of $64.8 million in 2014 and $72.5 million in 2013. Further discussion of reserve development can be found in note 6 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

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. Operating earnings refers to net earnings excluding after-tax net realized gains. Return on capital measures components of comprehensive earnings against a minimum required return on capital. Return on capital is the primary measure of executive bonus achievement and a significant component of manager and associate bonus targets. Bonus and profit sharing-related expenses attributable to the favorable reserve developments totaled $11.0 million, $10.6 million and $11.2 million for 2015, 2014 and 2013, respectively. These performance-related expenses impact policy acquisition, insurance operating and general corporate expenses line items in the financial statements. Partially offsetting the 2015, 2014 and 2013 increases were $1.9 million, $1.1 million and $1.2 million, respectively, in reductions to bonus and profit-sharing earned due to losses associated with natural catastrophe activity.

Equity in earnings of unconsolidated investees totaled $10.9 million in 2015, $9.9 million of which was from Maui Jim. The combined effect of a loss on the sale of an asset and unfavorable foreign exchange results led to Maui Jim's 16 percent decrease in earnings for 2015 compared to 2014. The remaining $1.0 million of equity in earnings of unconsolidated investees relates to our equity investment in Prime which increased from 2014 as a result of their growth and our additional investment in the company during the first quarter of 2015. Further discussion of the investment in Prime can be found in note 13 to the consolidated financial statements within Item 8, Financial Statement and Supplementary Data.

RLI INSURANCE GROUP

The insurance marketplace remains competitive across all of our segments. Excess capital continues to exist in our industry, whether from insurance carriers holding additional surplus, or non-traditional investors entering the marketplace. In 2015, the desire to deploy that capital led to a rise in merger and acquisition (M&A) activity in the insurance space. While the full impact of the recent M&A deals and consolidation within the industry will become evident over a longer horizon, the shorter term impact of excess capital has translated to increased competition for business. Another year without significant catastrophe activity in the U.S. has only added to these competitive pressures. On an overall basis, prices within our portfolio were flat in 2015, similar to the largely flat pricing trends seen in 2014. While relatively unchanged, the direction and magnitude of rate change has varied across our product portfolio. The most noteworthy pricing movements related to catastrophe exposed coverages in our property segment, which again experienced double-digit declines. Prices for these coverages continue to be impacted by abnormally low natural catastrophe activity and an abundance of capital in the market. We have experienced positive pricing trends for certain product lines elsewhere in our product portfolio, including transportation, marine and specialty personal coverages. Our top line declined 1 percent overall in 2015, largely due to our previously announced exit from crop reinsurance. Excluding the impact of crop, gross premiums written advanced 4 percent. The top line impact of crop is noteworthy as our crop reinsurance relationship was reduced for and ultimately ended with the 2015 crop year due to the acquisition of the cedant, though the impact on underwriting income was minimal. As expected, premiums from crop dropped to $9.4 million in 2015, from $50.3 million in 2014. Growth achieved during the year was balanced between mature lines in our portfolio, such as transportation and surety, and newer product initiatives, such as P&C package and our professional services group offerings. Expansion efforts and newer product initiatives over the past several years continued to play a significant role in premium production, and have accounted for approximately 20 percent of gross premiums written in each of the past three years. On a net basis, total premiums written increased 3 percent in 2015 and outpaced growth in gross premiums written largely due to cost savings realized on our 2015 reinsurance renewals. During the first half of 2015, we renewed all material reinsurance treaties which resulted in an $8.5 million reduction in ceded premiums from improved reinsurance rates, while some coverages were expanded. Excluding the impact of crop, net premiums written increased 6 percent. Net premium growth outpaced gross premiums written growth in 2014 and 2013, as well. In 2014 this result was also largely driven by cost savings realized on our annual reinsurance renewals, while the 2013 result was driven by increased retentions on certain casualty products where pricing trends were positive.

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Our underwriting income and combined ratios are displayed in the following tables. Solid underwriting results were bolstered by relatively low levels of catastrophe losses and favorable development in prior accident years' loss reserves in each of the last three years. The following tables and narrative provide a more detailed look at individual segment performance over the last three years.

GROSS PREMIUMS WRITTEN (DIRECT & ASSUMED)	Year ended December 31,		
(in thousands)	2015	2014	2013
Casualty	$ 519,670	$ 482,846	$ 456,953
Property	208,370	262,457	272,723
Surety	125,546	118,545	113,519
Total	$ 853,586	$ 863,848	$ 843,195

UNDERWRITING INCOME			
(in thousands)	2015	2014	2013
Casualty	$ 46,263	$ 45,941	$ 55,592
Property	29,025	32,918	27,604
Surety	33,270	28,160	23,597
Total	$ 108,558	$ 107,019	$ 106,793

COMBINED RATIO	2015	2014	2013
Casualty	88.8	88.0	82.8
Property	83.1	83.4	86.2
Surety	71.5	73.8	77.9
Total	84.5	84.5	83.1

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

NET PREMIUMS EARNED	Year ended December 31,		
(in thousands)	2015	2014	2013
CASUALTY			
Commercial and personal umbrella	$ 104,598	$ 100,420	$ 85,532
General liability	81,213	80,820	81,427
Professional services	71,034	58,327	42,063
Commercial transportation	65,564	58,911	50,287
P&C package business	40,410	35,371	30,603
Executive products	17,892	18,915	19,123
Medical professional liability	12,292	15,943	8,626
Other casualty	19,245	13,398	6,361
Total	$ 412,248	$ 382,105	$ 324,022
PROPERTY			
Commercial property	$ 75,749	$ 80,719	$ 76,939
Marine	47,016	49,235	57,122
Specialty personal	26,395	26,627	16,308
Property reinsurance	12,330	12,756	15,770
Crop reinsurance	9,358	28,293	31,421
Other property	76	146	2,581
Total	$ 170,924	$ 197,776	$ 200,141
SURETY			
Miscellaneous	$ 42,372	$ 39,026	$ 38,131
Commercial	29,529	25,778	23,133
Contract	28,269	26,592	27,176
Energy	16,819	16,098	18,199
Total	$ 116,989	$ 107,494	$ 106,639
Grand total	$ 700,161	$ 687,375	$ 630,802

Casualty

Casualty gross premiums written of $519.7 million were up 8 percent in 2015, following an increase of 6 percent in 2014 and 17 percent in 2013. The majority of products within the segment posted top line growth, driven by a combination of rate and exposure changes. Growth was led by transportation, which advanced 27 percent to $91.2 million, following a 1 percent decline in 2014 and 56 percent growth in 2013. Transportation capitalized on increased opportunities to write new and returning business in 2015. Several former transportation accounts, which had previously left RLI in search of low cost carriers, returned in 2015 in favor of our service and claim handling capabilities. Improved pricing also benefited most transportation coverages, most notably for the public transportation class, which increased 8 percent. Our P&C package business and professional services group also made significant contributions to overall growth. P&C package premiums increased 14 percent in 2015, the third consecutive year of double digit growth. Pricing for these coverages was flat during 2015, after declining 4 percent in the prior year. Total gross premiums from this business were $47.9 million, $42.0 million and $37.0 million in 2015, 2014 and 2013, respectively. Our professional services group posted $80.2 million in gross premiums written, up 8 percent from the prior year. This follows significant growth achieved in both 2014 and 2013, which totaled 24 percent and 38 percent, respectively.

Umbrella gross premiums written increased 5 percent in 2015, with most of this being exposure driven growth from commercial accounts, which are predominantly excess coverage. Growth of 8 percent on a net written basis outpaced gross premium growth due largely to increased retentions in 2015. Pricing trends for commercial umbrella have been less favorable compared to recent years, as rates for these coverages leveled off after experiencing double digit increases in 2013. For general liability, gross premiums written increased 1 percent to $83.8 million. The slightly improved top line follows a period of flat premiums in 2014 and an 11 percent decline in 2013, which related to re-underwriting efforts on habitational business. Re-underwriting efforts in 2013 led to non-renewal of certain policies and rate increases on others which had a negative net effect on the top line. Prior to re-underwriting, the habitational component represented nearly 50 percent of general liability revenue. By the end of 2013, this percentage had declined to nearly 25 percent. The increased rates and improved mix of business has resulted in improved current accident year underwriting results in each of the past three years.

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Net premium growth outpaced the growth achieved in gross premiums written in each of the last three years. The higher rate of growth in net premium during 2015 and 2014 was largely due to cost savings realized during our annual reinsurance renewals. In 2015, net premiums written advanced $39.6 million (10 percent) while gross premiums increased $36.8 million (8 percent). In 2014, net premiums written growth of $33.4 million (9 percent) outpaced growth in gross premiums written of $25.9 million (6 percent). For 2013, however, the bulk of the higher growth rate in net premium related to increased retentions during our 2013 reinsurance renewal. Given improved pricing on business we underwrite and overall volume growth, particularly in umbrella, we increased retentions on certain casualty products in 2013. Net premiums written advanced 28 percent in 2013, compared to 17 percent on a gross written basis.

