

RLI Corp.

Insurance—Cash Flow and Reserve Insight: A Weekly Report Spotlighting Key Issues Driving Insurance Stocks

Highlighted Analysis: RLI Corp.'s Reserve Analysis

Featured Stocks: RLI Corp.

Issue Summary: We did a statutory reserving analysis of RLI Corp. RLI has experienced higher-than-expected favorable development in 2011, which has surprised many analysts, us included. We found RLI's 2001-2010 accident-year statutory reserve redundancy to be \$125 million, or 16.6% of reserves, with moderately conservative assumptions for many lines of business.

Conclusion: We believe the increase in favorable prior-year development in 2011 will be above the norm and favorable development should continue at relatively healthy levels in 2012. We forecast overall favorable development in 2012 of \$52 million, compared with \$90 million expected in 2011 and an average of \$54 million for 2008-2010.

Stock Implications: Our analysis shows that RLI is unique in that it will likely continue to show favorable development from even the toughest years of the soft underwriting cycle. The result is that we expect favorable development to continue to boost earnings over the next two years, even as many competitors begin to exhibit deteriorating results in 2012. While RLI is clearly trading at a premium valuation to the group, we believe the premium is justified, as results will likely favorably diverge from the peer group going forward.

Insurance Trading Pattern: We expect RLI to continue to outperform HCC

Trend to Monitor: RLI has drastically outperformed HCC (HCC \$28.30; Underperform) over the course of the last 10 months: RLI's stock is up nearly 40% for the year, while HCC is actually down for the year following a disappointing prerelease on its reserves earlier this week. We expect this trend to continue. Even with the prerelease and subsequent lowering of HCC's mean consensus EPS, we still do not have confidence that HCC will succeed in meeting estimates this quarter. We reaffirm our Underperform rating for HCC.

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RLI Corp. is a top-tier specialty insurance holding company that underwrites and sells niche commercial insurance products across property, casualty, and surety business lines.

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Please consult the last page of this report for all disclosures.

William Blair & Company, L.L.C. receives or seeks to receive compensation for investment banking services from Chubb Corporation (The) and HCC Insurance Holdings, Inc. and RLI Corp. and Travelers Companies, Inc. (The). Investors should consider this report as a single factor in making an investment decision.

October 28, 2011

Stock Rating: **Market Perform**
 Company Profile: **Core Growth**

Symbol: RLI (NYSE)
 Price: \$70.96 (52-Wk.: \$51-\$72)
 Market Value (mil.): \$1,450
 Fiscal Year End: December
 Long-Term EPS Growth Rate: 15%
 Dividend/Yield: \$1.20/1.7%

	2010A	2011E	2012E
Estimates*			
EPS FY	\$5.29	\$5.01	\$5.02
CY		\$5.01	\$5.02

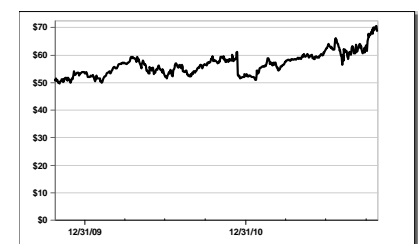
Valuation			
FY P/E	13.4x	14.2x	14.1x
CY P/E		14.2x	14.1x

* Estimates do not reflect the adoption of FAS 123R.

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	21
Float (mil.)	18
Average Daily Volume	118,356

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	16.6
Book Value Per Share (MRQ)	31.0
Enterprise Value (mil.)	1,605.3
EBITDA (TTM)	199.9
Enterprise Value/EBITDA (TTM)	8.0x
Return on Equity (TTM)	18.7

Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

Highlighted Analysis:

RLI Corp.'s Reserve Analysis

RLI Reserve Summary

RLI has surpassed expectations in 2011 because of a large amount of favorable prior-year development that has driven earnings and the stock higher. We estimate that RLI's 2001-2010 accident-year statutory reserve redundancy as of December 31, 2010, to be \$125 million, or 16.6% of reserves.

We forecast reserve development of \$52 million in 2012, which will be more in line with the level of favorable development in 2008 to 2010 calendar years, but down from \$90 million in 2011. Prior to this analysis, we projected RLI's favorable development in 2012 to be \$37 million.

RLI Corporation GAAP Prior Year Reserve Development Per Share

	2007	2008	2009	2010	2011YTD	2011E	2012E
Operating Earnings per share	\$6.52	\$4.99	\$4.70	\$5.29	\$4.25	\$5.35	\$4.98
Casualty favorable reserve development	\$2.10	\$1.23	\$1.66	\$1.61	\$1.96	\$2.19	\$1.34
Property favorable reserve development	\$0.04	(\$0.01)	(\$0.36)	\$0.05	\$0.32	\$0.33	\$0.08
Surety favorable reserve development	\$0.27	\$0.25	\$0.13	\$0.31	\$0.20	\$0.23	\$0.16
Total prior years' reserve development	\$2.41	\$1.47	\$1.43	\$1.97	\$2.48	\$2.75	\$1.58
% of overall EPS	37.0%	29.4%	30.4%	37.3%	58.3%	51.4%	31.7%

Sources: Company reports and William Blair & Company, L.L.C. estimates


RLI Corporation Reserve Analysis Summary 2001-2010 Accident Years

(dollars in thousands)

RLI Corp. Reserves By Line of Business	2010 Earned Premium	2010 Booked Reserves	% of Total Reserves	Selected Reserve	Redundancy/(Deficiency)	Red./(Def.) as % of Reserves
OTHER LIABILITY - OCCURRENCE	162,679	482,041	64.2%	392,181	89,860	18.6%
COMMERCIAL AUTO/TRUCK LIABILITY/MEDICAL	35,257	56,223	7.5%	48,028	8,195	14.6%
COMMERCIAL MULTIPLE PERIL	32,796	42,975	5.7%	44,617	(1,642)	-3.8%
Sum of Reserves Analyzed	230,732	581,239	77.5%	484,827	96,412	16.6%
Sum of Other Reserves	315,967	169,057	22.5%	169,057	28,063	16.6%
Total	546,692	750,292	100%	653,880	124,476	16.6%

Sources: SNL and William Blair & Company, L.L.C. estimates

Featured Stock

	Ticker	Rating	Price	2011 EPS Estimate	2012 EPS Estimate	2011 P/E	2012 P/E
	RLI	Market Perform	\$70.99	\$5.35	\$4.98	13.3x	14.3x
	Investment Summary: We continue to believe that RLI is one of the better-positioned commercial insurers in the current cycle. However, the company is currently trading at 12.4 times P/CF and 1.7 times current book value due to the recent appreciation in the stock YTD. We believe the company is fairly valued at these levels given the strong 3rd quarter and future growth expectations.						

