
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2020

or

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

For the transition period from to

Commission File Number: 001-09463

RLI Corp.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

37-0889946

(I.R.S. Employer Identification Number)

9025 North Lindbergh Drive, Peoria, IL

(Address of principal executive offices)

61615

(Zip Code)

(309) 692-1000

(Registrant's telephone number, including area code)

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

Title of each class
Common Stock \$0.01 par value

Trading Symbol
RLI

Name of each exchange on which registered
New York Stock Exchange

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of July 16, 2020, the number of shares outstanding of the registrant's Common Stock was 44,952,602.

Table of Contents

	Page
Part I - Financial Information	3
Item 1. Financial Statements	3
Condensed Consolidated Statements of Earnings and Comprehensive Earnings For the Three and Six-Month Periods Ended June 30, 2020 and 2019 (unaudited)	3
Condensed Consolidated Balance Sheets as of June 30, 2020 and December 31, 2019 (unaudited)	4
Condensed Consolidated Statements of Shareholders' Equity For the Three and Six-Month Periods Ended June 30, 2020 and 2019 (unaudited)	5
Condensed Consolidated Statements of Cash Flows For the Six-Month Periods Ended June 30, 2020 and 2019 (unaudited)	6
Notes to Unaudited Condensed Consolidated Interim Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures about Market Risk	37
Item 4. Controls and Procedures	37
Part II - Other Information	38
Item 1. Legal Proceedings	38
Item 1a. Risk Factors	38
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	38
Item 3. Defaults upon Senior Securities	38
Item 4. Mine Safety Disclosures	38
Item 5. Other Information	38
Item 6. Exhibits	38
Signatures	39

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

RLI Corp. and Subsidiaries Condensed Consolidated Statements of Earnings and Comprehensive Earnings (Unaudited)

(in thousands, except per share data)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
	2020	2019	2020	2019
Net premiums earned	\$ 208,734	\$ 207,541	\$ 424,316	\$ 412,230
Net investment income	16,917	16,998	34,695	33,563
Net realized gains (losses)	(2,109)	4,764	13,043	13,832
Net unrealized gains (losses) on equity securities	74,705	8,810	(55,690)	42,308
Consolidated revenue	\$ 298,247	\$ 238,113	\$ 416,364	\$ 501,933
Losses and settlement expenses	101,202	103,919	212,223	198,216
Policy acquisition costs	69,463	71,742	142,404	143,034
Insurance operating expenses	13,906	16,948	28,287	33,615
Interest expense on debt	1,903	1,861	3,800	3,722
General corporate expenses	1,994	3,283	3,749	6,559
Total expenses	\$ 188,468	\$ 197,753	\$ 390,463	\$ 385,146
Equity in earnings of unconsolidated investees	5,100	8,468	9,614	13,782
Earnings before income taxes	\$ 114,879	\$ 48,828	\$ 35,515	\$ 130,569
Income tax expense	22,713	8,361	4,616	24,629
Net earnings	\$ 92,166	\$ 40,467	\$ 30,899	\$ 105,940
Other comprehensive earnings, net of tax	53,571	27,864	40,540	57,165
Comprehensive earnings	\$ 145,737	\$ 68,331	\$ 71,439	\$ 163,105
Earnings per share:				
Basic:				
Basic net earnings per share	\$ 2.05	\$ 0.91	\$ 0.69	\$ 2.37
Basic comprehensive earnings per share	\$ 3.24	\$ 1.53	\$ 1.59	\$ 3.66
Diluted:				
Diluted net earnings per share	\$ 2.04	\$ 0.89	\$ 0.68	\$ 2.35
Diluted comprehensive earnings per share	\$ 3.22	\$ 1.51	\$ 1.58	\$ 3.62
Weighted average number of common shares outstanding:				
Basic	44,951	44,704	44,936	44,620
Diluted	45,274	45,219	45,311	45,056

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

[Table of Contents](#)

RLI Corp. and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

(in thousands, except share and per share data)	June 30, 2020	December 31, 2019
ASSETS		
Investments and cash:		
Fixed income:		
Available-for-sale, at fair value	\$ 2,075,093	\$ 1,983,086
(amortized cost of \$1,956,137 and allowance for credit losses of \$985 at 6/30/20)		
(amortized cost of \$1,915,278 and allowance for credit losses of \$0 at 12/31/19)		
Equity securities, at fair value (cost - \$270,987 at 6/30/20 and \$262,131 at 12/31/19)	422,198	460,630
Other invested assets	63,440	70,441
Cash	84,797	46,203
Total investments and cash	\$ 2,645,528	\$ 2,560,360
Accrued investment income	15,142	14,587
Premiums and reinsurance balances receivable, net of allowances for uncollectible amounts of \$17,139 at 6/30/20 and \$16,682 at 12/31/19	154,941	160,369
Ceded unearned premium	93,679	93,656
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for uncollectible amounts of \$8,035 at 6/30/20 and \$9,402 at 12/31/19	364,756	384,517
Deferred policy acquisition costs	87,560	85,044
Property and equipment, at cost, net of accumulated depreciation of \$65,762 at 6/30/20 and \$62,703 at 12/31/19	52,350	53,121
Investment in unconsolidated investees	112,662	103,836
Goodwill and intangibles	53,923	54,127
Other assets	38,738	36,104
TOTAL ASSETS	\$ 3,619,279	\$ 3,545,721
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Unpaid losses and settlement expenses	\$ 1,590,996	\$ 1,574,352
Unearned premiums	543,113	540,213
Reinsurance balances payable	24,777	25,691
Funds held	84,430	83,358
Income taxes-deferred	57,421	56,727
Bonds payable, long-term debt	149,395	149,302
Accrued expenses	35,998	66,626
Other liabilities	81,691	54,064
TOTAL LIABILITIES	\$ 2,567,821	\$ 2,550,333
Shareholders' Equity		
Common stock (\$0.01 par value)		
(Shares authorized - 200,000,000 at 6/30/20 and 100,000,000 at 12/31/19)		
(67,882,816 shares issued, 44,952,602 shares outstanding at 6/30/20)		
(67,799,229 shares issued, 44,869,015 shares outstanding at 12/31/19)	\$ 679	\$ 678
Paid-in capital	325,862	321,190
Accumulated other comprehensive earnings	93,035	52,473
Retained earnings	1,024,881	1,014,046
Deferred compensation	7,600	7,980
Less: Treasury shares at cost		
(22,930,214 shares at 6/30/20 and 12/31/19)	(400,599)	(400,979)
TOTAL SHAREHOLDERS' EQUITY	\$ 1,051,458	\$ 995,388
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 3,619,279	\$ 3,545,721

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

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

(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	Treasury Shares at Cost
Balance, January 1, 2019	44,504,043	\$ 806,842	\$ 674	\$ 305,660	\$ (14,572)	\$ 908,079	\$ 8,354	\$ (401,353)
Net earnings (loss)	—	65,473	—	—	—	65,473	—	—
Other comprehensive earnings (loss), net of tax	—	29,301	—	—	29,301	—	—	—
Deferred compensation	—	—	—	—	—	—	(1,039)	1,039
Share-based compensation	50,213	2,892	1	2,891	—	—	—	—
Dividends and dividend equivalents (\$0.22 per share)	—	(9,803)	—	—	—	(9,803)	—	—
Balance, March 31, 2019	44,554,256	\$ 894,705	\$ 675	\$ 308,551	\$ 14,729	\$ 963,749	\$ 7,315	\$ (400,314)
Net earnings (loss)	—	40,467	—	—	—	40,467	—	—
Other comprehensive earnings (loss), net of tax	—	27,864	—	—	27,864	—	—	—
Deferred compensation	—	—	—	—	—	—	215	(215)
Share-based compensation	232,941	7,217	2	7,215	—	—	—	—
Dividends and dividend equivalents (\$0.23 per share)	—	(10,305)	—	—	—	(10,305)	—	—
Balance, June 30, 2019	44,787,197	\$ 959,948	\$ 677	\$ 315,766	\$ 42,593	\$ 993,911	\$ 7,530	\$ (400,529)
(in thousands, except share and per share data)	Common Shares	Total Shareholders' Equity	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Earnings (Loss)	Retained Earnings	Deferred Compensation	Treasury Shares at Cost
Balance, January 1, 2020	44,869,015	\$ 995,388	\$ 678	\$ 321,190	\$ 52,473	\$ 1,014,046	\$ 7,980	\$ (400,979)
Cumulative-effect adjustment from ASU 2016-13	—	1,095	—	—	22	1,073	—	—
Net earnings (loss)	—	(61,267)	—	—	—	(61,267)	—	—
Other comprehensive earnings (loss), net of tax	—	(13,031)	—	—	(13,031)	—	—	—
Deferred compensation	—	—	—	—	—	—	(1,010)	1,010
Share-based compensation	53,641	3,863	1	3,862	—	—	—	—
Dividends and dividend equivalents (\$0.23 per share)	—	(10,343)	—	—	—	(10,343)	—	—
Balance, March 31, 2020	44,922,656	\$ 915,705	\$ 679	\$ 325,052	\$ 39,464	\$ 943,509	\$ 6,970	\$ (399,969)
Net earnings (loss)	—	92,166	—	—	—	92,166	—	—
Other comprehensive earnings (loss), net of tax	—	53,571	—	—	53,571	—	—	—
Deferred compensation	—	—	—	—	—	—	630	(630)
Share-based compensation	29,946	810	—	810	—	—	—	—
Dividends and dividend equivalents (\$0.24 per share)	—	(10,794)	—	—	—	(10,794)	—	—
Balance, June 30, 2020	44,952,602	\$ 1,051,458	\$ 679	\$ 325,862	\$ 93,035	\$ 1,024,881	\$ 7,600	\$ (400,599)

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

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

(in thousands)	For the Six-Month Periods Ended June 30,	
	2020	2019
Net cash provided by operating activities	\$ 83,773	\$ 105,347
Cash Flows from Investing Activities		
Purchase of:		
Fixed income securities, available-for-sale	\$ (185,502)	\$ (214,332)
Equity securities	(48,473)	(59,861)
Property and equipment	(3,413)	(3,004)
Other	(6,651)	(7,122)
Proceeds from sale of:		
Fixed income securities, available-for-sale	40,333	132,153
Equity securities	52,533	33,360
Other	2,596	1,842
Proceeds from call or maturity of:		
Fixed income securities, available-for-sale	121,911	52,113
Net proceeds from sale (purchase) of short-term investments	-	(35,803)
Net cash used in investing activities	\$ (26,666)	\$ (100,654)
Cash Flows from Financing Activities		
Cash dividends paid	\$ (21,119)	\$ (20,092)
Proceeds from stock option exercises	2,606	10,093
Net cash used in financing activities	\$ (18,513)	\$ (9,999)
Net increase (decrease) in cash	\$ 38,594	\$ (5,306)
Cash at the beginning of the period	46,203	30,140
Cash at June 30	<u>\$ 84,797</u>	<u>\$ 24,834</u>

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2019 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2020 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year. Certain reclassifications were made to 2019 to conform to the classifications used in the current year.

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

B. ADOPTED ACCOUNTING STANDARDS

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

ASU 2016-13 was issued to provide more decision-useful information about the expected credit losses on financial instruments. Previous guidance delayed the recognition of credit losses until it was probable a loss had been incurred. This update requires a financial asset measured at amortized cost to be presented at the net amount expected to be collected by means of an allowance for credit losses that is included in net earnings. Credit losses relating to available-for-sale debt securities are also required to be recorded through a reversible allowance for credit losses, but is limited to the amount by which fair value is less than amortized cost.

We adopted ASU 2016-13 on January 1, 2020 using the modified-retrospective approach. The standard applied to three of the Company's balance sheet accounts: available-for-sale fixed income securities, premiums receivable and reinsurance balances recoverable. The impact of this standard was and is expected to continue to be immaterial, as our fixed income portfolio is weighted towards higher rated bonds (84 percent rated A or better at June 30, 2020 and 85 percent at December 31, 2019), we purchase reinsurance from financially strong reinsurers, we have a long history of collecting premium receivables through various economic cycles and we had previously maintained an allowance for uncollectible premium and reinsurance balances. In total, the cumulative-effect adjustment made to the balance sheet as of the beginning of the year resulted in a \$1.1 million increase to retained earnings and an increase to accumulated other comprehensive earnings of less than \$0.1 million.

C. REINSURANCE

Ceded unearned premiums and reinsurance balances recoverable on paid and unpaid losses and settlement expenses are reported separately as assets, instead of being netted with the related liabilities, since reinsurance does not relieve the Company of our legal liability to our policyholders. Such balances are subject to the credit risk associated with the individual reinsurer. We continuously monitor the financial condition of our reinsurers and actively follow up on any past due or disputed amounts. As part of our monitoring efforts, we review their annual financial statements, quarterly disclosures and Securities and Exchange Commission (SEC) filings for those reinsurers that are publicly traded. We also review insurance industry developments that may impact the financial condition of our reinsurers. We analyze the credit risk associated with our reinsurance balances recoverable by monitoring the AM Best and Standard & Poor's (S&P) ratings of our reinsurers. Additionally, we perform an in depth reinsurer financial condition analysis prior to the renewal of our reinsurance placements.

Once regulatory action (such as receivership, finding of insolvency, order of conservation or order of liquidation) is taken against a reinsurer, the paid and unpaid balances recoverable from the reinsurer are specifically identified and charged to earnings in the form of an allowance for uncollectible amounts. We subject our remaining reinsurance balances receivable to detailed recoverability tests, including a segment-based analysis using the average default rating percentage by S&P rating, and

[Table of Contents](#)

record an additional allowance for unrecoverable amounts from reinsurers. This credit 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.

The allowances for uncollectible amounts on paid and unpaid reinsurance recoverables were \$15.9 million and \$8.0 million, respectively, at June 30, 2020. At December 31, 2019, the amounts were \$15.7 million and \$9.4 million, respectively. Adoption of ASU 2016-03 resulted in a \$1.3 million decrease to the allowance for uncollectible amounts on reinsurance recoverables in 2020, while other changes in the allowances were due to changes in the amount of reinsurance balances outstanding, the composition of reinsurers from whom the balances were recoverable and their associated S&P default ratings. No write-offs or recoveries were applied to the allowances in the first six months of 2020.

D. INTANGIBLE ASSETS

Goodwill and intangible assets totaled \$53.9 million and \$54.1 million at June 30, 2020 and December 31, 2019, respectively, as detailed in the following table:

Goodwill and Intangible Assets (in thousands)	June 30, 2020	December 31, 2019
Goodwill		
Energy surety	\$ 25,706	\$ 25,706
Miscellaneous and contract surety	15,110	15,110
Small commercial	5,246	5,246
Total goodwill	\$ 46,062	\$ 46,062
Intangibles		
Indefinite-lived intangibles - state insurance licenses	7,500	7,500
Definite-lived intangibles, net of accumulated amortization of \$3,674 at 6/30/20 and \$3,470 at 12/31/19	361	565
Total intangibles	\$ 7,861	\$ 8,065
Total goodwill and intangibles	\$ 53,923	\$ 54,127

All definite-lived intangible assets are amortized based on their estimated useful lives. Amortization of intangible assets was \$0.1 million for the second quarter of 2020 and \$0.2 million for the six-month period ended June 30, 2020, the same as for the comparable periods in 2019.

Annual impairment assessments were performed on our energy surety goodwill, miscellaneous and contract surety goodwill, small commercial goodwill and state insurance license indefinite-lived intangible asset during the second quarter of 2020. Based upon these reviews, none of the assets were impaired. In addition, there were no triggering events as of June 30, 2020 that would suggest an updated impairment test would be needed for our goodwill and intangible assets.

E. EARNINGS PER SHARE

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

(in thousands, except per share data)	For the Three-Month Period Ended June 30, 2020			For the Three-Month Period Ended June 30, 2019		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Earnings available to common shareholders	\$ 92,166	44,951	\$ 2.05	\$ 40,467	44,704	\$ 0.91
Effect of Dilutive Securities						
Stock options and restricted stock units	-	323		-	515	
Diluted EPS						
Earnings available to common shareholders	\$ 92,166	45,274	\$ 2.04	\$ 40,467	45,219	\$ 0.89
Anti-dilutive options excluded from diluted EPS		94			-	

(in thousands, except per share data)	For the Six-Month Period Ended June 30, 2020			For the Six-Month Period Ended June 30, 2019		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Earnings available to common shareholders	\$ 30,899	44,936	\$ 0.69	\$ 105,940	44,620	\$ 2.37
Effect of Dilutive Securities						
Stock options and restricted stock units	-	375		-	436	
Diluted EPS						
Earnings available to common shareholders	\$ 30,899	45,311	\$ 0.68	\$ 105,940	45,056	\$ 2.35
Anti-dilutive options excluded from diluted EPS		335			254	

F. COMPREHENSIVE EARNINGS

Our comprehensive earnings include net earnings plus after-tax unrealized gains and losses on our fixed income portfolio. In reporting other comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 21 percent. Other comprehensive earnings, as shown in the consolidated statements of earnings and comprehensive earnings, is net of tax expense of \$14.2 million and \$7.4 million for the second quarter of 2020 and 2019, respectively. For the six-month period ended June 30, 2020 and 2019, other comprehensive earnings is net of tax expense of \$10.8 million and \$15.2 million, respectively.

Unrealized gains, net of tax, on the fixed income portfolio were \$40.5 million for the first six months of 2020, compared to \$57.2 million during the same period last year. The unrealized gains were attributable to declining interest rates in both periods, which increased the fair value of securities held in the fixed income portfolio. For the first half of 2020, widening credit spreads partially offset the impact of the declining interest rates.

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

(in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
Unrealized Gains/Losses on Available-for-Sale Securities	2020	2019	2020	2019
Beginning balance	\$ 39,464	\$ 14,729	\$ 52,473	\$ (14,572)
Cumulative-effect adjustment of ASU 2016-13 (see note 1.B.)	-	-	22	-
Adjusted beginning balance	\$ 39,464	\$ 14,729	\$ 52,495	\$ (14,572)
Other comprehensive earnings before reclassifications	53,733	28,388	41,853	58,183
Amounts reclassified from accumulated other comprehensive earnings	(162)	(524)	(1,313)	(1,018)
Net current-period other comprehensive earnings (loss)	\$ 53,571	\$ 27,864	\$ 40,540	\$ 57,165
Ending balance	\$ 93,035	\$ 42,593	\$ 93,035	\$ 42,593
Balance of securities for which an allowance for credit losses has been recognized in net earnings			\$ 1,752	\$ -

[Table of Contents](#)

Credit losses on or the sale of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. We recognized \$0.1 million of credit loss expense on available-for-sale securities in the second quarter of 2020 and \$1.0 million in the first six months of 2020, increasing the allowance for credit losses on fixed income securities to \$1.0 million. No write-offs or recoveries were applied to the allowances in the first half of 2020. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table:

(in thousands)	Amount Reclassified from Accumulated Other Comprehensive Earnings				
	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,		
Component of Accumulated Other Comprehensive Earnings	2020	2019	2020	2019	Affected line item in the Statement of Earnings
Unrealized gains and losses on available-for-sale securities	\$ 312	\$ 664	\$ 2,618	\$ 1,289	Net realized gains (losses)
	(107)	-	(956)	-	Credit losses presented within net realized gains
	\$ 205	\$ 664	\$ 1,662	\$ 1,289	Earnings before income taxes
	(43)	(140)	(349)	(271)	Income tax expense
	\$ 162	\$ 524	\$ 1,313	\$ 1,018	Net earnings

G. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

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

Mortgage-backed Securities (MBS)/Commercial Mortgage-backed Securities (CMBS) and Asset-backed Securities (ABS): The pricing vendor evaluation methodology includes principally interest rate movements and new issue data. Evaluations of the tranches (non-volatile, volatile or credit sensitivity) are based on the pricing vendors' interpretation of accepted modeling and pricing conventions. This information is used to determine the cash flows for each tranche, benchmark yields, prepayment assumptions and to incorporate collateral performance. To evaluate MBS and CMBS volatility, an option

adjusted spread model is used in combination with models that simulate interest rate paths to determine market price information. This process allows the pricing vendor to obtain evaluations of a broad universe of securities in a way that reflects changes in yield curve, index rates, implied volatility, mortgage rates and recent trade activity. MBS/CMBS and ABS with corroborated, observable inputs are classified as Level 2. All of our MBS/CMBS and ABS are deemed Level 2.

Regulation D Private Placement Securities: All Regulation D privately placed bonds are classified as corporate securities and deemed Level 3. The pricing vendor evaluation methodology for these securities includes a combination of observable and unobservable inputs. Observable inputs include public corporate spread matrices classified by sector, rating and average life, as well as investment and non-investment grade matrices created from fixed income indices. Unobservable inputs include a liquidity spread premium calculated based on public corporate spread and private corporate spread matrices. The quantitative detail of the liquidity spread premium is neither provided nor reasonably available to the Company. An increase to the credit spread assumptions would result in a lower fair value measurement.

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

Common Stock: As of June 30, 2020, all of our common stock holdings are traded on an exchange. Exchange traded equities have readily observable price levels and are classified as Level 1 (fair value based on quoted market prices).

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

H. RISKS AND UNCERTAINTIES

Certain risks and uncertainties are inherent to our day-to-day operations. Adverse changes in the economy could lower demand for our insurance products or negatively impact our investment results, both of which could have an adverse effect on the revenue and profitability of our operations. The COVID-19 pandemic has resulted in and is expected to continue to result in significant disruptions in economic activity and financial markets. The cumulative effects of COVID-19 on the Company, and the effect of any other public health outbreak, cannot be predicted at this time, but could reduce demand for our insurance policies, result in increased level of losses, settlement expenses or other operating costs, reduce the market value of invested assets held by the Company or negatively impact the fair value of our goodwill.

Catastrophe Exposures

Our catastrophe reinsurance treaty renewed on January 1, 2020. We purchased limits of \$400 million in excess of \$25 million first-dollar retention for earthquakes in California, \$425 million in excess of \$25 million first-dollar retention for earthquakes outside of California and \$275 million in excess of \$25 million first-dollar retention for all other perils. These amounts are subject to certain co-participations by the Company on losses in excess of the \$25 million retentions. On March 1, 2020, we purchased \$100 million of additional catastrophe reinsurance protection on top of the previously described coverage. This increases the limits to \$500 million for earthquakes in California, \$525 million for earthquakes outside of California and \$375 for all other perils, all of which are still subject to \$25 million first-dollar retentions and certain co-participations in excess of the retentions.