Underwriting income for the casualty segment was $46.3 million in 2015, compared to $45.9 million in 2014 and $55.6 million in 2013. These results translated into combined ratios of 88.8, 88.0 and 82.8 for 2015, 2014 and 2013, respectively. Favorable development on prior accident years' loss reserves totaled $45.7 million, $52.8 million and $61.8 million, for 2015, 2014 and 2013, respectively. In each of these years, actuarial studies indicated that cumulative experience attributable to many casualty coverages for mature accident years was lower than carried reserves due to favorable loss frequency and severity trends, resulting in the release of reserves. We believe these improved trends are due in part to the quality of our underwriters' risk selection. In 2015, favorable development was experienced across multiple products. A majority of this favorable development was attributable to accident years 2006 through 2014, with more recent years representing a larger portion of the release. Similarly in 2014, favorable development was experienced across multiple products. Accident years 2007 through 2013 accounted for the majority of favorable experience in 2014. In 2013, favorable development was concentrated in accident years 2005 through 2012.

The segment's loss ratio was 53.0 in 2015, compared to 52.1 in 2014 and 45.9 in 2013. Each year reflected varying degrees of favorable reserve development on prior accident years which benefited results. In 2013, modest rate increases, relatively benign loss cost inflation and an improved mix of business resulted in a reduction to the current accident year loss ratio of over 3 points. We maintained this level of current accident year loss ratio performance in 2015 and 2014. The expense ratio for the casualty segment was 35.8 in 2015, compared to 35.9 in 2014 and 36.9 in 2013. During each of these periods, we continued to invest in expansion and new product initiatives. Increased premium has resulted from these investments and provided for improved expense leverage and a lower trending expense ratio.

Property

Gross premiums written in the property segment decreased by 21 percent ($54.1 million) in 2015 after decreasing 4 percent in 2014 and 3 percent in 2013. The majority of this decrease related to our crop reinsurance business, which declined $40.9 million. As noted in previous filings, we expected reduced premiums as our crop reinsurance share was reduced for 2015 and expired at the end of the 2015 crop year due to the acquisition of the cedant. Excluding the impact of crop, gross premiums written in the property segment declined 6 percent. Increased competition and alternative capital continued to impact this segment, in particular for our E&S property coverages. Our commercial property business, which includes our fire and difference in conditions (DIC) products, declined for the third consecutive year as both primary and reinsurance pricing for these coverages continued to fall. We experienced double digit rate decreases for wind and earthquake exposed catastrophe coverages for the second consecutive year during 2015. Fire and DIC premiums for 2015 decreased 9 percent and 10 percent, respectively. Slightly offsetting this was an increase in gross premiums written from marine, which delivered modest top line growth after experiencing declines in each of the past two years. Improved pricing contributed to the growth in marine, as rates increased 2 percent. The premium declines in 2014 and 2013 were due to re-underwriting efforts on the cargo and inland marine lines, which included exiting certain unprofitable accounts and increasing rates on others. These efforts were successful, as marine achieved rate increases on retained business of 5 percent and 9 percent in 2014 and 2013, respectively. On an overall basis, marine premiums written in 2014 and 2013 were down 10 percent and 7 percent, respectively.

Other products which contributed to the premium decline in the property segment included our recreational vehicles product (RV) and our other property reinsurance program. Premiums from RV were down 16 percent in 2015 to $13.4 million. Since its launch at the end of 2012, gross premiums written from recreational vehicles were $16.1 million in 2014 and $11.5 million in 2013. The decrease in this book was due to re-underwriting efforts initiated in the latter part of 2014 in response to heightened loss activity. Re-underwriting efforts have included filed rate changes and implementation of coverage restrictions, as well as termination of some producers. As a result of these efforts, we obtained a 14 percent rate increase on retained business. For other property reinsurance programs, excluding crop reinsurance, gross premiums declined slightly to $12.8 million, down from $13.1 million in 2014 and $16.1 million in 2013. A majority of business assumed in our other property reinsurance program is catastrophe exposed and is viewed as complementary and diversifying for our catastrophe strategy employed within our commercial property product. Where experience is adverse or pricing is deemed inadequate, as occurred

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in 2015, 2014 and 2013, underperforming or underpriced accounts are non-renewed. These results include premiums from our facultative reinsurance unit, which we discontinued during the third quarter of 2015 as a result of challenging market conditions. The overall impact of our exit from this book is minimal, as our facultative reinsurance operations generated gross premiums written of $3.5 million, $5.9 million and $9.1 million for 2015, 2014 and 2013, respectively.

Underwriting income was $29.0 million in 2015, compared to $32.9 million in 2014 and $27.6 million in 2013. The segment's results translated into combined ratios of 83.1, 83.4 and 86.2 for 2015, 2014 and 2013, respectively. These results reflect relatively small amounts of catastrophe losses, as no significant hurricane or earthquake activity has occurred during the past three years. Each of these periods were impacted, however, by seasonal storm losses. Results for 2015 included $11.8 million in losses from winter and spring storms, and favorable development on prior accident years' reserves, mainly from marine, which served to offset these losses. Favorable development improved underwriting results for the segment by $11.8 million. Positive underwriting performance from a current accident year standpoint is reflected in 2015 results, due in part to continued improvement from marine. The exit from crop did not have a significant impact from an underwriting income standpoint.

Results for 2014 included $4.7 million in spring storm losses and $0.3 million in losses related to earthquake activity in Napa Valley. Favorable development on prior accident years' reserves, primarily from marine, partially offset these losses and improved underwriting results for the segment by $1.1 million. Results were positive from a current accident year standpoint, as re-underwriting efforts on marine and other assumed coverages led to a nearly 3 point improvement in the current accident year loss ratio. Results for 2013 included $9.9 million in losses from spring storms, but were devoid of hurricane losses. In addition, results for 2013 were negatively impacted by increased loss activity on marine property coverages, specifically cargo and inland marine. Underwriting actions were taken to increase rates across both coverages, as well as exiting certain underperforming accounts. These adverse items were partially offset by $7.3 million of favorable development on prior accident years' reserves and lower losses from our commercial fire business. Approximately half of the favorable development related to reductions in prior years' hurricane reserves, with the remainder attributed to continued positive emergence on marine coverages.

The segment's loss ratio was 40.9 in 2015 compared to 45.3 in 2014 and 48.1 in 2013. The improved result for 2015 related to the increased benefit from favorable development on prior years' reserves. Results for 2014 reflected the aforementioned 3 point improvement in the current accident year loss ratio. The expense ratio for the property segment was 42.2 in 2015 compared to 38.1 in 2014 and 2013. The increased expense ratio for 2015 was driven largely by shifts in product mix within the segment, specifically with regard to crop, which carries a very low acquisition expense rate. The overall decline in earned premium also contributed to the higher expense ratio in 2015.

Surety

Gross premiums written for surety increased 6 percent in 2015, after increasing 4 percent in 2014 and being flat in 2013. While new entrants continue to impact this market, our underwriters have been able to find opportunities for growth, including through organic growth from our existing client base. The majority of products within the segment achieved premium growth, led by miscellaneous surety, our largest product line within the book. Miscellaneous surety increased 9 percent to $44.3 million in 2015, following a 6 percent increase in 2014 and a slight decline in 2013. Energy and commercial surety also contributed solid top line performance, up 8 percent and 7 percent, respectively. For energy surety, the improved result for 2015 followed declines posted in both 2014 and 2013. Falling energy prices over the last three years and M&A activity in the industry have continued to impact this business and pressure premium production. In 2015, however, we were able to take advantage of opportunities provided by industry consolidation and increase our top line. The increase for commercial surety represents continued growth, after increasing 15 percent in 2014 and 4 percent in 2013. Slightly offsetting this growth, our contract surety book declined 2 percent in 2015. Contract surety achieved modest top line growth in 2014 and 2013.

Underwriting income totaled $33.3 million in 2015, compared to $28.2 million in 2014 and $23.6 million in 2013. The segment's results translated into combined ratios of 71.5, 73.8 and 77.9 for 2015, 2014 and 2013, respectively. Underwriting performance for each of these years reflects a combination of positive current accident year results and favorable development in prior accident years' loss reserves. From a current accident year standpoint this segment has continued to deliver strong performance. Excluding the impact of favorable development in prior years' reserves, the combined ratio for each of the past three years has been in the low 80s.

The segment's loss ratio was 9.2 in 2015, compared to 7.3 in 2014 and 13.8 in 2013. While all three years benefited from favorable development in prior years' reserves, the amount in 2015 was $3.0 million lower than in 2014. This decrease drove the slightly higher loss ratio in 2015. Similarly, the higher loss ratio in 2013 also reflected a smaller amount of favorable prior

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years’ reserve development. In addition to the reserve development, results for 2014 were also impacted by $1.3 million of reinsurance reinstatement premium related to unfavorable development on prior years’ surety reserves. The expense ratio for the segment was 62.3 in 2015, compared to 66.5 in 2014 and 64.1 in 2013. The decrease in 2015 was due to the combined effect of shifts in mix toward products with lower acquisition expense rates and improved leveraging of our expense base. In addition, the above-mentioned reinstatement premium contributed to a higher expense ratio in 2014.