RLI Overall Reserve Analysis

RLI has proven over time to write business very profitably and this has been supported by a significant amount of favorable development. Below are the incurred loss ratios for each accident year of RLI's overall business. There has been steady favorable development in the 2003-2008 accident years followed by a hiccup in 2009, as there was adverse development for the first time at the 24 months reporting date since 2002. This adverse development was primarily driven by a significant increase in the Other Liability - Occurrence 2009 accident-year loss ratio, which has since developed favorably. Given the GAAP favorable development results of 2011, it appears the 2009 accident year will continue pattern of favorable development similar to what historical years have followed.

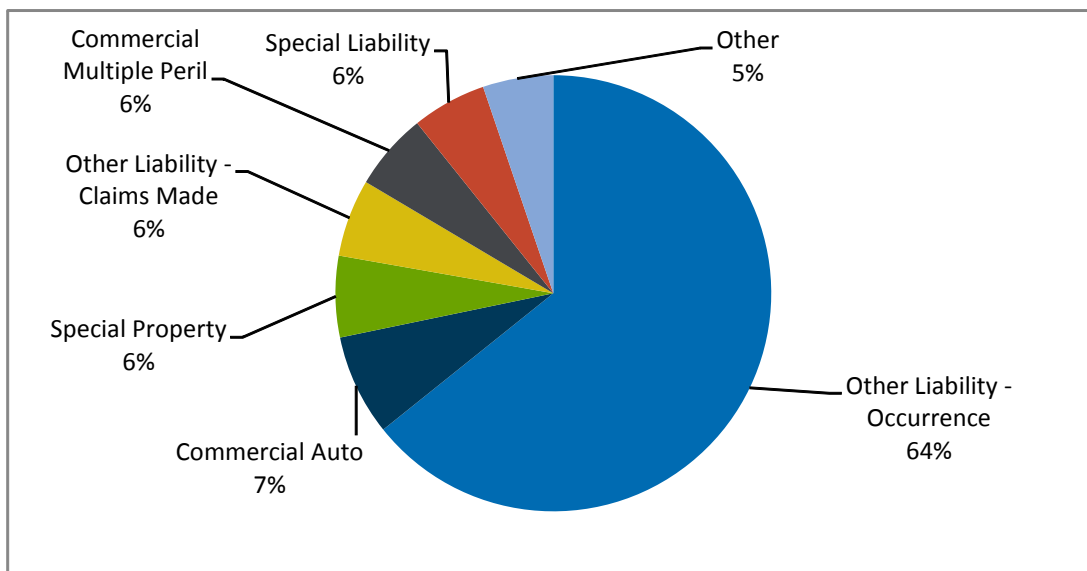
**RLI Corporation
All Lines of Business
Incurred Loss Ratios (%)**

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of development
2001	48.75	54.91	48.81	49.53	51.85	52.83	53.06	53.02	52.29	51.57	2.82
2002	49.14	49.90	47.89	45.61	47.81	46.79	45.39	44.94	44.57		(4.57)
2003	54.30	51.45	43.41	39.34	38.64	37.76	36.71	35.80			(18.50)
2004	55.94	50.85	46.38	41.77	39.75	38.20	37.13				(18.81)
2005	55.88	53.20	44.27	40.32	38.42	36.95					(18.93)
2006	49.33	42.33	40.41	37.99	35.84						(13.49)
2007	47.61	46.25	42.90	39.41							(8.20)
2008	50.61	49.56	43.61								(7.00)
2009	48.23	49.54									1.31
2010	51.46										0.00

Source: SNL

Looking at the distribution of reserves by line of business, 64% of RLI's statutory reserves are from the Other Liability - Occurrence line of business. The other smaller lines of business are fairly evenly split around 6% each.

**RLI Corporation
U.S. Statutory Reserve Distribution by Line of Business**



Source: SNL

RLI Corporation
Reserve Analysis Summary
2001-2010 Accident Years

(dollars in thousands)

RLI Corp. Reserves By Line of Business	2010 Earned Premium	2010 Booked Reserves	% of Total Reserves	Selected Reserve	Redundancy/(Deficiency)	Red./(Def.) as % of Reserves
OTHER LIABILITY - OCCURRENCE	162,679	482,041	64.2%	392,181	89,860	18.6%
COMMERCIAL AUTO/TRUCK LIABILITY/MEDICAL	35,257	56,223	7.5%	48,028	8,195	14.6%
COMMERCIAL MULTIPLE PERIL	32,796	42,975	5.7%	44,617	(1,642)	-3.8%
Sum of Reserves Analyzed	230,732	581,239	77.5%	484,827	96,412	16.6%
SPECIAL PROPERTY	140,844	45,285	6.0%	45,285	0	0.0%
OTHER LIABILITY - CLAIMS MADE	19,911	43,111	5.7%	43,111	0	0.0%
SPECIAL LIABILITY	30,984	41,474	5.5%	41,474	0	0.0%
FIDELITY AND SURETY	106,682	23,947	3.2%	23,947	0	0.0%
PRODUCT LIABILITY - OCCURRENCE	3,672	12,180	1.6%	12,180	0	0.0%
AUTO PHYSICAL DAMAGE	5,623	1,215	0.2%	1,215	0	0.0%
HOMEOWNER/FARROWNER	8,091	1,090	0.1%	1,090	0	0.0%
PRODUCT LIABILITY - CLAIMS-MADE	160	755	0.1%	755	0	0.0%
Total	546,692	750,292	100%	653,880	96,412	12.8%

Sources: SNL and William Blair & Company, L.L.C. estimates

Using primarily the chain ladder method, we estimated the redundancy/deficiency for three lines of business; the other lines of data had sparse data that made it difficult to project with reasonable accuracy. We found Other Liability – Occurrence to be \$89 million, or 18.6%, redundant; Commercial Auto was \$8.1 million, or 14.6%, redundant; and Commercial Multiple Peril was \$1.6 million, or -3.8%, redundant. For the lines of business we analyzed, we found the reserves 16.6% redundant; if we assumed all the other lines of business were exactly adequate, the overall reserves would come to 12.8% redundancy. Projecting the adequacy of the other lines of business is difficult because of limited data; however, the next few exhibits will give some context on how these lines of business have contributed to earnings and what we believe will happen.