2. INVESTMENTS

Our investments are primarily composed of fixed income debt securities and common stock equity securities. We carry our equity securities at fair value and categorize all of our debt securities as available-for-sale, which are carried at fair value.

Realized gains and losses on disposition of investments are based on specific identification of the investments sold on the settlement date. The following is a summary of the disposition of fixed income and equity securities for the six-month periods ended June 30, 2020 and 2019:

[Table of Contents](#)

SALES (in thousands)	Proceeds From Sales	Gross Realized		Net Realized Gain (Loss)
		Gains	Losses	
2020				
Available-for-sale	\$ 42,874	\$ 3,495	\$ (1,162)	\$ 2,333
Equities	52,533	19,569	(6,732)	12,837
2019				
Available-for-sale	\$ 133,473	\$ 2,346	\$ (1,106)	\$ 1,240
Equities	33,360	13,016	(711)	12,305

CALLS/MATURITIES (in thousands)	Proceeds	Gross Realized		Net Realized Gain (Loss)
		Gains	Losses	
2020				
Available-for-sale	\$ 121,911	\$ 294	\$ (9)	\$ 285
2019				
Available-for-sale	\$ 53,113	\$ 58	\$ (9)	\$ 49

FAIR VALUE MEASUREMENTS

Assets measured at fair value on a recurring basis as of June 30, 2020 and December 31, 2019 are summarized below:

(in thousands)	As of June 30, 2020			
	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fixed income securities - available-for-sale				
U.S. government	\$ —	\$ 186,838	\$ —	\$ 186,838
U.S. agency	—	32,091	—	32,091
Non-U.S. govt. & agency	—	7,692	—	7,692
Agency MBS	—	409,167	—	409,167
ABS/CMBS*	—	218,507	—	218,507
Corporate	—	758,066	7,059	765,125
Municipal	—	455,673	—	455,673
Total fixed income securities - available-for-sale	\$ —	\$ 2,068,034	\$ 7,059	\$ 2,075,093
Equity securities	422,198	—	—	422,198
Other invested assets	15,792	—	—	15,792
Total	\$ 437,990	\$ 2,068,034	\$ 7,059	\$ 2,513,083

(in thousands)	As of December 31, 2019			
	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fixed income securities - available-for-sale				
U.S. government	\$ —	\$ 193,661	\$ —	\$ 193,661
U.S. agency	—	38,855	—	38,855
Non-U.S. govt. & agency	—	7,628	—	7,628
Agency MBS	—	420,165	—	420,165
ABS/CMBS*	—	224,870	—	224,870
Corporate	—	690,297	1,770	692,067
Municipal	—	405,840	—	405,840
Total fixed income securities - available-for-sale	\$ —	\$ 1,981,316	\$ 1,770	\$ 1,983,086
Equity securities	460,630	—	—	460,630
Total	\$ 460,630	\$ 1,981,316	\$ 1,770	\$ 2,443,716

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

[Table of Contents](#)

As of June 30, 2020, we had \$7.1 million of Regulation D private placement fixed income securities whose fair value was measured using significant unobservable inputs (Level 3). The following table summarizes changes in the balance of these Level 3 securities.

(in thousands)	Level 3 Securities
Balance as of January 1, 2020	\$ 1,770
Net realized and unrealized gains (losses)	
Included in net earnings as a part of:	
Net investment income	(10)
Net realized gains (losses)	(96)
Included in other comprehensive earnings	(282)
Total net realized and unrealized gains (losses)	\$ (388)
Purchases	5,677
Balance as of June 30, 2020	\$ 7,059
Change in unrealized gains (losses) during the period for Level 3 assets held at period-end - included in net realized gains	\$ (96)
Change in unrealized gains (losses) during the period for Level 3 assets held at period-end - included in other comprehensive earnings (loss)	\$ (282)

The amortized cost and fair value of available-for-sale fixed income securities by contractual maturity as of June 30, 2020 were as follows:

	June 30, 2020	
Available-for-sale (in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 75,077	\$ 75,888
Due after one year through five years	472,458	495,968
Due after five years through 10 years	526,480	571,103
Due after 10 years	279,538	304,460
Mtge/ABS/CMBS*	602,584	627,674
Total available-for-sale	\$ 1,956,137	\$ 2,075,093

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

The amortized cost and fair value of available-for-sale securities at June 30, 2020 and December 31, 2019 are presented in the tables below. Amortized cost does not include the \$14.1 million and \$13.5 million of accrued interest receivable as of June 30, 2020 and December 31, 2019, respectively.

	June 30, 2020				
Available-for-sale (in thousands)	Cost or Amortized Cost	Allowance for Credit Losses	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Asset Class					
U.S. government	\$ 171,174	\$ -	\$ 15,664	\$ -	\$ 186,838
U.S. agency	27,913	-	4,178	-	32,091
Non-U.S. govt. & agency	7,316	-	401	(25)	7,692
Agency MBS	388,036	-	21,208	(77)	409,167
ABS/CMBS*	214,548	(54)	5,218	(1,205)	218,507
Corporate	717,748	(931)	54,610	(6,302)	765,125
Municipal	429,402	-	26,341	(70)	455,673
Total Fixed Income	\$ 1,956,137	\$ (985)	\$ 127,620	\$ (7,679)	\$ 2,075,093

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

Available-for-sale

(in thousands)

	December 31, 2019				
Asset Class	Cost or Amortized Cost	Allowance for Credit Losses	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government	\$ 186,699	\$ -	\$ 6,994	\$ (32)	\$ 193,661
U.S. agency	36,535	-	2,362	(42)	38,855
Non-U.S. govt. & agency	7,333	-	295	-	7,628
Agency MBS	411,808	-	8,920	(563)	420,165
ABS/CMBS*	222,832	-	2,514	(476)	224,870
Corporate	659,640	-	33,245	(818)	692,067
Municipal	390,431	-	16,131	(722)	405,840
Total Fixed Income	\$ 1,915,278	\$ -	\$ 70,461	\$ (2,653)	\$ 1,983,086

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

Allowance for Credit Losses and Unrealized Losses on Fixed Income Securities

We adopted ASU 2016-13, Financial Instruments – Credit Losses, on January 1, 2020, which required the recognition of a reversible allowance for credit losses on available-for-sale fixed income securities. See note 1. B. for more information on the adoption of the ASU. Available-for-sale securities in the fixed income portfolio are subjected to several criteria to determine if those securities should be included in the allowance for expected credit loss evaluation, including:

- 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 of or non-payment of interest and/or principal,
- 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
- Downgrades in credit quality by a major rating agency.

If changes in interest rates and credit spreads do not reasonably explain the unrealized loss for an available-for-sale security or if any of the criteria above indicate a potential credit loss, the security is subjected to a discounted cash flow analysis. Inputs into the discounted cash flow analysis include prepayment assumptions for structured securities, default rates and recoverability rates based on credit rating. The allowance for any security is limited to the amount that the securities fair value is below amortized cost.

As of June 30, 2020, the discounted cash flow analysis resulted in an allowance for credit losses on 36 securities totaling \$1.0 million. 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, we believe we will recover the amortized cost basis on the available-for-sale securities not included in the allowance for credit losses. We do not intend to sell the available-for-sale securities in an unrealized loss position and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost basis. We continually monitor the credit quality of our fixed income investments to assess if it is probable that we will receive our contractual or estimated cash flows in the form of principal and interest.

Prior to the adoption of ASU 2016-13, we conducted reviews of fixed income securities with unrealized losses to evaluate whether an impairment was other-than-temporary. Any credit-related impairment on fixed income securities we did not plan to sell and for which we were not more likely than not to be required to sell were recognized in net earnings, with the non-credit related impairment recognized in comprehensive earnings. We did not recognize any other-than-temporary impairment losses in earnings on the fixed income portfolio in the first six months of 2019.

As of June 30, 2020, in addition to the securities included in the allowance for credit losses, the fixed income portfolio contained 249 securities with an unrealized loss position for which an allowance for credit losses had not been recorded. The \$7.7 million in associated unrealized losses represents 0.4 percent of the fixed income portfolio's cost basis and 0.3 percent of total invested assets. Isolated to these securities, unrealized losses increased through the first six months of 2020, as increased credit

[Table of Contents](#)

spreads more than offset declines in interest rates during the period, primarily in the corporate portfolio. Of the total 285 securities, 32 have been in an unrealized loss position for 12 consecutive months or longer. The following table illustrates the total value of fixed income securities that were in an unrealized loss position as of June 30, 2020, after factoring in the allowance for credit losses, and December 31, 2019.

(in thousands)	June 30, 2020			December 31, 2019		
	< 12 Mos.	12 Mos. & Greater	Total	< 12 Mos.	12 Mos. & Greater	Total
U.S. government						
Fair value	\$ —	\$ —	\$ —	\$ 2,505	\$ 8,463	\$ 10,968
Amortized cost	—	—	—	2,506	8,494	11,000
Unrealized Loss	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (1)</u>	<u>\$ (31)</u>	<u>\$ (32)</u>
U.S. agency						
Fair value	\$ —	\$ —	\$ —	\$ 6,794	\$ —	\$ 6,794
Amortized cost	—	—	—	6,836	—	6,836
Unrealized Loss	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (42)</u>	<u>\$ —</u>	<u>\$ (42)</u>
Non-U.S. government						
Fair value	\$ 1,995	\$ —	\$ 1,995	\$ —	\$ —	\$ —
Amortized cost	2,020	—	2,020	—	—	—
Unrealized Loss	<u>\$ (25)</u>	<u>\$ —</u>	<u>\$ (25)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Agency MBS						
Fair value	\$ 22,294	\$ 468	\$ 22,762	\$ 21,548	\$ 41,718	\$ 63,266
Amortized cost	22,368	471	22,839	21,664	42,165	63,829
Unrealized Loss	<u>\$ (74)</u>	<u>\$ (3)</u>	<u>\$ (77)</u>	<u>\$ (116)</u>	<u>\$ (447)</u>	<u>\$ (563)</u>
ABS/CMBS*						
Fair value	\$ 34,445	\$ 15,578	\$ 50,023	\$ 74,968	\$ 18,036	\$ 93,004
Amortized cost	35,297	15,931	51,228	75,332	18,148	93,480
Unrealized Loss	<u>\$ (852)</u>	<u>\$ (353)</u>	<u>\$ (1,205)</u>	<u>\$ (364)</u>	<u>\$ (112)</u>	<u>\$ (476)</u>
Corporate						
Fair value	\$ 110,503	\$ 5,185	\$ 115,688	\$ 16,478	\$ 9,348	\$ 25,826
Amortized cost	116,140	5,850	121,990	16,950	9,694	26,644
Unrealized Loss	<u>\$ (5,637)</u>	<u>\$ (665)</u>	<u>\$ (6,302)</u>	<u>\$ (472)</u>	<u>\$ (346)</u>	<u>\$ (818)</u>
Municipal						
Fair value	\$ 12,038	\$ —	\$ 12,038	\$ 47,018	\$ —	\$ 47,018
Amortized cost	12,108	—	12,108	47,740	—	47,740
Unrealized Loss	<u>\$ (70)</u>	<u>\$ —</u>	<u>\$ (70)</u>	<u>\$ (722)</u>	<u>\$ —</u>	<u>\$ (722)</u>
Total fixed income						
Fair value	\$ 181,275	\$ 21,231	\$ 202,506	\$ 169,311	\$ 77,565	\$ 246,876
Amortized cost	187,933	22,252	210,185	171,028	78,501	249,529
Unrealized Loss	<u>\$ (6,658)</u>	<u>\$ (1,021)</u>	<u>\$ (7,679)</u>	<u>\$ (1,717)</u>	<u>\$ (936)</u>	<u>\$ (2,653)</u>

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

The following table shows the composition of the fixed income securities in unrealized loss positions, after factoring in the allowance for credit losses, at June 30, 2020 by the National Association of Insurance Commissioners (NAIC) rating and the generally equivalent Standard & Poor's (S&P) and Moody's ratings. The vast majority of the securities are rated by S&P and/or Moody's.

NAIC Rating	Equivalent S&P Rating	Equivalent Moody's Rating	(dollars in thousands)			Percent to Total
			Amortized Cost	Fair Value	Unrealized Loss	
1	AAA/AA/A	Aaa/Aa/A	\$ 100,257	\$ 98,089	\$ (2,168)	28.2 %
2	BBB	Baa	10,076	9,860	(216)	2.8 %
3	BB	Ba	51,161	49,264	(1,897)	24.7 %
4	B	B	42,541	40,086	(2,455)	32.0 %
5	CCC	Caa	5,822	5,019	(803)	10.5 %
6	CC or lower	Ca or lower	328	188	(140)	1.8 %
		Total	<u>\$ 210,185</u>	<u>\$ 202,506</u>	<u>\$ (7,679)</u>	<u>100.0 %</u>

Unrealized Gains and Losses on Equity Securities

Unrealized gains recognized on equity securities still held as of June 30, 2020 were \$72.4 million during the second quarter, while unrealized losses were \$42.9 million during the first half of 2020. Comparatively, unrealized gains recognized on equity securities still held as of June 30, 2019 were \$12.9 million during the second quarter and \$54.8 million during the first half of 2019.

Other Invested Assets

We had \$63.4 million of other invested assets at June 30, 2020, compared to \$70.4 million at the end of 2019. Other invested assets include investments in low income housing tax credit partnerships (LIHTC), membership in the Federal Home Loan Bank of Chicago (FHLBC), investments in private funds and investments in restricted stock. Our LIHTC investments are carried at amortized cost and our investment in FHLBC stock is carried at cost. Due to the nature of the LIHTC and our membership in the FHLBC, their carrying amounts approximate fair value. The private funds are carried at fair value, using each investment's net asset value. Restricted stock is carried at quoted market prices, as the restrictions expire within one year.

Our LIHTC interests had a balance of \$21.6 million at June 30, 2020, compared to \$23.3 million at December 31, 2019 and recognized a total tax benefit of \$0.9 million during the second quarter of 2020, compared to \$0.6 million the prior year. For the six-month periods ended June 30, 2020 and 2019, our LIHTC interest recognized a total benefit of \$1.8 million and \$1.2 million, respectively. Our unfunded commitment for our LIHTC investments totaled \$7.4 million at June 30, 2020 and will be paid out in installments through 2035.

As of June 30, 2020, \$14.6 million of investments were pledged as collateral with the FHLBC to ensure timely access to the secured lending facility that ownership of FHLBC stock provides. As of and during the six-month period ended June 30, 2020, there were no outstanding borrowings with the FHLBC.

Our investments in private funds totaled \$24.4 million at June 30, 2020, compared to \$46.0 million at December 31, 2019, and we had \$10.4 million of associated unfunded commitments at June 30, 2020. Our interest in private funds is generally restricted from being transferred or otherwise redeemed without prior consent by the respective entities. During the first quarter of 2020, one of the private funds transitioned into a publicly traded common stock. Short term restrictions, limiting our ability to sell without prior approval, were established and remain in place. Our investment in restricted stock was \$15.8 million as of June 30, 2020. For our remaining investments in private funds, the timed dissolution of the partnerships would trigger redemption.

Cash

Cash consists of uninvested balances in bank accounts. We had a cash balance of \$84.8 million at June 30, 2020, compared to \$46.2 million at the end of 2019.

3. HISTORICAL LOSS AND LAE DEVELOPMENT

The following table is a reconciliation of our unpaid losses and settlement expenses (LAE) for the first six months of 2020 and 2019:

(in thousands)	For the Six-Month Periods Ended June 30,	
	2020	2019
Unpaid losses and LAE at beginning of year		
Gross	\$ 1,574,352	\$ 1,461,348
Ceded	(384,517)	(364,999)
Net	\$ 1,189,835	\$ 1,096,349
Adoption impact of ASU 2016-13 on reinsurance balances recoverable	\$ (1,345)	\$ —
Increase (decrease) in incurred losses and LAE		
Current accident year	\$ 253,031	\$ 239,053
Prior accident years	(40,808)	(40,837)
Total incurred	\$ 212,223	\$ 198,216
Loss and LAE payments for claims incurred		
Current accident year	\$ (25,588)	\$ (23,624)
Prior accident years	(148,885)	(126,972)
Total paid	\$ (174,473)	\$ (150,596)
Net unpaid losses and LAE at June 30	\$ 1,226,240	\$ 1,143,969
Unpaid losses and LAE at June 30		
Gross	\$ 1,590,996	\$ 1,506,279
Ceded	(364,756)	(362,310)
Net	\$ 1,226,240	\$ 1,143,969

We adopted ASU 2016-13, Financial Instruments – Credit Losses, on January 1, 2020, which required financial assets, including reinsurance balances recoverable, to be presented at the net amount expected to be collected. We previously maintained an allowance for uncollectible reinsurance balances prior to the adoption of this update. However, in order to comply with the updated requirements, we released \$1.3 million of the allowance on uncollectible reinsurance balances upon adoption. The implementation guidance required the cumulative-effect adjustment be made to the beginning balance of retained earnings, rather than through net earnings like historical changes have and ongoing modifications will continue to be recorded. See note 1. B. for more information on the adoption of the ASU.

For the first six months of 2020, incurred losses and LAE included \$40.8 million of favorable development on prior years' loss reserves. The majority of products experienced modest amounts of favorable development on prior accident years, with notable contributions from transportation, executive products, general liability, marine, small commercial and surety. No products experienced significant adverse development.

For the first six months of 2019, incurred losses and LAE included \$40.8 million of favorable development on prior years' loss reserves. Transportation, general liability, commercial excess and personal umbrella, professional services and surety were drivers of the favorable development. Executive products experienced adverse development.

Actuarial models base future emergence on historic experience, with adjustments for current trends, and the appropriateness of these assumptions involved more uncertainty as of June 30, 2020. We expect there will be impacts to the timing of loss emergence and ultimate loss ratios for certain coverages we underwrite as a result of the spread of COVID-19 and the related economic shutdown. The industry is experiencing new issues, including the postponement of civil court cases, the extension of various statutes of limitations, changes in settlement trends and a significant reduction in economic activity and insured exposure in some classes. Our booked reserves include consideration of these factors, but the duration and degree to which these issues persist, along with potential legislative, regulatory or judicial actions, could result in loss reserve deficiencies and reduce earnings in future periods.

4. INCOME TAXES

Our effective tax rate for the three and six-month periods ended June 30, 2020 was 19.8 percent and 13.0 percent, respectively, compared to 17.1 percent and 18.9 percent, respectively, for the same periods in 2019. Effective rates are dependent upon components of pretax earnings and the related tax effects. The effective rate was higher for the three-month period in 2020 due to higher levels of pre-tax earnings and lower levels of tax-favored adjustments compared to 2019. For the six-month period, lower levels of pre-tax earnings caused tax-favored adjustments to be larger on a percentage basis in 2020 compared to the prior year.

Income tax expense (benefit) attributable to income from operations for the three and six-month periods ended June 30, 2020 and 2019 differed from the amounts computed by applying the U.S. federal tax rate of 21 percent to pretax income by the items detailed in the below table. In interim periods, income taxes are adjusted to reflect the effective tax rate we anticipate for the year, with adjustments flowing through the other items, net line.

(in thousands)	For the Three-Month Periods Ended June 30, 2020		2019		For the Six-Month Periods Ended June 30, 2020		2019	
	Amount	%	Amount	%	Amount	%	Amount	%
Provision for income taxes at the statutory rate of 21%	\$ 24,124	21.0 %	\$ 10,254	21.0 %	\$ 7,458	21.0 %	\$ 27,419	21.0 %
Increase (reduction) in taxes resulting from:								
Excess tax benefit on share-based compensation	(265)	(0.2)%	(2,191)	(4.5)%	(1,293)	(3.6)%	(2,932)	(2.3)%
Tax exempt interest income	(323)	(0.3)%	(309)	(0.6)%	(636)	(1.8)%	(654)	(0.5)%
Dividends received deduction	(212)	(0.2)%	(214)	(0.4)%	(484)	(1.4)%	(417)	(0.3)%
ESOP dividends paid deduction	(137)	(0.1)%	(140)	(0.3)%	(269)	(0.8)%	(277)	(0.2)%
Nondeductible expenses	161	0.1 %	414	0.8 %	364	1.0 %	922	0.7 %
Other items, net	(635)	(0.5)%	547	1.1 %	(524)	(1.4)%	568	0.5 %
Total tax expense (benefit)	\$ 22,713	19.8 %	\$ 8,361	17.1 %	\$ 4,616	13.0 %	\$ 24,629	18.9 %

5. STOCK BASED COMPENSATION

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

In 2015, our shareholders approved the 2015 RLI Corp. Long-Term Incentive Plan (2015 LTIP), which provides for equity-based compensation and replaced the 2010 LTIP. In conjunction with the adoption of the 2015 LTIP, effective May 7, 2015, options were no longer granted under the 2010 LTIP. Awards under the 2015 LTIP may be in the form of restricted stock, restricted stock units, stock options (non-qualified only), stock appreciation rights, performance units as well as other stock-based awards. Eligibility under the 2015 LTIP is limited to employees and directors of the Company or any affiliate. The granting of awards under the 2015 LTIP is solely at the discretion of the board of directors. The maximum number of shares of common stock available for distribution under the 2015 LTIP is 4,000,000 shares (subject to adjustment for changes in our capitalization and other events). Since the plan's approval in 2015, we have awarded 2,312,835 stock options and restricted stock units under the 2015 LTIP.

Stock Options

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

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

[Table of Contents](#)

The following tables summarize option activity for the six-month periods ended June 30, 2020 and 2019:

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2020	1,667,290	\$ 62.52		
Options granted	30,375	94.62		
Options exercised	(72,180)	45.92		\$ 3,181
Options canceled/forfeited	(2,370)	66.57		
Outstanding options at June 30, 2020	1,623,115	\$ 63.86	4.82	\$ 30,819
Exercisable options at June 30, 2020	878,335	\$ 57.70	3.89	\$ 21,544

	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in 000's)
Outstanding options at January 1, 2019	1,964,880	\$ 54.24		
Options granted	292,150	80.36		
Options exercised	(414,470)	44.70		\$ 14,941
Options canceled/forfeited	(33,600)	57.61		
Outstanding options at June 30, 2019	1,808,960	\$ 60.59	5.57	\$ 45,448
Exercisable options at June 30, 2019	672,110	\$ 52.17	4.21	\$ 22,544

Through 2019, the majority of our annual stock option grants were authorized at our regular board meeting in May. In addition, quarterly grants to certain retirement eligible employees were historically authorized at the May meeting. Since stock option grants to retirement eligible employees are fully expensed when issued, the approach allowed for a more even expense distribution throughout the year. In 2020, the COVID-19 pandemic created economic uncertainty and the Company deemed it prudent to defer any decision on whether to grant stock options until a later date. The options granted in the six-month period ended June 30, 2020 related to the quarterly grants authorized at the May 2019 board meeting.

In the first six months of 2020, 30,375 stock options were granted with a weighted average exercise price of \$94.62 and a weighted average fair value of \$14.48. We recognized \$0.6 million of expense in the second quarter of 2020 and \$1.6 million in the first six months of 2020 related to options vesting. Since options granted under our 2015 LTIP are non-qualified, we recorded a tax benefit of \$0.1 million in the second quarter of 2020 and \$0.3 million in the first six months of 2020 related to this compensation expense. Total unrecognized compensation expense relating to outstanding and unvested options was \$3.6 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized \$1.4 million of compensation expense in the second quarter of 2019 and \$2.4 million in the first six months of 2019. We recorded a tax benefit of \$0.3 million in the second quarter of 2019 and \$0.5 million in the first six months of 2019 related to this compensation expense.

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

	2020	2019
Weighted-average fair value of grants	\$ 14.48	\$ 13.33
Risk-free interest rates	1.54 %	2.42 %
Dividend yield	2.69 %	2.69 %
Expected volatility	22.68 %	22.71 %
Expected option life	4.99 years	4.96 years

The risk-free rate was determined based on U.S. treasury yields that most closely approximated the option's expected life. The dividend yield was determined based on the average annualized quarterly dividends paid during the most recent five-year period and incorporated a consideration for special dividends paid in recent history. The expected volatility was calculated based

on the median of the rolling volatilities for the expected life of the options. The expected option life was determined based on historical exercise behavior and the assumption that all outstanding options will be exercised at the midpoint of the current date and remaining contractual term, adjusted for the demographics of the current year's grant.

Restricted Stock Units

In addition to stock options, restricted stock units (RSUs) are granted with a value equal to the closing stock price of the Company's stock on the dates the units are granted. These units generally have a three-year cliff vesting, but have an accelerated vesting feature for participants who are retirement eligible, defined by the plan as those individuals whose age and years of service equals 75. In addition, the RSUs have dividend participation, which accrue as additional units and are settled with granted stock units at the end of the vesting period. RSUs are generally granted at our regular board meeting in May. However, in 2020, the COVID-19 pandemic created economic uncertainty and the Company deferred the decision on whether to grant RSUs to employees and outside directors until a later date.

As of June 30, 2020, 45,350 RSUs have been granted to employees under the 2015 LTIP and 28,946 remain outstanding. We recognized \$0.1 million of expense on these units in the second quarter of 2020 and \$0.3 million in the first six months of 2020. Total unrecognized compensation expense relating to outstanding and unvested RSUs was \$0.6 million, which will be recognized over the remainder of the vesting period. Comparatively, we recognized \$0.2 million in the second quarter of 2019 and \$0.3 million in the first six months of 2019.

In 2019, each outside director received RSUs with a fair market value that approximated \$50 thousand on the date of grant as part of annual director compensation. Director RSUs vest one year from the date of grant. As of June 30, 2020, 15,085 restricted stock units have been granted to directors under the 2015 LTIP and none remain outstanding. We recognized less than \$0.1 million of compensation expense on these units in the second quarter of 2020 and \$0.2 million in the first six months of 2020. Comparatively, we recognized \$0.2 million of compensation expense on these units in the second quarter of 2019 and \$0.3 million in the first six months of 2019.

6. OPERATING SEGMENT INFORMATION

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

REVENUES (in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
	2020	2019	2020	2019
Casualty	\$ 135,215	\$ 138,344	\$ 278,635	\$ 275,244
Property	45,387	39,972	89,735	78,718
Surety	28,132	29,225	55,946	58,268
Net premiums earned	\$ 208,734	\$ 207,541	\$ 424,316	\$ 412,230
Net investment income	16,917	16,998	34,695	33,563
Net realized gains (losses)	(2,109)	4,764	13,043	13,832
Net unrealized gains (losses) on equity securities	74,705	8,810	(55,690)	42,308
Total consolidated revenue	<u>\$ 298,247</u>	<u>\$ 238,113</u>	<u>\$ 416,364</u>	<u>\$ 501,933</u>
NET EARNINGS (LOSS) (in thousands)	2020	2019	2020	2019
Casualty	\$ 9,733	\$ 6,939	\$ 8,410	\$ 12,282
Property	6,167	(436)	16,075	7,810
Surety	8,263	8,429	16,917	17,273
Net underwriting income	\$ 24,163	\$ 14,932	\$ 41,402	\$ 37,365
Net investment income	16,917	16,998	34,695	33,563
Net realized gains (losses)	(2,109)	4,764	13,043	13,832
Net unrealized gains (losses) on equity securities	74,705	8,810	(55,690)	42,308
General corporate expense and interest on debt	(3,897)	(5,144)	(7,549)	(10,281)
Equity in earnings of unconsolidated investees	5,100	8,468	9,614	13,782
Earnings before income taxes	\$ 114,879	\$ 48,828	\$ 35,515	\$ 130,569
Income tax expense	22,713	8,361	4,616	24,629
Net earnings	<u>\$ 92,166</u>	<u>\$ 40,467</u>	<u>\$ 30,899</u>	<u>\$ 105,940</u>

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

NET PREMIUMS EARNED (in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
	2020	2019	2020	2019
Casualty				
Commercial excess and personal umbrella	\$ 42,321	\$ 34,340	\$ 82,409	\$ 66,621
General liability	22,651	25,347	46,649	49,235
Professional services	21,384	19,275	42,079	39,574
Commercial transportation	11,139	20,508	32,324	40,912
Small commercial	15,791	13,315	31,424	26,503
Executive products	6,975	6,381	14,306	12,450
Other casualty	14,954	19,178	29,444	39,949
Total	<u>\$ 135,215</u>	<u>\$ 138,344</u>	<u>\$ 278,635</u>	<u>\$ 275,244</u>
Property				
Marine	\$ 20,712	\$ 18,579	\$ 40,289	\$ 35,600
Commercial property	19,048	16,275	38,203	33,150
Specialty personal	4,936	4,792	9,936	9,376
Other property	691	326	1,307	592
Total	<u>\$ 45,387</u>	<u>\$ 39,972</u>	<u>\$ 89,735</u>	<u>\$ 78,718</u>
Surety				
Commercial	\$ 10,806	\$ 10,975	\$ 21,744	\$ 21,787
Miscellaneous	10,499	11,280	21,015	22,882
Contract	6,827	6,970	13,187	13,599
Total	<u>\$ 28,132</u>	<u>\$ 29,225</u>	<u>\$ 55,946</u>	<u>\$ 58,268</u>
Grand Total	<u>\$ 208,734</u>	<u>\$ 207,541</u>	<u>\$ 424,316</u>	<u>\$ 412,230</u>

7. LEASES

Right-of-use (ROU) assets are included in the other assets line item and lease liabilities are included in the other liabilities line item of the consolidated balance sheet. We determine if a contract contains a lease at inception and recognize operating lease ROU assets and operating lease liabilities based on the present value of the future minimum lease payments at the commencement date. As our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at the commencement date in determining the present value of future payments. Lease agreements may include options to extend or terminate. The options are exercised at our discretion and are included in operating lease liabilities if it is reasonably certain the option will be exercised. Lease agreements have lease and non-lease components, which are accounted for as a single lease component. Operating lease cost for future minimum lease payments is recognized on a straight-line basis over the lease term. Variable lease cost is expensed in the period in which the obligation is incurred. Sublease income is recognized on a straight-line basis over the sublease term.

The Company's operating lease obligations are for branch office facilities. Our leases have remaining lease terms of 1 to 15 years. The components of lease expense and other lease information as of and during the three and six-month periods ended June 30, 2020 and 2019 are as follows:

[Table of Contents](#)

(in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
	2020	2019	2020	2019
Operating lease cost	\$ 1,370	\$ 1,445	\$ 2,776	\$ 2,927
Variable lease cost	320	892	675	1,210
Sublease income	(42)	-	(42)	-
Total lease cost	<u>\$ 1,648</u>	<u>\$ 2,337</u>	<u>\$ 3,409</u>	<u>\$ 4,137</u>
Cash paid for amounts included in measurement of lease liabilities				
Operating cash outflows from operating leases	\$ 1,503	\$ 1,402	\$ 2,990	\$ 2,797
ROU assets obtained in exchange for new operating lease liabilities	\$ -	\$ 231	\$ 15	\$ 951
Reduction to ROU assets resulting from reduction to lease liabilities	\$ -	\$ 1,279	\$ -	\$ 1,279
Other non-cash reductions to ROU assets	\$ -	\$ -	\$ 1,192	\$ -

(in thousands)	June 30, 2020	December 31, 2019
Operating lease ROU assets	\$ 18,648	\$ 22,335
Operating lease liabilities	\$ 21,766	\$ 24,475
Weighted-average remaining lease term - operating leases	4.26 years	4.69 years
Weighted-average discount rate - operating leases	2.34 %	2.33 %

Future minimum lease payments under non-cancellable leases as of June 30, 2020 were as follows:

(in thousands)	June 30, 2020
2020	\$ 3,002
2021	5,976
2022	5,904
2023	4,386
2024	2,334
Thereafter	1,365
Total future minimum lease payments	<u>\$ 22,967</u>
Less imputed interest	(1,201)
Total operating lease liability	<u>\$ 21,766</u>

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

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 the Company. 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 in “Item 1A. Risk Factors” within the Annual Report on Form 10-K for the year ended December 31, 2019 and Part II within this report. 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.

OVERVIEW

RLI Corp. is a U.S.-based, specialty insurance company that underwrites select property and casualty insurance through major subsidiaries collectively known as RLI Insurance Group (Group). Our focus is on niche markets and developing unique products that are tailored to customers' needs. We hire underwriters and claim examiners with deep expertise and provide exceptional customer service and support. We maintain a highly diverse product portfolio and underwrite for profit in all market conditions. In 2019, we achieved our 24th consecutive year of underwriting profitability. Over the 24 year period, we averaged an 88.3 combined ratio. This drives our ability to provide shareholder returns in three different ways: the underwriting income itself, net investment income from our investment portfolio and long-term appreciation in our equity portfolio.

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

The property and casualty insurance business is cyclical and influenced by many factors, including price competition, economic conditions, natural or man-made disasters (for example, earthquakes, hurricanes, pandemics and terrorism), interest rates, state regulations, court decisions and changes in the law. One of the unique and challenging features of the property and casualty insurance business is that coverages must be priced before costs have fully developed, because premiums are charged before claims are incurred. This requires that liabilities be estimated and recorded in recognition of future loss and settlement obligations. Due to the inherent uncertainty in estimating these liabilities, there can be no assurance that actual liabilities will not be more or less than recorded amounts; if actual liabilities differ from recorded amounts, there will be an adverse or favorable effect on net earnings.

The casualty portion of our business consists largely of commercial excess, personal umbrella, general liability, transportation and executive products coverages, as well as package business and other specialty coverages, such as professional liability and workers' compensation for office-based professionals. We also assume a limited amount of hard-to-place risks through a quota share reinsurance agreement. The casualty business is subject to the risk of estimating losses and related loss reserves because the ultimate settlement of a casualty claim may take several years to fully develop. The casualty segment is also subject to inflation risk and may be affected by evolving legislation and court decisions that define the extent of coverage and the amount of compensation due for injuries or losses.

Our property segment is comprised primarily of commercial fire, earthquake, difference in conditions and marine coverages. We also offer select personal lines policies, including homeowners' coverages. Property insurance results are subject to the variability introduced by perils such as earthquakes, fires, hurricanes and other storms. 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 seek to limit our net aggregate exposure to a catastrophic event by minimizing the total policy limits written in a particular region, purchasing reinsurance and maintaining consistent policy terms and conditions throughout insurance cycles. We also use computer-assisted modeling techniques to provide estimates that help the Company carefully manage the concentration of risks exposed to catastrophic events.

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

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

GAAP, non-GAAP and Performance Measures

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

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

Underwriting Income

Underwriting income or profit represents one measure of the pretax profitability of our insurance operations and is derived by subtracting losses and settlement expenses, policy acquisition costs and insurance operating expenses from net premiums earned, which are all GAAP financial measures. Each of these captions is presented in the statements of earnings but is not subtotaled. However, this information is available in total and by segment in note 6 to the unaudited condensed consolidated interim financial statements in this quarterly report on Form 10-Q and in note 12 to the consolidated financial statements in our 2019 Annual Report on Form 10-K, regarding operating segment information. The nearest comparable GAAP measure is earnings before income taxes which, in addition to underwriting income, includes net investment income, net realized gains or losses, net unrealized gain or losses on equity securities, general corporate expenses, debt costs and our portion of earnings from unconsolidated investees. A reconciliation of net earnings to underwriting income follows:

(in thousands)	For the Three-Month Periods Ended June 30,		For the Six-Month Periods Ended June 30,	
	2020	2019	2020	2019
Net earnings	\$ 92,166	\$ 40,467	\$ 30,899	\$ 105,940
Income tax expense	22,713	8,361	4,616	24,629
Earnings before income taxes	\$ 114,879	\$ 48,828	\$ 35,515	\$ 130,569
Equity in earnings of unconsolidated investees	(5,100)	(8,468)	(9,614)	(13,782)
General corporate expenses	1,994	3,283	3,749	6,559
Interest expense on debt	1,903	1,861	3,800	3,722
Net unrealized (gains) losses on equity securities	(74,705)	(8,810)	55,690	(42,308)
Net realized (gains) losses	2,109	(4,764)	(13,043)	(13,832)
Net investment income	(16,917)	(16,998)	(34,695)	(33,563)
Net underwriting income	<u>\$ 24,163</u>	<u>\$ 14,932</u>	<u>\$ 41,402</u>	<u>\$ 37,365</u>

Combined Ratio

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

Critical Accounting Policies

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

The most critical accounting policies involve significant estimates and include those used in determining the liability for unpaid losses and settlement expenses, investment valuation, recoverability of reinsurance balances, deferred policy acquisition costs and deferred taxes. For a detailed discussion of each of these policies, refer to our 2019 Annual Report on Form 10-K.

[Table of Contents](#)

We adopted ASU 2016-13, Financial Instruments – Credit Losses, on January 1, 2020, which eliminated the concept of other-than-temporary impairment and required the recognition of a reversible allowance for credit losses on available-for-sale fixed income securities. See note 1. B. for more information on the adoption of the ASU. Available-for-sale securities in the fixed income portfolio are subjected to several criteria to determine if those securities should be included in the allowance for expected credit loss evaluation, including:

- 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 of or non-payment of interest and/or principal,
- 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
- Downgrades in credit quality by a major rating agency.

If changes in interest rates and credit spreads do not reasonably explain the unrealized loss for an available-for-sale security or if any of the criteria above indicate a potential credit loss, the security is subjected to a discounted cash flow analysis. Inputs into the discounted cash flow analysis include prepayment assumptions for structured securities, default rates and recoverability rates based on credit rating. The allowance for any security is limited to the amount that the securities fair value is below amortized cost. If we intend to sell a security or if we determine it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis, any allowance for credit loss or unrealized loss would be written off and the amortized cost basis of the security would be written down to the security’s fair value.

There have been no other significant changes to critical accounting policies during the year.

IMPACT OF COVID-19

The coronavirus (COVID-19) pandemic continues to impact individuals, businesses and the economy. As an employee-owned company, the health and well-being of our customers, partners and associates is our highest priority. While a large percentage of our associates are still working from home, our processes and controls continue to operate effectively and we have been able to maintain the highest service and support levels possible for our customers.

It is difficult to predict how and to what extent the economic slowdown will have on our revenues in the coming months. To date, our most impacted product line has been public transportation. A large number of our passenger transportation customers have been unable to effectively operate under social-distancing protocols and stay-at-home orders. For the six-month period ended June 30, 2020, transportation gross written premium was down \$33.3 million when compared to 2019. We would expect transportation premium to continue to be down from prior periods until the use of public transportation increases, which may not be until after there is a vaccine, effective treatment or significant reduction in cases. Additionally, slowdowns in the construction industry contributed to premium declines for our general liability and surety products in the second quarter. A number of our products support the construction industry and revenues may continue to be impacted to the extent this sector experiences disruption. However, we have many product lines that may see little to no impact on the amount of premium we write, including our personal lines products, management liability products and property businesses.

We have been fair and flexible with our customers in regards to modifying exposures and payment terms and we are in compliance with any applicable state regulatory directives on such changes. Insureds continue to make payments in accordance with the agreed upon schedules and we have not experienced a material increase in the amount of expense associated with uncollectible receivables.

The loss exposure arising out of the spread of COVID-19 and resulting shutdown will take time to resolve. We do not offer event cancellation, travel, trade credit or pandemic-related coverages which would be more directly impacted by the COVID-19 pandemic. The Company has received a number of claims, the majority of which relate to business interruption. We are reviewing the individual circumstances of each claim submitted and will fulfill our obligation to pay if coverage applies. The derivative implications that COVID-19 has on the economy may have negative implications on products that are correlated with the credit cycle, including, but not limited to, some of our executive products and surety offerings. In the second quarter of 2020, \$5.8 million of net reserves were established to address the increased risk of loss and expense that emanated from the economic downturn brought on by the pandemic. Combined with the reserves established in the first quarter

that addressed the expected increase in costs to investigate and defend business interruption claims, \$10.8 million of COVID-19 related net losses have been recognized in the first six months of 2020.

Actuarial models base future emergence on historic experience, with adjustments for current trends, and the appropriateness of these assumptions involved greater uncertainty as of June 30, 2020. We expect there will be impacts to the timing of loss emergence and ultimate loss ratios for certain coverages. The industry is experiencing new issues, including the postponement of civil court cases, the extension of various statutes of limitations, changes in settlement trends and a significant reduction in economic activity and insured exposure in some classes. Our booked reserves include consideration of these factors, but the duration and degree to which these issues persist, along with potential legislative, regulatory or judicial actions, could result in loss reserve deficiencies and reduce earnings in future periods.

We continue to evaluate opportunities for expense savings and efficiencies and have taken targeted actions to reduce or defer expenses, including certain hiring freezes, position consolidations and executive merit increase suspensions. Travel was limited and any decision on granting share-based compensation, which normally takes place at our May board meeting, was deferred until a later date, resulting in a reduced level of compensation expense in the second quarter. Bonus and profit sharing expense is correlated with company performance and is responsible for the largest portion of the total expense decline for the six-month period ended June 30, when compared to 2019. The performance-related expenses recognized for the 2020 fiscal year will be dependent on the full year's results and may increase or decrease in the second half of the year.

Although we have recovered a large portion of the market value declines recorded in the first quarter, equity securities have not fully returned to levels recorded at year end. Net after-tax realized and unrealized losses on equity securities were \$33.9 million in the first half of 2020. Conversely, lower interest rates increased the fair value of the fixed income portfolio, which resulted in \$40.5 million of after-tax other comprehensive earnings for the six-month period ended June 30, 2020. With the decline in yields, reinvestment rates are now lower than in previous years, which will cap the portfolio's ability to generate higher levels of investment income, absent a larger invested asset base.

Maui Jim, Inc. (Maui Jim) and Prime Holdings Insurance Services, Inc. (Prime) continued to contribute towards positive net earnings. While earnings for Prime were modestly higher, Maui Jim results were negatively impacted by the shutdown much of the traditional retail sector experienced during the second quarter. The economic downturn may continue to impact the results of these investees, particularly if there is any lasting impact on the retail sector as it relates to Maui Jim.

We produced solid operating results in the first half of the year and believe our financial position has remained strong despite the impact of the COVID-19 pandemic. We generated \$83.8 million of net operating cash inflows and believe we have adequate liquidity. Our revolving credit facility provides for a borrowing capacity of \$60.0 million, which can be increased to \$120.0 million under certain circumstances. Additionally, our membership in the Federal Home Loan Bank system provides a secured lending facility with an aggregate borrowing capacity of approximately \$30.0 million. There were no amounts outstanding under any of these facilities as of June 30, 2020. In addition to the \$160.7 million of cash and other investments maturing within one year as of June 30, 2020, we believe that cash generated from operations, the liquidity of our fixed income portfolio and our unused lines of credit provide sufficient sources of cash to meet our anticipated needs over the next 12 to 24 months.

Ultimately, the extent to which COVID-19 will impact our business will be influenced by how long it takes for the economy to recover. We continue to evaluate all aspects of our operations and are making necessary adjustments to manage our business. Our diversified portfolio of products and financial strength have allowed us to remain on solid footing. We believe we have a strong and sustainable underwriting approach that will allow us to weather the economic downturn and uncertainty we are currently experiencing.

RESULTS OF OPERATIONS

Six Months Ended June 30, 2020 Compared to Six Months Ended June 30, 2019

Consolidated revenue for the first half of 2020 decreased \$85.6 million from the first half of 2019 as performance in the equity portfolio varied significantly between the periods. Overall market declines resulted in \$55.7 million of unrealized losses on equity securities in 2020, while positive returns generated \$42.3 million of unrealized gains in our equity portfolio in the first half of 2019. Net premiums earned for the Group increased 3 percent, driven by growth from our casualty and property segments. Investment income increased 3 percent due to a larger asset base relative to the prior year. Realized gains during the first half were \$13.0 million and were comprised of \$12.8 million of realized gains on equity securities from rebalancing our portfolio, \$2.6 million of realized gains on the fixed income portfolio and \$2.4 million of other realized losses. This compares

[Table of Contents](#)

to \$12.3 million of realized gains on the equity portfolio, \$1.3 million of realized gains on the fixed income portfolio and \$0.2 million of other realized gains for the same period in 2019.