NET INVESTMENT INCOME AND REALIZED INVESTMENT GAINS

During 2015, net investment income decreased by 2 percent. The decrease was primarily due to a smaller invested asset base for most of the year. Additionally, an increased allocation to municipal securities contributed to the decline. While yields are lower on a pretax basis, municipals often exhibit higher after-tax yields versus taxable alternatives. The average annual yields on our investments were as follows for 2015, 2014 and 2013:

	2015	2014	2013
PRETAX YIELD			
Taxable (on book value)	3.42 %	3.58 %	3.66 %
Tax-exempt (on book value)	2.75 %	2.79 %	2.70 %
Equities (on fair value)	2.94 %	2.83 %	2.95 %
AFTER-TAX YIELD			
Taxable (on book value)	2.22 %	2.33 %	2.38 %
Tax-exempt (on book value)	2.61 %	2.64 %	2.56 %
Equities (on fair value)	2.51 %	2.43 %	2.53 %

The after-tax yield reflects the different tax rates applicable to each category of investment. Our taxable fixed income securities are subject to our corporate tax rate of 35.0 percent, our tax-exempt municipal securities are subject to a tax rate of 5.3 percent and our dividend income is generally subject to a tax rate of 14.2 percent. During 2015, the average after-tax yield on the taxable fixed income portfolio declined to 2.2 percent from 2.3 percent in 2014, while the average after-tax yield on the tax-exempt portfolio decreased slightly.

Despite bond prices falling slightly over the course of 2015, the fixed income portfolio increased by $43.0 million during the year as the majority of operating cash flows were used for fixed income purchases. During 2015, the portfolio experienced net realized gains of $10.8 million and ended 2015 with net unrealized gains of $20.0 million. The tax-adjusted total return on a mark-to-market basis was 2.5 percent. During 2015, our equity portfolio decreased by $35.2 million to $375.4 million.

During 2015, our equity portfolio experienced net realized gains of $22.1 million and ended 2015 with net unrealized gains of $173.0 million. The total return for the year on the equity portfolio was -2.6 percent.

Our investment results for the last five years are shown in the following table:

(in thousands)	Average Invested Assets (1)	Net Investment Income (2)(3)	Net Realized Gains (Losses) (3)	Change in Unrealized Appreciation (3)(4)	Annualized Return on Avg. Invested Assets	Tax Equivalent Annualized Return on Avg. Invested Assets
2011	1,851,654	63,681	17,036	32,855	6.1 %	6.3 %
2012	1,870,584	58,831	25,372	39,855	6.6 %	6.9 %
2013	1,881,470	52,763	22,036	(10,923)	3.4 %	3.7 %
2014	1,943,172	55,608	32,182	55,180	7.4 %	7.7 %
2015	1,957,914	54,644	39,829	(71,049)	1.2 %	1.5 %
5-yr Avg.	$ 1,900,959	$ 57,105	$ 27,291	$ 9,184	4.9 %	5.2 %

(1) Average amounts at beginning and end of year (inclusive of cash and short-term investments).
(2) Investment income, net of investment expenses.
(3) Before income taxes.
(4) Relates to available-for-sale fixed income and equity securities.

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We realized a total of $39.8 million in net investment gains in 2015. Included in this number is $22.1 million in net realized gains in the equity portfolio, $10.8 million in net realized gains in the fixed income portfolio and $6.9 million in other net realized losses related to the sale of RIC. In 2014, we realized $32.2 million in net investment gains. Included in this number is $29.5 million in net realized gains in the equity portfolio, $4.0 million in net realized gains in the fixed income portfolio and $1.3 million in other net realized losses. In 2013, we realized $22.0 million in net investment gains. We realized $21.5 million in net realized gains in the equity portfolio, $1.3 million in net realized gains in the fixed income portfolio and $0.8 million in other net realized losses.

We regularly evaluate the quality of our investment portfolio. When we determine that a specific security has suffered an other-than-temporary decline in value, the investment's value is adjusted by reclassifying the decline from unrealized to realized losses. This has no impact on shareholders' equity. We did not recognize any OTTI losses during 2015, 2014 or 2013.

As of December 31, 2015, we held 6 securities in our equity portfolio that were in unrealized loss positions. The total unrealized loss on these securities was $1.5 million. With respect to both the significance and duration of the unrealized loss positions, we have no equity securities in an unrealized loss position of greater than 20 percent for more than six consecutive months.

The fixed income portfolio contained 472 positions at an unrealized loss as of December 31, 2015. Of these 472 securities, 44 have been in an unrealized loss position for 12 consecutive months or longer and represent $5.4 million in unrealized losses. All fixed income securities in the investment portfolio continue to pay the expected coupon payments under the contractual terms of the securities. Based on our analysis, our fixed income portfolio is of a high credit quality and we believe we will recover the amortized cost basis.

Key components to our OTTI procedures are discussed in our critical accounting policy on investment valuation and OTTI and in note 2 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data. Based on our analysis, we have concluded that the securities in an unrealized loss position were not other-than-temporarily impaired at December 31, 2015.

INVESTMENTS

We maintain a diversified investment portfolio with an 80 percent fixed income and 20 percent equity target. We continually monitor economic conditions, our capital position and the insurance market to determine our tactical equity allocation. As of December 31, 2015, the portfolio had a fair value of $2.0 billion, a decrease of $12.7 million from the end of 2014.

We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. GAAP guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also describes three levels of inputs that may be used to measure fair value. For additional information, see notes 1 and 2 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

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As of December 31, 2015, 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		Quality*
U. S. government	$ 43,597	$ 43,543	$ (54)	2.2	%	AAA
U.S. agency	15,481	15,740	259	0.8	%	AAA
Non-U.S. govt & agency	5,035	4,478	(557)	0.2	%	BBB+
Agency MBS	250,060	254,892	4,832	13.1	%	AAA
ABS/CMBS**	91,559	91,948	389	4.7	%	AAA
Corporate	523,351	517,109	(6,242)	26.5	%	BBB+
Municipal	589,073	610,400	21,327	31.3	%	AA
Total fixed income	$ 1,518,156	$ 1,538,110	$ 19,954	78.8	%	AA-
Equities	$ 202,437	$ 375,424	$ 172,987	19.2	%	
Short-term investments	$ 6,262	$ 6,262	$ —	0.3	%	
Other invested assets	20,666	20,666	—	1.1	%	
Cash	11,081	11,081	—	0.6	%	
Total portfolio	$ 1,758,602	$ 1,951,543	$ 192,941	100.0	%	

*Quality ratings provided by Moody’s, S&P and Fitch

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

Quality in the previous table and in all subsequent tables is an average of each bond’s credit rating, adjusted for its relative weighting in the portfolio.

Fixed income represented 79 percent of our total 2015 portfolio compared to 76 percent in 2014. As of December 31, 2015, the fair value of our fixed income portfolio consisted of 34 percent AAA-rated securities, 31 percent AA-rated securities, 17 percent A-rated securities, 12 percent BBB-rated securities and 6 percent non-investment grade or non-rated securities. This compares to 17 percent AAA-rated securities, 45 percent AA-rated securities, 22 percent A-rated securities, 10 percent BBB-rated securities and 6 percent non-investment grade or non-rated securities in 2014.

In selecting the maturity of securities in which we invest, we consider the relationship between the duration of our fixed income investments and the duration of our liabilities, including the expected ultimate payout patterns of our reserves. We believe that both liquidity and interest rate risk can be minimized by such asset/liability management. As of December 31, 2015, our fixed income portfolio’s duration was 5.1 years.

Our equity portfolio had a fair value of $375.4 million at December 31, 2015, entirely classified as available-for-sale. Equities comprised 19 percent of our total 2015 portfolio, down from 21 percent in 2014. Securities within the equity portfolio are well diversified and are primarily invested in large-cap issues with a focus on dividend income. Our strategy is value oriented and security selection takes precedence over market timing. Likewise, low turnover throughout our long investment horizon minimizes transaction costs and taxes.