On a statutory basis, Other Liability – Occurrence has provided the largest favorable development of any line of business since 2005, although there is plentiful participation from most lines of business over the last several years. The statutory lines of business that would relate to the GAAP casualty segment also include Other Liability – Claims Made, Commercial Auto Liability, Product Liability, Special Liability, and a portion of the Commercial Multiple Peril. We note the 2010 \$84 million number does not match GAAP, as there are differences in the reporting between GAAP and statutory; however, this is useful to see directionally the impact of each line of business. The difference for overall development between SNL grouped statutory documents and GAAP is roughly \$20 million for each of the past four years (statutory being higher).

RLI Corporation
U.S. Statutory Prior Year Reserve Development
(dollars in thousands)

Line of Business	2005	2006	2007	2008	2009	2010
Oth Liab (Occurrence)	-39,319	-27,053	-47,046	-35,926	-34,699	-29,483
Comm'l Auto Liab	-5,769	-2,427	-17,617	373	-7,837	-8,143
Comm'l Multi Prl	-2,830	-5,321	-1,773	-1,959	-4,541	-6,189
Sum of LOBs Analyzed	-47,918	-34,801	-66,436	-37,512	-47,077	-43,815
Special Property	-11,426	-4,873	-15,660	-12,436	-11,063	-7,896
Oth Liab (Claims)	1,558	-8,349	-9,771	-2,160	-6,258	-8,467
Special Liab	288	125	1,082	2,580	12,171	-3,556
Fidelity & Surety	-3,081	-3,761	-15,006	-8,091	-7,316	-12,027
Product Liab (Occ)	-7,441	-2,795	-2,506	-5,906	-5,704	-5,107
Auto Phys	-565	-1,747	-2,993	-2,259	-1,382	-1,894
Other	1,505	6,499	3,057	3,384	411	-970
Sum of Other LOBs	-19,162	-14,901	-41,797	-24,888	-19,141	-39,917
All Lines	-67,080	-49,702	-108,233	-62,400	-66,266	-83,733

Sources: SNL and William Blair & Company, L.L.C.

Despite Other Liability – Occurrence representing 64% of the reserves, the favorable development has been less on a relative basis compared with the other lines, as Other Liability – Occurrence has represented 35% to 59% of total favorable development during the last six years (average of 50%). Just one quick thing to note about the 2010 calendar year: the Other Liability – Occurrence’s 35% ratio to total favorable development in 2010 was driven by a reserve strengthening in the 2009 accident year. Excluding the \$23.8 million of strengthening in the Other Liability – Occurrence 2009 accident year, we arrive at \$53.2 million of favorable development in 2010 compared with \$107.5 million total, a ratio of 50%.

RLI Corporation
U.S. Statutory Prior Year Reserve Development as % of Reserves

Line of Business	2005	2006	2007	2008	2009	2010
Oth Liab (Occurrence)	-10.3%	-6.3%	-9.9%	-7.4%	-6.9%	-5.8%
Comm'l Auto Liab	-6.6%	-2.7%	-20.5%	0.5%	-11.1%	-13.4%
Comm'l Multi Prl	-11.0%	-13.8%	-4.3%	-4.2%	-9.8%	-13.8%
LOBs Analyzed	-8.6%	-5.8%	-11.0%	-6.0%	-7.6%	-7.2%
Special Property	-16.5%	-6.5%	-22.3%	-21.5%	-18.1%	-17.6%
Oth Liab (Claims)	4.5%	-20.2%	-26.3%	-6.5%	-15.2%	-19.4%
Special Liab	55.8%	5.6%	11.3%	13.2%	40.4%	-8.1%
Fidelity & Surety	-9.3%	-10.9%	-38.7%	-27.6%	-28.7%	-37.3%
Product Liab (Occ)	-24.6%	-9.7%	-9.1%	-22.6%	-29.6%	-32.1%
Auto Phys	-11.1%	-27.6%	-52.9%	-50.5%	-39.2%	-67.5%
Other	18.3%	64.4%	19.3%	17.5%	1.9%	-4.3%
Other LOBs	-9.7%	-7.3%	-22.0%	-12.3%	-9.3%	-18.2%
All Lines	-9.9%	-6.6%	-13.4%	-7.9%	-8.0%	-10.2%

Sources: SNL and William Blair & Company, L.L.C.

The previous exhibit shows the data above as a percentage of reserves held at the end of the previous year. This is useful to get a picture on how well the reserves have been developing for RLI's smaller lines of business. Some of these numbers are eye-popping, and it really illustrates how well RLI has diverged from a lot of other insurers that have not been as fortunate in development of their reserves. The six-year average development for the reserves of lines of businesses we have not analyzed is 13.1% compared with 7.7% for the lines of business we did analyze. Given all this information, we will assume the redundancy for these other lines of business to be 16.6%, the same as the lines of business we analyzed. This arrives at an overall redundancy of \$125 million as of December 31, 2010.

RLI Corporation
Reserve Analysis Summary
2001-2010 Accident Years

(dollars in thousands)

RLI Corp. Reserves By Line of Business	2010 Earned Premium	2010 Booked Reserves	% of Total Reserves	Selected Reserve	Redundancy/(Deficiency)	Red./(Def.) as % of Reserves
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Sum of Reserves Analyzed	230,732	581,239	77.5%	484,827	96,412	16.6%
Sum of Other Reserves	315,967	169,057	22.5%	169,057	28,063	16.6%
Total	546,692	750,292	100%	653,880	124,476	16.6%

Sources: SNL and William Blair & Company, L.L.C. estimates

Other Liability – Occurrence Market Position

RLI is the 30th-largest Other Liability – Occurrence writer in the United States, according to statutory data, with \$185 million of direct written premiums.

Insurance Industry
U.S. Statutory Other Liability (Occurrence) Market
(dollars in thousands)

2010 Rank	Institution	Direct Written Premiums	2010 Market Share (%)
1	American International Group	3,759,643	13.39
2	Zurich Financial Services Ltd	1,948,072	6.94
3	Travelers Companies Inc.	1,774,703	6.32
4	ACE Ltd.	1,524,555	5.43
5	Liberty Mutual	1,502,169	5.35
6	Nationwide Mutual Group	1,062,937	3.79
7	Chubb Corp.	845,397	3.01
8	CNA Financial Corp.	822,331	2.93
9	State Farm Mutl Automobile Ins	772,056	2.75
10	Allianz SE	591,731	2.11
30	RLI Corp.	185,118	0.66
Total Oth Liab (Occurrence) Market		28,077,209	100.00

Source: SNL

On a state-by-state basis, its largest three states are New York, California, and Florida. RLI ranks No. 13 in New York, meaningfully ahead of its overall U.S. rank. New York, California, and Florida represent 57% of RLI's Other Liability - Occurrence premiums. On an overall industry basis, those three states sum to 27% of the overall market.

RLI Corporation
U.S. Statutory Other Liability Occurrence by State
(dollars in thousands)

State	Direct Written Premiums	State Rank	% Mkt Share	% of RLI OLO
New York	51,424	13	1.74	27.78
California	30,281	27	0.95	16.36
Florida	23,798	19	1.46	12.86
Texas	16,788	28	0.73	9.07
New Jersey	7,407	35	0.67	4.00
Massachusetts	5,737	27	0.85	3.10
Illinois	5,322	45	0.42	2.87
Pennsylvania	4,745	41	0.41	2.56
Minnesota	2,814	39	0.60	1.52
Michigan	2,685	46	0.43	1.45
Washington	2,209	47	0.43	1.19
Louisiana	1,755	55	0.34	0.95
Virginia	1,742	45	0.35	0.94
Other	28,411	NA	0.25	15.35
Total	185,118	32	0.66	100.00

Source: SNL

Other Liability - Occurrence Reserves

RLI's loss ratios have increased in 2009 and 2010 accident years in the Other Liability - Occurrence line of business. With the benefit of having three quarters of GAAP data so far in 2011, we can glean into the drivers behind this increase and how the reserves will play out.

RLI Corporation
Other Liability - Occurrence Incurred Loss Ratios (%)

Accident Year	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months	Points of development
2001	60.16	73.07	51.27	50.55	57.89	59.28	61.77	62.82	61.81	59.59	(0.57)
2002	56.17	61.42	56.82	53.49	56.79	57.25	53.86	54.06	52.90		(3.27)
2003	56.36	63.80	49.12	43.90	44.70	42.42	40.88	39.12			(17.24)
2004	61.95	55.01	52.57	47.53	44.69	42.92	41.04				(20.91)
2005	58.07	53.77	42.69	36.01	33.21	30.82					(27.25)
2006	57.42	47.46	45.06	43.20	39.17						(18.25)
2007	58.32	58.97	52.68	46.85							(11.47)
2008	61.90	60.64	53.01								(8.89)
2009	63.42	78.01									14.59
2010	71.01										

Source: SNL

It has been mentioned on the last two earnings calls that the casualty reserve development came from the 2001-2003 and 2005-2010 accident years, with an emphasis on the more recent years because of an overreaction of habitational general liability claims. In the triangle above, you can see that the 2009 and 2010 accident years have much higher loss ratios than anything historically, and in calendar year 2010, the 2009 accident year actually saw 15 points of adverse development.

Incorporating the comments from the 2011 earnings call, it seems that there was certainly room for these reserves to be released if the trends went favorable for the 2009 and 2010 accident years, as the increase in loss ratios could not be primarily driven by rate decreases (2008 accident year at 36 months is 53%, significantly lower than 78% for the 2009 accident year at 24 months). The company's statement that about one-third of the favorable development in the second quarter was due to the habitational business is consistent with the size of reserves being held in the other liability occurrence line of business. In addition, during the third-quarter conference call, the 2010 accident year was included as a driver of the favorable development, so it is likely the high loss ratio pick of 71% provided favorable development given that the initial reserve put up was much higher than historical accident years.

Looking at the paid-to-incurred and reported-to-incurred ratios, a general theme emerges with this line of business for RLI. The reported losses are way ahead of the paid losses, so if the company projected its loss reserves based on patterns of historical reported losses, it would arrive at less redundancy than if it projected its loss reserves on historical paid loss patterns.

RLI Corporation
Other Liability - Occurrence
Paid to Incurred Loss Ratios

Accident Year	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
2001	4.3%	12.6%	34.3%	56.0%	61.7%	72.4%	80.9%	83.4%	87.4%	92.8%
2002	7.1%	18.9%	40.4%	60.1%	66.8%	74.7%	83.9%	87.0%	90.2%	-
2003	2.1%	10.2%	29.6%	52.4%	65.2%	78.1%	85.5%	92.1%	-	-
2004	2.2%	14.1%	31.4%	54.3%	70.8%	81.7%	89.5%	-	-	-
2005	0.7%	8.1%	25.4%	47.2%	64.4%	79.4%	-	-	-	-
2006	1.4%	12.4%	26.6%	44.2%	59.2%	-	-	-	-	-
2007	2.9%	15.0%	29.8%	49.0%	-	-	-	-	-	-
2008	1.9%	10.1%	27.5%	-	-	-	-	-	-	-
2009	2.4%	10.0%	-	-	-	-	-	-	-	-
2010	1.5%	-	-	-	-	-	-	-	-	-

Source: SNL

The average paid-to-incurred loss ratios for 2009 and 2010 accident years are lower than the 2007 and 2008 accident years at 12 months. The lower the paid-to-incurred ratio is, the higher the degree of reserving conservatism. As we can see, the 2010 accident year paid-to-incurred loss ratio was much lower than 2007 through 2009, and was essentially equal to 2006. The 2005 and 2006 accident years experienced the most aggressive favorable development on an incurred basis of the past 10 accident years, and their paid losses at initial report were the lowest during the same time frame. On a paid-to-incurred basis, there appears to be room for significant releases in the 2006-2010 accident years, as the paid-to-incurred ratios are much lower at the latest report date compared with older years at equivalent report dates. The reserve summary illustrates how the paid loss ratios suggest that there is a sizable redundancy in this line of business.

Moving on to the reported-to-incurred loss ratios below, again, the lower the ratio, the more conservative the reserves are relative to reported losses. Reported losses are the sum of all the individual claims that the claim adjusters receive and assign a loss value to; they are the data that the actuaries receive (in addition to paid losses) to which they apply loss development factors to calculate the bulk and IBNR reserve.

RLI Corporation
Other Liability - Occurrence
Reported to Incurred Loss Ratios

Accident Years	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth
2001	13.1%	32.2%	67.9%	81.1%	81.7%	88.1%	88.0%	89.5%	91.3%	94.7%
2002	21.1%	46.0%	69.3%	79.8%	80.0%	85.4%	88.8%	92.0%	94.5%	-
2003	14.1%	36.0%	56.6%	73.6%	79.2%	86.9%	90.5%	95.0%	-	-
2004	18.1%	40.4%	57.1%	71.8%	82.9%	89.3%	95.1%	-	-	-
2005	9.7%	28.4%	50.3%	69.0%	79.6%	91.6%	-	-	-	-
2006	12.0%	35.6%	53.3%	67.4%	79.9%	-	-	-	-	-
2007	18.5%	38.3%	56.6%	74.0%	-	-	-	-	-	-
2008	14.6%	39.9%	61.4%	-	-	-	-	-	-	-
2009	19.7%	43.2%	-	-	-	-	-	-	-	-
2010	23.8%	-	-	-	-	-	-	-	-	-

Source: SNL

As shown above, there has been a divergence in the patterns of reported losses and paid losses. The reported losses as a percentage of incurred losses have risen for the 2009 and 2010 accident years, signifying that the actuaries are reserving less conservatively relative to the amount of reported losses. This is particularly evident for the 2009 accident year, as reported losses increased substantially at 24 months while the incurred loss ratio jumped to 78%; the reported-to-incurred ratio also jumped to 42.3%, the highest ratio since 2002 at 24 months. Little of this increase in reported losses has been paid, however, as the paid-to-incurred ratio at 24 months for 2009 accident year is lower than historical average at 10%.

Looking at it on a claims basis, there was an increase in claims per \$1 million of earned premium in the 2009 and 2010 accident years.

RLI Corporation
Other Liability - Occurrence
Number of claims reported direct & assumed per \$1M of net earned premium

Accident Years	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	18.35	26.87	30.83	32.77	33.71	34.54	35.04	35.35	35.68	35.96
2002	23.69	33.78	37.19	38.86	39.89	40.67	41.16	41.71	42.22	
2003	19.16	26.32	28.63	29.98	30.69	31.25	31.75	32.31		
2004	15.99	22.05	24.07	24.76	25.13	25.35	25.61			
2005	15.42	20.92	22.71	23.53	23.93	24.20				
2006	12.61	17.20	18.53	19.33	19.68					
2007	15.63	20.56	22.08	22.70						
2008	19.19	25.47	27.11							
2009	24.05	31.69								
2010	29.49									

Source: SNL

The table below shows the amount of claims closed with loss payment, and it is clear that the 2009 and 2010 accident years saw lower amounts of claims closed with payment as a percentage of reported claims.

RLI Corporation
Other Liability - Occurrence
% of Closed Claims with Payment to Reported Claims

Accident Years	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	10.7%	16.2%	19.2%	21.9%	22.7%	22.8%	23.3%	23.6%	23.8%	23.7%
2002	9.5%	16.5%	19.4%	21.5%	22.8%	23.2%	23.4%	23.4%	23.2%	
2003	9.1%	17.1%	20.8%	23.3%	24.5%	25.1%	25.4%	25.2%		
2004	8.6%	16.6%	20.5%	23.5%	25.0%	25.8%	26.0%			
2005	8.6%	16.3%	20.2%	22.1%	23.6%	24.1%				
2006	7.6%	14.3%	17.2%	19.2%	20.4%					
2007	7.5%	13.9%	16.8%	18.8%						
2008	8.4%	13.3%	16.2%							
2009	6.4%	11.1%								
2010	7.4%									

Source: SNL

The 2009 and 2010 accident years also saw a higher rate of claim dismissals (claims closed without loss payment).

RLI Corporation
Other Liability - Occurrence
Claims Dismissal Rate

Accident Years	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	43.4%	56.6%	62.2%	68.0%	71.6%	73.3%	73.9%	74.5%	75.1%	75.3%
2002	41.6%	57.4%	65.6%	70.1%	72.5%	73.7%	74.7%	75.2%	75.7%	
2003	40.4%	57.6%	64.8%	68.9%	70.7%	71.8%	72.9%	73.7%		
2004	42.3%	59.6%	65.3%	68.3%	70.4%	71.5%	72.5%			
2005	42.0%	62.7%	66.5%	69.5%	71.5%	73.1%				
2006	49.4%	64.4%	68.7%	71.4%	74.0%					
2007	54.3%	66.2%	69.6%	72.9%						
2008	53.4%	65.4%	69.9%							
2009	56.0%	67.6%								
2010	57.4%									

Source: SNL

Looking at the reported losses per claim excluding those closed without payment, we see that the average loss determined by the claim adjuster has increased for the 2009 and 2010 accident years compared with historical averages.

RLI Corporation
Average Reported Losses per Closed Claim w/ payment and Claims Outstanding

Accident Years	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2001	7,566	20,184	29,856	39,071	49,352	56,569	59,327	62,341	63,547	63,591
2002	8,586	19,634	30,726	36,734	41,383	45,723	45,920	48,077	48,721	
2003	6,980	20,567	27,602	34,644	39,367	41,903	42,921	43,639		
2004	12,168	24,953	35,903	43,423	49,827	53,069	55,438			
2005	6,327	19,557	28,190	34,590	38,746	43,285				
2006	10,776	27,541	41,407	52,588	61,108					
2007	15,088	32,508	44,464	56,272						
2008	10,090	27,498	39,873							
2009	11,831	32,788								
2010	13,450									

Source: SNL

This is a key exhibit, because in the reserve summary analysis below, the amount of weight put on the reported claims is crucial to determining how much redundancy is left in these reserves.

RLI Corporation
Other Liability - Occurrence
Reserve Summary Analysis #1
Reserve Picks Based Upon Reported Losses
(dollars in thousands)

	Earned Premium	Reported Ultimate Estimate	Paid Ultimate Estimate	Reported Triangle Loss Ratio	Paid Triangle Loss Ratio	Company Selected Loss Ratio	Selected Loss Ratio	Selected Reserve	Company Held Reserve	Redundancy/ (Deficiency)	Redundancy / (Deficiency) as % of Reserves
2001	105,556	62,897	62,897	59.6%	59.6%	59.6%	59.6%	4,558	4,558	0	0.0%
2002	116,013	61,243	61,045	52.8%	52.6%	52.9%	52.8%	5,887	6,014	127	2.1%
2003	189,839	74,814	76,996	39.4%	40.6%	39.1%	39.4%	6,436	5,879	(557)	-9.5%
2004	241,527	102,121	103,658	42.3%	42.9%	41.0%	42.3%	13,408	10,404	(3,004)	-28.9%
2005	252,521	77,985	76,467	30.9%	30.3%	30.8%	30.9%	16,204	16,052	(152)	-0.9%
2006	258,074	93,761	84,258	36.3%	32.6%	39.2%	36.3%	33,940	41,260	7,320	17.7%
2007	255,034	110,381	101,223	43.3%	39.7%	46.8%	43.3%	51,832	60,928	9,096	14.9%
2008	229,268	108,711	88,417	47.4%	38.6%	53.0%	47.4%	75,350	88,169	12,819	14.5%
2009	192,305	128,356	87,143	66.7%	45.3%	78.0%	66.7%	113,339	135,003	21,664	16.0%
2010	162,679	140,465	57,580	86.3%	35.4%	71.0%	78.7%	126,249	113,774	(12,475)	-11.0%
Total								447,204	482,041	34,837	7.2%

Sources: SNL and William Blair & Company, L.L.C. estimates

Using reported loss link ratios above we find the other liability – occurrence reserves to have a \$35 million redundancy (7.2% of reserves). This projection is not consistent with what has happened in 2011 in the casualty line of business, likely due to the over-reserving on a reported loss basis.

RLI Corporation
Other Liability - Occurrence
Reserve Summary Analysis #2
Reserve Picks Based Upon 50/50 Weighted Average of Paid and Reported Losses
(dollars in thousands)

	Earned Premium	Reported Ultimate Estimate	Paid Ultimate Estimate	Reported Triangle Loss Ratio	Paid Triangle Loss Ratio	Company Selected Loss Ratio	Selected Loss Ratio	Selected Reserve	Company Held Reserve	Redundancy/ (Deficiency)	Redundancy / (Deficiency) as % of Reserves
2001	105,556	62,897	62,897	59.6%	59.6%	59.6%	59.6%	4,558	4,558	0	0.0%
2002	116,013	61,243	61,045	52.8%	52.6%	52.9%	52.8%	5,887	6,014	127	2.1%
2003	189,839	74,814	76,996	39.4%	40.6%	39.1%	40.0%	7,527	5,879	(1,648)	-28.0%
2004	241,527	102,121	103,658	42.3%	42.9%	41.0%	42.6%	14,177	10,404	(3,773)	-36.3%
2005	252,521	77,985	76,467	30.9%	30.3%	30.8%	30.6%	15,445	16,052	607	3.8%
2006	258,074	93,761	84,258	36.3%	32.6%	39.2%	34.5%	29,189	41,260	12,071	29.3%
2007	255,034	110,381	101,223	43.3%	39.7%	46.8%	41.5%	47,253	60,928	13,675	22.4%
2008	229,268	108,711	88,417	47.4%	38.6%	53.0%	43.0%	65,203	88,169	22,966	26.0%
2009	192,305	128,356	87,143	66.7%	45.3%	78.0%	56.0%	92,733	135,003	42,270	31.3%
2010	162,679	140,465	57,580	86.3%	35.4%	71.0%	60.9%	97,281	113,774	16,493	14.5%
Total								379,252	482,041	102,789	21.3%

Sources: SNL and William Blair & Company, L.L.C. estimates

The second reserving scenario uses a 50/50 weighted average of the reported and paid loss picks; in this scenario, we arrive at a redundancy of \$103 million (21.3% of reserves). This larger redundancy, especially in the 2008-2010 accident years, is consistent with the comments on the earnings call and the larger-than-expected reserve development in calendar year 2011 on a GAAP basis.

RLI Corporation
Other Liability - Occurrence
Reserve Summary Analysis #3
Reserve Picks Based Upon Weighted Average of 1/3rd Paid and 2/3rd Reported Losses**

	Earned Premium	Reported Ultimate Estimate	Paid Ultimate Estimate	Reported Triangle Loss Ratio	Paid Triangle Loss Ratio	Company Selected Loss Ratio	Selected Loss Ratio	Selected Reserve	Company Held Reserve	Redundancy/ (Deficiency)	Redundancy / (Deficiency) as % of Reserves
2001	105,556	62,897	62,897	59.6%	59.6%	59.6%	59.6%	4,558	4,558	0	0.0%
2002	116,013	61,243	61,045	52.8%	52.6%	52.9%	52.7%	5,821	6,014	193	3.2%
2003	189,839	74,814	76,996	39.4%	40.6%	39.1%	39.8%	7,163	5,879	(1,284)	-21.8%
2004	241,527	102,121	103,658	42.3%	42.9%	41.0%	42.5%	13,920	10,404	(3,516)	-33.8%
2005	252,521	77,985	76,467	30.9%	30.3%	30.8%	30.7%	15,698	16,052	354	2.2%
2006	258,074	93,761	84,258	36.3%	32.6%	39.2%	35.1%	30,773	41,260	10,487	25.4%
2007	255,034	110,381	101,223	43.3%	39.7%	46.8%	42.1%	48,779	60,928	12,149	19.9%
2008	229,268	108,711	88,417	47.4%	38.6%	53.0%	44.5%	68,586	88,169	19,583	22.2%
2009	192,305	128,356	87,143	66.7%	45.3%	78.0%	59.6%	99,601	135,003	35,402	26.2%
2010	162,679	140,465	57,580	86.3%	35.4%	71.0%	60.9%	97,281	113,774	16,493	14.5%
Total								392,181	482,041	89,860	18.6%

*2010 Accident Year uses 50/50 weighted average

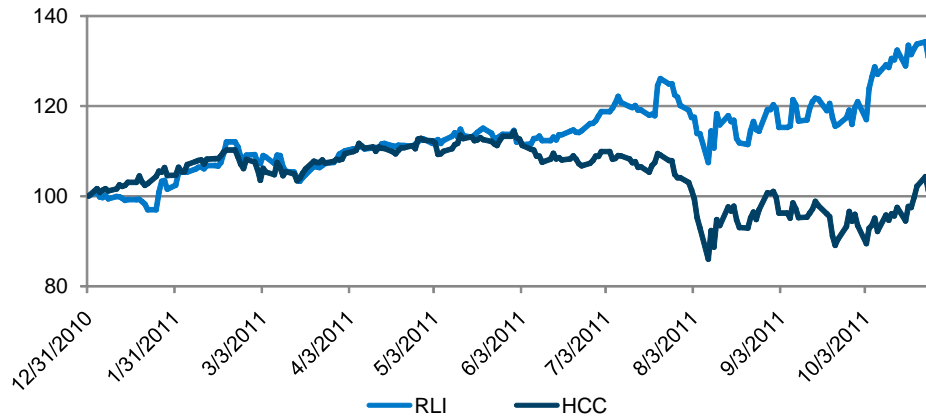
Sources: SNL and William Blair & Company, L.L.C. estimates

Ultimately we expect the redundancy to be somewhere between the first two scenarios, with a bias toward the \$103 million redundancy. Our third scenario and actual reserve pick for the Other Liability -Occurrence line of business uses a 50/50 weighted average of reported and paid for the 2010 accident year, and a two-thirds reported/one-third paid weighted average for the other accident years. We estimate a redundancy of \$90 million,, or 18.6%.

Insurance Trading Pattern: We expect RLI to continue to outperform HCC

RLI Corp. and HCC Insurance Holdings Inc. are two of the smaller specialty commercial insurers that we cover. RLI has drastically outperformed HCC over the course of the last 10 months, in part because of its focus on niche product lines and lack of exposure to long-tail liability lines like directors & officers (D&O) compared with HCC. RLI's stock is up nearly 40% for the year, while HCC is actually down for the year following a disappointing prerelease on its reserves earlier this week.

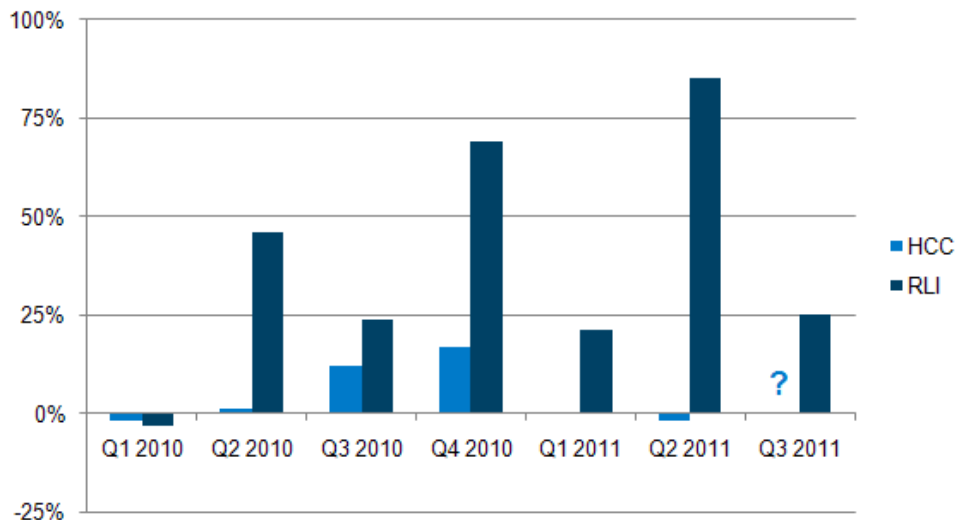
2011 YTD Stock Performance: RLI versus HCC
(Indexed to 12/31/10)



Source: Thomson One

We expect this trend to continue. Even with the prerelease and subsequent lowering of HCC's mean consensus EPS, we still do not have confidence that HCC will succeed in meetings estimates this quarter. We reaffirm our Underperform rating for HCC.

Earnings Surprise Over Last 7 Quarters
(% difference between reported EPS and consensus EPS)



Source: Thomson One

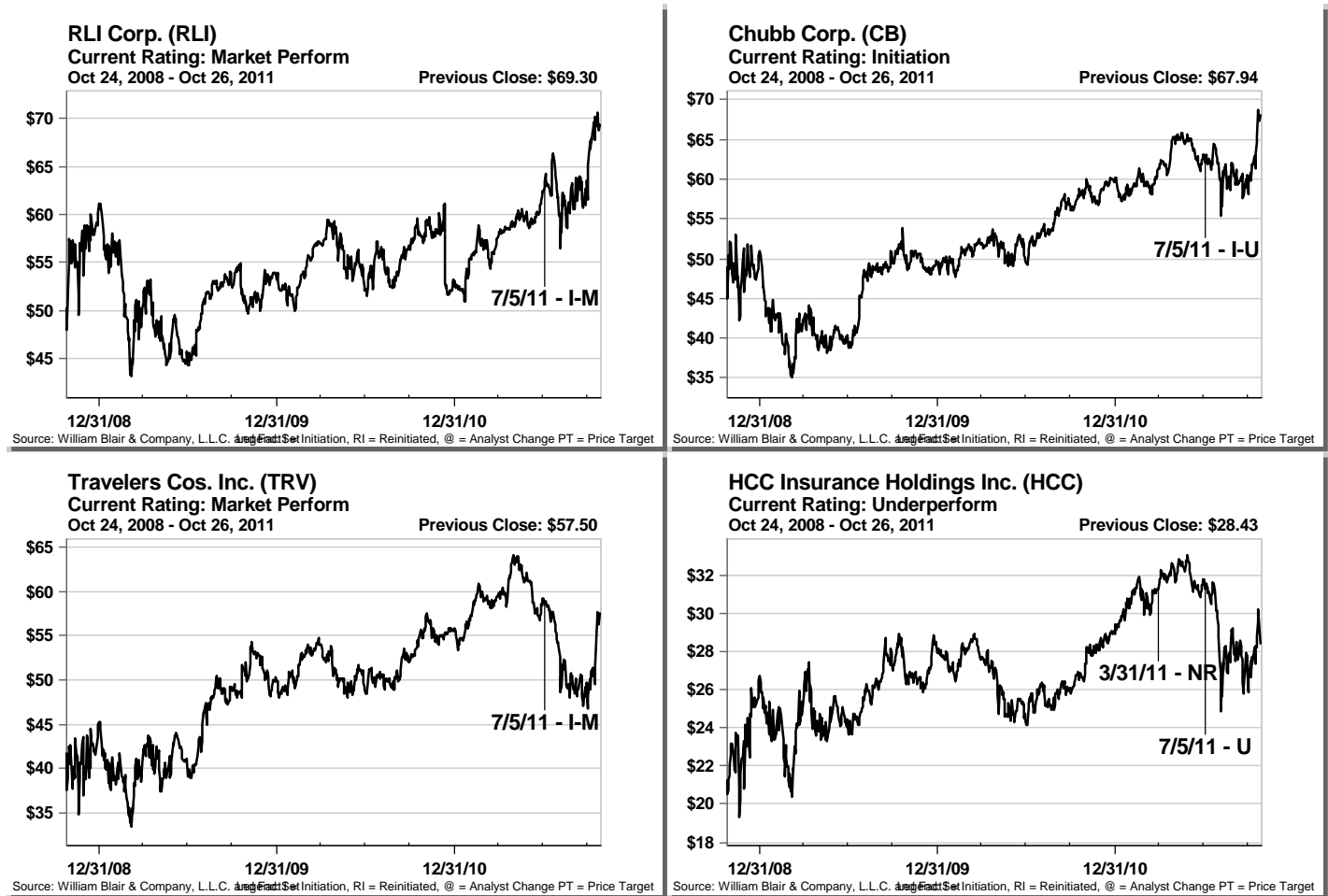
Insurance Industry: Cash Flow and Reserve Insight
William Blair Insurance Universe Performance
 (Week of 10/24/2011-10/28/2011)

PERFORMANCE UPDATE:

				Stock Fundamentals			Stock Performance							Estimates				
Ticker	Market Cap (\$BN)	Rating	Current Price 10/27/11	52-Week Range		Week Ending 10/21/2011	MTD	QTD	YTD	March 9, 2009 ¹ to Date	P/E 2011E	P/E 2012E	Price to Book	William Blair 2011 EPS Estimate	Consensus 2011 EPS Estimate	William Blair 2012 EPS Estimate	Consensus 2012 EPS Estimate	
S&P 500 Index			\$1,284.59	\$1,074.77	- \$1,370.58	4%	14%	14%	2%	90%								
S&P Financials Index			\$189.27	\$147.66	- \$231.20	7%	19%	19%	-12%	126%								
S&P Insurance Index			\$181.92	\$144.05	- \$202.30	5%	19%	19%	-3%	137%								
Insurance Brokers																		
AON Corporation	AON	\$16,243	Outperform	\$50.94	\$39.42	- \$54.58	3%	21%	21%	11%	32%	15.1x	13.5x	2.0x	\$3.37	\$3.39	\$3.77	\$3.80
Arthur J. Gallagher & Co.	AJG	\$3,498	Market Perform	\$31.92	\$24.29	- \$32.11	5%	21%	21%	10%	106%	23.5x	18.2x	3.0x	\$1.36	\$1.37	\$1.75	\$1.75
Brown & Brown, Inc.	BRO	\$3,186	Market Perform	\$22.82	\$16.77	- \$27.07	6%	28%	28%	-5%	46%	21.2x	20.8x	2.0x	\$1.07	\$1.10	\$1.10	\$1.22
Marsh & McLennan Companies, Inc.	MMC	\$16,640	Market Perform	\$31.79	\$24.71	- \$31.93	5%	20%	20%	16%	76%	17.6x	14.8x	2.6x	\$1.81	\$1.77	\$2.14	\$2.15
Willis Group Holdings PLC	WSH	\$6,414	Outperform	\$37.11	\$31.63	- \$42.42	-6%	8%	8%	7%	97%	13.3x	11.6x	NA	\$2.80	\$2.79	\$3.20	\$3.12
Average Insurance Broker							3%	20%	20%	8%	71%	18.1x	15.8x	2.4x				
Commercial Insurers																		
AmTrust Financial Services, Inc.	AFSI	\$1,497	Outperform	\$25.78	\$14.95	- \$26.24	7%	16%	16%	47%	274%	9.0x	8.7x	1.9x	\$2.88	\$2.82	\$2.95	\$2.85
The Chubb Corporation	CB	\$19,426	Underperform	\$69.88	\$55.39	- \$70.07	2%	16%	16%	17%	100%	12.4x	12.9x	1.2x	\$5.64	\$5.10	\$5.42	\$6.01
HCC Insurance Holdings, Inc.	HCC	\$3,127	Underperform	\$28.73	\$24.66	- \$33.12	-3%	6%	6%	-1%	41%	10.9x	10.3x	1.0x	\$2.63	\$2.47	\$2.78	\$3.00
National Interstate Corporation	NATL	\$481	Market Perform	\$27.37	\$18.66	- \$27.67	19%	25%	25%	28%	88%	14.3x	13.3x	1.6x	\$1.92	\$1.85	\$2.06	\$2.08
RLI Corp.	RLI	\$1,450	Market Perform	\$71.42	\$50.86	- \$71.86	2%	12%	12%	36%	66%	13.3x	14.3x	1.7x	\$5.35	\$5.34	\$4.98	\$4.37
The Travelers Companies, Inc.	TRV	\$23,846	Market Perform	\$59.40	\$45.97	- \$64.17	4%	22%	22%	7%	77%	17.4x	10.5x	1.0x	\$3.42	\$3.36	\$5.64	\$5.86
Tower Group, Inc.	TWGP	\$949	Market Perform	\$24.55	\$20.00	- \$27.86	5%	7%	7%	-4%	12%	9.4x	7.9x	0.9x	\$2.61	\$1.87	\$3.10	\$3.04
Average Commercial Insurer							5%	15%	15%	19%	94%	12.4x	11.1x	1.3x				
Insurance Services																		
The Crawford Company	CRDB	\$293	Outperform	\$7.09	\$2.48	- \$8.39	3%	32%	32%	109%	5%	10.3x	9.3x	NA	\$0.69	\$0.72	\$0.76	\$0.65
Fortegra Financial Corporation	FRF	\$108	Market Perform	\$5.40	\$4.81	- \$12.20	2%	3%	3%	-51%	NA	8.6x	7.0x	0.9x	\$0.63	\$0.66	\$0.77	\$0.89
Average Insurance Services							2%	18%	18%	29%	5%	9.4x	8.2x	0.9x				

William Blair & Company, L.L.C. is a market maker in the security of Chubb Corporation (The) and HCC Insurance Holdings, Inc. and RLI Corp. and Travelers Companies, Inc. (The) and may have a long or short position.

Additional information is available upon request.



Current Rating Distribution (as of 09/30/11)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	59	Outperform (Buy)	8
Market Perform (Hold)	31	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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