	For the Six-Month Periods Ended June 30,	
	2020	2019
Consolidated revenues (in thousands)		
Net premiums earned	\$ 424,316	\$ 412,230
Net investment income	34,695	33,563
Net realized gains (losses)	13,043	13,832
Net unrealized gains (losses) on equity securities	(55,690)	42,308
Total consolidated revenue	<u>\$ 416,364</u>	<u>\$ 501,933</u>

Net earnings for the first six months of 2020 totaled \$30.9 million, compared to \$105.9 million for the same period last year. The decrease in earnings for 2020 was primarily attributed to \$44.0 million of net after-tax unrealized losses on equity securities, compared to \$33.4 million of after-tax unrealized gains in 2019. Underwriting results for both periods reflect profitable current accident year results and favorable development from prior years' loss reserves. Favorable development on prior years' loss reserves provided additional pretax earnings of \$40.8 million in the first half of 2020 and 2019. Pretax losses from storms and civil unrest were \$6.5 million, compared to \$5.0 million of storm losses for the same period in 2019. Pretax bonus and profit sharing-related expenses associated with the net impact of prior years' reserve development and catastrophe losses totaled \$5.1 million in 2020, compared to \$5.3 million in 2019. These performance-related expenses affected policy acquisition, insurance operating and general corporate expenses. Bonus and profit-sharing amounts earned by executives, managers and associates are predominately influenced by corporate performance including operating earnings, combined ratio and return on capital.

During the first half of 2020, equity in earnings of unconsolidated investees totaled \$9.6 million. This amount includes \$5.2 million from Maui Jim and \$4.4 million from Prime. Comparatively, the first half of 2019 reflected \$13.8 million of earnings, including \$10.1 million from Maui Jim and \$3.7 million from Prime. The decline in earnings from Maui Jim is reflective of the shutdown much of the traditional retail sector experienced as a result of the pandemic during the second quarter.

Comprehensive earnings totaled \$71.4 million for the first six months of 2020, compared to \$163.1 million for the first half of 2019. Other comprehensive earnings primarily included net after-tax unrealized gains from the fixed income portfolio and totaled \$40.5 million in the first half of 2020, compared to \$57.2 million in 2019. The unrealized gains were attributable to declining interest rates in both periods, which increased the fair value of securities held in the fixed income portfolio. However, wider credit spreads partially offset the impact of the lower treasury rates in 2020.

Premiums

Gross premiums written for the Group increased \$18.8 million, or 4 percent, for the first half of 2020 when compared to the same period of 2019. Products in our property and casualty segments drove the growth. Net premiums earned increased \$12.1 million, or 3 percent, also driven by products in our property and casualty segments.

(in thousands)	Gross Premiums Written			Net Premiums Earned		
	For the Six-Month Periods Ended June 30,			For the Six-Month Periods Ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Casualty						
Commercial excess and personal umbrella	\$ 115,533	\$ 90,422	28 %	\$ 82,409	\$ 66,621	24 %
General liability	51,357	54,773	(6) %	46,649	49,235	(5) %
Professional services	45,967	44,984	2 %	42,079	39,574	6 %
Commercial transportation	15,097	48,391	(69) %	32,324	40,912	(21) %
Small commercial	33,257	30,208	10 %	31,424	26,503	19 %
Executive products	47,959	37,649	27 %	14,306	12,450	15 %
Other casualty	40,113	34,803	15 %	29,444	39,949	(26) %
Total	<u>\$ 349,283</u>	<u>\$ 341,230</u>	2 %	<u>\$ 278,635</u>	<u>\$ 275,244</u>	1 %
Property						
Marine	\$ 46,925	\$ 44,150	6 %	\$ 40,289	\$ 35,600	13 %
Commercial property	67,090	57,450	17 %	38,203	33,150	15 %
Specialty personal	10,177	10,957	(7) %	9,936	9,376	6 %
Other property	1,815	824	120 %	1,307	592	121 %
Total	<u>\$ 126,007</u>	<u>\$ 113,381</u>	11 %	<u>\$ 89,735</u>	<u>\$ 78,718</u>	14 %
Surety						
Commercial	\$ 20,902	\$ 22,223	(6) %	\$ 21,744	\$ 21,787	(0) %
Miscellaneous	22,260	22,400	(1) %	21,015	22,882	(8) %
Contract	14,533	14,949	(3) %	13,187	13,599	(3) %
Total	<u>\$ 57,695</u>	<u>\$ 59,572</u>	(3) %	<u>\$ 55,946</u>	<u>\$ 58,268</u>	(4) %
Grand Total	<u>\$ 532,985</u>	<u>\$ 514,183</u>	4 %	<u>\$ 424,316</u>	<u>\$ 412,230</u>	3 %

Casualty

Gross premiums written for the casualty segment were up \$8.1 million in the first six months of 2020. Premiums from commercial excess and personal umbrella increased \$25.1 million, due to an expanded distribution base in personal umbrella and rate increases. Small commercial continued to benefit from new production sources and geographic expansion. Substantial rate increases led to a 27 percent increase for our executive products group. Other casualty increased \$5.3 million, as our general binding authority (GBA) business continued to grow.

Commercial transportation has been significantly affected by the stay at home orders associated with COVID-19, particularly our public lines. Public transportation focuses on charter, school and transit busses, which stopped running to a large degree in March. The reduced utilization led to a \$33.3 million decline in gross premiums written in the first six months of 2020.

Property

Gross premiums written for the property segment were up \$12.6 million in the first half of 2020. Our commercial property business was up \$9.6 million, as an improving market allowed our underwriters to find more opportunities with acceptable rate levels. Additionally, rates on wind-prone and earthquake exposures continued to increase over the first half of the year. Rate increases and market disruption, which created new business opportunities, led to \$2.8 million of growth for our marine product. Other property premium increased as a result of property exposed GBA business that continues to gain scale.

Surety

The surety segment recorded gross premiums written of \$57.7 million for the first six months of 2020, a decrease of \$1.9 million from the same period last year. The economic slowdown and decreased commodity pricing has reduced demand for surety bonds. Additionally, we continually monitor our portfolio for higher risk accounts and have selectively eliminated exposures that no longer met our underwriting standards.

Underwriting Income

Underwriting income for the Group totaled \$41.4 million for the first six months of 2020, compared to \$37.4 million in the same period of 2019. Both periods reflect positive underwriting results for the current accident year and similar amounts of favorable reserve development on prior accident years. The combined ratio for the Group totaled 90.2 in the first half of 2020, compared to 90.9 in the same period of 2019. The loss ratio increased to 50.0 from 48.1, primarily due to the addition of \$10.8 million in current accident year reserves related to COVID-19 loss and claim defense costs. The Group's expense ratio decreased to 40.2 from 42.8, as 2019 experienced stronger growth in book value, which led to larger levels of bonus and profit-sharing expenses.

	For the Six-Month Periods Ended June 30,	
	2020	2019
Underwriting income (in thousands)		
Casualty	\$ 8,410	\$ 12,282
Property	16,075	7,810
Surety	16,917	17,273
Total	\$ 41,402	\$ 37,365
Combined ratio		
Casualty	97.0	95.5
Property	82.1	90.1
Surety	69.8	70.4
Total	90.2	90.9

Casualty

The casualty segment recorded underwriting earnings of \$8.4 million in the first half of 2020, compared to \$12.3 million of underwriting income for the same period last year. Reserve releases reduced loss and settlement expenses for the casualty segment by \$27.5 million, primarily on accident years 2016 through 2019. Transportation, general liability, executive products and small commercial were drivers of the favorable development. In comparison, \$30.7 million of reserves were released in the first half of 2019. General liability, professional services, transportation, commercial excess, personal umbrella and small commercial developed favorably, while executive products developed adversely.

The combined ratio for the casualty segment was 97.0 in 2020, compared to 95.5 in 2019. The segment's loss ratio was 61.7 in 2020, up from 58.3 in 2019. The loss ratio increased in 2020 as a result of less favorable development on prior years' reserves and the addition of \$7.7 million in current year reserves related to COVID-19 loss and defense costs. The expense ratio for the casualty segment was 35.3, down from 37.2 for the same period last year, as reduced levels of bonus and profit-sharing expenses were incurred.

Property

The property segment recorded underwriting income of \$16.1 million for the first six months of 2020, compared to \$7.8 million for the same period last year. Underwriting results for 2020 included \$5.5 million of favorable development on prior years' loss and catastrophe reserves, primarily from the marine business, \$5.3 million of storm and civil unrest losses and \$2.0 million of reserves related to COVID-19 investigative and defense costs. Comparatively, the 2019 underwriting results included \$2.1 million of favorable development on prior years' loss and catastrophe reserves and \$4.7 million of storm losses.

Underwriting results for the first half of 2020 translated into a combined ratio of 82.1, compared to 90.1 for the same period last year. The segment's loss ratio was 41.8 in 2020, down from 45.1 in 2019 due to lower current accident year losses and more favorable development on prior years' reserves. The segment's expense ratio decreased to 40.3 in 2020 from 45.0 in the prior year, as increased levels of earned premium allowed the segment to better leverage expenses.

Surety

The surety segment recorded underwriting income of \$16.9 million for the first half of 2020, compared to \$17.3 million for the same period last year. Both periods reflected positive current accident year underwriting performance and benefited from favorable development on prior years' loss reserves. Results for 2020 included favorable development on prior accident

[Table of Contents](#)

years' reserves, which decreased loss and settlement expenses for the segment by \$7.8 million, and offset \$1.1 million in current year reserves established for COVID-19 related losses. Comparatively, 2019 results included favorable development on prior accident years' loss reserves, which decreased the segment's loss and settlement expenses by \$8.0 million.

The combined ratio for the surety segment totaled 69.8 for the first six months of 2020, compared to 70.4 for the same period in 2019. The segment's loss ratio was 5.0 in 2020, up from 3.6 in 2019. The expense ratio was 64.8, down from 66.8 in the prior year.

Investment Income and Realized Capital Gains

Our investment portfolio generated net investment income of \$34.7 million during the first half of 2020, an increase of 3.4 percent from that reported for the same period in 2019. The increase in investment income was largely due to a larger asset base relative to the prior year.

Yields on our fixed income investments for the first half of 2020 and 2019 were as follows:

	2020	2019
Pretax Yield		
Taxable	3.22 %	3.44 %
Tax-Exempt	2.75 %	2.83 %
After-Tax Yield		
Taxable	2.54 %	2.72 %
Tax-Exempt	2.61 %	2.68 %

We recognized \$13.0 million of realized gains in the first half of 2020, which were comprised of \$12.8 million of realized gains on equity securities from rebalancing our portfolio, \$2.6 million of realized gains on the fixed income portfolio and \$2.4 million of other realized losses. This compares to realized gains of \$13.8 million in the first half of 2019, which were comprised of \$12.3 million of realized gains on the equity portfolio, \$1.3 million of realized gains on the fixed income portfolio and \$0.2 million of other realized gains.

The following table depicts the composition of our investment portfolio at June 30, 2020 as compared to December 31, 2019:

(in thousands)	June 30, 2020		December 31, 2019	
	Financial Stmt Value	%	Financial Stmt Value	%
Fixed income	\$ 2,075,093	78.4 %	\$ 1,983,086	77.5 %
Equity securities	422,198	16.0 %	460,630	18.0 %
Other invested assets	63,440	2.4 %	70,441	2.7 %
Cash and short-term investments	84,797	3.2 %	46,203	1.8 %
Total	\$ 2,645,528	100.0 %	\$ 2,560,360	100.0 %

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

The fixed income portfolio increased by \$92.0 million in the first six months of 2020. The increase was due to declines in interest rates during the first six months of the year, lifting the fair value of securities in the fixed income portfolio. Average fixed income duration was 4.6 years at June 30, 2020, reflecting our current liability structure and sound capital position. The equity portfolio decreased by \$38.4 million during the first six months of 2020 as the equity market sold off sharply in the first quarter.

Income Taxes

Our effective tax rate for the first six months of 2020 was 13.0 percent, compared to 18.9 percent for the same period in 2019. Effective rates are dependent upon components of pretax earnings or losses and the related tax effects. The effective rate was lower for the first half of 2020 as lower levels of pre-tax earnings caused tax-favored adjustments to be larger on a percentage basis when compared to the prior year.

Three Months Ended June 30, 2020 Compared to Three Months Ended June 30, 2019

Consolidated revenue for the second quarter of 2020 increased \$60.1 million from the second quarter of 2019. A partial recovery from the market declines experienced in the first quarter resulted in \$74.7 million of unrealized gains on equity securities in the second quarter of 2020, compared to \$8.8 million of unrealized gains in the second quarter of 2019. Net premiums earned for the Group increased 1 percent, driven by growth from our property segment, which offset declines in our surety segment. Investment income decreased 1 percent due to lower average yields relative to the prior year. Realized losses during the quarter were \$2.1 million and were comprised of \$2.3 million of realized losses on equity securities from rebalancing our portfolio, \$0.3 million of realized gains on the fixed income portfolio and \$0.1 million of other realized losses. This compares to realized gains of \$4.8 million in the second quarter of 2019, which were comprised of \$3.9 million of realized gains on the equity portfolio, \$0.7 million of realized gains on the fixed income portfolio and \$0.2 million of miscellaneous realized gains.

	For the Three-Month Periods Ended June 30,	
	2020	2019
Consolidated revenues (in thousands)		
Net premiums earned	\$ 208,734	\$ 207,541
Net investment income	16,917	16,998
Net realized gains (losses)	(2,109)	4,764
Net unrealized gains (losses) on equity securities	74,705	8,810
Total consolidated revenue	\$ 298,247	\$ 238,113

Net earnings for the second quarter of 2020 totaled \$92.2 million, compared to \$40.5 million for the same period in 2019. The increase in earnings for 2020 was primarily attributed to \$59.0 million of net after-tax unrealized gains on equity securities, compared to \$7.0 million in 2019. Underwriting results for both periods reflect profitable current accident year results and favorable development from prior years' loss reserves. Favorable development on prior years' loss reserves provided additional pretax earnings of \$25.6 million in the second quarter of 2020, compared to \$21.2 million in 2019. Catastrophe activity consisted of \$6.0 million of pretax storm and civil unrest losses in the second quarter of 2020, compared to \$4.0 million of storm losses in 2019. Pretax bonus and profit sharing-related expenses associated with the net impact of prior years' reserve development and catastrophe losses totaled \$2.9 million in 2020, compared to \$2.5 million in 2019. These performance-related expenses affected policy acquisition, insurance operating and general corporate expenses. Bonus and profit-sharing amounts earned by executives, managers and associates are predominately influenced by corporate performance including operating earnings, combined ratio and return on capital.

During the second quarter of 2020, equity in earnings of unconsolidated investees totaled \$5.1 million. This amount includes \$2.6 million from Maui Jim and \$2.5 million from Prime. Comparatively, the second quarter of 2019 reflected \$8.5 million of earnings, including \$6.5 million from Maui Jim and \$2.0 million from Prime. The decline in earnings from Maui Jim is reflective of the shutdown much of the traditional retail sector experienced as a result of the pandemic.

Comprehensive earnings totaled \$145.7 million for the second quarter of 2020, compared to \$68.3 million of comprehensive earnings for the second quarter of 2019. Other comprehensive earnings primarily included after-tax unrealized gains and losses from the fixed income portfolio. The second quarter's \$53.6 million of other comprehensive earnings was due to declines in interest rates, which increased the market value of the portfolio. This compares to \$27.9 million of other comprehensive earnings for the same period in 2019.

Premiums

Gross premiums written for the Group increased \$3.9 million for the second quarter of 2020 when compared to the same period of 2019. Rate increases across the property and casualty portfolios were the largest influence on growth. Net premiums earned increased \$1.2 million, also driven by products in the property segment.

(in thousands)	Gross Premiums Written			Net Premiums Earned		
	For the Three-Month Periods Ended June 30,			For the Three-Month Periods Ended June 30,		
	2020	2019	% Change	2020	2019	% Change
Casualty						
Commercial excess and personal umbrella	\$ 59,943	\$ 49,427	21 %	\$ 42,321	\$ 34,340	23 %
General liability	26,666	32,030	(17) %	22,651	25,347	(11) %
Commercial transportation	18,874	30,712	(39) %	11,139	20,508	(46) %
Professional services	24,469	23,958	2 %	21,384	19,275	11 %
Small commercial	17,140	16,244	6 %	15,791	13,315	19 %
Executive products	27,012	22,100	22 %	6,975	6,381	9 %
Other casualty	15,943	14,652	9 %	14,954	19,178	(22) %
Total	<u>\$ 190,047</u>	<u>\$ 189,123</u>	0 %	<u>\$ 135,215</u>	<u>\$ 138,344</u>	(2) %
Property						
Marine	\$ 25,814	\$ 24,070	7 %	\$ 20,712	\$ 18,579	11 %
Commercial property	37,311	33,900	10 %	19,048	16,275	17 %
Specialty personal	5,305	5,878	(10) %	4,936	4,792	3 %
Other property	856	512	67 %	691	326	112 %
Total	<u>\$ 69,286</u>	<u>\$ 64,360</u>	8 %	<u>\$ 45,387</u>	<u>\$ 39,972</u>	14 %
Surety						
Commercial	\$ 9,622	\$ 10,569	(9) %	\$ 10,806	\$ 10,975	(2) %
Miscellaneous	10,312	10,572	(2) %	10,499	11,280	(7) %
Contract	7,886	8,647	(9) %	6,827	6,970	(2) %
Total	<u>\$ 27,820</u>	<u>\$ 29,788</u>	(7) %	<u>\$ 28,132</u>	<u>\$ 29,225</u>	(4) %
Grand Total	<u>\$ 287,153</u>	<u>\$ 283,271</u>	1 %	<u>\$ 208,734</u>	<u>\$ 207,541</u>	1 %

Casualty

Gross premiums written for the casualty segment were up \$0.9 million in the second quarter of 2020. Premiums from commercial excess and personal umbrella increased \$10.5 million, due to an expanded distribution base in personal umbrella, which supplemented rate increases. Substantial rate increases led to a 22 percent increase for our executive products group.

Transportation continues to be significantly affected by the stay at home orders associated with COVID-19. This is particularly impactful on our public transportation book that has a focus on charter or city buses, which stopped running to a large degree in March. A slowdown or suspension of construction activity in certain parts of the country also led to the decline in general liability.

Property

Gross premiums written for the property segment totaled \$69.3 million for the second quarter of 2020, up \$4.9 million from the same period last year. Our commercial property business was up \$3.4 million, as rates on wind-prone and earthquake exposures continued to increase. Market disruption created new business opportunities and led to \$1.7 million of growth for our marine product. Other property premium increased as a result of property exposed GBA business that continues to gain scale.

Surety

The surety segment recorded gross premiums written of \$27.8 million for the second quarter of 2020, a decrease of \$2.0 million from the same period last year. The surety market remains very competitive. Additionally, the economic downturn, decreased commodity pricing and less regulation has reduced demand for bonds.

Underwriting Income

Underwriting income for the Group totaled \$24.2 million for the second quarter of 2020, compared to \$14.9 million in the same period last year. Both periods reflect positive underwriting results for the current accident year and favorable reserve

[Table of Contents](#)

development on prior accident years, with 2020 experiencing a larger benefit. The combined ratio for the Group totaled 88.4 in the second quarter of 2020, compared to 92.8 in the same period of 2019. The loss ratio decreased to 48.5 from 50.1, due to the increased level of favorable development in 2020. The Group's expense ratio decreased to 39.9 from 42.7, as 2019 experienced stronger earnings and growth in book value in the six-month period ended June 30, which led to larger levels of bonus and profit-sharing expenses.

	For the Three-Month Periods Ended June 30,	
	2020	2019
Underwriting income (loss) (in thousands)		
Casualty	\$ 9,733	\$ 6,939
Property	6,167	(436)
Surety	8,263	8,429
Total	\$ 24,163	\$ 14,932
Combined ratio		
Casualty	92.8	95.0
Property	86.4	101.1
Surety	70.6	71.2
Total	88.4	92.8

Casualty

The casualty segment recorded underwriting income of \$9.7 million in the second quarter of 2020, compared to \$6.9 million for the same period last year. Reserve releases reduced loss and settlement expenses for the casualty segment by \$21.1 million, primarily on accident years 2016 through 2018. Transportation, executive products, general liability and professional services were drivers of the favorable development. Partially offsetting these benefits, \$4.7 million of current year reserves were established in the second quarter of 2020 for COVID-19 related loss and defense costs. In comparison, \$17.5 million of reserves were released in the second quarter of 2019, with nearly every product contributing to the favorable development.

The combined ratio for the casualty segment was 92.8 in 2020, compared to 95.0 in 2019. The segment's loss ratio was 57.4 in 2020, down from 57.9 in 2019. The loss ratio decreased in 2020 as a result of a shift in mix of business towards products with lower loss booking ratios and more favorable development on prior years' reserves. The expense ratio for the casualty segment was 35.4, down from 37.1 for the same period last year, as reduced levels of bonus and profit-sharing expenses were incurred.

Property

The property segment recorded underwriting income of \$6.2 million for the second quarter of 2020, compared to \$0.4 million of underwriting loss for the same period last year. Underwriting results for 2020 included \$0.7 million of favorable development on prior years' loss and catastrophe reserves and \$4.8 million of storm and civil unrest losses. Comparatively, the 2019 underwriting results included \$0.1 million of adverse development on prior years' loss and catastrophe reserves and \$3.9 million of storm losses.

Underwriting results for the second quarter of 2020 translated into a combined ratio of 86.4, compared to 101.1 for the same period last year. The segment's loss ratio was 47.5 in 2020, down from 56.5 in 2019 due to the combination of a larger amount of favorable development and decreased current accident year non-catastrophe losses. The segment's expense ratio decreased to 38.9 in 2020 from 44.6 in the prior year, as increased levels of earned premium allowed the segment to better leverage expenses and reduced levels of bonus and profit-sharing expenses were incurred.

Surety

The surety segment recorded underwriting income of \$8.3 million for the second quarter of 2020, compared to \$8.4 million for the same period last year. Both periods reflected positive current accident year underwriting performance and benefited from favorable development on prior years' loss reserves. Results for 2020 and 2019 included favorable development on prior accident years' loss reserves across all products, which decreased the segment's loss and settlement expenses by \$3.8 million. Additionally, \$1.1 million of reserves were established in 2020 for COVID-19 related losses.

The combined ratio for the surety segment totaled 70.6 for the second quarter of 2020, compared to 71.2 for the same period in 2019. The segment's loss ratio was 7.1 in 2020, up from 4.1 in 2019 due to the recognition of COVID-19 related losses. The expense ratio was 63.5, down from 67.1 in the prior year as stronger growth in book value led to increased bonus and profit-sharing expenses in 2019.

Investment Income and Realized Capital Gains

Our investment portfolio generated net investment income of \$16.9 million during the second quarter of 2020, a decrease of 0.5 percent from that reported for the same period in 2019. The decrease in investment income was largely due to a decline in yields relative to the prior year.

Yields on our fixed income investments for the second quarter of 2020 and 2019 were as follows:

	2Q 2020	2Q 2019
Pretax Yield		
Taxable	3.17 %	3.43 %
Tax-Exempt	2.70 %	2.83 %
After-Tax Yield		
Taxable	2.50 %	2.71 %
Tax-Exempt	2.56 %	2.68 %

We recognized \$2.1 million of realized losses in the second quarter of 2020, which were comprised of \$2.3 million of realized losses on equity securities from rebalancing our portfolio, \$0.3 million of realized gains on the fixed income portfolio and \$0.1 million of other realized losses. This compares to realized gains of \$4.8 million in the second quarter of 2019, which were comprised of \$3.9 million of realized gains on the equity portfolio, \$0.7 million of realized gains on the fixed income portfolio and \$0.2 million of other realized gains.

Income Taxes

Our effective tax rate for the second quarter of 2020 was 19.8 percent, compared to 17.1 percent for the same period in 2019. Effective rates are dependent upon components of pretax earnings or losses and the related tax effects. The effective rate was higher for the second quarter of 2020 due to higher levels of pre-tax earnings and lower levels of tax-favored adjustments compared to 2019.

LIQUIDITY AND CAPITAL RESOURCES

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

The following table summarizes cash flows provided by (used in) our activities for the six-month periods ended June 30, 2020 and 2019:

(in thousands)	2020	2019
Operating cash flows	\$ 83,773	\$ 105,347
Investing cash flows	(26,666)	(100,654)
Financing cash flows	(18,513)	(9,999)
Total	\$ 38,594	\$ (5,306)

Our largest source of cash is premiums received from customers and our largest cash outflow is claim payments on insured losses. Cash flows from operating activities can vary among periods due to the timing in which these payments are made or received. Operating cash flows in the first half of 2020 were impacted by increased levels of loss and settlement expense payments relative to the first six months of 2019. Additionally, improved financial performance in 2019 resulted in a higher level of bonus and profit-sharing contributions that were paid in the first quarter of 2020, which also reduced operating cash flows in 2020.

[Table of Contents](#)

We have \$149.4 million in debt outstanding. On October 2, 2013, we completed a public debt offering, issuing \$150.0 million in senior notes maturing September 15, 2023 (a 10-year maturity), and paying interest semi-annually at the rate of 4.875 percent per annum. The notes were issued at a discount resulting in proceeds, net of discount and commission, of \$148.6 million. The estimated fair value for the senior note at June 30, 2020 was \$162.7 million. The fair value of our debt is estimated based on the limited observable prices that reflect thinly traded securities.

As of June 30, 2020, we had cash and other investments maturing within one year of approximately \$160.7 million and an additional \$496.0 million maturing between one to five years. Whereas our strategy is to be fully invested at all times, short-term investments in excess of demand deposit balances are considered a component of investment activities, and thus are classified as investments in our consolidated balance sheets.

We also maintain a revolving line of credit with Bank of Montreal, Chicago Branch, which permits us to borrow up to an aggregate principal amount of \$60.0 million. This facility was entered into during the first quarter of 2020 and replaced the previous \$50.0 million facility with JP Morgan Chase Bank N.A., which was set to expire on May 24, 2020. Under certain conditions, the line may be increased up to an aggregate principal amount of \$120.0 million. The facility has a three-year term that expires on March 27, 2023. As of and during the three-month period ended June 30, 2020, no amounts were outstanding on either facility.

Additionally, two of our insurance companies, RLI Ins. and Mt. Hawley, are members of the Federal Home Loan Bank of Chicago (FHLBC). Membership in the Federal Home Loan Bank System provides both companies access to an additional source of liquidity via a secured lending facility. Our membership allows each insurance subsidiary to determine tenor and structure at the time of borrowing. As of and during the six-month period ended June 30, 2020, there were no outstanding borrowing amounts with the FHLBC.

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

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

We maintain a diversified investment portfolio representing policyholder funds that have not yet been paid out as claims, as well as the capital we hold for our shareholders. Invested assets at June 30, 2020 have increased \$85.2 million from December 31, 2019. As of June 30, 2020, 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	\$ 171,174	\$ 186,838	\$ 15,664	7.1 %	AAA
U.S. agency	27,913	32,091	4,178	1.2 %	AAA
Non-U.S. govt. & agency	7,316	7,692	376	0.3 %	BBB
Agency MBS	388,036	409,167	21,131	15.5 %	AAA
ABS/CMBS**	214,548	218,507	3,959	8.2 %	AA+
Corporate	717,748	765,125	47,377	28.9 %	BBB+
Municipal	429,402	455,673	26,271	17.2 %	AA
Total Fixed Income	\$ 1,956,137	\$ 2,075,093	\$ 118,956	78.4 %	AA-
Equity	270,987	422,198	151,211	16.0 %	
Other Invested Assets	72,291	63,440	(8,851)	2.4 %	
Cash	84,797	84,797	—	3.2 %	
Total Portfolio	\$ 2,384,212	\$ 2,645,528	\$ 261,316	100.0 %	

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

**Asset-backed and commercial mortgage-backed securities

Quality is an average of each bond's credit rating, adjusted for its relative weighting in the portfolio. As of June 30, 2020, our fixed income portfolio had the following rating distribution:

[Table of Contents](#)

AAA	45.9 %
AA	17.9 %
A	20.4 %
BBB	9.3 %
BB	3.2 %
B	2.4 %
CCC	0.3 %
NR	0.6 %
Total	100.0 %

As of June 30, 2020, the duration of the fixed income portfolio was 4.6 years. Our fixed income portfolio remained well diversified, with 1,288 individual issues.

Our investment portfolio has limited exposure to structured asset-backed securities. As of June 30, 2020, we had \$137.9 million in ABS which are pools of assets collateralized by cash flows from several types of loans, including home equity, credit cards, autos and structured bank loans in the form of collateralized loan obligations (CLOs).

As of June 30, 2020, we had \$80.6 million in commercial mortgage backed securities and \$409.2 million in mortgage backed securities backed by government sponsored enterprises (GSEs - Freddie Mac, Fannie Mae and Ginnie Mae). Excluding the GSE backed MBS, our exposure to ABS and CMBS was 8.2 percent of our investment portfolio at quarter end.

We had \$765.1 million in corporate fixed income securities as of June 30, 2020, which includes \$98.2 million invested in a high yield credit strategy. This high-yield portfolio consists of floating rate bank loans and bonds that are below investment grade in credit quality and offer incremental yield over our core fixed income portfolio.

We also maintain an allocation to municipal fixed income securities. As of June 30, 2020, we had \$455.7 million in municipal securities. The municipal portfolio includes approximately 73 percent tax-exempt securities and 27 percent taxable securities. Approximately 86 percent of our municipal bond portfolio maintains an 'AA' or better rating, while 99 percent of the municipal bond portfolio is rated 'A' or better.

Our equity portfolio had a fair value of \$422.2 million as of June 30, 2020 and is also a source of liquidity. The securities within the equity portfolio remain primarily invested in large-cap issues with a focus on dividend income. In the equity portfolio, the strategy remains one of value investing, with security selection taking precedence over market timing.

As of June 30, 2020, our equity portfolio had a dividend yield of 2.1 percent, compared to 1.9 percent for the S&P 500 index. Because of the corporate dividend-received-deduction applicable to our dividend income, we pay an effective tax rate of 13.1 percent on dividends, compared to 21.0 percent on taxable interest and 5.3 percent on municipal bond interest income. The equity portfolio is managed in a diversified and granular manner, with 221 individual securities and three ETF positions. No single stock exposure is greater than 2 percent of the equity portfolio.

We had \$63.4 million of other invested assets at June 30, 2020, including investments in low income housing tax credit partnerships, membership in the FHLBC, investments in private funds and investments in restricted stock. As of June 30, 2020, \$14.6 million of investments were pledged as collateral with the FHLBC to ensure timely access to the secured lending facility that ownership of FHLBC stock provides. As of and during the six-month period ending June 30, 2020, there were no outstanding borrowings with the FHLBC.

Our investment portfolio does not have any exposure to derivatives.

Our capital structure is comprised of equity and debt outstanding. As of June 30, 2020, our capital structure consisted of \$149.4 million in 10-year maturity senior notes maturing in 2023 (debt) and \$1.1 billion of shareholders' equity. Debt outstanding comprised 12.4 percent of total capital as of June 30, 2020. Interest and fees on debt obligations totaled \$3.8 million during the first six months of 2020, compared to \$3.7 million during the same period in 2019. We have incurred interest expense on debt at an average annual interest rate of 4.91 percent for the three-month periods ended June 30, 2020 and 2019.

We paid a regular quarterly cash dividend of \$0.24 per share on June 19, 2020, a \$0.01 increase over the prior quarter. We have increased dividends in each of the last 45 years.

Our three insurance subsidiaries are subsidiaries of RLI Corp, with RLI Ins. as the first-level, or principal, insurance subsidiary. At the holding company (RLI Corp.) level, we rely largely on dividends from our insurance company subsidiaries to meet our obligations for paying principal and interest on outstanding debt, corporate expenses and dividends to RLI Corp. shareholders. As discussed further below, dividend payments to RLI Corp. from our principal insurance subsidiary are restricted by state insurance laws as to the amount that may be paid without prior approval of the insurance regulatory authorities of Illinois. As a result, we may not be able to receive dividends from such subsidiary at times and in amounts necessary to pay desired dividends to RLI Corp. shareholders. On a GAAP basis, as of June 30, 2020, our holding company had \$1.1 billion 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 \$43.4 million in liquid assets, which would cover the majority of our annual holding company expenditures. Unrestricted funds at the holding company are available to fund debt interest, general corporate obligations and dividend payments to our shareholders. If necessary, the holding company also has other potential sources of liquidity that could provide for additional funding to meet corporate obligations or pay shareholder dividends, which include a revolving line of credit, as well as access to capital markets.

Ordinary dividends, which may be paid by our principal insurance subsidiary without prior regulatory approval, are subject to certain limitations based upon statutory income, surplus and earned surplus. The maximum ordinary dividend distribution from our principal insurance subsidiary in a rolling 12-month period is limited by Illinois law to the greater of 10 percent of RLI Ins. policyholder surplus, as of December 31 of the preceding year, or the net income of RLI Ins. for the 12-month period ending December 31 of the preceding year. Ordinary dividends are further restricted by the requirement that they be paid from earned surplus. Any dividend distribution in excess of the ordinary dividend limits is deemed extraordinary and requires prior approval from the Illinois Department of Insurance (IDOI). In the first six months of 2020, RLI Ins. paid \$22.0 million in ordinary dividends to RLI Corp. In 2019, our principal insurance subsidiary paid ordinary dividends totaling \$59.0 million. As of June 30, 2020, \$43.3 million of the net assets of our principal insurance subsidiary were not restricted and could be distributed to RLI Corp. as ordinary dividends without prior approval from the IDOI. Because the limitations are based upon a rolling 12-month period, the amount and impact of these restrictions vary over time. In addition to restrictions from our principal subsidiary's insurance regulator, we also consider internal models and how capital adequacy is defined by our rating agencies in determining amounts available for distribution.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

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

Credit risk is the potential loss resulting from adverse changes in an issuer's ability to repay its debt obligations. We monitor our portfolio to ensure that credit risk does not exceed prudent levels. We have consistently invested in high credit quality, investment grade securities. Our fixed maturity portfolio has an average rating of AA-, with 84 percent rated A or better by at least two nationally recognized rating organizations.

On an overall basis, our exposure to market risk has not significantly changed from that reported in our 2019 Annual Report on Form 10-K. The COVID-19 pandemic does present new and emerging uncertainty to the financial markets. See further discussion in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Part II, Item 1A., Risk Factors, of this Quarterly Report on Form 10-Q.

ITEM 4. Controls and Procedures

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

[Table of Contents](#)

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

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

PART II - OTHER INFORMATION

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

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2019, as updated in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2020.

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

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

In 2010, our Board of Directors implemented a \$100 million share repurchase program. We did not repurchase any shares during 2020. We have \$87.5 million of remaining capacity from the repurchase program. The repurchase program may be suspended or discontinued at any time without prior notice.

Item 3. Defaults Upon Senior Securities - Not Applicable.

Item 4. Mine Safety Disclosures - Not Applicable.

Item 5. Other Information - Not Applicable.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description of Document</u>	<u>Reference</u>
3.1	Amended and Restated Certificate of Incorporation	Incorporated by reference to the Company's Current Report on Form 8-K filed May 8, 2020.
10.1	RLI Corp. 2015 Long-Term Incentive Plan	Attached as Exhibit 10.1.
10.2	RLI Corp. Annual Incentive Compensation Plan	Attached as Exhibit 10.2.
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Attached as Exhibit 31.1.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Attached as Exhibit 31.2.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Attached as Exhibit 32.1.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Attached as Exhibit 32.2.
101	iXBRL-Related Documents	Attached as Exhibit 101.
104	Cover Page Interactive Data File	Embedded in Inline XBRL and contained in Exhibit 101.

SIGNATURES

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

RLI Corp.

/s/ Todd W. Bryant

Todd W. Bryant

Vice President, Chief Financial Officer

(Principal Financial and Chief Accounting Officer)

Date: July 24, 2020

**RLI CORP.
2015 LONG-TERM INCENTIVE PLAN**

(As Amended and Restated, Effective May 7, 2020)

1. **Purpose.** The purpose of the RLI Corp. 2015 Long-Term Incentive Plan (the “Plan”) is to promote the interests of the Company and its shareholders by providing key personnel of the Company and its Affiliates with an opportunity to acquire a proprietary interest in the Company and reward them for achieving a high level of corporate performance and thereby develop a strong incentive to put forth maximum effort for the continued success and growth of the Company and its Affiliates. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel of outstanding ability. The Plan is also intended to provide Outside Directors with an opportunity to acquire a proprietary interest in the Company, to compensate Outside Directors for their contribution to the Company and to aid in attracting and retaining Outside Directors. No further awards shall be made under the Company’s Omnibus Stock Plan or the 2010 Long-Term Incentive Plan after the Effective Date of this Plan. The Company amended the Plan, effective August 14, 2019 to revise the definition of “Disabled” or “Disability” with respect to a member of the Board of Directors, and further amended the Plan, effective May 7, 2020, to revise the method for determining eligibility for “Retirement” and to eliminate obsolete provisions relating to Code Section 162(m).

2. **Definitions, Gender and Number.**

2.1. **Definitions.** The capitalized terms used elsewhere in the Plan have the meanings set forth below.

- a. “Affiliate” means any entity that is an “eligible issuer” of Company Stock within the meaning of Code Section 409A.
- b. “Agreement” means a written contract (i) consistent with the terms of the Plan entered into between the Company or an Affiliate and a Participant and (ii) containing the terms and conditions of an Award in such form and not inconsistent with the Plan as the Committee shall approve from time to time, together with all amendments thereto, which amendments may be unilaterally made by the Company (with the approval of the Committee) unless such amendments are deemed by the Committee to be materially adverse to the Participant and not required as a matter of law.
- c. “Award” or “Awards” means a grant made under the Plan in the form of Restricted Stock, Restricted Stock Units, Options, Stock Appreciation Rights or Performance Units.
- d. “Board” means the Board of Directors of the Company.
- e. “Cause” means the Participant’s: (i) failure to comply with any material policies and procedures of the Company or Affiliate; (ii) conduct reflecting dishonesty or disloyalty to the Company or Affiliate, or which may have a negative impact on the reputation of the Company or Affiliate; (iii) commission of a felony, theft or fraud, or violations of law involving moral turpitude; (iv) failure to perform the material duties of his or her employment; (v) excessive absenteeism; (vi) unethical behavior; or (vii) violation of a material policy of the Company. If a Participant’s employment is terminated for “Cause,” the date on which the Participant’s employment is considered to be terminated, for purposes hereof, shall be the time at which such Participant is instructed or notified to cease performing job responsibilities for the Company or any Affiliate, whether or not for other reasons, such as payroll, benefits or compliance with legal procedures or requirements, he or she may still have other attributes of an employee.
- f. “Change in Control” shall mean and include each of the following:

- i. The date any “Person,” within the meaning of Section 13(d) or 14(d) under the Exchange Act, including any group (within the meaning of Section 13(d)(3) under the Exchange Act), becomes the “Beneficial Owner,” as such term is defined in Rule 13d-3 promulgated under the Exchange Act, of 30% or more of the combined voting power of the Company’s outstanding shares, other than beneficial ownership by (A) the Company or any subsidiary of the Company, (B) any employee benefit plan of the Company or any subsidiary of the Company or (C) any entity of the Company for or pursuant to the terms of any such plan.

Notwithstanding the foregoing, a Change in Control shall not occur as the result of an acquisition of outstanding shares of the Company by the Company which, by reducing the number of shares outstanding, increases the proportionate number of shares beneficially owned by a Person to 30% or more of the shares of the Company then outstanding; provided, however, that if a Person becomes the Beneficial Owner of 30% or more of the shares of the Company then outstanding by reason of share purchases by the Company and shall, after such share purchases by the Company, become the Beneficial Owner of any additional shares of the Company, then a Change in Control shall be deemed to have occurred; or

- ii. The date the Company consummates a merger or consolidation with another entity, or engages in a reorganization with or a statutory share exchange or an exchange offer for the Company’s outstanding voting stock of any class with another entity or acquires another entity by means of a statutory share exchange or an exchange offer, or engages in a similar transaction; provided that no Change in Control shall have occurred by reason of this paragraph unless either:

- (A) the stockholders of the Company immediately prior to the consummation of the transaction would not, immediately after such consummation, as a result of their beneficial ownership of voting stock of the Company immediately prior to such consummation

- (I) be the Beneficial Owners, directly or indirectly, of securities of the resulting or acquiring entity entitled to elect a majority of the members of the board of directors or other governing body of the resulting or acquiring entity; and

- (II) be the Beneficial Owners of the resulting or acquiring entity in substantially the same proportion as their beneficial ownership of the voting stock of the Company immediately prior to such transaction; or

- (B) those persons who were directors of the Company immediately prior to the consummation of the proposed transaction would not, immediately after such consummation, constitute a majority of the directors of the resulting entity.

- iii. The date of the sale or disposition, in one or a series of related transactions, of all or substantially all of the assets of the Company to any Person (as defined in paragraph (i) above) other than an Affiliate; or

- iv. The date the number of duly elected and qualified directors of the Company who were not either elected by the Company's Board or nominated by the Board or its nominating/governance committee for election by the shareholders shall constitute a majority of the total number of directors of the Company as fixed by its Bylaws.

The Committee shall have full and final authority, which shall be exercised in its discretion, to determine conclusively whether a Change in Control of the Company has occurred pursuant to the above definition, and the date of the occurrence of such Change in Control and any incidental matters relating thereto.

In addition, if a Change in Control constitutes a payment event with respect to any Award which provides for the deferral of compensation and is subject to Code Section 409A, the transaction or event described in paragraph (i), (ii), (iii) or (iv) with respect to such Award must also constitute a "change in control event," as defined in Treasury Regulation Section 1.409A-3(i)(5) to the extent required by Section 409A.

- g. "Committee" means the Executive Resources Committee of the Board, or any other committee of the Board comprised solely of two or more Non-Employee Directors designated by the Board to administer the Plan under Plan Section 3.1 and constituted so as to permit grants thereby to comply with Exchange Act Rule 16b-3.
- h. "Company" means RLI Corp., an Illinois corporation, or any successor to all or substantially all of its businesses by merger, consolidation, purchase of assets or otherwise.
- i. "Disabled" or "Disability," with respect to a Participant, means that the Participant satisfies the requirements to receive long-term disability benefits under the Company-sponsored group long-term disability plan in which the Participant participates (or in the case of a Director, would have satisfied the requirements of the Company-sponsored long-term disability plan had the Director participated) without regard to any waiting periods, or that the Participant has been determined by the Social Security Administration to be eligible to receive Social Security disability benefits. In addition, if Disability constitutes a payment event with respect to any Award which provides for the deferral of compensation and is subject to Code Section 409A, the disability described in the preceding sentences of this Section 2(i) must be a "disability" within the meaning of Treasury Regulation Section 1.409A-3(i)(4). A Participant shall not be considered to be "Disabled" unless the Participant furnishes proof of the Disability to the Company in such form and manner as the Company may require.
- j. "Dividend Equivalent" means an amount equal to the amount of the dividends that would be paid on the number of Shares subject to an Award (but not an Option or Stock Appreciation Right) if such Shares were issued and outstanding. Dividend Equivalents earned with respect to an Award shall become earned, vested and payable only if and to the extent the underlying Award becomes earned, vested and payable.
- k. "Effective Date" means the date specified in Section 12.
- l. "Employee" means an employee (including an officer or director who is also an employee) of the Company or an Affiliate.
- m. "Exchange Act" means the Securities Exchange Act of 1934, as amended and in effect from time to time or any successor statute.

- n. “Exchange Act Rule 16b-3” means Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as in force and in effect from time to time or any successor regulation.
- o. “Fair Market Value” as of any date means, unless otherwise expressly provided in the Plan:
 - i. the closing sale price of a Share on such date, or on the next business day, if such date is not a business day, as reflected on the NYSE or any other national securities exchange registered under the Exchange Act on which the Shares are traded, or
 - ii. if clause (i) is inapplicable, the mean between the closing “bid” and the closing “asked” quotation of a Share on the date immediately preceding that date, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a closing bid and asked quotation is made, on the over-the-counter market or any other quotation system then in use, or
 - iii. if clauses (i) and (ii) are inapplicable, what the Committee determines in good faith to be 100% of the fair market value of a Share on that date, using such criteria as it shall determine, in its sole discretion, to be appropriate for valuation.

The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 16.

- p. “Full Value Award” means an Award in the form of Restricted Stock, Restricted Stock Units or Performance Units.
- q. “Fundamental Change” means a dissolution or liquidation of the Company, a sale of substantially all of the assets of the Company, a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or a statutory share exchange involving capital stock of the Company.
- r. “Good Reason” means any of the following conditions arising without the consent of the Participant: (i) a material diminution in base salary or in the opportunity for any bonus or incentive compensation; (ii) a material diminution in the Participant’s authority, duties or responsibilities; (iii) a material diminution in the authority, duties or responsibilities of the supervisor to whom the Participant is required to report, including a requirement that the Participant report to an officer or employee instead of directly to the Board; (iv) a material diminution in the budget over which the Participant retains authority; (v) a material change in the geographic location at which the Participant must perform services; or (vi) any action or inaction that results in a material breach in the terms of an applicable employment agreement. A termination will only be considered to have been made for Good Reason if the Participant provides notice of the existence of such condition to the Company or any successor employer within 90 days of the existence of such condition.
- s. “Insider,” as of a particular date, means any person who, as of that date is an officer of the Company as defined under Exchange Act Rule 16a-1(f) or its successor provision.
- t. “Option” means a right to purchase Stock. Only options that are non-statutory options (*i.e.* options that do not qualify for special tax treatment under Code Section 422) may be issued under the Plan.

- u. “Outside Director” means a member of the Board who is considered a non-employee director within the meaning of Exchange Act Rule 16b-3(b)(3) or its successor provision.
- v. “Participant” means a person or entity to whom an Award is or has been made in accordance with the Plan.
- w. “Performance Cycle” means the period of time specified in an Agreement over which Performance Units are to be earned.
- x. “Performance Goals” means the performance goals established by the Committee in connection with the grant of an Award. “Performance Unit” means an Award made pursuant to Plan Section 11.
- y. “Plan” means this RLI Corp. 2015 Long-Term Incentive Plan, as may be amended and in effect from time to time.
- z. “Qualifying Termination” means an involuntary Separation from Service or Separation from Service for Good Reason that occurs within 2 years following a Change in Control. In addition, if the Participant’s Separation from Service occurs prior to a Change in Control and it is determined that such termination (A) was at the request of a third party who has indicated an intention or taken steps reasonably calculated to effect a Change in Control and who subsequently effectuates a Change in Control or (B) otherwise occurred in connection with, or in anticipation of, a Change in Control which actually occurs, for purposes of this definition, the date of a Change in Control with respect to the Participant shall mean the date immediately prior to the date of Participant’s Termination of Employment.
- aa. “Restricted Stock” means an Award of Stock granted under Plan Section 7 so long as such Stock remains subject to the restrictions described in Section 7 or the Agreement.
- bb. “Restricted Stock Unit” means the right to receive a Share in the future granted under Section 8 of the Plan provided that the requisite restrictions and conditions for payment of the Share are satisfied, as set forth in the Agreement.
- cc. “Retirement” or “Retires” means a Participant’s Separation from Service on or after the date when the Participant’s age plus years of service equal at least 75. For this purpose, (i) a Participant’s age shall be measured in whole and partial years (with partial years measured in days) as of the date of the Participant’s Separation from Service and (ii) a Participant’s years of service shall be based only on the Participant’s actual service with the Company (and not with any other employer that may be acquired by the Company with respect to service prior to the acquisition, except as otherwise provided by the Company in writing) and shall be calculated based on the number of whole and partial years of employment (with partial years measured in days) that the Participant has completed from the date of the Participant’s initial employment with the Company through the date of the Participant’s Separation from Service. Notwithstanding the foregoing, the Committee may specify, in its discretion, in a written Award Agreement, policy or guideline that a Participant will be considered to have had a “Retirement” if the Participant satisfies the terms of a non-competition covenant or under such other terms and conditions as specified by the Committee in its discretion.
- dd. “Section 16” or “Section 16(b)” means Section 16 or Section 16(b), respectively, of the Exchange Act or any successor statute and the rules and regulations promulgated thereunder as in effect and as amended from time to time.

- ee. “Separation from Service,” of a Participant,” has the meaning set forth in Code Section 409A(a)(2)(A)(i).
- ff. “Share” means a share of Stock.
- gg. “Stock” means the common stock, par value \$1.00 per share, of the Company.
- hh. “Stock Appreciation Right” means a right, the value of which is determined in relation to the appreciation in value of Shares pursuant to an Award granted under Plan Section 10.
- ii. “Term” means the period during which an Option Award or Stock Appreciation Right may be exercised or the period during which the restrictions or terms and conditions placed on Restricted Stock, Restricted Stock Units or any other Award are in effect.

2.2. Gender and Number. Except when otherwise indicated by the context, reference to the masculine gender shall include, when used, the feminine gender and any term used in the singular shall also include the plural.

3. Administration and Indemnification

3.1. Administration

- a. The Committee shall administer the Plan. The Committee shall have exclusive power to (i) make Awards, (ii) determine when and to whom Awards will be granted, the form of each Award, the amount of each Award, and any other terms or conditions of each Award consistent with the Plan, and (iii) determine whether, to what extent and under what circumstances, Awards may be settled, paid or exercised in cash, Shares or other Awards, or other property or canceled, forfeited or suspended. Each Award shall be subject to an Agreement authorized by the Committee. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Notwithstanding the foregoing, the Board shall have the sole and exclusive power to administer the Plan with respect to Awards granted to Outside Directors.
- b. To the extent within its sole discretion and subject to Plan Sections 15 and 16, other than price, the Committee may amend the terms and conditions of any outstanding Award.
- c. It is the intent that the Plan and all Awards granted pursuant to it shall be administered by the Committee so as to permit the Plan and Awards to comply with Exchange Act Rule 16b-3, except in such instances as the Committee, in its discretion, may so provide. If any provision of the Plan or of any Award would otherwise frustrate or conflict with the intent expressed in this Section 3.1(c), that provision to the extent possible shall be interpreted and deemed amended in the manner determined by the Committee so as to avoid the conflict. To the extent of any remaining irreconcilable conflict with this intent, the provision shall be deemed void as applicable to Insiders to the extent permitted by law and in the manner deemed advisable by the Committee.
- d. The Committee’s interpretation of the Plan and of any Award or Agreement made under the Plan and all related decisions or resolutions of the Board or Committee shall be final and binding on all parties with an interest therein. Consistent with its terms, the Committee shall have the power to establish, amend or waive regulations to administer the Plan. In carrying out any of its responsibilities, the Committee shall have discretionary authority to construe the terms of the Plan and any Award or Agreement made under the Plan.

3.2. Indemnification. Each person who is or shall have been a member of the Committee, or of the Board, and any other person to whom the Committee delegates authority under the Plan, shall be indemnified and held harmless by the Company, to the extent permitted by law, against and from any loss, cost, liability or expense that may be imposed upon or reasonably incurred by such person in connection with or resulting from any claim, action, suit or proceeding to which such person may be a party or in which such person may be involved by reason of any action taken or failure to act, made in good faith, under the Plan and against and from any and all amounts paid by such person in settlement thereof, with the Company's approval, or paid by such person in satisfaction of any judgment in any such action, suit or proceeding against such person, provided such person shall give the Company an opportunity, at the Company's expense, to handle and defend the same before such person undertakes to handle and defend it on such person's own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person or persons may be entitled under the Company's Articles of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

4. Shares Available Under the Plan; Other Plan Maximums

4.1. Share Counting Rules

- a. The number of Shares available for distribution under the Plan shall not exceed 4,000,000 (subject to adjustment pursuant to Plan Section 16).
- b. Any Shares subject to the terms and conditions of an Award under the Plan that are not used because the terms and conditions of the Award are not met may again be used for an Award under the Plan.
- c. Any unexercised or undistributed portion of any terminated, expired, exchanged, or forfeited Award, or any Award settled in cash in lieu of Shares shall be available for further Awards.
- d. For the purposes of computing the total number of Shares granted under the Plan, the following rules shall apply to Awards payable in Shares where appropriate:
 - i. each Share that is subject to a Full Value Award shall be counted as 2.5 Shares;
 - ii. each Option Award shall be deemed to be the equivalent of the maximum number of Shares that may be issued upon exercise of the particular Option;
 - iii. each Stock Appreciation Right shall be deemed to be equivalent to the gross number of Shares with respect to which the Stock Appreciation Right may be exercised;
 - iv. an Award (other than an Option) payable in some other security shall be deemed to be equal to the number of Shares to which it relates;
 - v. where the number of Shares available under the Award is variable on the date it is granted, the number of Shares shall be deemed to be the maximum number of Shares that could be received under that particular Award;
 - vi. where two or more types of Awards (all of which are payable in Shares) are granted to a Participant in tandem with each other, such that the exercise of one type of Award with respect to a number of Shares cancels at least an equal number of Shares of the other, each such joint Award shall be deemed to be the equivalent of the maximum number of Shares available under the largest single Award; and

- vii. the following Shares shall not again be made available for issuance as Awards under the Plan: (A) Shares that are exchanged by a Participant or withheld by the Company as full or partial payment in connection with any Award under the Plan; (B) any Shares withheld by the Company or tendered by a Participant to satisfy the tax withholding obligations related to any Award under the Plan; (C) Shares not issued or delivered as a result of the net settlement of an outstanding Award; and (D) Shares purchased on the open market with any cash proceeds from the exercise of Stock Options.

Additional rules for determining the number of Shares granted under the Plan may be made by the Committee as it deems necessary or desirable.

- e. No fractional Shares may be issued under the Plan; however, cash shall be paid in lieu of any fractional Share in settlement of an Award.

4.2. Other Plan Maximums

- a. The maximum number of Shares that may be awarded to a Participant in any fiscal year in the form of Options is 500,000 and the maximum number of Shares that may be awarded to a Participant in any fiscal year in the form of Stock Appreciation Rights is 500,000.
- b. The maximum number of Shares that may be awarded to a Participant in any fiscal year in the form of a Full Value Awards is 250,000.
- c. Notwithstanding anything in (a) and (b), above, to the contrary, the maximum number of Shares that may be awarded to a Participant who is an Outside Director in any fiscal year is 30,000.

5. **Eligibility.** Participation in the Plan shall be limited to Employees and to certain other individuals or entities who are not Employees but who provide services to the Company or an Affiliate, such as services provided in the capacity of a director. The granting of Awards is solely at the discretion of the Committee. References herein to “employed,” “employment” or similar terms (except “Employee”) shall include the providing of services as a director.

6. **General Terms of Awards**

6.1. **Amount and Conditions of Award.** Each Agreement shall set forth the Participant’s number of Shares of Restricted Stock, Restricted Stock Units, and Performance Units subject to the Agreement, or the number of Shares to which the Option Award subject to the Agreement applies or with respect to which payment upon the exercise of the Stock Appreciation Right subject to the Agreement is to be determined, as the case may be, together with such other terms and conditions applicable to the Award as determined by the Committee acting in its sole discretion, which may include conditions on Options or Stock Appreciation Rights becoming exercisable.

6.2. **Term.** Each Agreement, other than those relating solely to Awards of Shares without restrictions, shall set forth the Term of the Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit, or the Performance Cycle for the Performance Units, as the case may be. The maximum Term for Options and Stock Appreciation Rights shall be ten years.

6.3. **Vesting.** All time-vested Awards under the Plan shall have a minimum vesting period of at least one year; provided, however, that Awards may provide for acceleration of vesting upon such terms and conditions as shall be set forth in the Agreement, which may include acceleration of vesting in the event of the Participant’s death, Disability or Retirement. Acceleration of the Performance Cycle of Performance Units shall be subject to Plan Section 11.6; and provided further that for purposes of this Section 6.3

Awards granted to Outside Directors shall be deemed to have a vesting period of one year if they vest on the date of the annual meeting scheduled for the following year, even if such annual meeting occurs earlier than one year after the date of grant.

6.4. Transferability. Except as set forth in this Section 6.4 or as may be required by law or court order, during the lifetime of a Participant to whom an Award is granted, only that Participant (or that Participant's legal representative) may exercise an Option or Stock Appreciation Right, or receive payment with respect to any other Award. No Award of Restricted Stock (before the expiration of the restrictions), Restricted Stock Units, Options, Stock Appreciation Rights or Performance Units may be sold, assigned, transferred, exchanged or otherwise encumbered other than to a beneficiary in the event of a Participant's death. Any attempted transfer in violation of this Section 6.4 shall be void and of no effect.

Notwithstanding the foregoing, the Committee, in its sole discretion, may determine to permit a Participant to transfer an Award to any one or more Permitted Transferees, subject to the following terms and conditions: (i) an Award transferred to a Permitted Transferee shall not be assignable or transferable by the Permitted Transferee other than by will or the laws of descent and distribution; (ii) an Award transferred to a Permitted Transferee shall continue to be subject to all the terms and conditions of the Award as applicable to the original Participant (other than the ability to further transfer the Award); (iii) the Participant and the Permitted Transferee shall execute any and all documents requested by the Company, including, without limitation documents to (A) confirm the status of the transferee as a Permitted Transferee, (B) satisfy any requirements for an exemption for the transfer under applicable federal, state and foreign securities laws and (C) evidence the transfer; and (iv) be permitted under applicable law, including Code Section 409A. For purposes of this subsection, Permitted Transferee shall mean: with respect to a Participant, any "family member" of the Participant, as defined under the instructions to use the Form S-8 Registration Statement under the Securities Act, after taking into account any state, federal, local or foreign tax and securities laws applicable to transferable Awards.

6.5. Rights as Shareholder. Subject to Section 7.4, each Agreement shall provide that a Participant shall have no rights as a shareholder with respect to any securities covered by an Award unless and until the date the Participant becomes the holder of record of the Stock, if any, to which the Award relates.

7. Restricted Stock Awards

7.1. Nature of Award. An Award of Restricted Stock under the Plan shall consist of Shares subject to restrictions on transfer and conditions of forfeiture, which restrictions and conditions shall be included in the applicable Agreement. The Committee may provide for the lapse or waiver of any such restriction or condition based on such factors or criteria as the Committee, in its sole discretion, may determine.

7.2. Restrictions on Stock Certificate. Except as otherwise provided in the applicable Agreement, each Stock certificate issued with respect to an Award of Restricted Stock shall either be deposited with the Company or its designee, together with an assignment separate from the certificate, in blank, signed by the Participant, or bear such legends with respect to the restricted nature of the Restricted Stock evidenced thereby as shall be provided for in the applicable Agreement.

7.3. Terms and Conditions of Award. The Agreement shall describe the terms and conditions by which the restrictions and conditions of forfeiture upon awarded Restricted Stock shall lapse. Upon the lapse of the restrictions and conditions, Shares free of restrictive legends, if any, relating to such restrictions shall be issued to the Participant or a beneficiary.

7.4. Rights of a Shareholder. Unless otherwise provided in the Agreement, a Participant with a Restricted Stock Award shall have all the rights of a shareholder including, but not limited to, the right to receive dividends and the right to vote the Shares of Restricted Stock; provided that any such dividends shall be subject to the same vesting and other conditions that apply to the Shares of Restricted Stock to which they relate.

7.5. Separation from Service. A Participant must satisfy all of the terms and conditions of a Restricted Stock Award in order for the restrictions on the Shares subject to the Award to lapse. If a Participant Separates from Service before satisfaction of these terms and conditions, the Participant will immediately forfeit the Award. However, unless otherwise provided in the Agreement, if a Participant has a Separation from Service during the Term of a Restricted Stock Award because of the Participant's death or Disability all restrictions shall lapse with respect to a number of Shares of Restricted Stock under the Award that has been prorated for the portion of the Term of the Award prior to the Participant's Separation from Service. The Agreement may provide for other circumstances, including, but without limitation, the Participant's Retirement, under which the Participant may receive a prorated Award. Any Shares of Restricted Stock as to which restrictions do not lapse under the preceding sentences or under the Agreement shall terminate at the date of the Participant's Separation from Service and such Shares of Restricted Stock shall be forfeited to the Company.

8. Restricted Stock Unit Awards

8.1. Nature of Award. An Award of Restricted Stock Units shall consist of the right to receive Shares in the future provided that certain restrictions or conditions are satisfied. The Committee may provide for the lapse or waiver of any such restriction or condition based on such factors or criteria as the Committee, in its sole discretion, may determine.

8.2. Terms and Conditions of Award. The Agreement shall describe the terms and conditions required to be satisfied in order for the Participant to be entitled to payment of the Shares subject to the Award.

8.3. No Rights of a Shareholder. Shares shall not be issued to the Participant until and unless the restrictions and conditions described in Section 8.2 are satisfied, or at such later date as may be provided in the Agreement or other document. The Agreement shall specify whether the holder of a Restricted Stock Unit Award shall be entitled to receive Dividend Equivalents with respect to the number of Shares subject to such Award. Any Dividend Equivalents credited with respect to Restricted Stock Units shall be subject to the same vesting and other conditions that apply to the Restricted Stock Units to which they relate. Prior to the settlement of a Restricted Stock Unit Award, the Participant shall have no rights as a shareholder of the Company with respect to the Shares subject to such Award.

8.4. Separation from Service. A Participant must satisfy all of the terms and conditions of a Restricted Stock Unit Award in order to be entitled to receive the Shares subject to the Award. If a Participant Separates from Service before satisfaction of these terms and conditions, the Participant will immediately forfeit the Award. However, unless otherwise provided in the Agreement, if a Participant has a Separation from Service during the Term of a Restricted Stock Unit Award because of the Participant's death or Disability all restrictions shall lapse with respect to a number of Shares under the Award that has been prorated for the portion of the Term of the Award prior to the Participant's Separation from Service. The Agreement may provide for other circumstances, including, but without limitation, the Participant's Retirement, under which the Participant may receive a prorated Award. Any Restricted Stock Units as to which restrictions do not lapse under the preceding sentences or under the Agreement shall terminate at the date of the Participant's Separation from Service and such Restricted Stock Units shall be forfeited to the Company.

8.5. Cash Distributions. The Committee, in its discretion, may elect to settle Restricted Stock Units in the form of cash rather than Shares.

9. Stock Options

9.1. Terms of All Options

- a. All Option Awards shall be granted pursuant to an Agreement. The purchase price of each Share subject to an Option Award shall be determined by the Committee and set

forth in the Agreement, but shall not be less than 100% of the Fair Market Value of a Share as of the date the Option Award is granted (except as provided in Plan Section 16).

- b. The purchase price of the Shares with respect to which Options are exercised shall be payable in full at the time of exercise, provided that to the extent permitted by law and as may be permitted by the Committee, the Agreement may permit some or all Participants to simultaneously exercise Options and sell the Shares thereby acquired pursuant to a brokerage or similar relationship and use the proceeds from the sale as payment of the purchase price of the Shares, or exercise the Option Award in a "net exercise," by which the number of Shares subject to the Option Award that would otherwise have been distributed to the Participant is reduced by the aggregate purchase price of the Shares being exercised divided by the then Fair Market Value of a Share. "Net exercise" may also be used in conjunction with a reduction in the number of shares subject to the Option Award to meet tax withholding obligations, as provided in Section 14. The purchase price may also be payable in cash or by delivery or tender of Shares (by actual delivery or attestation) having a Fair Market Value as of the date the Option Award is exercised equal to the purchase price of the Shares being purchased pursuant to the Option, or a combination thereof, as determined by the Committee, but no fractional Shares will be issued or accepted. Notwithstanding anything in this Section 9.1(b) to the contrary, a Participant exercising an Option Award shall not be permitted to pay any portion of the purchase price with Shares if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company.
- c. Each Option Award shall be exercisable in whole or in part on the terms provided in the Agreement. In no event shall any Option Award be exercisable at any time after the expiration of its Term. When an Option Award is no longer exercisable, it shall be deemed to have lapsed or terminated.
- d. Upon receipt of notice of exercise, the Committee may elect to pay cash in lieu of delivering the Shares for which an Option Award is being exercised by paying the Participant an amount equal to the excess of the Fair Market Value of the Shares over the aggregate purchase price for the Shares for which the Option Award is being exercised on the effective date of such exercise.
- e. No Participant shall be entitled to receive Dividend Equivalents with respect to the number of Shares subject to an outstanding Option.

9.2. Separation from Service. Unless otherwise provided in the Agreement:

- a. If a Participant has a Separation from Service because of the Participant's death, then any Option Award that has not expired or been terminated shall become exercisable in full and may be exercised by the Participant's beneficiary at any time, or from time to time, within one year after the date of the Participant's death.
- b. If a Participant has a Separation from Service due to Disability, then any Option Award that has not expired or been terminated shall become exercisable in full, and the Participant or the Participant's beneficiary may exercise such Option Award at any time, or from time to time, within three years after the Participant's Separation from Service.
- c. If a Participant Retires, then any Option Award that has not expired or been terminated shall remain exercisable for three years after the Participant's Separation from Service, but, unless otherwise provided in the Agreement, only to the extent that such Option Award was exercisable immediately prior to such Participant's Separation from Service.

- d. If a Participant has a Separation from Service (that is not a Qualifying Termination) for any reason other than death, Retirement or other than following his or her Disability, then any Option Award that has not expired or been terminated shall, unless the Committee shall otherwise provide in the Agreement, remain exercisable for three months after Separation from Service, but only to the extent that such Option Award was exercisable immediately prior to the Separation from Service.
- e. Notwithstanding Sections 9.2 (d) and unless otherwise provided in the Agreement, if the Participant experiences a Qualifying Termination, the Option Award shall remain exercisable until the expiration of the Term.
- f. Notwithstanding Sections 9.2(a)-(e) and unless otherwise provided in the Agreement, if the Participant is an Outside Director, the Option Award shall remain exercisable until the expiration of the Term, even after the director's termination of services as a director, but only to the extent that such Option Award was exercisable immediately prior to such Outside Director ceasing to be a director.
- g. Notwithstanding the Plan Section 9.2 (a)-(f), in no event shall an Option Award be exercisable if the Participant's employment (or service as a director) is terminated due to "Cause."

10. **Stock Appreciation Rights**

10.1. **Nature of Award.** An Award of a Stock Appreciation Right shall entitle the Participant (or a beneficiary), subject to terms and conditions determined by the Committee to receive upon exercise of the Stock Appreciation Right, all or a portion of the excess of the Fair Market Value of a specified number of Shares as of the date of exercise of the Stock Appreciation Right over a specified price that shall not be less than 100% of the Fair Market Value of such Shares as of the date of grant of the Stock Appreciation Right. No Participant shall be entitled to receive Dividend Equivalents with respect to the number of Shares subject to an outstanding Stock Appreciation Right.

10.2. **Connection with Other Awards.** A Stock Appreciation Right may be granted in connection with part or all of, in addition to, or completely independent of an Option Award or any other Award under the Plan. If issued in connection with a previously or contemporaneously granted Option, the Committee may impose a condition that exercise of a Stock Appreciation Right cancels a pro rata portion of the Option Award with which it is connected and vice versa.

10.3. **Terms of Award.** Each Stock Appreciation Right may be exercisable in whole or in part on the terms provided in the Agreement. No Stock Appreciation Right shall be exercisable at any time after the expiration of its Term. When a Stock Appreciation Right is no longer exercisable, it shall be deemed to have lapsed or terminated.

10.4. **Payment.** Upon exercise of a Stock Appreciation Right, payment to the Participant or a beneficiary shall be made in a lump sum. Payment shall be made in the form of Shares. The Agreement may provide for a limitation upon the amount or percentage of the total appreciation on which payment may be made.

10.5. **Separation from Service.** Unless otherwise provided in the Agreement:

- a. If a Participant has a Separation from Service because of the Participant's death, then any Stock Appreciation Right that has not expired or been terminated shall become exercisable in full and may be exercised by the Participant's beneficiary at any time, or from time to time, within one year after the date of the Participant's death.

- b. If a Participant has a Separation from Service due to Disability, then any Stock Appreciation Right that has not expired or been terminated shall become exercisable in full, and the Participant or the Participant's beneficiary may exercise such Stock Appreciation Right at any time, or from time to time, within three years after the Participant's Separation from Service.
- c. If a Participant Retires, then any Stock Appreciation Right that has not expired or been terminated shall remain exercisable for three years after the Participant's Separation from Service, but, unless otherwise provided in the Agreement, only to the extent that such Stock Appreciation Right was exercisable immediately prior to such Participant's Separation from Service.
- d. If a Participant has a Separation from Service (that is not a Qualifying Termination) for any reason other than death or other than following his or her Disability or Retirement, then any Stock Appreciation Right that has not expired or been terminated shall, unless the Committee shall otherwise provide in the Agreement, remain exercisable for three months after Separation from Service, but only to the extent that such Stock Appreciation Right was exercisable immediately prior to the Separation from Service.
- e. Notwithstanding Sections 10.2 (d) and unless otherwise provided in the Agreement, if the Participant experiences a Qualifying Termination, the Option Award shall remain exercisable until the expiration of the Term.
- f. Notwithstanding Sections 10.5(a)-(e), and unless otherwise provided in the Agreement, if the Participant is an Outside Director, the Stock Appreciation Right shall remain exercisable until the expiration of the Term even after such Outside Director ceases to be a director of the Company, but only to the extent that such Stock Appreciation Right was exercisable immediately prior to such Outside Director ceasing to be a director.
- g. Notwithstanding Sections 10.5(a)-(f), in no event shall a Stock Appreciation Right be exercisable if the Participant's employment (or service as a director) is terminated due to "Cause."

11. Performance Units

11.1. Nature of Award. An Award of Performance Units shall consist of the right to receive cash or Shares in the future provided that certain Performance Goals are satisfied during a Performance Cycle.

11.2. Terms and Conditions of Award. The Agreement shall describe the terms and conditions required to be satisfied in order for the Participant to be entitled to payment of the Shares subject to the Award, including the Performance Goals (and their target levels) to be satisfied as a condition of receiving the Award. The Agreement shall also describe when delivery of the Shares or cash subject to the Performance Units will occur should the Performance Goals be attained.

11.3. Determination of Award. Following the conclusion of each Performance Cycle, the Committee shall determine the extent to which (a) Performance Goals have been attained, and (b) the number of Shares or cash payable with respect to the Award.

11.4. No Rights of a Shareholder. Shares shall not be issued to the Participant until provided in the Agreement (or other document deferring receipt of the Shares, as may be permitted by the Committee). The Agreement shall specify whether the holder of a Performance Unit Award shall be entitled to receive Dividend Equivalents with respect to the number of Shares subject to such Award. Any Dividend Equivalents credited with respect to Performance Units shall be subject to the same vesting and other conditions that apply to the Performance Units to which they relate. Prior to the settlement of a

Performance Unit Award, the Participant shall have no rights as a shareholder of the Company with respect to the Shares subject to such Award.

11.5. Separation from Service. A Participant must satisfy all of the terms and conditions of a Performance Unit Award in order to be entitled to receive the Shares subject to the Award. If a Participant Separates from Service before satisfaction of these terms and conditions, the Participant will immediately forfeit the Award. However, unless otherwise provided in the Agreement, if a Participant has a Separation from Service during the Performance Cycle because of the Participant's death or Disability all restrictions shall lapse with respect to a number of Shares under the Award that has been prorated for the portion of the Term of the Award prior to the Participant's Separation from Service. The Agreement may provide for other circumstances, including, but without limitation, the Participant's Retirement, under which the Participant may receive a prorated Award. Any Performance Units as to which restrictions do not lapse under the preceding sentences or under the Agreement shall terminate at the date of the Participant's Separation from Service and such Performance Units shall be forfeited to the Company.

11.6. Adjustments to Awards. The Agreement may permit an acceleration of the Performance Cycle and an adjustment of performance targets and payments with respect to some or all of the Performance Units awarded to a Participant, upon the occurrence of certain events, which may, but need not include, without limitation, a change in the accounting practices of the Company; a change in the Participant's title or employment responsibilities; the Participant's death, Disability or Retirement; or, with respect to payments in Shares, an event specified in Plan Section 16. The Agreement also may provide for a limitation on the value of an Award of Performance Units that a Participant may receive.

12. Effective Date and Duration of the Plan

- a. Effective Date. The Plan became effective as of May 7, 2015.
- b. Duration of the Plan. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 15, or May 7, 2025 (the "Termination Date"); provided, however, that Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date unless limited in the Agreement or otherwise. The date and time of approval by the Committee of the granting of an Award shall be considered the date and time at which the Award is made or granted.
- c. Notwithstanding anything to the contrary herein, each Award granted under the Plan or subject to a written binding contract on or before November 2, 2017 shall be subject to the Plan as in effect as of the date on which such Award was granted, and it is intended that each such Award will continue to be subject to Code Section 162(m) as in effect prior to the enactment of the Tax Cuts and Jobs Act.

13. Plan Does Not Affect Employment Status

- a. Status as an eligible Employee shall not be construed as a commitment that any Award will be made under the Plan to that eligible Employee or to eligible Employees generally.
- b. Nothing in the Plan or in any Agreement or related documents shall confer upon any Employee or Participant any right to continue in the employment of the Company or any Affiliate or constitute any contract of employment or affect any right that the Company or any Affiliate may have to change such person's compensation, other benefits, job responsibilities, or title, or to terminate the employment of such person with or without Cause.

14. Tax Withholding. The Company shall have the right to require a Participant or other person receiving Shares under the Plan to pay the Company a cash amount sufficient to cover any required withholding taxes before

actual receipt of those Shares. In lieu of all or any part of a cash payment from a person receiving Shares under the Plan, the Committee may, in its discretion, require that the individual cover all or any part of the required withholdings through a reduction of the number of Shares delivered or delivery or tender return to the Company of Shares held by the Participant or other person, in each case valued in the same manner as used in computing the withholding taxes under the applicable laws; provided, however, that in the case of Share withholding the amount withheld may not exceed the amount determined by applying the maximum individual statutory tax rate in the Participant's applicable jurisdiction; provided that the Company shall be permitted to limit the number of Shares so withheld to a lesser number if necessary, in the judgment of the Committee, to avoid adverse accounting consequences or for administrative convenience.

15. Amendment, Modification and Termination of the Plan

15.1. In General. The Board may at any time and from time to time amend, suspend or terminate the Plan. Except as limited in Section 15.2 below, the Committee may at any time alter or amend any or all Award Agreements under the Plan to the extent permitted by law.

15.2. Exceptions. No amendment, suspension or termination of the Plan will materially and adversely affect any right acquired by any Participant or beneficiary under an Award granted before the date of amendment, suspension or termination, unless otherwise agreed to by the Participant in the Agreement or otherwise, or required as a matter of law; but it will be conclusively presumed that any adjustment for the changes described in Plan Sections 11.6 or 16 does not adversely affect these rights.

16. Adjustment for Changes in Capitalization. In connection with a (i) Fundamental Change, (ii) recapitalization, (iii) reclassification, (iv) cash or stock dividend or other distribution (other than ordinary cash dividends), (v) stock split, (vi) stock combination, (vii) stock exchange, or (viii) any other similar corporate transaction (individually and collectively, the "Event")—which would otherwise impact or affect (a) the aggregate number or type of Shares available for Awards under the Plan, including any adjustment in the manner in which the maximum number of Shares or types of Awards available under the Plan are determined and counted; (b) the maximum number of Shares permitted to be issued to an individual Participant in any fiscal year; (c) the number or type of Shares and amount of cash subject to outstanding Awards; (d) the grant, exercise price or value of outstanding Awards; and/or (e) the terms and conditions of any outstanding Award (including, without limitation, any applicable performance targets or criteria with respect to any Performance Units) — the Committee shall make such adjustments in Awards as it deems equitable and appropriate, in its sole discretion, to reflect such Event. In making any such adjustments, the Committee shall round fractional Shares to the nearest whole Share.

17. Change in Control. In the event of a Change in Control, the Committee shall take one of the actions described in Sections 17.1 or 17.2.

17.1. Substitution. If the Change in Control is a merger, consolidation or statutory share exchange, make appropriate provision for the replacement of the outstanding Awards by the substitution of equity-based awards of the corporation surviving any merger or consolidation with substantially similar terms and conditions (or, if appropriate, equity-based awards of the parent corporation of the Company or such surviving corporation), provided such equity-based awards preserve the full economic value of the outstanding Awards (to the extent permitted under Code Section 409A, or, if applicable, the stock rights exemption from Code Section 409A) and provide for full vesting of the Award in the event the Participant experiences a Qualifying Termination.

17.2. Acceleration of Vesting and Payment of Awards.

- a. Options and Stock Appreciation Rights. In the case of Awards of Options and Stock Appreciation Rights, at least ten days before the occurrence of the Change in Control, declare, and provide written notice to each holder of the Option Award or Stock Appreciation Right of the declaration that each outstanding Option Award and Stock Appreciation Right, whether or not then exercisable, shall be cancelled at the time of, or immediately before the occurrence of, the Change in Control in exchange for payment to each holder of an Option Award or Stock Appreciation Right, within ten (10) days after

the Change in Control of cash equal to (a) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value per Share exceeds the purchase price per Share covered by such Option, or (b) for each Stock Appreciation Right, the price determined pursuant to Section 10. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option Award shall immediately become exercisable in full and each person holding an Option Award or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option Award or Stock Appreciation Right, to exercise the Option Award as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 17.2(a), each outstanding Option Award and Stock Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Change in Control shall be cancelled at the time of, or immediately before, the Change in Control, as provided in the declaration. Notwithstanding the foregoing, no person holding an Option Award or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 17.2(a) if such Option Award or Stock Appreciation Right shall have terminated, expired or been cancelled.

- b. **Full Value Awards.** In the case of Full Value Awards that are time-based vested, provide for either full vesting or pro-rated vesting (based on the number of months that have expired since the Award was granted) and payout of cash or Shares under the Award; and in the case of Full Value Awards that are performance-based, provide for full vesting and payout of cash or Shares based on the assumption that the performance goal(s) for the Award were met at target.

18. Forfeitures and Clawback

18.1. **Forfeiture.** An Agreement may provide that if a Participant has received or been entitled to delivery of Shares pursuant to an Award within six months before the Participant's Separation from Service with the Company, the Committee, in its sole discretion, may require the Participant to return or forfeit the Shares or cash received with respect to the Award (or its economic value as of: (a) the date of the exercise of Options or Stock Appreciation Rights, (b) the date of, and immediately following, the lapse of restrictions on Restricted Stock, Restricted Stock Units, or the receipt of Shares without restrictions, or (c) the date on which the right of the Participant to payment with respect to Performance Units vests, as the case may be), in the event of certain occurrences specified in the Agreement. The Committee's right to require forfeiture must be exercised within any period required by law. The occurrences may, but need not, include termination for "Cause," competition with the Company, unauthorized disclosure of material proprietary information of the Company, a violation of applicable business ethics policies of the Company, a violations of applicable law, or any other occurrence specified in the Agreement within the period or periods of time specified in the Agreement.

18.2. **Required Clawback.** The Company reserves the right to require a Participant to forfeit or return to the Company any cash or Shares received under an Award under the Plan to the extent required by law, under any applicable exchange listing standard or under any applicable policy adopted by the Company that is designed to meet any legal obligations or obligations under any applicable exchange listing standard.

19. Beneficiary Upon Death. In the event that any interest in Stock is or becomes distributable under the Plan at the time of the Participant's death, such interest shall be distributed to the beneficiary or beneficiaries designated by the Participant. Such interest shall be distributed according to the terms of the Plan and the Agreement. In order for a beneficiary designation to be valid for purposes of the Plan, it must be completed and filed with the Company according to the rules established by the Company. If the Participant has not completed a beneficiary designation, or all such beneficiaries have predeceased the Participant, then any amount that becomes payable under the Plan by reason of the Participant's death shall be paid to the Participant's estate. If there is any question as to the legal right of any person to receive a distribution under the Plan by reason of the Participant's death, the amount in question may, at the discretion of the Committee, be paid to the Participant's estate, in which event the Company shall have

no further liability or responsibility to anyone with respect to such amount. This Section 19 shall apply to all Awards granted under the Plan.

20. Corporate Mergers, Acquisitions, Etc. The Committee may also grant Options, Stock Appreciation Rights, Restricted Stock or other Awards under the Plan in substitution for, or in connection with the assumption of, existing options, stock appreciation rights, restricted stock or other award granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to which the Company or an Affiliate is a party. The terms and conditions of the substitute Awards may vary from the terms and conditions set forth in the Plan to the extent the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

21. Unfunded Plan. Except with respect to Awards of Restricted Stock, the Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, the Committee, nor the Board shall be deemed to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and a Participant or beneficiary. Except with respect to Awards of Restricted Stock, to the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

22. Limits of Liability

- a. Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.
- b. Except as may be required by law, neither the Company nor any member of the Board or of the Committee, nor any other person participating in any determination of any question under the Plan, or in the interpretation, administration or application of the Plan, shall have any liability to any party for any action taken, or not taken, in good faith under the Plan.

23. Compliance with Applicable Legal Requirements. No certificate for Shares distributable pursuant to the Plan shall be issued and delivered unless the issuance of the certificate complies with all applicable legal requirements including, without limitation, compliance with the provisions of applicable state securities laws, the Securities Act of 1933, as amended and in effect from time to time or any successor statute, the Exchange Act and the requirements of the exchanges on which the Company's Shares may, at the time, be listed.

24. Deferrals and Settlements. The Committee may require or permit Participants to elect to defer the issuance of Shares under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts.

25. Other Benefit and Compensation Programs. Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay laws of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or an Affiliate unless expressly so provided by such other plan, contract or arrangement, or unless the Committee expressly determines that an Award or portion of an Award should be included to accurately reflect competitive compensation practices or to recognize that an Award has been made in lieu of a portion of competitive cash compensation.

26. Requirements of Law

- a. To the extent that federal laws do not otherwise control, the Plan and all determinations made and actions taken pursuant to the Plan shall be governed by the laws of the State of

Illinois without regard to its conflicts-of-law principles and shall be construed accordingly.

- b. If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

27. Repricing; Shareholder Approval. Except as provided in Plan Section 16, neither the Board nor any committee thereof shall cause the Company to take any of the following actions without receiving the prior approval of the shareholders of the Company:

- a. adjusting or amending the exercise price of any outstanding Award, whether through amendment, replacement grant, exchange or other means;
- b. providing for the cancellation of an Option Award in exchange for cash or another Award when the Option's exercise price per Share exceeds the Fair Market Value of a Share; or
- c. providing for the cancellation of a Stock Appreciation Right in exchange for cash or another Award when the Stock Appreciation Right's base price per Share exceeds the Fair Market Value of a Share.

28. Compliance with Code Section 409A. Any benefit under the Plan that is or becomes subject to Code Section 409A is intended to comply with the requirements of Code Section 409A, and the benefit will be administered, and any Plan term governing such benefit will be interpreted, accordingly. Notwithstanding any other provision in the Plan or any Agreement to the contrary, if at the time of the Participant's Separation from Service, the Participant is a "specified employee" within the meaning of Code Section 409A(a)(2)(B)(i), distributions made on account of the Participant's Separation from Service that are subject to Code Section 409A may not be made before the date that is six months after Participant's Separation from Service. In such instance, and notwithstanding the payment terms under an individual Agreement, distributions will commence on the first day of the seventh month following the Separation from Service and the first monthly distribution shall include the aggregate payments (if any) that were delayed pursuant to this paragraph. For purposes of this Plan, any series of installment payments to which a Participant may be entitled under any Award subject to 409A shall be treated as a right to a series of separate payments under Section 409A.

Date: May 7, 2020

RLI CORP.

By /s/ Jonathan E. Michael

Chief Executive Officer

**RLI CORP. ANNUAL INCENTIVE COMPENSATION PLAN
EFFECTIVE JANUARY 1, 2020**

I. ESTABLISHMENT AND PURPOSE

RLI Corp. (the “Company”) established the RLI Incentive Compensation Plan (the “Plan”), effective January 1, 2006, for the benefit of its employees and employees of its Affiliates. The Plan was intended to amend, consolidate and restate certain prior incentive compensation plans established by the Company. The terms of the Plan, as set forth herein, shall apply to Awards granted under the Plan on and after the Effective Date. Except as otherwise provided, Awards granted under the Company’s incentive compensation plans in effect prior to the Effective Date shall be governed by the terms of such plans.

The Company previously restated the Plan, effective January 1, 2009, to comply with the requirements of the final regulations issued under Section 409A (“Section 409A”) of the Internal Revenue Code of 1986, as amended (“Code”); again, effective January 1, 2010, to amend the Plan’s definition of “Retirement”, to amend provisions of the Plan relating to the designation of Plan beneficiaries, to change the term “Board Approval Limit” to “Committee Approval Limit”, and to clarify the application of the maximum Award provision; again, effective January 1, 2011 to expand the Plan’s definition of “Performance Goals” and to expand the circumstances under which a Participant may be considered to have a “Retirement” under the Plan; again effective January 1, 2016, to provide for Bonus Banks and other contingent deferred payments of Awards to become vested upon a Change in Control, to further expand the Plan’s definition of “Performance Goals” and in certain other clarifying respects; again for Performance Periods beginning on or after January 1, 2018 to reflect the revision of Code section 162(m) to remove the performance based compensation exception in that section; and again effective January 1, 2020 to change the manner in which eligibility for Retirement is measured.

The Plan is intended to align incentive compensation with achieving the financial performance factors on which the Company’s market value is driven. The Plan is also designed to promote the accomplishment of management’s primary annual objectives as reflected in the Company’s annual operating plan and in the objectives established by management for employees, and to recognize the achievement of management’s objectives through the payment of incentive compensation.

The Plan provides for incentive payments to employees based upon the achievement of pre-established performance goals. The performance goals may be annual, partial-year or multi-year goals. The Company may adopt a variety of bonus and incentive programs under the Plan.

II. DEFINITIONS

For purposes of the Plan, unless the context otherwise requires, the following terms shall have the meanings set forth below.

2.1 “Affiliate” means any corporation that is part of a controlled group within the meaning of Code Section 414(b) or (c).

2.2 “Award” means an award of incentive compensation under the Plan to a Participant in accordance with the terms set forth herein.

2.3 “Board” means the Board of Directors of the Company as constituted at the relevant time.

2.4 “Bonus Bank” means a deferred payment arrangement established under Section 6.2.

2.5 “Bonus Payment Date” means the date on which Awards with respect to a Performance Period are paid, which shall not be later than March 15th of the year following the applicable Performance Period except to the extent the payment of such Award is credited to a Participant’s Bonus Bank or otherwise deferred pursuant to the terms of the RLI Corp. Executive Deferred Compensation Plan.

2.6 “Bonus Pool” means an amount available for distribution to Participants who have been assigned an interest in the Bonus Pool (e.g. the Market Value Potential bonus pool arrangement in effect as of the Effective Date).

2.7 “Cause” means termination for reasons described in Section 6.3.

2.8 “Change in Control” means each of the following:

(i) The date any “Person,” within the meaning of Section 13(d) or 14(d) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), including any group (within the meaning of Section 13(d)(3) under the Exchange Act), becomes the “Beneficial Owner,” as such term is defined in Rule 13d-3 promulgated under the Exchange Act, of 30% or more of the combined voting power of the Company’s outstanding shares, other than beneficial ownership by (A) the Company or any subsidiary of the Company, (B) any employee benefit plan of the Company or any subsidiary of the Company or (C) any entity of the Company for or pursuant to the terms of any such plan. Notwithstanding the foregoing, a Change in Control shall not occur as the result of an acquisition of outstanding shares of the Company by the Company which, by reducing the number of shares outstanding, increases the proportionate number of shares beneficially owned by a Person to 30% or more of the shares of the Company then outstanding; provided, however, that if a Person becomes the Beneficial Owner of 30% or more of the shares of the Company then outstanding by reason of share purchases by the Company and shall, after such share purchases by the Company, become the Beneficial Owner of any additional shares of the Company, then a Change in Control shall be deemed to have occurred; or

(ii) The date the Company consummates a merger or consolidation with another entity, or engages in a reorganization with or a statutory share exchange or an exchange offer for the Company’s outstanding voting stock of any class with another entity or acquires another entity by means of a statutory share exchange or an exchange offer, or engages in a similar transaction; provided that no Change in Control shall have occurred by reason of this paragraph unless either:

- (A) the stockholders of the Company immediately prior to the consummation of the transaction would not, immediately after such consummation, as a result of their beneficial ownership of voting stock of the Company immediately prior to such consummation
 - (I) be the Beneficial Owners, directly or indirectly, of securities of the resulting or acquiring entity entitled to elect a majority of the members of the board of directors or other governing body of the resulting or acquiring entity; and
 - (II) be the Beneficial Owners of the resulting or acquiring entity in substantially the same proportion as their beneficial ownership of the voting stock of the Company immediately prior to such transaction; or
- (B) those persons who were directors of the Company immediately prior to the consummation of the proposed transaction would not, immediately after such consummation, constitute a majority of the directors of the resulting entity.

(iii) The date of the sale or disposition, in one or a series of related transactions, of all or substantially all of the assets of the Company to any Person (as defined in paragraph (i) above) other than an Affiliate; or

(iv) The date the number of duly elected and qualified directors of the Company who were not either elected by the Company’s Board or nominated by the Board or its nominating/governance committee for election by the shareholders shall constitute a majority of the total number of directors of the Company as fixed by its By-Laws.

The Committee shall have full and final authority, which shall be exercised in its discretion, to determine conclusively whether a Change in Control of the Company has occurred pursuant to the above definition, and the date of the occurrence of such Change in Control and any incidental matters relating thereto.

In addition, if a Change in Control constitutes a payment event with respect to any Award which provides for the deferral of compensation and is subject to Code Section 409A, the transaction or event described in paragraph (i), (ii), (iii) or (iv) with respect to such Award must also constitute a “change in control event,” as defined in Treasury Regulation Section 1.409A-3(i)(5) to the extent required by Section 409A.

2.9 “Code” means the Internal Revenue Code of 1986, as amended.

2.10 “Committee” means the Executive Resources Committee of the Board, as constituted at the relevant time.

2.11 “Committee Approval Limit” means a predetermined Award level above which the independent directors of the Board approve Awards in accordance with Section 5.3(b).

2.12 “Company” means RLI Corp., an Illinois corporation.

2.13 “Disability or Disabled,” with respect to a Participant, means that: (a) the Participant (i) satisfies the requirements to receive long-term disability benefits under the Company-sponsored group long-term disability plan in which the Participant participates without regard to any waiting periods, and (ii) the Participant is unable to engage in any substantial gainful activity by reasons of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months; or (b) the Participant has been determined by the Social Security Administration to be eligible to receive Social Security disability benefits. A Participant shall not be considered to be “Disabled” unless the Participant furnishes proof of the Disability to the Company in such form and manner as the Company may require.

2.14 “Eligible Employee,” for any Performance Period, means those employees of the Company and its Affiliates as may be designated to participate in the Plan for such Performance Period. An employee who is designated as eligible to participate in the Plan for a particular Performance Period is not necessarily eligible to participate in the Plan for any other Performance Period.

2.15 “Effective Date” means January 1, 2020.

2.16 “Executive Officer” means those employees designated by the Board to be Executive Officers of the Company for purposes of Section 16 of the Securities Exchange Act of 1934.

2.17 “Fiscal Year” means the calendar year.

2.18 “Normal Retirement Date,” of a Participant, means the date on which the Participant has attained a combined age and years of service with the Company of seventy-five. For this purpose, (i) the Participant’s age shall be measured in whole and partial years (with partial years measured in days) as of the date of the Participant’s Retirement and (ii) the Participant’s service with the Company shall be based only on the Participant’s actual service with the Company (and not with any other employer that may be acquired by the Company with respect to service prior to the acquisition, except as otherwise provided by the Company in writing) and shall be calculated based on the number of whole and partial years of employment (with partial years measured in days) that the Participant has completed from the date of a Participant’s initial employment with the Company through the date of the Participant’s Retirement.

2.19 “Participant,” for any Performance Period, means an Eligible Employee who has commenced participating in the Plan for such Performance Period.

2.20 “Performance Goals,” of a Participant for a Performance Period, are the goals established for the Performance Period, the achievement of which may be a condition for receiving an Award under the Plan.

Performance Goals must be established by the Committee (for Executive Officers) and by the Plan Administrative Committee (for all participants). A Performance goal may provide the method for computing the amount of compensation payable if the goal is attained or may permit discretion to assess the achievement level. The Committee may adjust Performance Goals or performance results to prevent dilution or enlargement of an Award as a result of extraordinary events or circumstances as determined by the Committee or to exclude the effects of extraordinary, unusual or nonrecurring events, changes in accounting principles, discontinued operations, acquisitions, divestitures and material restructuring charges.

Performance Goals may be based, but are not required to be based, on one or more performance criteria, including without limitation the following, and may be based on attainment of a particular level of, or on a positive change in, such criteria: revenue, revenue per employee, earnings before income tax (profit before taxes), earnings before interest and income tax, net earnings (profit after taxes), earnings per employee, earnings per share, operating income, total shareholder return, stock price, market share, return on equity, return on capital, before-tax return on net assets, after-tax return on net assets, economic value added (economic profit), market value potential, underwriting profit, price-to-book ratio, price-to-earnings ratio, combined ratio, book value, book value per share, net operating cash flow, investment income, comprehensive earnings, gross written premium, net written premium, sales, costs, expense ratio, loss ratio, operating leverage, dividends paid, contribution from new products, customer satisfaction and employee satisfaction. Such criteria may relate to one or any combination of two or more of Company, Affiliate, division or individual performance.

2.21 “Performance Period” means, generally, the Fiscal Year. However, the Committee may, in its discretion, designate a shorter or longer Performance Period.

2.22 “Plan Administrative Committee” means the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, and Chief Human Resources Officer of the Company or such other officers as the Committee may designate from time to time.

2.23 “Retirement,” of a Participant, means the Participant’s Termination of Employment with the Company and all Affiliates on or after the Participant’s Normal Retirement Date. In addition, the Committee or the Administrative Committee may specify, in its discretion, in a written Award agreement, policy or guideline that the Participant will be considered to have had a “Retirement”, and accordingly not forfeit otherwise forfeitable Plan benefits, if the Participant satisfies the terms of a non-competition covenant or under such other terms and conditions as specified by the Committee in its discretion.

2.24 “Salary,” of a Participant for a Performance Period means the annualized base compensation payable to a Participant determined by the salary rate in effect on the last day of the Performance Period. The salary rate shall be determined without regard to reductions or deferrals of compensation under qualified and nonqualified plans or welfare benefit plans. The salary rate shall be determined without regard to fringe benefits, bonuses or other payments in addition to the Participant’s base compensation.

2.25 “Target Performance Award” means a dollar amount (which may be expressed as a percentage of Salary) established for a Participant if the Performance Goal for the Participant is achieved. The Target Performance Award may also state the maximum amount that may actually be paid to the Participant under Section 5.3 (which may be expressed as a percentage of Salary.)

2.26 “Termination of Employment” with respect to a Participant, means the Participant’s separation from service with all Affiliates, within the meaning of Section 409A(a)(2)(A)(i) of the Code and the regulations under such section. Solely for this purpose, a Participant who is an eligible Employee will be considered to have a Termination of Employment when the Participant dies, retires, or otherwise has a termination of employment with all Affiliates. The employment relationship is treated as continuing intact while the Participant is on military leave, sick leave, or other bona fide leave of absence if the period of such leave does not exceed six months, or if longer, so long as the individual retains a right to reemployment with an Affiliate under an applicable statute or by contract. For purposes hereof, a leave of absence constitutes a bona fide leave of absence only if there is a reasonable expectation that the Participant will return to perform services for an Affiliate. If the period of leave exceeds six months and the individual

does not retain a right to reemployment under an applicable statute or by contract, the employment relationship is deemed to terminate on the first date immediately following such six-month period. Notwithstanding the foregoing, where a leave of absence is due to any medically determinable physical or mental impairment that can be expected to last for a continuous period of not less than six months, where such impairment causes the employee to be unable to perform the duties of such employee's position of employment or any substantially similar position of employment, the Company may substitute a 29-month period of absence for such six-month period.

Whether a termination of employment has occurred is determined based on whether the facts and circumstances indicate that the Affiliate and the Participant reasonably anticipated that no further services will be performed after a certain date or that the level of bona fide services the Participant will perform after such date will permanently decrease to no more than 49 percent of the average level of bona fide services performed over the immediately preceding 36-month period (or the full period of services if the Participant has been providing services for less than 36 months).

Notwithstanding anything in the Plan to the contrary, in determining whether a Participant has had a Termination of Employment with an Affiliate, an entity's status as an "Affiliate" shall be determined substituting "50 percent" for "80 percent" each place it appears in Code Section 1563(a)(1),(2), and (3) and in Treasury Regulation Section 1.414(c)-2.

The Company shall have discretion to determine whether a Participant has experienced a Termination of Employment in connection with an asset sale transaction entered into by the Company or an Affiliate, provided that such determination conforms to the requirements of Section 409A and the regulations and other guidance issued under such section, in which case the Company's determination shall be binding on the Participant.

III. ADMINISTRATION

3.1 Duties of Committee. The Committee will administer the Plan. Any actions taken by the Committee shall be by a majority vote of all Committee members or by unanimous written consent. The Committee may establish such rules and regulations as it deems necessary for the Plan and its interpretation. In addition, the Committee may make such determinations and take such actions in connection with the Plan as it deems necessary. Each determination made by the Committee in accordance with the provisions of the Plan will be final, binding and conclusive. The Committee may rely on the financial statements certified by the Company's independent public accountants.

3.2 Duties of Plan Administrative Committee. Except as provided in Section 3.3, the Committee may delegate some or all of its administrative powers and responsibilities under the Plan to the Plan Administrative Committee. Unless the Committee determines otherwise, the Committee shall be treated as delegating its authority to the Plan Administrative Committee to the full extent permitted hereunder. The Plan Administrative Committee may make such determinations and take such actions within the scope of such delegation and as otherwise provided in the Plan, as it deems necessary. The Plan Administrative Committee may further delegate any duties delegated to it pursuant to this Section 3.2 to other officers or employees of the Company and any such delegation may allow for further delegation to other officers or employees. Each determination made by the Plan Administrative Committee, or its delegate, will be final, binding and conclusive. The Plan Administrative Committee and its delegates may rely on the financial statements certified by the Company's independent public accountants. Notwithstanding any such delegation, the Committee may review and change any decision made by the Plan Administrative Committee or its delegate.

3.3 Committee's Sole Authority with Respect to Executive Officers; Amendment or Termination of Plan. Notwithstanding anything in the Plan to the contrary, in the case of Awards to Executive Officers, the Committee has retained the sole and exclusive authority to (i) establish the applicable Performance Goals, (ii) determine the achievement of the applicable Performance Goals, and (iii) adjust the amount of the Awards pursuant to Section 5.2 and 5.3. The Committee shall have sole and exclusive authority to modify, suspend,

terminate or reinstate the Plan. The Committee's authority under this paragraph 3.3 is subject to review and approval by the Board.

IV. ELIGIBILITY TO PARTICIPATE

Participation in the Plan is limited to Eligible Employees. Prior to or during a Performance Period, the Committee, or the Plan Administrative Committee, as appropriate, shall determine which employees are Eligible Employees for the Performance Period. The Committee has final authority to approve or disapprove the selection of any Eligible Employee. An Eligible Employee shall become a Participant only upon approval by the Committee or Plan Administrative Committee and compliance with such terms and conditions as the Committee or Plan Administrative Committee may from time to time establish for the implementation of the Plan.

V. CALCULATION OF AWARDS

A Participant's Award for a Performance Period is determined as follows:

5.1 Establishing Performance Goals and Target Performance Awards and Committee Approval Limits. Prior to or during a Performance Period, the Committee (in the case of Participants who are Executive Officers) and the Plan Administrative Committee, or its delegate, (in the case of all other Participants), shall establish the Performance Goal or Goals and each Participant's Target Performance Award. Alternatively the Committee (in the case of Participants who are Executive Officers) and the Plan Administrative Committee, or its delegate (in the case of all other Participants), may establish a Bonus Pool for one or more Participants and assign Participants an interest in the Bonus Pool. In addition, the Committee shall establish a Committee Approval Limit for each Award made to an Executive Officer.

5.2 Calculation of Awards. Following the close of a Performance Period, the Committee (in the case of the Executive Officers) and the Plan Administrative Committee (in the case of all other Participants) shall determine the actual Award payable to a Participant. Except as provided by the Committee (in the case of Executive Officers) and the Plan Administrative Committee (in the case of all other Participants), no Award will be paid to a Participant if the percentage achievement of a Performance Goal is below any minimum level of performance established for such Performance Goal. In no event shall the aggregate of all Award payments (including the amount of any Award credited to a Bonus Bank) with respect to a Participant in any Fiscal Year exceed \$7,500,000, provided, however, that a payout from a bonus bank in a given year representing a partial payout of the amount of an Award credited to the bonus bank in the same year, shall not be counted toward the maximum to avoid double counting of such amount.

5.3 Adjustments and Certifications of Awards. Once the determination in section 5.2 is made, the Committee, in the case of a Participant who is an Executive Officer, and the Plan Administrative Committee or its delegate in all other cases, shall:

- (a) Review the amount of each Award and make any adjustments it, in its sole discretion, deems appropriate to the amount of the Award. In general, each Participant's Award will be the amount pre-established (when the Performance Goals were established) for achievement of the Performance Goals at the achievement levels described in Section 5.1. However, at the discretion of the Committee (in the case of Executive Officers) or Plan Administrative Committee (in the case of all other Participants), this amount may be increased or decreased based upon such objective or subjective criteria, as such Committee or Plan Administrative Committee deems appropriate.
- (b) In the case of any Award subject to a Committee Approval Limit, the independent directors serving on the Board may reduce the actual Award, but not below the Committee Approval Limit.

VI. PAYMENT OF AWARDS

6.1 Timing of Award Payment. Except as provided in Section 6.2 or as otherwise provided in the underlying written Award, program, guideline or other similar arrangement, a Participant's Award for a Performance Period shall be paid in a cash lump sum to him or her on the Bonus Payment Date immediately following the end of the Fiscal Year in which the Performance Period ends. A Participant who is also eligible to Participate in the RLI Corp. Executive Deferred Compensation Plan may elect to defer some or all of any amount otherwise payable to him or her under this Section 6.1 to the extent permitted by such plan.

6.2 Bonus Bank. Prior to the beginning of a Performance Period, the Committee may specify that a portion of an Award will be credited to a Bonus Bank. Any such Award will be in writing and shall specify a fixed schedule of payments and such other terms and conditions as the Committee or Plan Administrative Committee may choose. The terms of the Award may provide that amounts credited to the Bonus Bank may be reduced if Performance Goals in a subsequent Performance Period are not met. Amounts deposited to the Bonus Bank will be credited with interest equivalent to the interest rate on three-year U.S. Government Treasury Bills in effect at the beginning of the fiscal year.

6.3 Change in Employment Status During Performance Period. Except as provided in this Section 6.3 or as otherwise provided in the underlying written Award, program, guideline or other similar arrangement, in order to receive a payment, a Participant must be employed by the Company or Affiliate on (i) the date of actual payment with respect to an Award that is not held under a Bonus Bank, and (ii) the date of actual payout from a Bonus Bank arrangement. If the Participant dies or becomes Disabled or has a Termination of Employment due to Retirement during a Performance Period, the Participant (or the Participant's beneficiary in the case of the Participant's death) will be entitled to receive a pro rata portion of the Award (that is not held under a Bonus Bank), but only if the Award expressly provides for such payment. In such case, the payment of the Award will be made at the same time as if the Participant had remained employed through the date of payment.

If the Participant dies or becomes Disabled at a time when a Participant has a balance in a Bonus Bank, the Participant (or the Participant's beneficiary in the case of the Participant's death) will be entitled to receive a payment equal to the balance of the Bonus Bank within 30 days of the death or Disability, adjusted for interest through the end of the preceding quarter. If the Participant has a Retirement, payment of the Bonus Bank will be made as specified in the underlying written Bonus Bank agreement, policy or guideline. Notwithstanding anything in this Section 6.3 or under any underlying Award agreement, policy or guideline to the contrary, a Participant shall not be entitled to any Award for a Performance Period if the Participant's employment is terminated by the Company or Affiliate for "Cause". For these purposes "Cause" shall mean the Participant's: (a) failure to comply with any material policies and procedures of the Company or Affiliate; (b) conduct reflecting dishonesty or disloyalty to the Company or Affiliate, or which may have a negative impact on the reputation of the Company or Affiliate; (c) commission of a felony, theft or fraud, or violations of law involving moral turpitude; (d) failure to perform the material duties of his or her employment; (e) excessive absenteeism; (f) unethical behavior; or (g) violation of a material policy of the Company. If a Participant's employment is terminated for "Cause," the date on which the Participant's employment is considered to be terminated, for purposes of this Section 6.3, shall be the time at which such Participant is instructed or notified to cease performing job responsibilities for the Company or any Affiliate, whether or not for other reasons, such as payroll, benefits or compliance with legal procedures or requirements, he or she may still have other attributes of an employee.

Notwithstanding the terms of any written Award agreement, policy or guideline, upon a Change in Control, any amounts then credited to such Participant's Bonus Bank and any other amounts earned during any full or partial Performance Period commencing prior to such Change in Control, including those amounts that are subject to subsequent conditions, shall not be subject to forfeiture or reduction, except in the event of a termination of such Participant's employment for Cause or pursuant to Section 6.5. Such amounts shall be payable to such Participant at the time and form prescribed by the written Award agreement, policy or guideline, in accordance with Code Section 409A.

6.4 Beneficiary. A Participant may designate one or more beneficiaries to receive Plan benefits payable by reason of the Participant's death. In order for such designation to be valid for purposes of the Plan, it must be completed and filed with the Company according to the rules established by the Company. If the Participant has not completed a beneficiary designation, or all such beneficiaries have predeceased the Participant, then any amount that becomes payable under the Plan by reason of the Participant's death shall be paid to the personal representative of the Participant's estate. If there is any question as to the legal right of any person to receive a distribution under the Plan by reason of the Participant's death, the amount in question may, at the discretion of the Committee, be paid to the personal representative of the Participant's estate, in which event the Company shall have no further liability to anyone with respect to such amount. This Section 6.4 shall apply to all Awards granted under the Plan.

6.5 Forfeiture. All Awards paid to the Chief Executive Officer and Chief Financial Officer of the Company under this Plan are subject to forfeiture as provided in Section 304 of the Sarbanes-Oxley Act of 2002, and the implementing rules and regulations. In addition, the Company reserves the right to require a Participant to forfeit or return to the Company any cash or other amount received under an Award under the Plan to the extent required by law, under any applicable exchange listing standard or under any applicable policy adopted by the Company that is designed to meet any legal obligations or obligations under any applicable exchange listing standard.

6.6 Code Section 409A Compliance and Payment Grace Period. The Plan (and any underlying Award, policy, guideline or other similar arrangement) is intended to comply in form and operation with Code Section 409A and the regulations promulgated thereunder. Notwithstanding any provision to the contrary, if any amount payable under the Plan (or any underlying Award, policy, guideline, or other similar arrangement) constitutes deferred compensation, within the meaning of Code Section 409A, and becomes payable to a Specified Employee as a result of the Specified Employee's Termination of Employment, the payment will be deferred (if not already deferred) until the earlier to occur of (i) the first day of the seventh month following such employee's Termination of Employment or (ii) the date of such employee's death. Consistent with the requirements of Section 409A, a Plan distribution that is a "short-term deferral" exempt from Section 409A shall be deemed to be paid on the Bonus Payment Date if it is paid no earlier than January 1st immediately preceding, and no later than the March 15th immediately following, the Bonus Payment Date.

VII. MISCELLANEOUS

7.1 No Guaranty of Employment. Neither the adoption nor maintenance of the Plan, the designation of an employee as an Eligible Employee, the setting of Performance Goals, nor the provision of any Award under the Plan shall be deemed to be a contract of employment between the Company or an Affiliate and any employee. Nothing contained in the Plan shall give any employee the right to be retained in the employ of the Company or an Affiliate or to interfere with the right of the Company or an Affiliate to discharge any employee at any time, nor shall it give the Company or an Affiliate the right to require any employee to remain in its employ or to interfere with the employee's right to terminate employment at any time.

7.2 Release. Any payment of an Award to or for the benefit of a Participant or beneficiary that is made in good faith by the Company in accordance with the Company's interpretation of its obligations hereunder shall be in full satisfaction of all claims against the Company for payments under the Plan to the extent of such payment.

7.3 Notices. Any notice provided by the Company under the Plan may be posted to a Company-designated web-site.

7.4 Nonalienation. No benefit payable at any time under the Plan shall be subject in any manner to alienation, sale, transfer, assignment, pledge, levy, attachment, or encumbrance of any kind by any Participant or beneficiary.

7.5 Plan is Unfunded. All Awards under the Plan shall be paid from the general assets of the Company. No Participant shall be deemed to have, by virtue of being a Participant in the Plan, any claim

on any specific assets of the Company such that the Participant would be subject to income taxation on any Award prior to distribution to him or her, and the rights of a Participant or beneficiary to any payment to which he or she is otherwise entitled under the Plan shall be those of an unsecured general creditor of the Company.

7.6 Tax Liability. The Company may withhold from any payment of Awards or other compensation payable to or on behalf of a Participant or beneficiary such amounts as the Company determines are reasonably necessary to pay any taxes required to be withheld under applicable law.

7.7 Captions. Article and section headings and captions are provided for purposes of reference and convenience only and shall not be relied upon in any way to construe, define, modify, limit, or extend the scope of any provision of the Plan.

7.8 Invalidity of Certain Plan Provisions. If any provision of the Plan is held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provision of the Plan and the Plan shall be construed and enforced as if such provision had not been included.

7.9 Venue. As a substantial portion of the duties and obligations of the parties created by the Plan will be performed in Peoria, Illinois, it shall be the sole and exclusive venue for any arbitration, litigation, special proceedings, or other proceedings between the parties in connection with the Plan.

7.10 Hold Harmless. A Participant shall hold the Company harmless from and pay any cost, expense or fee (not to exceed the bank balance) incurred by the Company with respect to any claim, due or demand asserted by any person, except the Company against any amounts due the Participant under the Plan.

7.11 No Other Agreements. The terms and conditions set forth herein constitute the entire understanding of the Company and the Participants with respect to the matters addressed herein.

7.12 Incapacity. In the event that any Participant is unable to care for the Participant's affairs because of illness or accident, any payment due may be paid to the Participant's duly qualified guardian or other appointed legal representative.

7.13 Applicable Law. The Plan and all rights under it shall be governed by and construed according to the laws of the State of Illinois.

Date: May 7, 2020

RLI CORP.

By /s/ Jonathan E. Michael
Chief Executive Officer

CERTIFICATION

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

I, Jonathan E. Michael, certify that:

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

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

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

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

- (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

- (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 24, 2020

/s/ Jonathan E. Michael

Jonathan E. Michael
Chairman & CEO

CERTIFICATION

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

I, Todd W. Bryant, certify that:

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

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

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

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

- (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

- (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 24, 2020

/s/ Todd W. Bryant

Todd W. Bryant
Vice President, Chief Financial Officer

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

In connection with the Quarterly Report of RLI Corp. (the "Company") on Form 10-Q for the period ending June 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jonathan E. Michael, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ Jonathan E. Michael

Jonathan E. Michael
Chairman & CEO
July 24, 2020

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

In connection with the Quarterly Report of RLI Corp. (the "Company") on Form 10-Q for the period ending June 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Todd W. Bryant, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

/s/ Todd W. Bryant

Todd W. Bryant
Vice President, Chief Financial Officer
July 24, 2020