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FIXED INCOME PORTFOLIO

As of December 31, 2015, our fixed income portfolio had the following rating distributions:

FAIR VALUE (in thousands)	AAA	AA	A	BBB	Below Investment Grade	No Rating	Fair Value
Bonds:							
U.S. government & agency (GSE)	$ 51,644	$ 7,639	$ —	$ —	$ —	$ —	$ 59,283
Non-U.S. government & agency	—	—	—	4,478	—	—	4,478
Corporate - financial	—	9,127	105,490	58,595	9,477	—	182,689
All other corporate	5,101	13,941	88,039	109,381	82,801	—	299,263
Corporate financial - private placements	—	—	11,459	2,139	—	—	13,598
All other corporate - private placements	—	4,999	9,821	6,739	—	—	21,559
Municipal	116,446	443,824	45,174	—	—	4,956	610,400
Structured:							
GSE - RMBS	$ 219,305	$ —	$ —	$ —	$ —	$ —	$ 219,305
Non-GSE RMBS - prime	—	—	—	—	—	—	—
Non-GSE RMBS - Alt A	—	—	—	—	—	—	—
Non-GSE RMBS - subprime	—	—	—	—	—	—	—
ABS - utility	7,715	—	—	—	—	—	7,715
ABS - credit cards	8,778	—	—	—	—	—	8,778
ABS - auto loans	20,687	—	—	—	—	—	20,687
All other ABS	7,718	1,245	—	—	—	—	8,963
GSE - CMBS	35,587	—	—	—	—	—	35,587
CMBS	45,805	—	—	—	—	—	45,805

CDOs/CLOs	—	—	—	—	—	—	—
Total	$ 518,786	$ 480,775	$ 259,983	$ 181,332	$ 92,278	$ 4,956	$ 1,538,110

Mortgage-Backed, Commercial Mortgage-Backed and Asset-Backed Securities

The following table summarizes the distribution of our mortgage-backed securities (MBS) portfolio by investment type, as of the dates indicated:

AGENCY MBS

(in thousands)	Amortized Cost	Fair Value	% of Total	
2015				
Planned amortization class	$ 42,548	$ 42,479	17	%
Sequential	35,988	35,587	14	%
Pass-throughs	171,524	176,826	69	%
Total	$ 250,060	$ 254,892	100	%
2014				
Planned amortization class	$ 41,231	$ 41,320	16	%
Sequential	21,812	21,645	8	%
Pass-throughs	193,400	201,503	76	%
Total	$ 256,443	$ 264,468	100	%

Our allocation to agency mortgage-backed securities totaled $254.9 million as of December 31, 2015. MBS represented 17 percent of the fixed income portfolio compared to $264.5 million or 18 percent of that portfolio as of December 31, 2014.

We believe MBS investments add diversification, liquidity, credit quality and additional yield to our portfolio. Our objective for the MBS portfolio is to provide reasonable cash flow stability where we are compensated for the call risk associated with residential refinancing. The MBS portfolio includes mortgage-backed pass-through securities and collateralized

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mortgage obligations (CMO). A mortgage pass-through is a security consisting of a pool of residential mortgage loans which returns principal and interest cash flows to investors each month. A CMO has a more finite payment structure and can reduce the risks associated with prepayment. CMO securities are divided into maturity classes that are paid off under certain expected interest rate conditions. Our MBS portfolio does not include interest-only securities or principal-only securities. As of December 31, 2015, all of the securities in our MBS portfolio were rated AAA and issued by Government Sponsored Enterprises (GSEs) such as the Governmental National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC).

Variability in the average life of principal repayment is an inherent risk of owning mortgage-related securities. However, we reduce our portfolio's exposure to prepayment risk by seeking characteristics that tighten the probable scenarios for expected cash flows. As of December 31, 2015, the MBS portfolio contained 69 percent of pure pass-throughs compared to 76 percent as of December 31, 2014. An additional 17 percent of the MBS portfolio was invested in planned amortization class CMOs (PACs), up from 16 percent in 2014. CMO PACs are securities whose cash flows are designed to remain constant in a variety of mortgage prepayment environments.

The following table summarizes the distribution of our asset-backed and commercial mortgage-backed securities portfolio as of the dates indicated:

ABS/CMBS (in thousands)	Amortized Cost	Fair Value	% of Total	
2015				
CMBS	$ 45,289	$ 45,805	50	%
Auto	20,796	20,687	23	%
Business	1,246	1,245	1	%
Equipment	7,749	7,718	8	%
Utility	7,797	7,715	8	%
Credit card	8,682	8,778	10	%
Total	$ 91,559	$ 91,948	100	%
2014				
CMBS	$ 88,509	$ 89,748	66	%
Auto	17,266	17,265	13	%
Business	1,493	1,479	1	%
Equipment	3,030	3,015	2	%
Utility	11,402	11,417	9	%
Credit card	12,194	12,380	9	%
Total	$ 133,894	$ 135,304	100	%

An asset-backed security (ABS) or commercial mortgage-backed security (CMBS) is a securitization collateralized by the cash flows from a specific pool of underlying assets. These asset pools can include items such as credit card payments, auto loans and residential or commercial mortgages. As of December 31, 2015, ABS/CMBS investments were $91.9 million (6 percent) of the fixed income portfolio, compared to $135.3 million (9 percent) as of December 31, 2014. All but one security in the ABS/CMBS portfolio was rated AAA as of December 31, 2015. We believe that ABS/CMBS investments add diversification and additional yield to the portfolio while often adding superior cash flow stability over mortgage pass-throughs or CMOs.

When making investments in MBS/ABS/CMBS, we evaluate the quality of the underlying collateral, the structure of the transaction (which dictates how any losses in the underlying collateral will be distributed) and prepayment risks. All of our collateralized securities carry the highest credit rating by one or more major rating agency and continue to pay according to contractual terms. We had $2.2 million in unrealized losses in these asset classes as of December 31, 2015.

Municipal Fixed Income Securities

As of December 31, 2015, municipal bonds totaled $610.4 million (40 percent) of our fixed income portfolio, compared to $481.4 million (32 percent) as of December 31, 2014. We actively increased our holdings in the sector upon completion of a strategic asset allocation review in the middle part of the year. We believe municipal fixed income securities can provide

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diversification and additional tax-advantaged yield to our portfolio. Our objective for the municipal fixed income portfolio is to provide reasonable cash flow stability and increased after-tax yield.

Our municipal fixed income portfolio is comprised of general obligation (GO) and revenue securities. The revenue sources include sectors such as sewer and water, public improvement, school, transportation and colleges and universities.

As of December 31, 2015, approximately 47 percent of the municipal fixed income securities in the investment portfolio were GO and the remaining 53 percent were revenue based. Ninety-two percent of our municipal fixed income securities were rated AA or better, while 99 percent were rated A or better.

Corporate Debt Securities

As of December 31, 2015, our corporate debt portfolio totaled $517.1 million (34 percent) of the fixed income portfolio compared to $562.7 million (38 percent) as of December 31, 2014. Our allocation to the corporate debt portfolio decreased during the year as we rotated toward municipals. The corporate allocation includes floating rate bank loans and bonds that are below investment grade in credit quality and offer incremental yield over our core fixed income portfolio. The corporate debt portfolio has an overall quality rating of BBB+, diversified among 499 issues.

The following table illustrates our corporate debt exposure to the financial and non-financial sectors as of December 31, 2015, including fair value, cost basis and unrealized gains and losses:

CORPORATES

(in thousands)	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross unrealized losses
Bonds:				
Corporate - financial	$ 181,131	$ 182,689	$ 4,558	$ (3,000)
All other corporate	307,950	299,263	3,103	(11,790)
Financials - private placements	12,969	13,598	629	—
All other corporate - private placements	21,301	21,559	275	(17)
Total	$ 523,351	$ 517,109	$ 8,565	$ (14,807)

We believe corporate debt investments add diversification and additional yield to our portfolio. Because corporates make up a large portion of the fixed income opportunity set, the corporate debt investments will continue to be a significant part of our investment program.

The amortized cost and fair value of fixed income securities at December 31, 2015, by contractual maturity, are shown as follows:

TOTAL FIXED INCOME

(in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 9,529	$ 9,643
Due after one year through five years	275,198	276,100
Due after five years through 10 years	565,477	572,675
Due after 10 years	326,333	332,852
Mtge/ABS/CMBS*	341,619	346,840
Total fixed income	$ 1,518,156	$ 1,538,110

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

EQUITY SECURITIES

As of December 31, 2015, our equity portfolio totaled $375.4 million (19 percent) of the investment portfolio, compared to $410.6 million (21 percent) as of December 31, 2014. Our common stock portfolio decreased through some minor rebalancing into fixed income but in large part to the decline in equity prices over the course of the year. The securities within the equity portfolio remain primarily invested in large-cap issues with a focus on dividend income. In addition, we have investments in three broadly diversified, exchange traded funds (ETFs) that represent market indexes similar to the Russell

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1000 Index, the S&P 500 Index, and the S&P 500 Utilities Index. No one fund makes up more than 50 percent of the ETF allocation, and the philosophy mirrors that of the actively managed equity portfolio, with a preference for dividend income and lower anticipated volatility than the market (as measured by the S&P 500). Additionally, we own two diversified energy ETF securities. We did not recognize any impairment losses in the equity portfolio during 2015 or 2014.

