S&P Capital IQ

CONTENTS

RLI Corp. NYSE:RLI

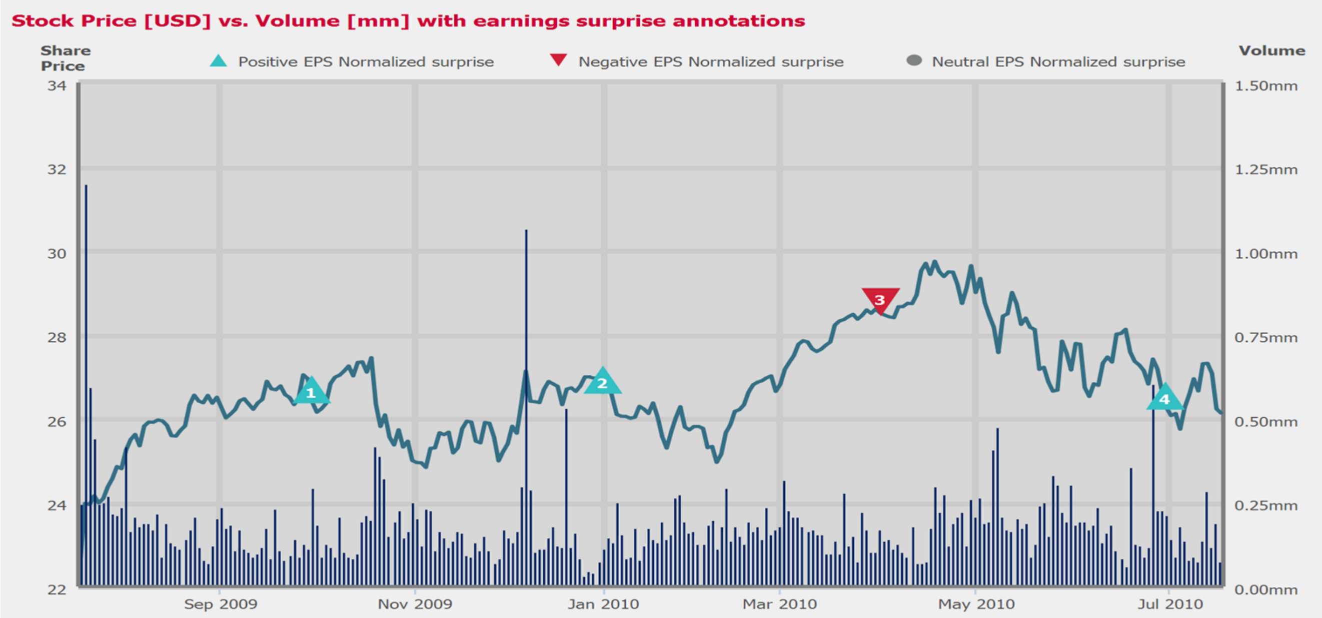
FQ3 2010 Earnings Call Transcripts

Tuesday, October 19, 2010 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	-FY 2011-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.48	0.60	25.00	0.49	2.24	1.94
Revenue (mm)	138.87	149.62	7.74	139.98	564.43	560.87

Currency: USD
Consensus as of Oct-19-2010 2:31 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	0.47	0.59	25.53 %
FQ4 2009	0.48	0.58	22.92 %
FQ1 2010	0.48	0.47	(2.08 %)
FQ2 2010	0.51	0.76	49.02 %

Call Participants

EXECUTIVES

John E. Robison
Former Chief Investment Officer and Treasurer

Jonathan E. Michael
Chairman and Chief Executive Officer

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Michael J. Stone
Director

ANALYSTS

Bijan Moazami
FBR Capital Markets & Co., Research Division

Caroline Steers
Macquarie Research

Court Dignan

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

Doug Mewhirter
FBW

John Grimstad

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Raymond Iardella

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the RLI Corp Third Quarter Earnings Teleconference Call. [Operator Instructions]

Before we get started, let me remind everyone that through the course of the teleconference, RLI management may make comments that reflect their intentions, beliefs and expectations for the future. As always, these forward-looking statements are subject to certain risk factors, which could cause actual results to differ materially. These risk factors are listed in the company's various SEC filings, including in the annual Form 10-K, which should be reviewed carefully. The company has filed a Form 8-K with the Securities and Exchange Commission that contains the press release announcing third quarter results.

RLI management may make reference during the call to operating earnings and earnings per share from operations, which are non-GAAP measures of financial results. RLI's operating earnings and earnings per share from operations consist of net earnings after the elimination of after-tax realized investment gains or losses. RLI management believes this measure is useful in gauging core operating performance across the reporting periods but may not be comparable to other companies' definitions of operating earnings.

The Form 8-K contains reconciliation between operating earnings and net earnings. The Form 8-K and press release are available at the company’s website at www.rlicorp.com. At the request of the company, we will open the conference up for questions and answers following the presentation.

I will now turn the conference over to RLI's Treasurer and Chief Investment Officer, Mr. John Robison. Please go ahead, sir.

John E. Robison
Former Chief Investment Officer and Treasurer

Thank you. Good morning to everyone. Welcome to the RLI Earnings Teleconference for the Third Quarter of 2010.

Joining me for today's call are Jon Michael, President and CEO of RLI Corp.; Joe Dondanville, Senior Vice President and Chief Financial Officer; and Mike Stone, President and Chief Operating Officer of RLI Insurance Company.

The format for the call is as follows. I'll give a brief review of the financial highlights and discuss the investment portfolio. Mike Stone will talk about the quarter's operations, then we'll open the call to questions, and Jon Michael will finish up with some closing comments.

Our third quarter operating earnings were $1.19 per share. Included in this quarter's earnings are $20 million in pretax favorable development and prior years' loss reserves which came from all segments. The combined ratio for the third quarter was 83.1. Gross written premiums were basically flat when compared to the third quarter of last year and flat through the first nine months of this year compared to last.

We were able to offset the premium declines in our Casualty lines, which are sensitive to economic conditions such as building and transportation industries with our crop and other assumed property reinsurance risks. Comprehensive earnings were $58 million for the quarter and $115 million year-to-date. Through nine months, our book value per share has grown 11% to $43.54.

Turning to the investment portfolio. As of September 30, our overall allocation was 78% in fixed income securities, 15% in equities and 7% in short-term investments. The total return on our investment portfolio was nearly 4% for the quarter. Our total return in the bond portfolio was 2.5%, while equities were up 11.4%. Year-to-date, our total return in the portfolio is nearly 7%.

Investment income was $16.8 million for the quarter, up 3% over the same period last year and flat through the first nine months of this year. Changes to asset allocation reducing our muni holdings and going into taxable securities along with a growing asset base has helped offset the declining reinvestment rates.

Continued weak economic indicators have sparked more speculation of further quantitative easing by the Fed and has led to an extended rally in treasury yields. With the highest unemployment rate in over 25 years, consumer confidence in spending remains subdued. Leverage helped fuel the economy over the past 10 years. And if consumers deleverage and increase their savings rate, this constrains their spending. This, combined with the Fed's open-market actions, has helped keep rates low for an extended period.

While the yield curve remains very steep given where rates are, we are not extending duration at this time and remain asset liability matched. Our duration is at 3.5 versus 5.1 last year at this time. We continue to look at more defensive securities such as step-ups and floating rate coupons as we invest our cash flows.

Equities continue to be volatile with equities posting the best September return dating back to 1939 and pushing the indices into positive territory for the year. The gains came as a result of modestly improving economic data and a growing belief that the additional quantitative easing will prevent a double-dip recession. While we have allocated some funds into equities during the market decline, most of the increase in our allocation has come from appreciations. We focus on equities with lower volatility and dividend income. We believe this provides better protection in a declining market, while providing long-term book value growth to enhance shareholder value.

While we continue to believe in the long-term benefits of equities, we think the economic headwinds are strong enough to warrant caution. We are dollar cost averaging small amounts into equities and will continue to do so over time as the economic recovery strengthens.

On the municipal bond front, we have reduced our exposures to roughly 13% of our portfolio versus 23% this time last year. As you know, over the past year, we have weighed the risk versus the return in our muni bond portfolio and opted to reduce exposures where we see higher risks. While this increases our effective tax rate, we believe state and local governments continue to be fiscally strained, and this sector will continue to come under pressure with budgetary shortfalls.

The tax equivalent book yield on our fixed income portfolio is approximately 4.9%, and the book yield on our equity portfolio is 4%. The portfolio quality remains AA, and as I indicated before, the duration is 3.5. No change from the previous quarter. Finally, we had no securities that were deemed OTTI for the quarter.

Turning to the share repurchase. During the quarter, we repurchased 35,000 shares at an average price of $56.39. Over the last five years, we have returned over $400 million in capital to shareholders in the form of dividends and share repurchases. As we have said many times, our first choice is to deploy our capital to create shareholder value. When we do not see opportunities to effectively use our excess capital, we return it to shareholders. We have roughly $94 million remaining on our current share buyback authorization.

For the operations highlights, I will now turn the call over to Mike Stone. Mike?

Michael J. Stone
Director

Thanks, John, and good morning, everybody. Another excellent quarter as we continue to benefit from benign loss cost inflation. Combined ratio of 83 is excellent even by our standards. Our gross written premium, basically flat in a very difficult environment, both from a pricing standpoint and the continuing weak economy.

In our Casualty segment, gross written premium is down about 5% for the quarter, 9% year-to-date. Rates are basically flat for the quarter and down about 3% year-to-date. We posted 84 combined ratio in this segment. We continue to walk away from under-priced business in this segment, and we are actually raising rates in our general liability product line as the accident year results are north of 100 combined ratio. This product is under considerable pressure from the standard lines companies packaging much of this business, which is usually in the surplus line space, as well as abundant E&S competition.

We would expect our competitors are well above 100. And remember that we typically outperform the industry by some 10 combined ratio points.

The economy and market softening is a double hit to our Casualty business, and construction, which is a big part of this area, is not moving forward yet. So there's quite a bit of competition chasing less and less premium. We will continue to underwrite carefully in this space.

In our Property area, gross written premium up 5% for the quarter, 15% year-to-date, a combined ratio of 89, both driven by our Crop business and RLI Re, our facultative reinsurance business. Our E&S Property business is down a bit in the quarter and down a bit year-to-date. Obviously, the benign CAT year and prices are reflecting a lack of a major CAT loss this year.

Our Marine business is down about 14% for the quarter and year-to-date, as we continue to re-underwrite this business and competition remains intense in this space. Surety, an excellent quarter, 63 combined ratio. Gross written premium down a bit, but it's up a bit year-to-date. Our Energy Surety business is under pressure due to the drilling freeze in the Gulf. We’d expect that to pick back up as that starts to unfreeze, if you will, but licensing in there is very slow. We are very mindful of what a weak economy can do in Surety, and we're being very careful as we underwrite this business.

Overall, a very good quarter, as I said. We continue to invest in new products and build out our portfolio. And we are seeing meaningful production from those new products. For example, crop, design professionals, fac re [facultative reinsurance], while we shrink under-priced products, for example, our general liability, our transportation.

We continue to deliver excellent results in a very difficult market place in a weak economy. John, that's it.

John E. Robison
Former Chief Investment Officer and Treasurer
Thanks, Mike. We're now ready to open the call up for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Ken Billingsley from BGB Securities.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

If you could give a little bit of insight on rates and exposure units being down. Could you talk about competition as it revolves around terms and conditions? And is there a magnifying impact to income statements in the future due to competitors not only lowering rates but offering more coverage than maybe what you are comfortable offering?

Michael J. Stone
Director

Yes, Ken, it's Mike Stone. As you would expect at this stage in the cycle, we're starting to see a little bit of that. Not nearly to the extent that I think we saw in the late 90s, but we're starting to see a little bit on the Casualty side with some of the typical exclusions that you would see, for example, lead, mold, those kind of things on Habitational business being removed. On the Property side, there's pressure on deductibles. But overall, I don't think we're – we’re not seeing a complete running away from the terms and conditions that are important to our business. So we're starting to see some of it. It's really kind of a pricing that's more difficult right now. And the standard lines guys, if you want to call that, reducing terms and conditions. Because obviously, they don't have a lot of the conditions and exclusions that the surplus lines companies would have. But that's where most of the competition’s coming from.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Back in the end of '08, early '09, a lot of CEOs were talking about rates should go up, but they weren't raising rates themselves, that too has changed. Can you just comment maybe what you're seeing regarding the fact that fewer people are talking about maybe that rates are going to go up in the near-term like they did 12, 18 months ago, yet the combined ratios on an accident-year basis are in the 103 to 108 range?

Michael J. Stone
Director

Well, I mean, obviously, we're bumping along the bottom. I think that's the point. And there's not been any real emphasis catalyst for a broad strengthening. And when you have the standard lines companies eating into the E&S space the way they are, it also has a lot of capital chasing not as much premium. And I think results are going to have to get worse, reported results are going to have to get worse. There needs to be some sort of catalyst. But you're right, that industry can't operate in this investment environment, at 108, 110, it’ll come home. It's just a matter of time.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

And on the financial D&O product, I heard earlier today that there's fewer writers out there. Is that creating an opportunity for you? Or how are you addressing that line of business?

Michael J. Stone
Director

Again, it's Mike Stone. We're not much of a player on financial institutions in the D&O space. So we'll write a little bit of Side A for financial institutions. That is basically the bankruptcy protection. But financial institution pricing has been fairly robust in the D&O space for a while. So we're not a competitor overall in that space.

Kenneth G. Billingsley
BGB Securities, Inc., Research Division

Your comment was made that there -- and we see this a lot at the end of the year where underwriters are tending to grab business before year end whether they admit to it or not. Are you expecting to see as strong of a push in competition as people are trying to lock in some premiums before year end?

Michael J. Stone
Director

It's Mike Stone again. That's certainly our fear that the fourth quarter is usually a tough quarter for us. It's a tough quarter for underwriting companies in a soft marketplace. So those companies that have premium budgets, and those budgets are part of compensation plans, it's tough. We don't have those kinds of goals, objectives. They're not part of our compensation plan, so it's harder for us in a soft market in the fourth quarter, typically.

Operator

Your next question comes from the line of Caroline Steers from Macquarie.

Caroline Steers
Macquarie Research

My first question is just on market opportunities. In your press release, you mentioned that you were looking at some niche opportunities now. And I was wondering where you were seeing those opportunities, in what lines of business? And whether you're looking more towards acquiring teams or whether M&A is more up your alley?

Jonathan E. Michael
Chairman and Chief Executive Officer

Jon Michael. Of course, we have in the past, niche opportunities come our way in the acquisition of teams mainly. That's our preferred method of growth in terms of inorganic-type growth. But at the same time, we look at acquisition opportunities in the form of companies. And we haven't done one of those for a long time. But I would not rule out that sort of activity for us because we have been and we'll continue to seek those types of opportunities. But our preferred method of growth inorganically is acquiring teams or start-up operations.

Caroline Steers
Macquarie Research

And then, is there any particular segment that you're more interested in? Is it more the reinsurance segment? And then, sort of what's preventing some M&A from happening now because we haven't seen too much?

Jonathan E. Michael
Chairman and Chief Executive Officer

It's not the Reinsurance segment. We had started up a Facultative Property Reinsurance segment. And of course, we are now a participant on a crop reinsurance deal, but that's not our preferred direction. We're looking at more specialty niche-type products, and they run across the board for that.

Caroline Steers
Macquarie Research

And then just finally, did you mention what years the casualty development came from, or what lines of business?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

This is Joe Dondanville. The Casualty development came from 2005 through 2010, some positive and some negative as well as some older '99 and prior adverse development. And the lines, the adverse is the old discontinued reinsurance programs back in prior to '99 or prior to '96. But the casualty came in a variety of areas including our D&O area, our personal umbrella, transportation, and GL was a mix of positive in the prior accident years and negative in the current accident year.

Operator

Your next question comes from the line of Raymond Iardella from Oppenheimer.

Raymond Iardella

First one, I guess, for Mike Stone. I think you had made some comments last quarter that you were seeing some encouraging signs in the Commercial Trucking business from an exposure perspective. Can you talk about whether you're still seeing this trend? Or I guess are there any other favorable exposure comps in other lines of business?

Michael J. Stone
Director

Yes, we continue to see, on the trucking side, a little bit of increased activity. So miles driven are up a bit. So receipts are up a bit. Last year, at this time, in prior quarters, we were having return premiums. We're not having that. That's not taking place today. But rates are still fairly soft. But from that perspective, we're seeing some positive trajectory, so we're encouraged there. I mean, typically, I would say that that's the industry’s canary, if you will. And typically, we'll start to harden sooner than the rest of them because it's a short-tail Casualty line, but that's the one positive. We're not seeing that broadly in that product line now. That's broadly from a standpoint of rate increases or reduced competition, there's still a considerable amount of competition.

Raymond Iardella

And then I guess, from a loss perspective, I know you had mentioned on the Casualty side, you were seeing an increase in the accident year loss ratio, I guess, in the general liability product, and you guys were kind of reacting to that by raising price. But it looked like the property accident year loss ratio ticked up a little bit in the quarter as well. Is that just due to, I guess, a change in business mix with the crop and then the assumed property book? Or is that something else is driving that?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

The crop is causing the loss ratio to go up on the property side. But we’ve had some summer storm losses from some of the small CATs that hit the Midwest during the year, during the second quarter. So we had an uptick in actual losses on the buyer and on the assumed reinsurance portion that are more seasonal.

Raymond Iardella

And then I guess, quick numbers question. How much do you have in cash and I guess short-term securities at the holding company? Do you have that number, by chance?

Michael J. Stone
Director

Probably about $50 million or less. It's not a significant amount of cash there. But it was in short-term investments.

Operator

[Operator Instructions] We'll go to our next question from John Grimstad from Piper Jaffray.

John Grimstad

I was wondering if you would just give a little bit of color on frequency trends within each line. Any signs that point to an uptick? Thoughts on the remainder of the year?

Michael J. Stone
Director

It's Mike Stone. I think, obviously, we've seen a bit of uptick on the GL side, on the frequency side. On transportation, a bit of an uptick. I think beyond that it's nothing unusual. Those are the two that we're seeing a bit of an uptick.

John Grimstad

And the other lines, as you said, pretty much stable, no deviation either way?

Michael J. Stone
Director

Surety's probably down a little bit. But yes, the other lines are fairly stable.

John Grimstad

And going forward, do you expect this to kind of play through the remainder of the year as well?

Michael J. Stone
Director

Well, certainly on the GL side, we would expect that it's not going to come to a screeching halt. But we're re-underwriting that and expect to have less of that as we move through, quarter-to-quarter. Transportation is fairly short tail. I mean, hopefully, that will reduce itself as well.

Operator

Our next question comes from the line of Dean Evans from KBW Investment Bank.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

I guess, we sort of addressed why the accident year was a bit higher on the Property side. I was wondering if you could touch on the Casualty side. That also seemed to be running a little above recent trend.

Michael J. Stone
Director

Yes, it's Mike Stone. Our general liability is -- by the way, is our largest Casualty product is performing less well than it has in the past. Obviously, there's a considerable amount of competition in that space. As I said earlier, the standard line guys are packaging up this business, leaving less business in the E&S space being chased by an abundant amount of competition. So we are pulling back. We're raising rates, and obviously, we're shrinking as a result.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

So there's really no one-time items? Just sort of the general toughness in the GL market?

Michael J. Stone
Director

Yes, I'd say so.

Dean Evans
Keefe, Bruyette, & Woods, Inc., Research Division

To touch back on the Property side, do you have at hand the actual dollar value of CAT losses in the quarter? You did mention there were some items that helped drive the loss ratio up?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

It's approximately $2 million.

Operator

Our next question comes from the line of Doug Mewhirter from RBC Capital Markets.

Doug Mewhirter
FBW

First question revolves around Surety. Looks like your -- actually, your loss trends are, seem to be very favorable, both on the favorable reserve development, but also your loss picture actually coming down as well if you look at year-to-date or compared with the quarter last year. I was wondering if you could comment on that. And especially regarding the worsening economy and you have more contractors going out of business. It sounded maybe a comparison when the economy was like really scraping bottom and that might be an indicator? Or is it change in mix or just better underwriting?

Michael J. Stone
Director

Let me just try this -- first I'm going to let Joe augment what I say. First off, I think we've been conservative. We're not unmindful of what a weak economy can do to Surety. We're also not unmindful of what bad Surety underwriting can do to us. We've been through that. So we've been very careful about our underwriting. Like I said we've been conservative about how we’ve looked at the loss picture. I think we're starting to see favorable results. I mean, we're starting to believe that our results are going to be better than we expected and our underwriting better than we expected. Certainly, again, we're still not unmindful of what a weak economy can do in contract surety and commercial surety. We've also not seen commercial surety underwriting getting aggressive. Our competition doesn't seem to be getting very aggressive in that space either. So we are benefiting from that. In prior cycles, it's gotten very aggressive. So we feel pretty good about our underwriting in this space right now.

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

I'll talk a little bit about the releases. They're generated from the commercial surety and contract surety, as Mike has spoken to, I guess, a little bit more favorable outcomes than what we had thought were going to occur with the economic downturn. And those are coming from accident years 2007, '08, and '09. We just haven't seen the losses develop. And although that we're trending, that seems to be the direction we're headed, we still look at this as potential exposure going forward.

Doug Mewhirter
FBW

I just have two numbers questions to follow up. First, do you have at hand the amount of ProAg premiums that you wrote or actually that you assumed in the quarter? And also, I guess, the year-over-year premium, I would assume premium declines in your GL and your transportation books?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Okay, the ProAg was about $3.5 million in the quarter. And just to comment, our expectations on the crop premium starting out was about 10% higher than what's actually come in. So it didn't meet our original expectations. And I think you'll see that not just for us, but for the whole crop industry. The premiums we expect to be down. And looking at the transportation for the quarter, it was flat. And for GL, it was off by about a little over $4 million or about 17% for the quarter. And I think Mike had spoken about the re-underwriting in the GL area that occurred this quarter.

Operator

Your next question comes from the line of Meyer Shields from Stifel, Nicolaus [Stifel Financial Corp.]

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Joe, if I can ask a couple more questions on the Casualty loss development. If we take out that $0.52, let me ask does that $0.52 include the strengthening you mentioned for earlier quarters in 2010?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

No. That's just prior year only.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

So the year-to-date number would probably be, a better read, about 105% accident year?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Yes.

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Secondly, just looking forward in terms of transportation. We've got CSA 2010 coming up. Can you tell yet what the impact is likely to be on, I guess, exposure units and in terms of competition?

Michael J. Stone
Director

I'm sorry, what was the first part of that question, Meyer?

Meyer Shields
Stifel, Nicolaus & Company, Incorporated, Research Division

Well, we looked at the regulatory initiative CSA 2010 in terms of monitoring truck driver safety records. So we've seen a lot of estimates in that that's going to knock out, let's say, 10% of driver right now. But it should make for safer drivers, and therefore, better risk. So I'm wondering if you're seeing an impact yet in terms of how insurance-buying behavior is changing.

Michael J. Stone
Director

Yes, it's Mike Stone. I don't put as much stock in that as some other people do. We're not seeing it yet. Obviously, our underwriting process already involves a very careful review of individual drivers, both from a licensing standpoint, prior-accident standpoint. So I think we're ahead of the curve when it comes to underwriting in this space, anyway. So how much impact it will have overall, that's I think difficult to assess. Obviously, it should have some beneficial effect going forward, but being able to quantify that would be rather difficult right now.

Operator

Your next question comes from the line of Bijan Moazami from FBR Capital Markets.

Bijan Moazami
FBR Capital Markets & Co., Research Division

First, I can probably back into the numbers. But what accident year loss ratio are you assuming the Surety business now?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

The accident loss ratio on Surety, Bijan, for the year, is I think around 21, 22.

Bijan Moazami
FBR Capital Markets & Co., Research Division

And how does that compare with the accident year loss ratio for previous years?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

It's a little better. I think in prior years, it might have been closer to 25.

Bijan Moazami
FBR Capital Markets & Co., Research Division

Okay, fully adjusted?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Yes.

Bijan Moazami
FBR Capital Markets & Co., Research Division

And what is the overall reserves that you carry for the Surety business, IBNR in case?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

That I do not have in hand, Bijan, we'll have to get back to you.

Bijan Moazami
FBR Capital Markets & Co., Research Division

And in terms of Property, you guys have been growing the Property business. What's your appetite for DIC and where are you growing at this point?

Michael J. Stone
Director

It's Mike Stone. Obviously, the growth in Property’s coming mostly from crops. But our DIC -- typically, our DIC business, what we've said over the past several years, is only going to grow if rates grow. While we have a little bit of room within our internal appetite, we don't have a lot. And rates in DIC, earthquake we're talking about here, are off considerably in the quarter. There's been increased competition there. So we're comfortable with where we are. We're probably not going to grow that by much. Rates come up, and we're able to be able to get more premium for that exposure. Our premium will go up but not by a -- simply by a function of the rate. We're not going to add to the exposure in any meaningful amount.

Bijan Moazami
FBR Capital Markets & Co., Research Division

In your prepared remarks, Mike, you were saying that the loss cost is relatively benign. And there were a couple of court cases in California on the work comp side that has pushed up the loss cost at least on the indemnity. Have you guys seen other cases that would suggest that the courts are becoming a little bit more aggressive or the jury is giving larger awards than before?

Michael J. Stone
Director

Yes, I think we've seen some cases. There's another California case on indemnification that affects the Contracting business. We are starting to see some tort reform to unravel. I think it's a little early on the jury awards. I think we'll see that as we get new judiciary by the current administration and more liberal state governments as well. So I think there's some -- over time, we'll see an impact of that.

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Bijan, the Surety reserve number is approximately $20 million.

Operator

Our next question comes from the line of Vinay Misquith from Crédit Suisse.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

Can you give us a sense of why the favorable reserve development has stayed so strong for so long? Would that be a function of market conditions, in the sense that frequencies and severities have been lower than what you expected?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

This is Joe Dondanville. That, coupled with a relatively low inflation rate.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And do you think that, that's a negative for pricing, overall? Because this trend should also impact competitors, correct?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

Correct. And yes, I think it bodes not well for increases in pricing.

Vinay Gerard Misquith
Crédit Suisse AG, Research Division

And the second point was on GL. I believe you mentioned that there was an uptick in GL frequencies. If you could just elaborate on that. And was it just on certain parts of your portfolio? Or do you think this is an industry issue?

Joseph E. Dondanville
Former Chief Financial Officer, Senior Vice President and Principal Accounting Officer

It is on a selected portion of our GL book in which we are pushing rate in order to try to correct it, which is causing -- rate and re-underwriting is causing the book to decline. So it's not the largest portion of our GL book.

Operator

[Operator Instructions] We'll go to our next question from Court Dignan from Fidelity.

Court Dignan

I had a question on the balance sheet. You guys have a great track record and basically some basic block and tackling things just blend in generating underwriting return. And you’ve hit on a lot of the headwinds in the market today in terms of the standard line creep and other factors. And I was just looking, your statutory surplus is up, I don't know, maybe 50% over the last four or five years. And you're writing, I think, less premium. You're at, I think, below a 0.6 premium to surplus. And obviously, you enjoy a premium multiple for a good reason. It just seems like you add all of those things together and does it make sense to consider sort of a large one-time special dividend to return some of the capital that doesn't look like it's got any great usage right now? You continue to generate capital at a healthy pace, and I don't think there’s like too many great reasons to think that anything in the cycle is going to change in the near-term. So I'm just wondering if you could comment on that.

Jonathan E. Michael
Chairman and Chief Executive Officer

It's Jon Michael. Of course, we have a dividend policy. Sure, we look at something like a special dividend and we have a buyback program. Our preferred method of deployment of capital would be to use it ourselves to find new opportunities. But in that search, we're going to be very careful. And we will look at the aforementioned uses of capital in terms of dividend policy, buyback and special dividend. So obviously, we couldn't comment on really any of those things until they become fact.

Court Dignan

I don't know what happens with tax rates, but I'd be willing to bet that they're not going to go lower. Does a factor like that factor into your thinking in terms of near-term capital management?

Jonathan E. Michael
Chairman and Chief Executive Officer

I think, perhaps, this year. But we always take that in mind when looking at our own dividend policy. And other than that, I can't say really anything more about it. I mean, it's just, yes, we think like you, it doesn't appear that tax rates are going to go down. Nobody’s talking about that from a political standpoint, so we have to take that into account.

Court Dignan

And can you just remind me what the process would be at RLI? Would it be a board vote in order to execute something like a special dividend? And when would be the next time the board...

Jonathan E. Michael
Chairman and Chief Executive Officer

It doesn't go to the shareholders. Anything of any size, yes, dividends have to be approved by the board, right.

Court Dignan

And when is the next board meeting?

Jonathan E. Michael
Chairman and Chief Executive Officer

This quarter.

Operator

[Operator Instructions] As there are no further questions, I will now turn the conference back to Mr. Jonathan Michael.

Jonathan E. Michael
Chairman and Chief Executive Officer

Thank you. We're pleased to report another good quarter. All of our segments reported positive results. Premiums are flat from last year. That's good, considering the economy and the insurance marketplace that we're faced with. Our conservative underwriting approach has and will continue to serve us well. We talked about we are looking for ways to find new niches, and we'll continue to do that. We've been successful over the past several years, and this past year, of start-up operations and new niches. And we'll continue to look for ways to deploy our capital.

Speaking of capital, we have plenty of it. And we're mindful of ways to deploy that capital. I thank you all for joining us this morning and look forward to talking to you at our year-end press conference. Thanks. Bye.

Operator
Ladies and gentlemen, if you wish to access a replay for this call, you may do so by dialing 1 (888) 203-1112 with an ID number of 6349778. This concludes our conference for today. Thank you all for participating and have a nice day. All parties may now disconnect.