S&P Capital IQ

CONTENTS



# RLI Corp. NYSE:RLI

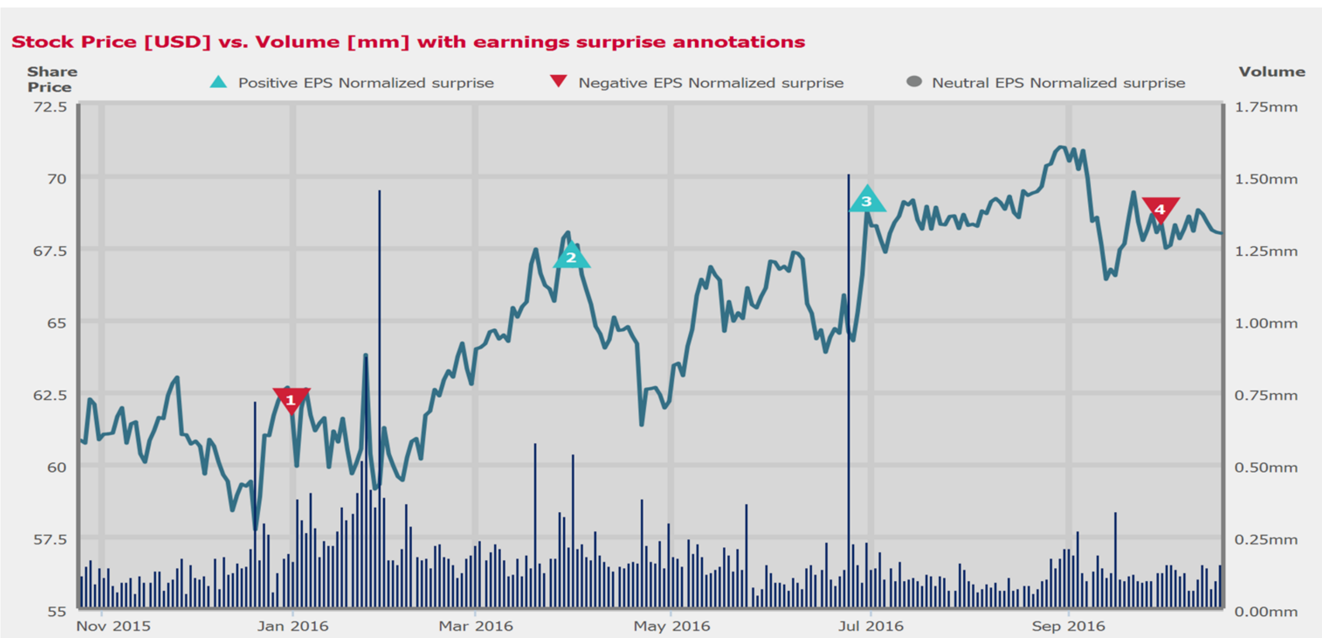
## *FQ4 2016 Earnings Call Transcripts*

Thursday, January 26, 2017 4:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ4 2016- | | | -FQ1 2017- | -FY 2016- | |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL |
| **EPS Normalized** | 0.50 | 0.56 | ▲12.00 | 0.50 | 1.98 | 2.08 |
| **Revenue (mm)** | 198.76 | 212.30 | ▲6.82 | 201.68 | 795.00 | 816.33 |

Currency: USD
Consensus as of Jan-26-2017 12:02 PM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2015** | 0.64 | 0.56 | ▼(12.50 %) |
| **FQ1 2016** | 0.49 | 0.54 | ▲10.20 % |
| **FQ2 2016** | 0.60 | 0.61 | ▲1.67 % |
| **FQ3 2016** | 0.59 | 0.37 | ▼(37.29 %) |

# Call Participants

## EXECUTIVES

**Aaron H. Jacoby**
*Vice President of Corporate Development*

**Craig William Kliethermes**
*President and Chief Operating Officer*

**Jonathan E. Michael**
*Chairman and Chief Executive Officer*

**Thomas L. Brown**
*Chief Financial Officer and Senior Vice President*

## ANALYSTS

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

**Ian Gutterman**
*Balyasny Asset Management L.P.*

**Jeff Schmitt**

**Kenneth G. Billingsley**
*Compass Point Research & Trading, LLC, Research Division*

**Mark Alan Dwelle**
*RBC Capital Markets, LLC, Research Division*

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

# Presentation

**Operator**

Good morning, and welcome, ladies and gentlemen, to the RLI Corp. Fourth Quarter Earnings Teleconference. At this time, I would like to inform you that this conference is being recorded. [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 risks and factors -- risk factors which could cause actual results to differ materially. These risk factors are listed in the company's various SEC filings, including 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 the fourth quarter results.

RLI management may make references during the call to operating earnings and earnings per share per -- 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 in the investment gains or losses. RLI's management believes this measure is useful in gauging core operating performance along reporting periods but may not be comparable to other company definitions of the operating earnings.

The Form 8-K contains reconciliation between operating earnings and net earnings. The Form 8-K and press release are available on the company's website at www.rlicorp.com.

I will now turn the conference over to RLI's Vice President, Corporate Development, Mr. Aaron Jacoby. Please go ahead.

**Aaron H. Jacoby**
*Vice President of Corporate Development*

Thank you. Good morning to everyone. Welcome to the RLI Earnings Call for the fourth quarter of 2016.

Joining me on today's call are Jon Michael, Chairman and CEO; Craig Kliethermes, President and Chief Operating Officer; and Tom Brown, Vice President and Chief Financial Officer.

I'm going to turn the call over to Tom first to give some brief opening comments on the quarter's financial results, then Craig will talk about operations and market conditions. Next, we'll open the call to questions, and Jon will finish up with some closing comments.

Tom?

**Thomas L. Brown**
*Chief Financial Officer and Senior Vice President*

Thanks, Aaron, and good morning, everyone. Key metrics of our success this quarter, include a 90 combined ratio and 3% topline growth, leading to operating earnings of $0.56 per share.

On a net basis, favorable reserve development aided this quarter's results by $12 million, over 50% higher than last year's fourth quarter.

Losses from Hurricane Matthew, $6.6 million on a net basis, served to partially offset the prior year's favorable development but came in below what we had estimated on our third quarter earnings call, which occurred within a few days of the event.

Turning to topline, consistent with recent quarterly trends, our Casualty segment drove most of the growth, up 6% in terms of gross premiums written. The Surety segment was up 1%, while Property was down 6% due to continued tough competitive conditions, particularly in catastrophe-exposed products.

In terms of the combined ratio, we accomplished a 90.3 for the quarter. Casualty came in at an 86.6 combined ratio and Surety posted an 89.1 combined ratio.

Property ran a 102.9 combined ratio, however, absent the impact of Hurricane Matthew, would have also turned in a sub-90 combined.

This being the fourth quarter, I'd like to share a few additional accomplishments for the year.

Many of these, I'm sure Craig will provide additional details and they certainly deserve repeating.

First, we ended the year with an 89.5 combined ratio. This not only marks the 21st consecutive year with an underwriting profit but also the 12th straight year below a 90 combined ratio.

Investment returns for the year were excellent, with a total return on the portfolio of 5.7% on the strength of our equity portfolio and despite a moderate rise in interest rates.

Heading into 2017, our investment portfolio is well positioned to take advantage of higher rates as fixed income sectors should offer more opportunities to invest marginal dollars that mark yields of our current book yield.

As mentioned in our press release, our effective tax rate was positively impacted by the tax benefit associated with a $9.9 million dividend received from Maui Jim in the fourth quarter.

We recorded tax in our share of investee earnings, assuming the corporate capital gains of tax rate of 35%. As the dividend is periodically received, a 7% tax rate is applicable to amounts received from affiliates. The tax savings associated with this dividend added $0.06 per share to earnings in the quarter.

In addition, we received a tax benefit from dividends that passed to our ESOP. Similar to last year, the special dividend paid in the quarter resulted in a $0.05 per share increased earnings from the resulting tax deduction. Combined, these 2 tax benefits served to lower our fourth quarter effective rate by 13.5 points and our full year tax rate by 3.3 points.

All in, book value was up 14% for the year, inclusive of dividends. On that count, we also paid a $2 special dividend in the fourth quarter, continuing our approach to good stewardship of your capital.

In the last decade, our strong earnings capacity, combined with active capital management has returned over $1.2 billion to shareholders.

And with that, I'll turn the call over to Craig Kliethermes. Craig?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Thanks, Tom. Good morning, everyone. As Tom mentioned, we were able to grow the topline 3% for the quarter, while reporting a 90% combined ratio.

For the year, we ended up with gross written premium growth of 2.5% and a combined ratio of 89.5, our 12th consecutive year under a 90 combined ratio and 21st consecutive year of delivering underwriting profit.

Our associates are very proud of their track record of success, and we believe it is unmatched by anyone our size in this industry.

We have performed relatively well, given the prolonged soft market, but the challenges for our industry continue. Rates, in aggregate, are not moving directionally or in proportion to underlying loss cost, which is not sustainable in the long term for our industry. While each year proves to be more challenging to produce acceptable underwriting margins, we believe the difference makers are the quality of our people, their unrelenting focus on underwriting profit, our alignment of compensation and ownership and our diversified product mix. These factors allow us to differentiate ourselves in all markets, but particularly at this time, in the cycle.

These same qualities served to deliver solid underwriting results to our shareholders again this year. I would like to provide some detail by segment.

In Casualty, we grew 6% for the quarter with a combined ratio of 87% as overall favorable reserve development fell more in line with our past trends. We grew 8% for the year, while reporting a 92 combined ratio. We were able to achieve modest growth, while rates remained relatively flat across most products within this segment.

Transportation makes up a little less than 20% of this segment and 12% of our company's premium. Price increases in this segment continue to allow us to grow our Transportation business, which was up 10% for the quarter. The growth rate is at a slower pace than in recent quarters. We are approaching this business cautiously as the entire market continues to go through some disruption, with increasing medical trends and traffic congestion, more distracted drivers and pedestrians on the roadside and a noticeably more active plaintiff bar. Business has also continued to struggle with attracting and retaining experienced drivers.

As mentioned last quarter, we are still addressing some underperforming geographies and classes of our own, which did drive some adverse development again this quarter. Although we have not been immune to the underlying severity trends that are affecting the commercial auto line, we still believe we are generating an underwriting margin in this business and continue to look for selective opportunities in a challenging market.

We continue to see growth from both established and new surplus lines Casualty businesses, including excess liability, energy, health care, security guards, environmental and large retention business.

In addition, our admitted professional and package businesses continue to find opportunities.

All of these businesses are performing as or better than expected, and we continue to invest in people and product where it makes sense.

As a testament to our diversified portfolio, we did get some help from our executive products business that had a particularly good bottom line result this year. It's more traditional products are fighting some strong competitive headwinds, but they're finding some offsetting growth opportunities in select new niches that are showing promise.

The underwriting and claim team have delivered very good underwriting results over the long run, despite being one of our more volatile Casualty businesses.

Our Property business was down 6% for the quarter, while reporting 103 combined ratio, largely the result of Hurricane Matthew. For the year, we ended down 11% on the top line and reported a 92 combined ratio, margins continue to erode in our catastrophe-exposed business, with rates down double digits for the quarter and the year.

During the quarter, we did make a decision to forego 2 products within our Property segment. We began nonrenewing our RV business, which has struggled to find any level of profitability over the last 4 years. In addition, we entered into a renewal rights transaction with a third party on our assumed Specialty Catastrophe business, which we determined was no longer a strategic fit.

The total 2016 premium for these businesses was approximately $22 million, but over the last several years, they consistently failed to achieve any level of sustainable underwriting profit. This is a good example of our willingness to cull the underperforming products in our portfolio and sacrifice top line. Underwriting profit is King and these decisions, although difficult, will improve our bottom line going forward.

Our Surety segment was flat for the quarter, while reporting an 89 combined ratio. For the year, the segment grew 2% at a combined ratio of 78%.

Our Miscellaneous Surety business, which is transactional in nature grew 7% for the quarter and continued to post very good underwriting margins for the year and the quarter.

The Surety business overall, continues to draw significant competition, particularly in the large account sector. We compete in contract, energy, and the commercial classes in this space. This business is severity-driven, and the infrequency of loss in this sector invites undisciplined underwriting behavior. This quarter was a good reminder of the volatility that is inherent in this type of Surety business, particularly one of our moderate size. Our Surety segment realized 2 significant losses for the quarter, 1 each from our energy and commercial businesses. Despite this, both were still able to report an underwriting profit for the quarter and the year.

But growth opportunities appear somewhat limited for them until there is more discipline restored to the market.

Overall, we are still finding growth opportunities and the underwriting results for the quarter and the year were differentiating. Growth in this challenging market will likely be measured and cautious. We are very proud of our track record of underwriting results.

At RLI, we understand that underwriting profits don't come easily, particularly at this time in the cycle. This is no time to become complacent.

Underwriting is paramount at RLI. We spell underwriting with a capital U. We refer to this as our disciplined approach to evaluating and taking risk to tightly align teamwork and communication between our talented underwriters, claim and analytical staff. We act like owners, because that is exactly what we are, and because of this, we will remain vigilant in our pursuit of underwriting profits across a diversified portfolio of products, pruning out the underperformers and nurturing and growing those businesses that deliver results.

I want to thank the RLI associates for another great year of delivering differentiating results to our shareholders. Now I'll turn it over to Aaron.

**Aaron H. Jacoby**
*Vice President of Corporate Development*
Thanks, Craig. Operator, we can now open the call for questions.

# Question and Answer

**Operator**

[Operator Instructions] And the first question comes from Randy Binner with FBR.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

I wanted to ask a couple and apologize if I missed it, I had another call, I came in late. First, can you provide more color. I think, you said that there is an Assumed Casualty business you exited in 2016. Did you totally exit that business? And I'm curious and more color there.

And then the other piece of my question, if this helps in answering it, is just kind of an update or review on the areas that had issues last quarter, which were personal umbrella and I believe, the Ambulette or commercial auto business in New York.

**Craig William Kliethermes**
*President and Chief Operating Officer*

Randy, this is Craig. I'll start and maybe Tom might want to jump in as well if we start to talk about the reserves. But I think, your first question was about exiting. We have -- it's not Casualty by the way, it was an assumed specialty treaty book of business. We actually do assume business in a couple of different areas at RLI. So -- but the assumed Property business, it was more of a regional focus. That, we did decide to enter into a renewal rights contract. It was fairly -- relatively small book of business. And that was really a big part of the problem.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

So it was small. So we're -- is it more like a rate thing? Or is it more like individual single losses were amplified because of the size of book was small.

**Craig William Kliethermes**
*President and Chief Operating Officer*

It was about $10 million book of business, and it was mostly CAT-driven. It was -- the whole idea was to try to diversify our book of business in places where we don't write a lot of CAT. So in the Northeast and a bit in I'll say northern Florida and some other states in the Southeast, to kind of complement our book and -- of E&S Property business. And we found we just really couldn't reach the scale that we needed to really manage that book of business, so we decided to forgo it.

You asked about I think, the second question was on the reserving front and if -- last quarter, I think we reported both on transportation and the personal umbrella book, I'm not sure that there was any other things we really talked much about. But on the personal umbrella front, I would say that things returned to more of a normal state or at least what normal look like prior to last quarter. So last -- this quarter, this past quarter performed very much like it had previous to the third quarter. So I'd say to some extent, that has, we think -- believe that's returned to normal. Or what we defined as normal. So we no longer -- we actually saw favorable development in that product line this quarter. So still watching it closely obviously because there's a fair amount of auto exposure in personal umbrella. So watching that closely, but this quarter returned to normal. On the transportation front. I mean, it was more of the same. We saw more development from, yes, the -- it was more of the metro area, New York metro area and particularly in the, what we call non-emergency medical transport, paratransit business. We have effectively exited that business, all the paratransit business pretty much countrywide and we are watching the New York State closely. So but we continue to see a little bit of development there.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

Okay. And so that's still adverse. And then, sorry, I just -- was the Assumed Specialty Treaty Property business the only one exited? Or did you allude to another business that was exited in the fourth quarter?

**Craig William Kliethermes**
*President and Chief Operating Officer*

I did refer to the recreational vehicle business. And we had reported on that a little bit, I think, in past. Again we couldn't really get scale in that business. The results, I think, are a bit related to probably underlying auto trends that we're seeing -- everyone is seeing, I think, countrywide. And we just didn't -- we could just never achieve a level of profitability there and given where we were at, we just didn't see that there was going to be an opportunity in the intermediate term to get back to profitability. So we threw the kitchen sink at trying to fix it over the last 3 or 4 years and we just determined that, that was probably not the right -- the right way to go, was probably to exit at this point in time.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

And so was that whole issue exacerbated by like CAT losses throughout 2016? Or was it more just kind of core accident frequency and severity trends?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Well the RV business was really core. I mean, they certainly had some losses, I think, affiliated with the Louisiana flood. And that business is about $12 million business, but that wasn't -- the flood in Louisiana was not the reason that we decided to exit that business. It was -- it had never made an underwriting profit for us.

**Operator**

And we'll go next to Arash Soleimani with KBW.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Just to clarify, the RV business also is within Property, so the $22 million all comes from Property?

**Craig William Kliethermes**
*President and Chief Operating Officer*

That's correct. And RV, I'd say 80% of -- interesting in RV, most of the losses are actually physical damage claims for us. And so this is really -- that's really a physical damage issue, not a liability issue. And -- but yes, both of those products are in the Property segment.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. And was the 12 -- or the $0.23 of favorable development you had in Casualty, was that pretty much spread across most products? Or was it coming specifically from certain areas?

**Thomas L. Brown**
*Chief Financial Officer and Senior Vice President*

Arash, it's Tom Brown. Yes, it was pretty much across the board with the exception, as Craig mentioned, Transportation. More in the recent prior accident years, 2013 to '15. So it was pretty consistent.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. And the exit you mentioned from the nonemergency business, was that just in New York specifically or in other areas as well?

**Thomas L. Brown**
*Chief Financial Officer and Senior Vice President*

We are no longer in the nonemergency medical transport business, period.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

And then just jumping into the Casualty segment on the quarter loss ratio, just excluding CATs and development, that looks like it trended up year-over-year. I was just trying to get a sense of is that solely a function of pricing, or are there product mix changes in there leading to that. I just wanted to know if you can talk about that a bit.

**Craig William Kliethermes**
*President and Chief Operating Officer*

I mean, I think any -- this is Craig, Arash. Any increase in the current accident year that you might be seeing, I don't know that we see it in our numbers, but it would be mix related. It's just the -- I mean, you heard me talk, we've got some products growing, some products shrinking, that can significantly -- they don't all perform at the same loss ratio or combined ratio. So obviously, you can have some fairly sizable changes depending on what -- how things are proportioned.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

You said it was business mix related?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Yes, pretty much.

**Arash Soleimani**
*Keefe, Bruyette, & Woods, Inc., Research Division*

Okay. And then just one other question I had in terms of, I guess, tax policy. I know there's still a lot of uncertainty around that. Would the appetite of your underwriters or how they are looking at the business change at all, if after-tax returns go up?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Arash, this is Craig I'm going to just speak for our underwriters, they don't -- they are singularly focused on driving underwriting profit. So they don't really look at after-tax, some of them are listening today, this might be the first time they even know what our combined ratio was for the whole company, today because they are focused on their product and how they are performing from an underwriting perspective.

**Operator**

And we'll now go to Jeff Schmitt with William Blair.

**Jeff Schmitt**

You had mentioned in the transportation line obviously, frequency and severity has been up, but you also said there was -- you're seeing a more active plaintiff bar. Is that just in that line? Or are you seeing that kind of across the board?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Jeff, this is Craig Kliethermes. We -- I mean, I'd say we've seen it more in the Transportation space. But we've seen it across – well I think it started with wheelbase businesses in general so I think we've seen in transportation and I'd say a lesser extent in our personal umbrella business. But I think we're seeing it across all the liability businesses, a much more active plaintiff bar.

**Jeff Schmitt**

And is it more active in terms of obviously, just more lawsuits? But -- or is it also higher payouts or verdicts as well?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Well, I think you've probably seen, I mean, there's public things that have been published about how verdicts have been on the rise, particularly recently. I mean I think that just emboldens the plaintiff bar to push even farther for -- I'll say it's harder to get them to settle things before they get to the courthouse steps. And I guess, I'll say unfortunately, at least in some jurisdictions, we've found juries have been willing to cooperate a little more with the plaintiff bar or side with the plaintiff bar a little more. I could speculate why that might be, but we feel like we've seen it and that's what I'd say about that matter.

**Jeff Schmitt**

Yes. Okay. And then, in terms of, could you speak to what you're seeing for construction activity? I think, it's about 1/3 of total premium. Is that right?

**Craig William Kliethermes**
*President and Chief Operating Officer*

That is true. I mean, we could -- continue to see activity up I mean, moderately, but much better than it was obviously, in the depths of the economic crisis. So and we are hopeful that it's going to continue to increase it sounds like with the new administration's focus on infrastructure and building, hopefully that will create more opportunities for us.

**Operator**

And we'll go next to Mark Dwelle with RBC Capital Markets.

**Mark Alan Dwelle**
*RBC Capital Markets, LLC, Research Division*

Just a couple of questions that we haven't really covered yet. I think, Tom in your opening comments, you kind of suggested that book yields and reinvestment yields had kind of reached some degree of parity, did I hear that right?

**Thomas L. Brown**
*Chief Financial Officer and Senior Vice President*

Yes Mark, thanks, it's Tom. Yes, we have seen over the course of particularly the last half of the year, the spread routine, the book yield, which is low to mid-3s and the market yield starting to narrow and found some opportunities during the quarter, a bit out of the curve to get some fairly decent returns on some fixed income securities.

**Mark Alan Dwelle**
*RBC Capital Markets, LLC, Research Division*

That probably alludes for a pretty decent set up for this year if we're at least assuming the interest rate market continues to track a little bit higher. That's my comment, not yours.

The second question I wanted to ask was related to the Maui Jim dividend. I think, I've asked this question in years past, I just want to check my understanding of it. So you book the earnings related to Maui Jim over the course of the year. To the extent that you receive a dividend at the end of the year, the dividend ends up offsetting the balance sheet value that you are carrying Maui Jim at and the credit goes against your tax amounts that you had accrued along the way during the year related to their earnings. Is that right?

**Jonathan E. Michael**
*Chairman and Chief Executive Officer*

Yes, that's correct. Jon Michael here. That's correct.

**Mark Alan Dwelle**
*RBC Capital Markets, LLC, Research Division*

And then the last question I guess, everybody is kind of kicked around the whole Property thing fairly thoroughly. The last question I wanted to ask related to that was to the extent you are exiting these 2 lines, are you contemplating identifying or any new lines in the Property sector? Or will we just, I guess, continue to see the mix of the overall book, continue to migrate more and more towards the Casualty side, at least given where pricing is right now?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Mark, this is Craig. As of right now -- I mean we are always looking for new opportunities whether they be Property, Casualty or Surety. I can't tell you where those opportunities are going to lie. And obviously, it takes a little while to earn off the premium for the products that we've taken a pass on. So certainly as of right now, you can probably expect the distribution will continue to shift towards Casualty.

**Mark Alan Dwelle**
*RBC Capital Markets, LLC, Research Division*

Maybe I can ask the question a little bit better. This is a shift because these lines weren't performing, not a shift in favor of more greater emphasis on other lines?

**Craig William Kliethermes**
*President and Chief Operating Officer*

That's correct. I mean, our underwriters are making really the decisions about where there's opportunities to grow and shrink. So the portfolio, the mix of the portfolio is really just the result of those underlying decisions. It's not a top-down driven decision to say let's go allocate more and find things. And so in Property, we're looking all the time and a little bit agnostic in regards to where we find them, obviously, but we're only interested in the ones that can produce an underwriting profit. So -- I mean, we've always been a constant state of culling, pruning the portfolio and nurturing and growing those that have opportunity, and we continue -- we will continue to do that.

**Operator**

[Operator Instructions] We'll go next to Ian Gutterman with Balyasny.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

I also wanted to follow up with a few things on the Property side. First, at the risk of stating the obvious, you're getting rid of a little more than 10% of your Property book, is it reasonable to assume that there probably won't be growth in the Property book this year? Or are there existing lines you think can make up for it?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Again, Ian -- this is Craig. I mean, we are always looking. I'm not going to be overly hopeful on the CAT side of things, which is really the bulk of the portfolio, CAT-exposed type of businesses. We are looking both for new opportunities and new ways of doing business in that space. But the existing businesses we have are -- it is a very competitive market, so I don't know that, that's the prudent approach, is to charge ahead into a business that margins are shrinking at a double-digit pace, basically.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Just making sure. And then more -- the part I'm more curious about is just how to think about the mix of the combined ratio going forward. So as you said, these businesses were not making you money. So I assume getting rid of that probably helps the ax smear [ph] next year. On the other hand, I know back to when you've exited some of the other businesses and as the topline has come down the expense ratio has gone up. So does exiting these put more pressure on the expense ratio? And does that offset the improvement you get on the loss ratio? Or were these maybe high expense businesses to begin with so we won't see much of an expense drag? I'm just trying to think through the mix components, I guess.

**Craig William Kliethermes**
*President and Chief Operating Officer*

Yes. Well I mean, the products that we -- that these 2 products that I particularly mentioned are products that have a fairly high variable cost component. So those expenses are going away. The fixed costs obviously, we are either addressing by -- if we don't -- if we no longer need to provide that kind of support, we would be addressing it through people or reallocating in some sense a few people to the things that are growing, as opposed to let's say going out and hiring new people from the outside. We would just reallocate those resources to something that was growing. So it's a combination of both.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Okay, got it. And then on the Casualty business, you mentioned, I think, this was probably across this book, but I assume it is Casualty as well, that pricing is below trend in many lines. Obviously, transportation is the exception to that. Is the improvement in transportation enough to offset the pressures elsewhere, that you would expect similar profitability in '17 versus '16? Or is transportation not enough today, and we should probably expect a little bit lower margins this coming year?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Well, I mean, I would say, again, that at least and I'm only going to speak for RLI, is I can show you past history how this has proven out, but changes in margin are more, at least at RLI, more than just change in price, okay? It also involves selection. So I think we have pretty good selectors. And so even though we might not be getting price in some lines, we think we're probably doing a better job at selecting, which means you got to get rid of the underperforming pieces of each product and continue to try to find ways to grow the more profitable ones. So I mean, that's how we look at things. So as far as price, we started getting price in -- certainly in transportation, the rates are hopefully keeping up with loss costs overall and we're getting some in professional liability, and a few other spots, I think on the Casualty side. Most of the Casualty portfolio is flat.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Got it. And then just lastly, any additional color on the Surety losses? Were they sort of market losses that you participated in? Or were they single clients of yours that it was something specific to RLI? I'm just kind of curious if there's anything interesting about those.

**Craig William Kliethermes**
*President and Chief Operating Officer*

I mean, there's nothing really of that interest to me. You do occasionally have losses in that portfolio and our retentions are, I think we take a couple million dollars net retention on that. So when you have a loss, usually Surety losses are bigger, at least in those account-driven ones.

As far as the count --- as far as the type of product or the type of participation, I mean, we don't participate in syndicated deals on the Surety side. We participate maybe on a select number of bonds within an account, but there are bonds that we participate in 100%, not one we share with anyone.

**Operator**

And we'll go next to Ken Billingsley with Compass Point.

**Kenneth G. Billingsley**
*Compass Point Research & Trading, LLC, Research Division*

I wanted to just follow up on some of the Property side and maybe I misinterpreted your comments but I believe you said you're looking for some new ways to write business. And looking at the cost of reinsurance, would you look at some of your customer base where you've historically had good customers but you don't like the price and maybe utilize reinsurance temporarily to keep them if you think it can be profitable in that manner? Or continue on the same path of not utilizing reinsurance as a capital measure?

**Jonathan E. Michael**
*Chairman and Chief Executive Officer*

Ken, it's Jon Michael. We don't really view reinsurance that way. We are not big on leveraging our partner reinsurers even if it's temporary. Obviously, we negotiate hard on all the deals we do, but if we feel like an account is not profitable we're not going to write the accounts. So.

**Kenneth G. Billingsley**
*Compass Point Research & Trading, LLC, Research Division*

So you'll just -- you'd let that account go, and just try to capture it later when pricing is better. And then, can you give me maybe an idea of what you meant by just maybe new ways to write some of these lines? Are there some alternative ways that allow you to write some of these customers given the pricing trends?

**Craig William Kliethermes**
*President and Chief Operating Officer*

Well, we've looked at partner -- this is Craig, we have looked at partnering with some people that have a similar appetite as us and participate, let's say, side-by-side with us in risk. So we've looked at that as an opportunity as a way to build some capacity in a market that's soft. So -- and maybe where it's beyond our risk appetite maybe they need a little bit bigger limit, and we're willing -- we like the account but we're not willing to put out the same level of capacity and we could find a partner that's willing to do that. So we’ve done that on a couple of fronts in that space. It hasn't obviously, generated growth, it's really just a way to kind of offset some of the decline and hopefully, set up something that might work well if the market changes.

**Kenneth G. Billingsley**
*Compass Point Research & Trading, LLC, Research Division*

So it's more of a case of, at least in that example, of shifting to maybe some larger account than maybe what you have traditionally focused on.

**Craig William Kliethermes**
*President and Chief Operating Officer*

Marginally.

**Ian Gutterman**
*Balyasny Asset Management L.P.*

Marginally. Are the risk profiles the same in general? I mean, if you were to -- instead of writing [indiscernible].

**Craig William Kliethermes**
*President and Chief Operating Officer*

Yes. As Jon said, we don't -- we're not changing our appetite. We couldn't even if we wanted to. Our underwriters are going to write the type of risk they are comfortable with. But there are occasions and it happens in Property, it might happen in our D&O book, it might happen in our Surety book, where we like the account a lot, but there is a limit on how much capacity we are willing to put out with our capital. So we are already a participant on the deal, it's just we need more capacity so we partnered with some select people to help us build capacity on those really -- on those accounts we really like. But it's not a broadening our appetite to the point and to venturing into something that we're not comfortable with.

**Operator**

If there are no further questions, I will now turn the conference back to Jonathan Michael.

**Jonathan E. Michael**
*Chairman and Chief Executive Officer*

Thank you, and thanks for attending, everybody. We had one question about what would happen in the event that we had a decline in the corporate tax rate.

I think, I'd point out that a decline in the corporate tax rate will come with some nuances in terms of what the deductions are going to be. And so, I think, all industries are going to be fighting to keep those deductions, and it will be interesting to see what happens to the Property and Casualty industry in terms of being able to lower the tax rate. Obviously, if the Feds lower the tax rate and don't do anything to the deductions, that will be a big boon for our industry. But I suspect that there will be some offsets there. So I think, the bigger impact of what's -- I anticipate to happen, is the economic activity and that would -- in this country. And any infrastructure building -- Craig mentioned 1/3 to 40% of our business is construction related. That will be huge for us, because that would give us more opportunities to underwrite good profitable business, both on Property, Casualty and Surety side. So that will be -- that's a bigger upside for us than any tax bill, I think. So but a federal income tax decline may -- it may level the playing field with our Bermuda competition. So those are just a few comments that I'd make about what is happening in this country vis-à-vis the political climate.

We are proud that we -- this is our 21st year of producing an underwriting profit, 21st consecutive year. And that -- it's our 12th year of being under 90 combined ratio. So -- and our book value was up 14%, including the dividends that we paid. We can't be prouder of our customers. I want to thank our customers, our agents and our brokers and especially our employees who helped deliver these results. So thanks again for attending, and we'll talk to you at the beginning of the first quarter.

**Operator**

Ladies and gentlemen, if you wish to access the replay for this call, you may do so by dialing 1 (888) 203-1112, with the ID of 5027803.
This concludes the conference for today. Thank you for participating, and have a nice day. All parties may now disconnect.