The following table illustrates the distribution by sector of our equity portfolio as of December 31, 2015, including fair value, cost basis and unrealized gains and losses:

(in thousands)	Cost Basis	Fair Value	% of Total Fair Value	Net Unrealized Gain/Loss
Common stock:				
Consumer discretionary	$ 8,335	$ 20,325	5.4 %	$ 11,990
Consumer staples	13,595	32,201	8.6 %	18,606
Energy	10,750	19,570	5.2 %	8,820
Financials	29,368	48,344	12.9 %	18,976
Healthcare	4,115	22,335	5.9 %	18,220
Industrials	15,347	29,870	8.0 %	14,523
Information technology	14,740	28,054	7.5 %	13,314
Materials	2,220	6,090	1.6 %	3,870
Telecommunications	3,869	10,708	2.9 %	6,839
Utilities	28,892	47,724	12.6 %	18,832
ETFs	71,206	110,203	29.4 %	38,997
Total	$ 202,437	$ 375,424	100.0 %	$ 172,987

INTEREST AND CORPORATE EXPENSE

We incurred $7.4 million of interest expense on outstanding debt during 2015, compared to $7.4 million in 2014 and $8.1 million in 2013. We completed a public debt offering in October 2013, issuing $150.0 million in senior notes, and used a portion of the proceeds to repay $100.0 million in senior notes that were originally set to mature in January 2014. Due to the timing of the transaction settlements associated with the new debt issuance and repayment of the 2014 notes, our weighted average debt balance was slightly higher in 2013, resulting in the higher interest expense. At December 31, 2015, 2014 and 2013, our long-term debt consisted of $150.0 million in senior notes maturing September 15, 2023, and paying interest semi-annually at the rate of 4.875 percent.

As discussed previously, general corporate expenses tend to fluctuate relative to our incentive compensation plans. Our compensation model measures components of comprehensive earnings against a minimum required return on our capital. Bonuses are earned as we generate earnings in excess of this required return. In 2015, 2014 and 2013, we exceeded the required return, resulting in the accrual of executive bonuses. Excluding this variable component tied to performance, other general corporate expenses were relatively flat in 2015 compared to 2014.

INVESTEE EARNINGS

We maintain a 40 percent equity interest in Maui Jim, a manufacturer of high-quality sunglasses. Maui Jim's chief executive officer owns a controlling majority of the outstanding shares of Maui Jim. Maui Jim is a private company, and as such, the market for its stock is limited. Our investment in Maui Jim is carried at the holding company, RLI Corp., level as it is not core to our insurance operations. As a minority shareholder, we are subject to the decisions of the controlling shareholder, which may impact the value of our investment. In 2015, we recorded $9.9 million in earnings from this investment compared to $12.0 million in 2014 and $10.9 million in 2013. Sunglass sales were down 2 percent in 2015, after increasing 14 percent in 2014 and 6 percent in 2013. A loss on the sale of an asset and unfavorable foreign exchange results also led to Maui Jim's decrease in earnings for 2015 compared to 2014.

In 2014 and 2013, we received dividends from Maui Jim. Dividends from Maui Jim have been irregular in nature and while they provide added liquidity when received, we do not rely on those dividends to meet our liquidity needs. While these dividends do not flow through the investee earnings line, they do result in the recognition of a tax benefit, which is discussed in the income tax section that follows.

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On February 5, 2014, we invested $5.3 million for a 20 percent equity ownership interest in Prime Holdings Insurance Services, Inc. (Prime). On March 4, 2015, we invested an additional $1.7 million, increasing our total equity ownership to 27 percent. Prime writes business through two Illinois domiciled insurance carriers, Prime Insurance Company, and excess and surplus lines company, and Prime Property and Casualty Insurance Inc., an admitted insurance company. In 2015, we recorded $1.0 million in investee earnings from this investment compared to $0.3 million in 2014. Additionally, we entered into a 25 percent quota share reinsurance treaty with Prime, effective January 1, 2014, which contributed $11.3 million of gross premiums written and $10.9 million of net premiums earned during 2015, compared to $10.2 million of gross premiums written and $5.3 million of net premiums earned during 2014.

INCOME TAXES

Our effective tax rates were 30.1 percent, 28.5 percent and 28.1 percent for 2015, 2014 and 2013, respectively. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher in 2015 due largely to reduced tax benefits associated with dividends paid to our Employee Stock Ownership Plan (ESOP) and received from our unconsolidated investees.

Dividends paid to our Employee Stock Ownership Plan (ESOP) result in a tax deduction. Special dividends paid to the ESOP in 2015, 2014 and 2013 resulted in tax benefits of $2.5 million, $3.6 million and $1.7 million, respectively. These tax benefits reduced the effective tax rate for 2015, 2014 and 2013 by 1.2 percent, 1.9 percent and 1.0 percent, respectively.

Our net earnings include equity in earnings of unconsolidated investees, Maui Jim and Prime. The investees do not have a policy or pattern of paying dividends. As a result, we record a deferred tax liability on the earnings at the corporate capital gains rate of 35 percent. In the fourth quarters of 2014 and 2013, we received a $6.6 million and $13.2 million dividend from Maui Jim, respectively. No dividend was received from any unconsolidated investee in 2015. In accordance with GAAP guidelines on income taxes, we recognized a $1.8 million and $3.7 million tax benefit for 2014 and 2013. The tax benefit is generated from applying the lower tax rate applicable to affiliated dividends (7 percent), as compared to the corporate capital gains rate on which the deferred tax liabilities were based. Standing alone, the dividend resulted in a 1.0 percent and 2.1 percent reduction to the 2014 and 2013 effective tax rates, respectively. In determining the appropriate tax rate to apply, we anticipate recovering our investments through means other than the receipt of dividends, such as a sale.

In addition, our pretax earnings in 2015 included $25.1 million of investment income that is partially exempt from federal income tax, compared to $25.3 million and $24.5 million in 2014 and 2013, respectively.

NET UNPAID LOSSES AND SETTLEMENT EXPENSES

The primary liability on our balance sheet relates to unpaid losses and settlement expenses, which represents our estimated liability for losses and related settlement expenses before considering offsetting reinsurance balances recoverable. The largest asset on our balance sheet, outside of investments, is the reinsurance balances recoverable on unpaid losses and settlement expenses, which serves to offset this liability.

The liability can be split into two parts: (1) case reserves representing estimates of losses and settlement expenses on known claims and (2) IBNR reserves representing estimates of losses and settlement expenses on claims that have occurred but have not yet been reported to us. Our gross liability for both case and IBNR reserves is reduced by reinsurance balances recoverable on unpaid losses and settlement expenses to calculate our net reserve balance. This net reserve balance increased to $805.9 million at December 31, 2015, from $785.9 million as of December 31, 2014. This reflects incurred losses of $299.0 million in 2015 offset by paid losses of $279.0 million compared to incurred losses of $296.6 million offset by $285.2 million paid in 2014. The overall increase in our net loss and LAE reserves between 2015 and 2014 was small, but there were changes by segment as discussed in note 6 to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

Gross reserves (liability) and the reinsurance balances recoverable (asset) were both subject to the same influences that affected net reserves and behaved similarly. Total gross and ceded loss and LAE reserves decreased to $1.10 billion and $297.8 million, respectively, at December 31, 2015, from $1.12 billion and $335.1 million, respectively, at December 31, 2014.

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LIQUIDITY AND CAPITAL RESOURCES

OVERVIEW

We have three primary types of cash flows: (1) operating cash flows, which consist mainly of cash generated by our underwriting operations and income earned on our investment portfolio, (2) investing cash flows related to the purchase, sale and maturity of investments and (3) financing cash flows that impact our capital structure, such as changes in debt and shares outstanding. The following table summarizes these three cash flows over the last three years.

(in thousands)	2015	2014	2013
Operating cash flows	$ 152,586	$ 123,085	$ 134,966
Investing cash flows (uses)	(60,597)	22,771	(101,932)
Financing cash flows (uses)	(111,528)	(154,705)	(37,879)

We have posted positive operating cash flow in each of the last three years. Variations in operating cash flow between periods are largely driven by the volume and timing of premium receipt, claim payments, reinsurance and taxes. In addition, fluctuations in insurance operating expenses impact operating cash flow. During 2015, the majority of cash flows were used in financing activities, due largely to the payment of special dividends. Financing cash flows noted in the above table include special dividends totaling $87.1 million, $129.3 million and $64.5 million for 2015, 2014 and 2013, respectively. In 2013, cash flows also reflect a net financing cash inflow related to our public debt offering.

We have entered into certain contractual obligations that require us to make recurring payments. The following table summarizes our contractual obligations as of December 31, 2015.

CONTRACTUAL OBLIGATIONS

	Payments due by period				
(in thousands)	Less than 1 yr.	1-3 yrs.	3-5 yrs.	More than 5 yrs.	Total
Loss and settlement expense reserves	$ 294,578	$ 421,239	$ 200,143	$ 187,825	$ 1,103,785
Long-term debt	—	—	—	150,000	150,000
Operating leases	4,487	7,072	4,842	5,267	21,668
Total	$ 299,065	$ 428,311	$ 204,985	$ 343,092	$ 1,275,453

Loss and settlement expense reserves represent our best estimate of the ultimate cost of settling reported and unreported claims and related expenses. As discussed previously, the estimation of loss and loss expense reserves is based on various complex and subjective judgments. Actual losses and settlement expenses paid may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements. Similarly, the timing for payment of our estimated losses is not fixed and is not determinable on an individual or aggregate basis. The assumptions used in estimating the payments due by periods are based on our historical claims payment experience. Due to the uncertainty inherent in the process of estimating the timing of such payments, there is a risk that the amounts paid in any period can be significantly different than the amounts disclosed above. Amounts disclosed above are gross of anticipated amounts recoverable from reinsurers. Reinsurance balances recoverable on unpaid loss and settlement reserves are reported separately as assets, instead of being netted with the related liabilities, since reinsurance does not discharge us of our liability to policyholders. Reinsurance balances recoverable on unpaid loss and settlement reserves totaled $297.8 million at December 31, 2015, compared to $335.1 million in 2014.

The next largest contractual obligation relates to long-term debt outstanding. On October 2, 2013, we completed a public debt offering of $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. The notes were issued at a discount resulting in proceeds, net of discount and commission, of $148.6 million. We are not party to any off-balance sheet arrangements.

Our primary objective in managing our capital is to preserve and grow shareholders' equity and statutory surplus to improve our competitive position and allow for expansion of our insurance operations. Our insurance subsidiaries must maintain certain minimum capital levels in order to meet the requirements of the states in which we are regulated. Our insurance companies are also evaluated by rating agencies that assign financial strength ratings that measure our ability to meet our obligations to policyholders over an extended period of time.

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We have historically grown our shareholders' equity and/or policyholders' surplus as a result of three sources of funds: (1) earnings on underwriting and investing activities, (2) appreciation in the value of our invested assets and (3) the issuance of common stock and debt.

At December 31, 2015, we had cash, short-term investments and other investments maturing within one year of approximately $27.0 million and an additional $276.1 million of investments maturing between 1 to 5 years. We 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 $40.0 million. This facility was entered into during the second quarter of 2014 and replaced the previous $25.0 million facility which expired on May 31, 2014. Under certain conditions, the line may be increased up to an aggregate principal amount of $65.0 million. The facility has a four-year term that expires on May 28, 2018. As of and during the year ended December 31, 2015, no amounts were outstanding on the revolving line of credit.

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. According to our current membership, aggregate borrowing capacity is approximately $35 million at year end. However, under certain circumstances, that capacity may be increased based on additional FHLBC stock purchased and available collateral. Our membership allows each insurance subsidiary to determine tenor and structure at the time of borrowing. As of and during the year ended December 31, 2015, no amounts were outstanding with the FHLBC.

We believe that cash generated by operations, cash generated by investments and cash available from financing activities will provide sufficient sources of liquidity to meet our anticipated needs over the next 12 to 24 months. We have generated positive operating cash flow for more than 30 consecutive years. The primary factor in our ability to generate positive operating cash flow is underwriting profitability, which we have achieved for 20 consecutive years.

OPERATING ACTIVITIES

The following list highlights some of the major sources and uses of cash flow from operating activities:

Sources	Uses
Premiums received	Claims
Loss payments from reinsurers	Ceded premium to reinsurers
Investment income (interest & dividends)	Commissions paid
Unconsolidated investee dividends from affiliates	Operating expenses
	Interest expense

Income taxes

Our largest source of cash is from premiums received from our customers, which we receive at the beginning of the coverage period for most policies. Our largest cash outflow is for claims that arise when a policyholder incurs an insured loss. Because the payment of claims occurs after the receipt of the premium, often years later, we invest the cash in various investment securities that earn interest and dividends. We use cash to pay commissions to brokers and agents, as well as to pay for ongoing operating expenses such as salaries, rent, taxes and interest expense. We also utilize reinsurance to manage the risk that we take on our policies. We cede, or pay out, part of the premiums we receive to our reinsurers and collect cash back when losses subject to our reinsurance coverage are paid.

The timing of our cash flows from operating activities can vary among periods due to the timing by which payments are made or received. Some of our payments and receipts, including loss settlements and subsequent reinsurance receipts, can be significant, so their timing can influence cash flows from operating activities in any given period. We are subject to the risk of incurring significant losses on catastrophes, both natural (such as earthquakes and hurricanes) and man-made (such as terrorism). If we were to incur such losses, we would have to make significant claims payments in a relatively concentrated period of time.

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INVESTING ACTIVITIES

The following list highlights some of the major sources and uses of cash flow from investing activities:

Sources	Uses
Proceeds from bonds sold, called or matured	Purchase of bonds
Proceeds from stocks sold	Purchase of stocks
	Acquisitions
	Purchase of property & equipment

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 December 31, 2015, our portfolio had a carrying value of $2.0 billion. Portfolio assets at December 31, 2015, decreased by $12.7 million, or 1 percent, from December 31, 2014.

Our overall investment philosophy is designed to first protect policyholders by maintaining sufficient funds to meet corporate and policyholder obligations and then generate long-term growth in shareholders' equity. Because our existing and projected liabilities are sufficiently funded by the fixed income portfolio, we can improve returns by investing a portion of the surplus (within limits) in a risk assets portfolio largely made up of equities. As of December 31, 2015, 46 percent of our shareholders' equity was invested in equities, compared to 49 percent at December 31, 2014 and 51 percent at December 31, 2013.

The fixed income portfolio is structured to meet policyholder obligations and optimize the generation of after-tax investment income and total return.

FINANCING ACTIVITIES

In addition to the previously discussed operating and investing activities, we also engage in financing activities to manage our capital structure. The following list highlights some of the major sources and uses of cash flow from financing activities:

Sources	Uses

Proceeds from stock offerings	Shareholder dividends
Proceeds from debt offerings	Debt repayment
Short-term borrowing	Share buy-backs
Shares issued under stock option plans	

Our capital structure is comprised of equity and debt obligations. As of December 31, 2015, our capital structure consisted of $149.7 million in 10-year maturity senior notes (long-term debt) and $823.5 million of shareholders' equity. Debt outstanding comprised 15 percent of total capital as of December 31, 2015.

In December 2012, we filed a universal shelf registration statement with the SEC for the potential offering and sale of securities, including debt and equity securities. The shelf registration facilitated our $150.0 million public debt offering completed in October 2013 and expired in December 2015.

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 December 31, 2015, our holding company had $823.5 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 $45.2 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 issuances of common stock and debt.

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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. In 2015, 2014 and 2013, our principal insurance subsidiary paid ordinary dividends totaling $125.0 million, $185.0 million and $40.0 million, respectively, to RLI Corp. Any dividend distribution in excess of the ordinary dividend limits is deemed extraordinary and requires prior approval from the Illinois Department of Insurance. No extraordinary dividends were paid in 2015, 2014 or 2013. As of December 31, 2015, $58.2 million of the net assets of our principal insurance subsidiary are not restricted and could be distributed to RLI Corp. as ordinary dividends. Because the limitations are based upon a rolling 12-month period, the presence, amount and impact of these restrictions vary over time.

Our 159th consecutive dividend payment was declared in February 2016 and will be paid on March 18, 2016, in the amount of $0.19 per share. Since the inception of cash dividends in 1976, we have increased our annual dividend every year.

OUTLOOK FOR 2016

The insurance and reinsurance industry is poised to record an underwriting profit in 2015 for the third consecutive year, benefitting from low catastrophe activity, continued favorable reserve releases and generally benign loss cost trends. This profitability has attracted capital to the industry from traditional carriers looking to deploy capital generated from their businesses and from newer sources such as pension funds. These alternative capital providers are attracted to the industry’s current margins as well as the perceived diversification of returns relative to traditional investments. We believe that economic conditions and market dynamics the insurance industry experienced in 2015 will largely continue in 2016.

As the overall underwriting environment continues to perform well by historical standards, there are pockets of stress in particular lines of business that we anticipate will continue in 2016. For example, in the personal and commercial auto markets, increased loss activity and inadequate reserving have impacted a number of market participants. This market is also adjusting to new competitive dynamics and trends that may put long-term pressure on the insurance industry, such as the growth of ride-sharing services and technological advancements. Similarly, the property catastrophe market has been challenged by pricing declines over the last several years. The influx of alternative capital and lack of material catastrophe events have led to lower prices over the last three years, and we expect that soft pricing trend to continue in 2016.

Broader economic conditions are expected to have varied impacts on RLI and the market in 2016. The economy has been growing at a slow pace over the last several years, a trend largely forecasted to continue. Mediocre economic growth will temper the ability of the industry to grow premium volume. Particular subsets of the economy are poised to benefit from recent trends such as an increase in miles driven as a result of an improving economy and lower gas prices, or continued growth in construction activity. On the other hand, the energy sector is being negatively impacted by the decline in oil prices. Given our varied exposure to multiple areas of the U.S. economy, including customers in the transportation, construction and energy industries, we expect growth to be challenging.

Our business model is well suited to deal with difficult or uncertain market conditions. In particular, we remain well-diversified across products, industries and geographies. Our underwriters are empowered to navigate changing market conditions in a decentralized manner and incentivized to maximize profits, particularly by eschewing growth when market conditions warrant restraint. We expect to continue making investments in hiring underwriters and entering new product markets. Specific details regarding our insurance segments follows.

CASUALTY

We expect some overall growth from the casualty segment. This segment includes a number of diverse products that are subject to unique market conditions and changing profit opportunities, so growth rates among products will vary. While we do not expect transportation to grow at the same pace as 2015, some growth is likely to occur as we focus on superior underwriting and claim services. The E&S excess casualty book has benefited from decreased competition over the last couple of years, a trend we do not expect to last. With carriers and managing general agencies reentering the market in search of premium, individually underwritten standalone casualty business will be pressured to relax underwriting standards. We recently added underwriters to focus on additional classes of business in the E&S casualty group, but expect measured growth from these opportunities. Package business has the potential for growth as we expand certain products and classes geographically. Growth in these products will be slow in 2016 as we begin to establish new relationships across the country and customize coverages. Rate change was flat for the casualty segment in 2015, and we see no signs of improvement in 2016.

We should continue to achieve positive rate in our commercial auto business as industry trends allow, but our construction based business will be more pressured for rate decreases due to a higher level of competition. Overall moderate growth is expected for the segment.

PROPERTY

The property segment will have another challenging year in 2016. With no material catastrophe losses in the industry, rates on those exposures will continue to decrease while terms and conditions will be under pressure. In marine, recent re-underwriting efforts were completed in 2015, positioning this business to achieve profitable growth in 2016. Although some marine classes have recorded five consecutive years of slight rate increases, ongoing rate increases in 2016 will be challenging. We continue to adjust the recreational vehicle book to attain profitability. Since we implemented a rate increase and revised our claim handling processes, we have seen premium shrink and this trend will likely continue. Finally, gross written premium of $9.4 million of crop reinsurance and $3.5 million of facultative reinsurance in 2015 will not be available given the previously discussed termination of these businesses. While the top line will likely decrease for all of these reasons, the overall property segment should remain profitable, assuming normal catastrophe experience.

SURETY

Although the surety segment remains very competitive, we believe this segment will experience modest growth in 2016. Continued investments in technology and expansion of marketing initiatives will drive continued organic growth, while modest economic growth will provide a slight tailwind. The recent decline in oil prices could potentially hamper these trends, which increases underwriting risk as well as pressure on our energy surety customers. Although overall economic growth trends have been favorable, there is a chance that premium growth will be hampered by slowing conditions. There is also a risk that certain credit-related exposures related to our commercial and contract surety business will become more challenging under such circumstances.

INVESTMENTS

Global macroeconomic influences brought higher levels of volatility to U.S. capital markets in 2015. A stronger U.S. dollar and the commodity complex in decline were central themes of the year and had a widespread impact on the global economy. Monetary policy in the U.S. was partly responsible for relative currency weakness abroad as the Federal Reserve began a process to tighten policy and raise rates in the fourth quarter of the year. While much anticipated, the move to lift the Fed Funds target rate has created some uncertainty around the sustainability of the domestic recovery, which stands as one of the shallowest on record. Despite GDP growth of around 2 percent, the labor market has continued to heal with recent reports outlining positive additions to payrolls and an unemployment rate nearing a full reading. Slow growth and low inflation were major influences on Treasury yields that continue to underperform the expectations for higher rates. The bellwether 10 year Treasury yield ended 2015 at 2.27 percent, up 0.10 percent from year end 2014. Stocks and corporate bonds struggled in the second half of the year and exhibited greater volatility than in recent memory. High yield bonds have been trading at recession-like levels and were highly levered to the price of oil in 2015. The current environment has the potential to derail the Federal Reserve's monetary policy plan for a higher Fed Funds rate in 2016 although we have anticipated a slower process for policy to normalize for some time. We believe that lower input and gasoline prices can be stimulative and that a consistently positive jobs report offers a constructive backdrop for the U.S. to lead world growth in the near term.

Our portfolio handled 2015 in stride, with a low, but positive total return. Municipals were well equipped to cushion against wider credit spreads in other fixed income sectors and were a principal contributor to strong relative returns in our bond portfolio. The equity portfolio can be characterized by lower beta, value-oriented names with a preference for dividend income. This strategy struggled to keep up with higher growth names in 2015 and stocks broke with their recent trend of a meaningful contribution to book value growth.

Our investment focus remains on supporting year-to-year operations through current income and contributing to long-term growth in book value in surplus assigned strategies like equities. We do not expect the yield environment to change significantly in the first half of 2016 and any potential for higher levels of investment income will be most acutely influenced by a larger invested asset base over the course of the year.

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PROSPECTIVE ACCOUNTING STANDARDS

Prospective accounting standards are those which we have not implemented because the implementation date has not yet occurred. For a discussion of relevant prospective accounting standards, see note 1.D. to the consolidated financial statements within Item 8, Financial Statements and Supplementary Data.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

MARKET RISK DISCLOSURE

Market risk is a general term describing the potential economic loss associated with adverse changes in the fair value of financial instruments. Management of market risk is a critical component of our investment decisions and objectives. We manage our exposure to market risk by using the following tools:

- Monitoring the fair value of all financial assets on a constant basis,
- Changing the character of future investment purchases as needed and
- Maintaining a balance between existing asset and liability portfolios.

FIXED INCOME AND INTEREST RATE RISK

The most significant short-term influence on our fixed income portfolio is a change in interest rates. Because there is intrinsic difficulty predicting the direction and magnitude of interest rate moves, we attempt to minimize the impact of interest rate risk on the balance sheet by matching the duration of assets to that of our liabilities. Furthermore, the diversification of sectors and given issuers is core to our risk management process, increasing the granularity of individual credit risk. Liquidity and call risk are elements of fixed income that we regularly evaluate to ensure we are receiving adequate compensation. Our fixed income portfolio has a meaningful impact on financial results and is a key component in our enterprise risk simulations.

Interest rate risk can also affect our income statement due to its impact on interest expense. As of December 31, 2015 and 2014, we had no short-term debt obligations. We maintain a debt obligation that is long-term in nature and carries a fixed interest rate. As such, our interest expense on this obligation is not subject to changes in interest rates. As this debt is not due until 2023, we will not assume additional interest rate risk in our ability to refinance this debt for nearly ten years.

EQUITY PRICE RISK

Equity price risk is the potential that we will incur economic loss due to the decline of common stock prices. Beta analysis is used to measure the sensitivity of our equity portfolio to changes in the value of the S&P 500 Index (an index representative of the broad equity market). Our current equity portfolio has a beta of 0.9 in comparison to the S&P 500 with a beta of 1.0. This lower beta statistic reflects our long-term emphasis on maintaining a value-oriented, dividend-driven investment philosophy for our equity portfolio.

SENSITIVITY ANALYSIS

The tables that follow detail information on the market risk exposure for our financial investments as of December 31, 2015. Listed on each table is the December 31, 2015, fair value for our assets and the expected pretax reduction in fair value given the stated hypothetical events. This sensitivity analysis assumes the composition of our assets remains constant over the period being measured and also assumes interest rate changes are reflected uniformly across the yield curve. For example, our ability to hold non-trading securities to maturity mitigates price fluctuation risks. For purposes of this disclosure, market-risk-sensitive instruments are all classified as held for non-trading purposes, as we sold our remaining trading securities during 2013. The examples given are not predictions of future market events, but rather illustrations of the effect such events may have on the fair value of our investment portfolio.

As of December 31, 2015, our fixed income portfolio had a fair value of $1.5 billion. The sensitivity analysis uses scenarios of interest rates increasing 100 and 200 basis points from their December 31, 2015, levels with all other variables held constant. Such scenarios would result in decreases in the fair value of the fixed income portfolio of $87.1 million and $170.3 million, respectively.

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As of December 31, 2015, our equity portfolio had a fair value of $375.4 million. The base sensitivity analysis uses market scenarios of the S&P 500 Index declining both 10 percent and 20 percent. These scenarios would result in approximate decreases in the equity fair value of $32.3 million and $64.6 million, respectively.

Counter to the base scenarios shown in Tables 1 and 2, Tables 3 and 4 quantify the opposite impact. Under the assumptions of falling interest rates and an increasing S&P 500 Index, the fair value of our assets will increase from their present levels by the indicated amounts.

TABLE 1

Effect of a 100-basis-point increase in interest rates and a 10 percent decline in the S&P 500:

(in thousands)	12/31/15 Fair Value	Interest Rate Risk	Equity Risk
Held for non-trading purposes:			
Fixed income securities	$ 1,538,110	$ (87,073)	$ —
Equity securities	375,424	—	(32,289)
Total non-trading	$ 1,913,534	$ (87,073)	$ (32,289)

TABLE 2

Effect of a 200-basis-point increase in interest rates and a 20 percent decline in the S&P 500:

(in thousands)	12/31/15 Fair Value	Interest Rate Risk	Equity Risk
Held for non-trading purposes:			
Fixed income securities	$ 1,538,110	$ (170,344)	$ —
Equity securities	375,424	—	(64,578)
Total non-trading	$ 1,913,534	$ (170,344)	$ (64,578)

TABLE 3

Effect of a 100-basis-point decrease in interest rates and a 10 percent increase in the S&P 500:

(in thousands)	12/31/15 Fair Value	Interest Rate Risk	Equity Risk
Held for non-trading purposes:			
Fixed income securities	$ 1,538,110	$ 86,478	$ —
Equity securities	375,424	—	32,289
Total non-trading	$ 1,913,534	$ 86,478	$ 32,289

TABLE 4

Effect of a 200-basis-point decrease in interest rates and 20 percent increase in the S&P 500:

(in thousands)	12/31/15 Fair Value	Interest Rate Risk	Equity Risk
Held for non-trading purposes:			
Fixed income securities	$ 1,538,110	$ 148,465	$ —
Equity securities	375,424	—	64,578
Total non-trading	$ 1,913,534	$ 148,465	$ 64,578

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Item 8. Financial Statements and Supplementary Data

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Consolidated Balance Sheets

(in thousands, except per share data)	December 31, 2015	2014
Assets		
Investments and Cash:		
Fixed income:		
Available-for-sale, at fair value (amortized cost - $1,518,156 in 2015 and $1,448,204 in 2014)	$ 1,538,110	$ 1,495,087
Equity securities available-for-sale, at fair value (cost - $202,437 in 2015 and $193,535 in 2014)	375,424	410,642
Short-term investments, at cost which approximates fair value	6,262	16,339
Other invested assets	20,666	11,597
Cash	11,081	30,620
Total investments and cash	$ 1,951,543	$ 1,964,285
Accrued investment income	$ 14,878	$ 14,629
Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of $14,898 in 2015 and $14,245 in 2014	143,662	154,573
Ceded unearned premiums	52,833	53,961
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of $11,885 in 2015 and $13,049 in 2014	297,844	335,106
Deferred policy acquisition costs, net	69,829	65,123
Property and equipment, at cost, net of accumulated depreciation of $38,447 in 2015 and $34,365 in 2014	47,102	42,549
Investment in unconsolidated investees	70,784	60,046
Goodwill and intangibles	71,294	72,695
Other assets	16,810	12,575
Total assets	$ 2,736,579	$ 2,775,542
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and settlement expenses	$ 1,103,785	$ 1,121,040
Unearned premiums	422,094	401,412
Reinsurance balances payable	37,556	38,013
Funds held	54,254	51,481
Income taxes - deferred	63,993	82,285
Bonds payable, long-term debt	149,668	149,625
Accrued expenses	55,742	63,148
Other liabilities	26,018	23,476
Total liabilities	$ 1,913,110	$ 1,930,480
Shareholders' equity:		
Common stock ($1 par value, authorized 100,000,000 shares, issued 66,474,342 shares in 2015 and 66,032,929 shares in 2014, and outstanding 43,544,128 shares in 2015 and 43,102,715 shares in 2014)	$ 66,474	$ 66,033
Paid in capital	221,345	213,737
Accumulated other comprehensive earnings, net of tax	123,774	171,383
Retained earnings	804,875	786,908

Deferred compensation	10,647	13,769
Treasury stock, at cost (22,930,214 shares in 2015 and 2014)	(403,646)	(406,768)
Total shareholders' equity	$ 823,469	$ 845,062
Total liabilities and shareholders' equity	$ 2,736,579	$ 2,775,542

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Earnings and Comprehensive Earnings

	Years ended December 31,		
(in thousands, except per share data)	2015	2014	2013
Net premiums earned	$ 700,161	$ 687,375	$ 630,802
Net investment income	54,644	55,608	52,763
Net realized gains	39,829	32,182	22,036
Consolidated revenue	$ 794,634	$ 775,165	$ 705,601
Losses and settlement expenses	$ 299,045	$ 296,609	$ 259,801
Policy acquisition costs	241,078	229,283	210,651
Insurance operating expenses	51,480	54,464	53,557
Interest expense on debt	7,426	7,438	8,095
General corporate expenses	9,837	10,222	8,746
Total expenses	$ 608,866	$ 598,016	$ 540,850
Equity in earnings of unconsolidated investees	10,914	12,338	10,915
Earnings before income taxes	$ 196,682	$ 189,487	$ 175,666
Income tax expense:			
Current	$ 52,104	$ 48,596	$ 43,346
Deferred	7,034	5,446	6,065
Income tax expense:	$ 59,138	$ 54,042	$ 49,411
Net earnings	$ 137,544	$ 135,445	$ 126,255
Other comprehensive earnings (loss), net of tax	(47,609)	35,356	(7,143)
Comprehensive earnings	$ 89,935	$ 170,801	$ 119,112
Basic:			
Net earnings per share	$ 3.18	$ 3.15	$ 2.95
Comprehensive earnings per share	$ 2.08	$ 3.97	$ 2.79
Diluted:			
Net earnings per share	$ 3.12	$ 3.09	$ 2.90
Comprehensive earnings per share	$ 2.04	$ 3.90	$ 2.74
Weighted average number of common shares outstanding			
Basic	43,299	43,020	42,744
Diluted	44,131	43,819	43,514

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Shareholders' Equity

(in thousands, except per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	Treasury Stock at Cost
Balance, January 1, 2013	42,525,248	$ 796,363	$ 65,455	$ 202,535	$ 143,170	$ 778,202	$ 11,106	$ (404,105)
Net earnings	—	$ 126,255	$ —	$ —	$ —	$ 126,255	$ —	$ —
Other comprehensive earnings (loss), net of tax	—	(7,143)	—	—	(7,143)	—	—	—
Deferred compensation under Rabbi trust plans	—	—	—	—	—	—	456	(456)
Stock option excess tax benefit	—	6,310	—	6,310	—	—	—	—
Exercise of stock options	457,176	318	458	(140)	—	—	—	—
Dividends paid ($2.17 per share)	—	(93,137)	—	—	—	(93,137)	—	—
Balance, December 31, 2013	42,982,424	$ 828,966	$ 65,913	$ 208,705	$ 136,027	$ 811,320	$ 11,562	$ (404,561)
Net earnings	—	$ 135,445	$ —	$ —	$ —	$ 135,445	$ —	$ —
Other comprehensive earnings (loss), net of tax	—	35,356	—	—	35,356	—	—	—
Deferred compensation under Rabbi trust plans	—	—	—	—	—	—	2,207	(2,207)
Stock option excess tax benefit	—	1,766	—	1,766	—	—	—	—
Exercise of stock options	120,291	3,386	120	3,266	—	—	—	—
Dividends paid ($3.71 per	—	(159,857)	—	—	—	(159,857)	—	—

share)								
Balance, December 31, 2014	43,102,715	$ 845,062	$ 66,033	$ 213,737	$ 171,383	$ 786,908	$ 13,769	$ (406,768)
Net earnings	—	$ 137,544	$ —	$ —	$ —	$ 137,544	$ —	$ —
Other comprehensive earnings (loss), net of tax	—	(47,609)	—	—	(47,609)	—	—	—
Deferred compensation under Rabbi trust plans	—	—	—	—	—	—	(3,122)	3,122
Stock option excess tax benefit	—	11,413	—	11,413	—	—	—	—
Exercise of stock options	441,413	(3,364)	441	(3,805)	—	—	—	—
Dividends paid ($2.75 per share)	—	(119,577)	—	—	—	(119,577)	—	—
Balance, December 31, 2015	43,544,128	$ 823,469	$ 66,474	$ 221,345	$ 123,774	$ 804,875	$ 10,647	$ (403,646)

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

(in thousands)	2015	2014	2013
Cash flows from operating activities:			
Net earnings	$ 137,544	$ 135,445	$ 126,255
Adjustments to reconcile net earnings to net cash provided by operating activities			
Net realized gains	(39,829)	(32,182)	(22,036)
Depreciation	5,406	4,557	3,765
Other items, net	15,006	10,818	13,104
Change in:			
Accrued investment income	(249)	1,081	(1,307)
Premiums and reinsurance balances receivable (net of direct write-offs and commutations)	10,911	(2,064)	(13,154)
Reinsurance balances payable	(457)	(9,321)	3,375
Funds held	2,773	(10,175)	5,023
Ceded unearned premium	1,128	6,446	12,785
Reinsurance balances recoverable on unpaid losses	37,262	19,818	4,960
Deferred policy acquisition costs	(4,706)	(3,615)	(9,164)
Accrued expenses	(7,406)	3,552	9,663
Unpaid losses and settlement expenses	(17,255)	(8,393)	(29,050)
Unearned premiums	20,682	9,331	22,735
Income taxes			
Current	7,069	(155)	5,966
Deferred	7,034	5,446	6,065
Stock option excess tax benefit	(11,413)	(1,766)	(6,310)
Changes in investment in unconsolidated investees:			
Undistributed earnings	(10,914)	(12,338)	(10,915)
Dividends received	—	6,600	13,200
Net proceeds from trading portfolio activity	—	—	6
Net cash provided by operating activities	$ 152,586	$ 123,085	$ 134,966

Cash flows from investing activities:

Purchase of: