FORM 10-K

Annual report pursuant to section 13 and 15(d)

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
SEC Accession No. 0001047469-99-011722

FILER

RLI CORP

CIK:**84246**| IRS No.: **370889946** | State of Incorp.:**IL** | Fiscal Year End: **1231**
Type: **10-K** | Act: **34** | File No.: **001-09463** | Film No.: **99574612**
SIC: **6331** Fire, marine & casualty insurance

Business Address
9025 N LINDBERGH DR
PEORIA IL 61615
3096921000

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended______________DECEMBER 31, 1998_________

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from_________to____________

Commission File Number ____________0-6612______________

RLI CORP.

(Exact name of registrant as specified in its charter)

ILLINOIS	37-0889946
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employers Identification No.)

9025 NORTH LINDBERGH DRIVE, PEORIA, ILLINOIS	61615
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (309) 692-1000

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

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock $1.00 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

_X_ Yes No___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on February 26, 1999 as reported on the New York Stock Exchange, was $306,409,698. Shares of Common Stock held directly or indirectly by each officer and director along with shares held by the Company ESOP have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant's Common Stock, $1 par value, on February 26, 1999 was $10,408,822.

DOCUMENTS INCORPORATED BY REFERENCES.

Portions of the Annual Report to Shareholders for the past year ended December 31, 1998, are incorporated by reference into Parts I and II of this document.

Portions of the Registrant's definitive Proxy Statement for the 1999 annual meeting of security holders to be held May 6, 1999, are incorporated herein by reference into Part III of this document.

Exhibit index is located on pages 34-35 of this document.

PART I

Item 1. BUSINESS

(a) General Development of Business

As used in this Form 10-K, the term "Company" refers to RLI Corp. and its subsidiaries and affiliates, unless the context otherwise indicates.

RLI Corp., which was incorporated in Illinois in 1965, merged into and became a Delaware corporation in 1984. In May of 1993, RLI Corp. changed its state of incorporation back to Illinois through a merger. RLI Corp. is a holding company, which, through its subsidiaries, underwrites selected property and casualty insurance.

SIGNIFICANT DEVELOPMENT

UNDERWRITERS INDEMNITY HOLDING COMPANY MERGER

On January 29, 1999, the Company acquired Underwriters Indemnity Holdings, Inc., ("UIH") located in Houston, Texas. The Company paid $40.7 million in cash in exchange for all outstanding shares of UIH subject to post-closing contingencies. Included in the transaction were both of UIH's operating insurance subsidiaries, Underwriters Indemnity Company of Texas ("UIC") and Planet Indemnity Company of Colorado ("PIC"). UIC and PIC specialize in the marketing and underwriting of surety products for oil, gas, mining and other energy-related exposures. Both UIC and PIC are rated "A-" (Excellent) by A.M. Best.

(b) Financial Information about Industry Segments

Selected information about industry segments is included herein as Item 8.

(c) Narrative Description of Business

RLI INSURANCE GROUP

RLI Insurance Group is composed primarily of two main insurance companies. RLI Insurance Company, the principal subsidiary, writes multiple lines of insurance on an admitted basis in all 50 states, the District of Columbia and Puerto Rico. Mt. Hawley Insurance Company, a subsidiary of RLI Insurance Company, writes multiple lines of insurance on an admitted basis in Kansas and surplus lines insurance in the remaining 49 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam. Other companies in the RLI Insurance Group include: Replacement Lens Inc., RLI Insurance Agency, Ltd., RLI Insurance Ltd., Underwriters Indemnity Company and Planet Indemnity Company.

Since 1977, when the Company first began underwriting specialty property and casualty coverages for commercial risks, highly cyclical market conditions and a number of other factors have influenced the Company's growth and underwriting profits. The Company, as a "niche" company rather than an "all lines" company, seeks to develop expertise and large homogeneous books of business in areas generally overlooked by traditional markets.

In response to the soft market conditions of the early 1980's, which were characterized by severe rate competition and excess underwriting capacity, the Company limited its writings in specialty property and casualty lines and terminated certain lines and sources of production.

Significant rate increases resulted when the insurance market hardened in late 1984. The Company responded by expanding its premium volume in targeted lines. Since 1987, the industry has experienced generally soft market conditions featuring intensified competition for admitted and surplus lines insurers, resulting in rate decreases. The Company has continually monitored its rates and controlled its costs in an effort to maximize profits during this entrenched soft market condition. As a result of catastrophic losses, such as Hurricane Andrew and the Northridge Earthquake, property rates hardened in California, Florida and the wind belt, but remained soft in other areas of the country. In 1994 and 1995, rates hardened and premium growth was achieved in the commercial property book of business. Otherwise, rates for property and casualty lines have declined over time. To maintain profitability, underwriters have tightened selection criteria, broadened their focus to other market segments and given up business where rates dropped too low.

The Company initially wrote specialty property and casualty insurance through independent underwriting agents. The Company opened its first branch office in 1984, and began to shift from independent underwriting agents to wholly-owned branch offices which market to wholesale producers. The Company also markets certain products to retail producers from its Specialty Marketing Division located at the Home Office in Peoria, Illinois. The Company produces business under agreements with underwriting general agents. Additional underwriting agents are being accepted under the auspices of

Company product vice presidents. The majority of the specialty property and casualty business is marketed through the Specialty Markets and Surety divisions and branch offices located in Los Angeles, California; San Diego, California; San Francisco, California; Glastonbury, Connecticut; Atlanta, Georgia; Alpharetta, Georgia; Honolulu, Hawaii; Chicago, Illinois; Overland Park, Kansas; Boston, Massachusetts; St. Paul, Minnesota; New York City, New York; Dallas, Texas; Houston, Texas and Seattle, Washington.

The following table provides for the year ended December 31, 1998 the geographic distribution of the Company's risks insured as represented by direct premiums earned for all product lines. For the year ended December 31, 1998, no other state accounted for more than 2% of total direct premiums earned for all product lines.

<TABLE>
<CAPTION>

STATE	DIRECT PREMIUMS EARNED	PERCENT OF TOTAL
California	$100,662,702	36.60%
Florida	24,036,160	8.74
New York	21,698,605	7.89
Texas	20,740,580	7.54
Hawaii	10,513,187	3.82
Ohio	8,867,799	3.23
New Jersey	8,090,247	2.94
Illinois	7,328,351	2.67
Michigan	5,644,425	2.05
Pennsylvania	5,627,816	2.05
All Other	61,785,825	22.47
Total direct premiums	$274,995,697	100.00%

</TABLE>

The Company presently underwrites selected property and casualty insurance primarily in the following lines:

A. PROPERTY SEGMENT

1. COMMERCIAL PROPERTY. The Company's commercial property coverage consists primarily of excess and surplus lines and specialty insurance such as fire and difference in conditions which includes earthquake, flood and collapse coverages. The Company writes coverage for a wide range of commercial and industrial classes such as office buildings, apartments, condominiums, certain industrial and mercantile structures, and buildings under construction. The Company also writes boiler and machinery and ocean marine insurance under the same management as commercial property. The Alpharetta, Boston, Chicago, Dallas, Houston, Los Angeles, and, San Francisco branch offices are responsible for underwriting this coverage. In 1998, 1997, and 1996, net earned premiums totaled $42,281,000, $48,799,000, and $47,822,000, or 25%, 29%, and 31% respectively, of the Company's consolidated revenues.

2. HOMEOWNERS/RESIDENTIAL PROPERTY. In 1997, the Company assumed a highly profitable book of homeowners and dwelling fire business for Hawaii homeowners from the Hawaii Property Insurance Association. In the aftermath of Hurricane Iniki in 1992, this business was available at reasonable rates and terms. Net earned premiums totaled $9,689,000 and $13,229,000 or 6% and 8% of the Company's consolidated revenues for 1998 and 1997, respectively.

B. SURETY SEGMENT

3. SURETY. In 1993, the Company began writing surety business. This product line is underwritten from the Home Office in Peoria and through the Dallas, Houston and Seattle branch offices. The initial target market of the Surety Division was a wide range of commercial surety bonds written primarily through the independent agency system. In 1996, the Company expanded their product offering to include contract bonds for small size contractors. Net earned premiums totaled $18,307,000, $11,491,000, and $4,407,000, or 11%, 8%, and 3% of the Company's consolidated revenues for 1998, 1997, and 1996, respectively.

The acquisition of Underwriter's Indemnity Holdings, Inc., and its operating insurance subsidiaries provide an ideal situation for our surety line to grow in new directions. The facility is a leader in the oil and gas field and will begin generating premium income in 1999.

C. CASUALTY SEGMENT

4. GENERAL LIABILITY. The Company writes general liability coverages through its Los Angeles, Glastonbury, Chicago, Alpharetta, and Dallas branch offices. The Company's general liability business consists primarily of coverage for third party liability of commercial insureds including manufacturers, contractors, apartments and mercantile risks. Net earned premiums totaled $23,726,000, $26,332,000, and $34,834,000, or 14%, 16%, and 22% of the Company's consolidated revenues for the years 1998, 1997, and 1996, respectively.

5. COMMERCIAL AND PERSONAL UMBRELLA LIABILITY. The Company's commercial umbrella coverage is produced through its Overland Park, St. Paul, Alpharetta, Glastonbury, and Dallas branch offices, and through an underwriting general agency in San Francisco. The coverage is principally written in excess of primary liability insurance provided by other carriers and, to a small degree, in excess of primary liability written by the Company. The expansion into California and the introduction of internet based production of smaller premium light hazard businesses contributed to significant premium growth in 1998. The personal umbrella coverage, which is produced through the Specialty Markets Division, is written in excess of the homeowners and automobile liability coverage provided by other carriers. Net earned premiums totaled $29,086,000, $22,566,000, and $21,282,000, or 17%, 12%, and 14% of the Company's consolidated revenues for the years 1998, 1997, and 1996, respectively.

6. DIRECTORS' AND OFFICERS' LIABILITY/MISCELLANEOUS PROFESSIONAL LIABILITY. The Company produces Directors' and Officers' Liability through underwriting facilities in San Diego, Los Angeles, and New York City. The Company also offers Miscellaneous Professional Liability for a variety of low to moderate classes of risks. D&O is a relatively small component of the overall P&C market, which has been subject to severe competition. Underwriters have relinquished market share rather than accept inadequate pricing. Net earned premiums totaled $3,054,000, $4,430,000, and $5,000,000, or 2%, 3%, and 3%, of the Company's consolidated revenues for the years 1998, 1997, and 1996, respectively.

7. EMPLOYER'S EXCESS INDEMNITY. Since 1993, the Company has written Employer's Excess Indemnity coverage for businesses which have opted out of the Workers' Compensation plan in the state of Texas. The coverage is similar to accident and health, in that it indemnifies the employer for expenses resulting from a work related injury or disease, excess of a self-insured retention (SIR). The SIR can range from $50,000 to $500,000. The product is underwritten out of the Overland Park branch office. A return to excessive competition for Texas workers' compensation business has reduced the market for this product since 1996. Net earned premiums totaled $1,722,000, $5,130,000, and $6,566,000, or 1%, 3%, and 4%, of the Company's consolidated revenues for 1998, 1997, and 1996, respectively.

8. TRANSPORTATION. In 1997, the Company opened a transportation insurance facility in Atlanta to offer automobile liability and physical damage insurance to local, intermediate and long haul truckers, public transportation risks and equipment dealers. Incidental, related insurance coverages are also offered, including general liability, commercial umbrella and excess liability, and motor truck cargo. The facility is staffed by highly experienced transportation underwriters who produce business through independent agents and brokers nationwide. Net earned premiums totaled $3,806,000 or 2% of the Company's consolidated revenues for 1998.

9. OTHER. Smaller programs offered by the Company include: excess medical, in-home business, personal automobile (Hawaii only), ocean marine and occupational accident. Net earned premiums from these lines totaled $10,653,000, $9,907,000, and $10,744,000, or 6%, 5%, and 7% of the Company's consolidated revenues for the years, 1998, 1997, and 1996, respectively.

COMPETITION

The Company's specialty property and casualty insurance subsidiaries are part of an extremely competitive industry which is cyclical and historically characterized by periods of high premium rates and shortages of underwriting capacity followed by periods of severe competition and excess underwriting capacity. Within the United States alone, approximately 3,500 companies, both stock and mutual, actively market property and casualty products. The combination of products, service, pricing and other methods of competition vary from line to line. The Company's principal methods of meeting this competition are innovative products, marketing structure and quality service to the agents and policyholders at a fair price. The Company competes favorably in part because of its sound financial base and reputation, as well as its broad geographic penetration into all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam. In the property and casualty area, the Company has acquired experienced underwriting specialists in its branch and Home offices. In 1987, the insurance industry, in general, entered into a "soft" or highly competitive period during which insurance rates generally decreased. The specialty property and casualty market continues to be soft with some rate increases experienced in the property lines in California, Florida and the wind belt from 1993 through 1995. Since 1996, competition reasserted itself and the Company reduced rates somewhat. The Company has, however, continued to maintain its underwriting and marketing standards by not seeking market share at the expense of earnings. New products and new programs are offered where the opportunity exists to provide needed insurance coverage with exceptional service on a profitable basis.

RATINGS

During 1992, the A.M. Best rating for RLI Insurance Company, the principal subsidiary of the Company, was upgraded to "A" (Excellent). During 1993, Mt. Hawley Insurance Company's (an indirect subsidiary of the Company) A.M. Best rating was upgraded to "A" (Excellent). During 1998, A.M. Best reaffirmed "A" ratings for both RLI Insurance Company and Mt. Hawley Insurance Company.

During 1997, the Company for the first time applied for and received a claims-paying rating from Standard & Poor's. As a result, rating of "A" (Good) was received for the combined insurance operation. In 1998, the "A" rating was reaffirmed, with the addition of a "Positive Future Outlook". The addition of the positive outlook to the rating indicates that Standard & Poor's anticipates that there is a good chance that RLI's rating could increase within the next year.

A.M. Best ratings for the industry range from "A++" (Superior) to "F" (In Liquidation) with some companies not being rated. Standard & Poor's ratings for the industry range from "AAA" (Superior) to "CC" (Default Expected). Publications of both A.M. Best and Standard & Poor's indicate that "A" ratings are assigned to those companies that, in their opinion, have achieved excellent overall performance when compared to the standards established by these firms and have a strong ability to meet their obligations to policyholders over a long period of time. In evaluating a company's financial and operating performance, both firms reviews the company's profitability, leverage and liquidity as well as the company's spread of risk, the quality and appropriateness of its reinsurance, the quality and diversification of its assets, the adequacy of its policy and loss reserves, the adequacy of its surplus, its capital structure and the experience and objectives of its management. These ratings are based on factors relevant to policyholders, agents, insurance brokers and intermediaries and are not directed to the protection of investors.

As of December 31, 1998, the Company had no public debt outstanding, therefore, no debt rating existed.

REINSURANCE

The Company reinsures a significant portion of its property and casualty insurance exposure, paying to the reinsurer a portion of the premiums received on such policies. Earned premiums ceded to non-affiliated reinsurers totaled $135,269,000, $138,198,000, and $140,928,000 in 1998, 1997, and 1996, respectively. Insurance is ceded principally to reduce net liability on individual risks and to protect against catastrophic losses. Although reinsurance does not legally discharge an insurer from its primary liability for the full amount of the policies, it does make the assuming reinsurer liable to the insurer to the extent of the insurance ceded.

The Company attempts to purchase reinsurance from a limited number of financially strong reinsurers. Retention levels are adjusted each year to maintain a balance between the growth in surplus and the cost of reinsurance. At December 31, 1998, the Company had prepaid reinsurance premiums and reinsurance recoverables on paid and unpaid losses and settlement expenses with American Re-Insurance Company (rated A++ "superior" by A.M. Best Company) that amounted to 80,365,000. All other reinsurance balances recoverable, when considered by individual reinsurer, are less than 10% of shareholders' equity.

The following table sets forth the largest reinsurers in terms of amounts recoverable before reinsurance payables from such reinsurers as of December 31, 1998. Also shown are the amounts of written premium ceded by the Company to such reinsurers during 1998.

<TABLE>
<CAPTION>

	GROSS REINSURER EXPOSURE AS OF DECEMBER 31, 1998	PERCENT OF TOTAL	CEDED PREMIUMS WRITTEN	PERCENT OF TOTAL

American Re-Insurance Co.	$80,365,000	32.97%	$30,916,000	21.27%
General Reins Corp.	23,469,000	9.63	12,631,000	8.69
Employer's Re	12,505,000	5.13	8,700,000	5.98
Transatlantic Reinsurance	11,439,000	4.69	10,047,000	6.91
NAC Reinsurance Corporation	7,057,000	2.89	4,516,000	3.11
Everest Re	7,043,000	2.89	6,163,000	4.24
TIG Insurance Co.	6,218,000	2.55	1,299,000	.89
St. Paul Fire & Marine	5,915,000	2.43	4,166,000	2.86
Old Lyme Ins. Co. of RI	5,543,000	2.27	6,394,000	4.40
Lloyd's of London	4,580,000	1.88	11,017,000	7.58
All other reinsurers	79,644,000	32.67	49,523,000	34.07
Total ceded exposure	$243,778,000	100.00%	$145,372,000	100.00%

As of December 31, 1998, the Company held $9,448,000 in irrevocable letters of credit, $7,575,000 under trust agreements and $1,313,508 in cash to collateralize a portion of the total amount recoverable.

Since 1992, the Company has purchased non-proportional contracts. This allows the Company to retain a larger percentage of the premium and a larger portion of the initial loss risk. Under non-proportional reinsurance, the ceding company retains losses on a risk up to a specified amount and the reinsurers assume any losses above that amount. Since 1989, through its various reinsurance programs, the Company has generally limited its maximum retained exposure on any one risk to $1,000,000. The Company seeks to limit its net aggregate exposure to a single catastrophic event to less than 10% of shareholders' equity by purchasing various types of reinsurance.

In 1998, the Company's underwriting was supported by up to $220,000,000 in traditional reinsurance protection. In 1999, the Company has enhanced this protection by adding an additional $30,000,000 in catastrophe reinsurance protection at improved terms and conditions. Using computer-assisted techniques, the Company quantifies and monitors its exposure to earthquake risk, the most significant catastrophe exposure to the Company. Detail is captured for each location covered for earthquake risk and the Probable Maximum Loss (PML) for each risk is determined. The PML calculation for each risk includes all faults to which the risk is exposed. Richter scale magnitudes used in the PML calculations are determined and applied separately for each fault. The Company uses the greater of the magnitude of an earthquake which only occurs every 100 years or 6.5 on the Richter scale in its PML calculations. Several widely accepted methods are used to estimate the magnitude of the 100 year event for each fault. Underwriting decisions are based on the PML as determined by the system, which calculates PML's on over 200 faults. Portfolio runs are made regularly to determine the Company's overall exposure on each fault from all risks covered. Total exposure after facultative reinsurance is managed by the Company to fall within the limits covered by the Company's chosen net retention, working layer treaty reinsurance and catastrophe reinsurance.

In 1998, the Company continued its innovative catastrophe reinsurance and loss financing program with Centre Reinsurance (Centre Re). The program, called Catastrophe Equity Puts (CatEPuts)-SM-, augments the Company's traditional reinsurance by integrating its loss financing needs with a pre-negotiated sale of securities linked to exchange-traded shares. CatEPuts allows the Company to put up to $50.0 million of its convertible preferred shares to Centre Re at a pre-negotiated rate in the event of a catastrophic loss provided the loss does not reduce GAAP equity to less than $55.0 million. CatEPuts is intended to be a three-year program and is designed to enable the Company to continue operating after a loss of such magnitude that its reinsurance capacity is exhausted. If the Company exercises its option to put preferred shares to Centre Re, then Centre Re, in turn, has the option to reinsure certain business written by the Company on a prospective basis.

FACTORS AFFECTING SPECIALTY PROPERTY AND CASUALTY PROFITABILITY

The profitability of the specialty property and casualty insurance business is generally subject to many factors, including rate competition, the severity and frequency of claims, natural disasters, state regulation of premium rates, default of reinsurers, interest rates, general business conditions, regulatory measures and court decisions that define and expand the extent of coverage and the amount of compensation due for injuries or losses. One of the distinguishing features of the property and casualty insurance business is that its product must be priced before the ultimate claims costs can be known. In addition, underwriting profitability has tended to fluctuate over cycles of several years' duration. Insurers generally had profitable underwriting results in the late 1970's, substantial underwriting losses in the early 1980's and somewhat smaller underwriting losses in 1986 and 1987. During the years 1988 through 1992, underwriting losses increased due to increased rate competition and the frequency and severity of catastrophic losses, although pre-tax operating income remained profitable due to investment income gains. Since 1993, the industry experienced improvement in underwriting losses, particularly in years with fewer catastrophe losses. The trends experienced during the late 1980s, however, have continued, and companies continue to post underwriting losses but remain profitable through investment income gains. As well, ongoing rate cuts are of concern to financial analysts. For 1998, the industry's statutory combined ratio is estimated to be 104.5. The Company believes that certain other factors affect its ability to underwrite specialty lines successfully, including:

SPECIALIZED UNDERWRITING EXPERTISE. The Company employs experienced professionals in its branch offices. Each office restricts its production and underwriting of business to certain classes of insurance reflecting the particular areas of expertise of its key underwriters. In accepting risks, all independent and affiliated underwriters are required to comply with risk parameters, retention limits and rates prescribed by the Company's home office underwriting group, which reviews submissions and periodically audits and monitors underwriting files and reports on losses over $100,000. Compensation of senior underwriters is substantially dependent on the profitability of the business for which they are responsible. The loss of any of these professionals could have an adverse effect on the Company's underwriting abilities and earnings in these lines.

The Company's Underwriting Policy limits extension of binding authority to independent agents. The Company's product distribution falls into distinct categories, with binding authority following the categorization.

BROKER BUSINESS. The largest volume of broker generated premium is Commercial Property, General Liability, Commercial Umbrella and Commercial Automobile. This business is produced through wholesale brokers who are not affiliated with the Company. Only a Company underwriter has the authority to bind the Company on such risks.

INDEPENDENT AGENT BUSINESS. The Surety Division offers its business through a variety of independent agents. Additionally, the Specialty Markets Division writes program business, such as Personal Umbrella and the In-Home Business Policy, through independent agents. Homeowners Dwelling Fire and Personal Auto are produced through independent agents in Hawaii. Each of these programs involves detailed eligibility criteria which are incorporated into strict underwriting guidelines. The programs involve prequalification of each risk using the "smart" system accessible by the independent agent. The independent agent cannot bind the risk unless they receive approval through the Company's "smart" system.

UNDERWRITING AGENTS. The Surety Division has authorized two underwriting general agencies to underwrite contract surety business on behalf of RLI, primarily in the East and Southeast. An underwriting agency in San Francisco is authorized to underwrite commercial umbrella business in select Western states. An underwriting agency in New York is authorized to underwrite and handle claims for low limit deductible buy-backs on program business, primarily in the East. Other underwriting agencies have been designated to underwrite programs involving ocean marine insurance, property and liability insurance for apartment risks, farm insurance, miscellaneous professional insurance and commercial automobile.

These underwriting general agencies receive some compensation through contingent profit commission. Otherwise, producers of business who are not Company employees are generally compensated on the basis of direct commissions with no provision for any contingent profit commission. There are a few volume incentives for producers handling association business, with the increased commission involved being tied to the program's underwriting profit. This represents less than 5% of the business.

RETENTION LIMITS. The Company limits its net retention of single and aggregate risks through the purchase of reinsurance. See "Business -- Specialty Property and Casualty Insurance Segment -- Reinsurance." The amount of reinsurance available fluctuates according to market conditions. Reinsurance arrangements are subject to annual renewal. Any significant reduction in the availability of reinsurance or increase in the cost of reinsurance could adversely affect the Company's ability to insure specialty property and casualty risks at current levels or to add to the amount thereof.

CLAIMS ADJUSTMENT ABILITY. The Company has a professional claims management team with proven experience in all areas of multi-line claims work. This team supervises and administers all claims and directs all outside legal and adjustment specialists. Whether a claim is being handled by the Company's claim specialist or has been assigned to a local attorney or adjuster, detailed attention is given to each claim to minimize loss expenses while providing for loss payments in a fair and equitable manner.

EXPENSE CONTROL. Management continues to review all areas of the Company's operations to streamline the organization, emphasizing quality and customer service, while minimizing expenses. These strategies will help to contain the growth of future costs. Maintaining and improving underwriting and other key organizational systems continues to be paramount as a means of supporting the Company's orderly growth in anticipation of a market rebound, as it is the Company's philosophy to retain its talented insurance professionals and to build infrastructure in spite of the soft market. Other insurance operating expenses as a percent of gross written premiums for the years 1998, 1997, and 1996, were 6%, 7%, and 6%, respectively.

ENVIRONMENTAL EXPOSURES. The Company is subject to environmental claims and exposures through its commercial umbrella, general liability, and discontinued assumed reinsurance lines of business. Within these lines, the Company's environmental exposures include environmental site cleanup, asbestos removal, and mass tort liability. The majority of the exposure is in the excess layers of the Company's commercial umbrella and assumed reinsurance books of business.

The following table represents inception-to-date paid and unpaid environmental exposure data (including incurred but not reported losses) for the periods ended 1998, 1997, and 1996:

<TABLE>
<CAPTION>

Inception-to-date (in thousands)	December 31 1998	1997	1996
<S>	<C>	<C>	<C>
Loss and Loss Adjustment Expense (LAE) payments			
Gross	$ 14,690	$11,570	$8,267
Ceded	(9,140)	(7,646)	(5,761)
Net	$ 5,550	$ 3,924	$ 2,506
Unpaid losses and LAE at end of year			
Gross	$ 12,360	$14,880	$17,596
Ceded	(5,875)	(8,842)	(11,150)
Net	$ 6,485	$ 6,038	$ 6,446

</TABLE>

Although the Company's environmental exposure is limited as a result of entering the liability lines after the industry had already recognized it as a problem, Management cannot determine the Company's precise ultimate liability with any reasonable degree of certainty. This ultimate liability is difficult to assess due to evolving legislation on such issues as joint and several liability, retroactive liability, and standards of cleanup. Additionally, the Company participates primarily in the excess layers, making it even more difficult to assess the ultimate impact.

LOSSES AND SETTLEMENT EXPENSES

Many years may elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. To recognize liabilities for unpaid losses, insurers establish reserves, which are balance sheet liabilities. The reserves represent estimates of future amounts needed to pay claims and related expenses with respect to insured events which have occurred.

When a claim is reported, the claims department establishes a "case reserve" for the estimated amount of the ultimate payment. The estimate reflects the informed judgment of professional claims personnel, based on the Company's reserving practices and the experience and knowledge of such personnel regarding the nature and value of the specific type of claim. Estimates for losses incurred but not yet reported are determined on the basis of statistical information, including the Company's past experience. The Company does not use discounting (recognition of the time value of money) in reporting its estimated reserves for losses and settlement expenses.

The reserves are closely monitored and reviewed by management, with changes reflected as a component of earnings in the current accounting period. For lines of business without sufficiently large numbers of policies or that have not accumulated sufficient development statistics, industry average development patterns are used. To the extent that the industry average development experience improves or deteriorates, the Company adjusts prior accident years' reserves for the change in development patterns. Additionally, there may be future adjustments to reserves should the Company's actual experience prove to be better or worse than industry averages.

As part of the reserving process, historical data is reviewed and consideration is given to the anticipated impact of various factors such as legal developments and economic conditions, including the effects of inflation. The reserving process provides implicit recognition of the impact of inflation and other factors affecting claims payments by taking into account changes in historic payment patterns and perceived probable trends. Changes in reserves from the prior years' estimates are calculated based on experience as of the end of each succeeding year (loss and settlement expense development). The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher than the original estimate.

Due to the inherent uncertainty in estimating reserves for losses and settlement expenses, there can be no assurance that the ultimate liability will not exceed amounts reserved, with a resulting adverse effect on the Company. Based on the current assumptions used in calculating reserves, Management believes the Company's overall reserve levels at December 31, 1998 are adequate to meet its future obligations.

The table which follows is a reconciliation of the Company's unpaid losses and settlement expenses for the years 1998, 1997, and 1996.

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,		
(Dollars in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Unpaid losses and settlement expenses at beginning of year:			
Gross	$404,263	$405,801	$418,986
Ceded	(155,711)	(157,995)	(186,678)
Net	248,552	247,806	232,308
Increase (decrease) in incurred losses and settlement expenses:			
Current accident year	68,131	61,771	69,724
Prior accident years	(3,403)	(520)	(1,463)
Total incurred	64,728	61,251	68,261
Loss and settlement expense payments for claims incurred:			
Current accident year	(14,762)	(11,284)	(11,026)
Prior accident years	(54,927)	(49,023)	(41,143)
Total paid	(69,689)	(60,307)	(52,169)
Insolvent reinsurer charged off (recovered)	7,911	(627)	607
Loss reserves commuted	(4,240)	429	(1,201)
Unpaid losses and settlement expenses at end of year	$247,262	$248,552	$247,806
Unpaid losses and settlement expenses at end of year:			
Gross	$415,523	$404,263	$405,801
Ceded	(168,261)	(155,711)	(157,995)
Net	$247,262	$248,552	$247,806

------- ------- -------
------- ------- -------

</TABLE>

Explanation of significant components of reserve development by calendar year are as follows:

1996 During 1996, the Company experienced approximately $1,463,000 of favorable development on loss reserves. This development resulted from approximately $1,519,000 of favorable development in the property lines of business. Various property claims closed during the year were settled below recorded reserves. The remaining $56,000 of adverse development relates to the net effect of changes made to casualty loss reserves. This development is a result of reserve strengthening of $3,557,000 made in the General Liability and Miscellaneous Professional business on accident years 1987 through 1995. This increase was offset by favorable development and reserve decreases of $3,501,000 in the Umbrella and Excess Employer's Indemnity programs on accident years 1986 and 1993 through 1995.

1997 During 1997, the Company experienced approximately $520,000 of favorable development on loss reserves. The development results from loss reserve adjustments in various lines of business. Reserve strengthening was necessary on the Property line of business due to development on the Lender's Single Interest program. As a result, an increase of $1,465,000 was made to IBNR reserves. This increase, however, was offset by $1,985,000 of favorable development on the Company's other casualty, in-home business, and surety bonding programs.

1998 During 1998, the Company experienced $3,402,000 of favorable development on loss reserves. This development was the net result from several reserve adjustments amongst various programs. Reserve strengthening of $2,600,000 to the surety line of business in the third quarter was offset by favorable development in primarily the personal umbrella product. Favorable development of approximately $3,000,000 on a deductible buy-back program resulted in a reclass between loss reserves and contingent commissions. This reclass was warranted by favorable loss development and had no impact to earnings.

The table on the following page presents the development under generally accepted accounting principles of the Company's balance sheet reserves for 1989 through 1998. The top line of the table shows the reserves at the balance sheet date for each of the indicated periods. This represents the estimated amount of losses and settlement expenses arising in all prior years that are unpaid at the balance sheet date, including losses that had been incurred but not yet reported to the Company. The lower portion of the table shows the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual periods.

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,				
(Dollars in thousands)	1989	1990	1991	1992	1993
<S>	<C>	<C>	<C>	<C>	<C>
Net Liability for unpaid losses and settlement expenses at end of year	$105,025	$111,152	$119,411	$140,248	$175,491
Paid (cumulative) as of:					
One year later	15,525	18,579	22,332	24,589	36,416
Two years later	26,685	35,963	37,763	46,342	63,675
Three years later	40,341	44,088	49,462	64,364	84,614
Four years later	44,714	52,322	57,085	78,994	96,741
Five years later	51,153	56,413	65,318	85,746	106,631
Six years later	54,546	62,989	70,270	92,689	
Seven years later	59,444	66,254	75,668		
Eight years later	62,266	71,373			
Nine years later	67,235				
Liability re-estimated as of:					
One year later	91,646	101,251	108,249	128,600	166,666
Two years later	89,112	98,505	105,747	132,850	164,218
Three years later	87,981	95,690	107,777	132,376	157,286
Four years later	87,403	97,041	106,326	127,426	168,782
Five years later	90,030	96,490	100,968	140,536	163,127
Six years later	88,982	93,159	117,529	134,950	

Seven years later	85,381	96,973	107,103		
Eight years later	90,154	99,622			
Nine years later	94,151				
Net cumulative redundancy (deficiency)	$10,874	$11,530	$12,308	$5,298	$12,364
Gross liability				$268,043	$310,767
Reinsurance recoverable				(127,795)	(135,276)
				--------	--------
Net liability				$140,248	$175,491
Gross re-estimated liability					$283,890
Re-estimated recoverable					(120,763)

Net re-estimated liability					$163,127
Gross cumulative redundancy (deficiency)					$ 26,877

</TABLE>

<TABLE>
<CAPTION>

	Year Ended December 31,				
(Dollars in thousands)	1994	1995	1996	1997	1998
<S>	<C>	<C>	<C>	<C>	<C>
Net Liability for unpaid losses and settlement expenses at end of year	$204,771	$232,308	$247,806	$248,552	$247,262
Paid (cumulative) as of:					
One year later	46,905	37,505	47,999	54,927	
Two years later	73,972	75,485	85,342		
Three years later	100,936	103,482			
Four years later	121,834				
Five years later					
Six years later					
Seven year later					
Eight years later					
Nine years later					
Liability re-estimated as of:					
One year later	218,499	220,185	240,264	245,150	
Two years later	214,352	228,636	242,865		
Three years later	212,964	222,761			
Four years later	217,790				
Five years later					
Six years later					
Seven years later					
Eight years later					
Nine years later					
Net cumulative redundancy (deficiency)	$(13,019)	$9,547	$4,941	$3,402	
Gross liability	$394,966	$418,986	$405,801	$404,263	$415,523
Reinsurance recoverable	(190,195)	(186,678)	(157,995)	(155,711)	(168,261)
	--------	--------	--------	--------	--------
Net liability	$204,771	$232,308	$247,806	$248,552	$247,262
Gross re-estimated liability	$408,715	$404,867	$407,051	$408,424	
Re-estimated recoverable	(190,925)	(182,106)	(164,186)	(163,274)	
	--------	--------	--------	--------	
Net re-estimated liability	$217,790	$222,761	$242,865	$245,150	
Gross cumulative redundancy (deficiency)	$(13,749)	$ 14,119	$(1,250)	$ (4,161)	

</TABLE>

OPERATING RATIO

PREMIUMS TO SURPLUS RATIO

The following table shows, for the periods indicated, the Company's insurance subsidiaries' statutory ratios of net premiums written to policyholders' surplus. While there is no statutory requirement applicable to the Company which establishes a permissible net premiums written to surplus ratio, guidelines established by the National Association of Insurance Commissioners provide that this ratio should generally be no greater than 3 to 1.

<TABLE>

<CAPTION>

(Dollars in thousands)	1998	1997	1996	1995	1994
	YEAR ENDED DECEMBER 31,				
Statutory net premiums written	$145,701	$144,674	$130,908	$130,453	$131,164
Policyholders' surplus	$314,484	$265,526	$207,787	$172,313	$136,125
Ratio	.5 to 1	.5 to 1	.6 to 1	.8 to 1	1.0 to 1

GAAP AND STATUTORY COMBINED RATIOS

The underwriting experience of the Company is best indicated by its GAAP combined ratio, which is the sum of (a) the ratio of incurred losses and settlement expenses to net premiums earned (loss ratio) and (b) the ratio of policy acquisition costs and other operating expenses to net premiums earned (expense ratio).

GAAP	1998	1997	1996	1995	1994
	YEAR ENDED DECEMBER 31,				
Loss ratio	45.4	43.2	52.2	64.4	72.5
Expense ratio	42.8	43.6	35.2	43.1	44.4
Combined ratio	88.2	86.8	87.4	107.5(1)	116.9(1)

</TABLE>

(1) Excluding the effects of the Northridge Earthquake, the GAAP combined ratio for the years ended 1995 and 1994 would have been 86.2 and 91.1, respectively.

The Company also calculates the statutory combined ratio, which is not indicative of GAAP underwriting profits due to accounting for multiple-year retrospectively-rated reinsurance contracts and policy acquisition costs differently for statutory accounting purposes compared to GAAP. The statutory combined ratio is the sum of (a) the ratio of statutory loss and settlement expenses incurred to statutory net premiums earned (loss ratio) and (b) the ratio of statutory policy acquisition costs and other underwriting expenses to statutory net premiums written.

<TABLE>
<CAPTION>

Statutory	1998	1997	1996	1995	1994
	YEAR ENDED DECEMBER 31,				
Loss ratio	48.0	43.0	52.3	63.6	73.4
Expense ratio	40.4	47.4	36.8	42.9	43.5
Combined ratio	88.4	90.4	89.1	106.5 (3)	116.9 (3)
Industry combined ratio	104.5 (1)	101.6 (2)	105.8 (2)	106.4 (2)	108.4 (2)

</TABLE>

(1) Source: Insurance Information Institute. Estimated for the year ended December 31, 1998.

(2) Source: A.M. Best Aggregate & Averages -- Property-Casualty (1997 Edition).

(3) Excluding the effects of the Northridge Earthquake, the statutory combined ratio for the years ended 1995 and 1994 would have been 85.3 and 89.7, respectively.

INVESTMENTS

The investment portfolios of the Company are managed by an Investment Committee of the Board of Directors. The Company follows an investment policy that is reviewed quarterly and revised periodically.

The investment portfolio serves primarily as the funding source for loss reserves and secondly as a source of income and appreciation. For these reasons, RLI's primary investment criteria are quality and liquidity, followed by yield and potential for appreciation. Investments of the highest quality and marketability are critical for preserving the Company's claims paying ability. Virtually all of RLI's fixed income investments are U.S. Government or AA-rated or better taxable and tax- exempt securities. Common stock investments are limited to securities listed on national exchanges and by the Securities Valuation Office of the National Association of Insurance Commissioners.

During 1998, operating cash flows were used to acquire fixed income instruments composed primarily of intermediate-term municipal and U.S. Government and Agency securities. Additionally, a smaller portion of funds was allocated to the equity portfolio and an investment grade convertible debenture portfolio designed to provide diversification and yield enhancement to the portfolio.

RLI's mix of fixed income securities continues to be biased toward U.S. Government and Agency securities due to their high liquidity and almost risk-free nature. The mix of tax-exempt and taxable instruments within the portfolios is decided at the time of purchase on the basis of available after-tax returns and overall taxability of all invested assets. Almost all securities reviewed for purchase are either high grade municipal or U.S. Government or Agency, debt instruments. As part of its investment philosophy, the Company attempts to avoid exposure to default risk by holding, almost exclusively, instruments ranked in the top two grades of investment security quality by Standard & Poor's and Moody's (i.e. AAA and AA). As of December 31, 1998, 96% of the fixed income portfolio was rated AA or better. Interest rate risk is limited by restricting and managing acceptable call provisions among new security purchases.

The municipal bond component of the fixed maturity portfolio increased $28.2 million, to $172.1 million; and comprised 52.3% of the Company's total fixed maturity portfolio, up 9.2% from year- end 1997. The taxable U.S. Government and Agency portion of the fixed income portfolio declined by $34.3 million to $143.7 million, or 43.7% of the total versus 53.3% at year end 1997. Investment grade corporate securities totaled $4.2 million compared to $5.0 million at year- end 1997, while convertible debenture securities totaled $8.9 million, an increase over last year's $6.5 million.

The Company follows a program of matching assets to anticipated liabilities to ensure its ability to hold securities until maturity. The Company's long-term accounts payable and other liabilities are added to the estimate of its unpaid losses and settlement expenses, broken out by line of business. These anticipated liabilities are then factored against ultimate payout patterns and the resulting payout streams are fully funded with the purchase of fixed-income securities of like maturity. Management believes that both liquidity and interest rate risk can best be minimized by such asset/liability matching.

Aggregate maturities for the fixed maturity securities are as follows:

<TABLE>
<CAPTION>

MATURITY YEAR	PAR VALUE	AMORTIZED VALUE	FAIR VALUE	CARRYING VALUE
1999	$32,600,000	$32,684,341	$33,229,363	$32,786,941
2000	32,685,000	33,064,261	34,055,168	33,229,235
2001	22,250,000	22,850,114	23,547,318	22,930,970
2002	28,930,000	29,964,671	30,991,320	30,225,787
2003	34,740,000	34,889,536	35,911,948	34,904,449
2004	20,345,000	20,429,631	21,182,564	20,438,600
2005	29,090,000	29,244,928	30,640,999	29,362,843
2006	21,540,000	21,606,893	22,525,427	21,538,659
2007	16,650,000	16,769,639	17,309,025	16,640,301
2008	20,355,000	20,235,585	20,995,265	20,131,847
2009	21,635,000	21,465,486	22,652,738	21,465,486
2010	23,280,000	23,582,486	24,334,504	23,582,486
2011	6,865,000	6,846,070	7,050,834	6,908,160
2012	7,415,000	7,401,994	7,632,658	7,401,994
2013	7,105,000	6,882,043	6,936,197	6,894,863
2014	0	0	0	0
2015	0	0	0	0
2016	0	0	0	0
2017	750,000	416,574	413,438	413,438
2018	0	0	0	0

TOTAL	$326,235,000	$328,334,252	$339,408,766	$328,856,059

</TABLE>

At December 31, 1998, the Company's equity securities were valued at $296.5 million, an increase of $45.1 million from the $251.4 million held at the end of 1997. During 1998, net common equity investments totaling $8.6 million were purchased and pretax unrealized appreciation of common equity securities totaled $36.0 million. Equity securities represented 43.8% of cash and invested assets at the end of 1998, an increase from the 41.6% at year-end 1997. As of the year-end, total equity investments held at the operating companies represented 88.2% of the combined statutory surplus of the insurance subsidiaries.

Combined cash and short-term investments totaling $51.9 million at year-end 1998 represented 7.7% of cash and invested assets versus 3.1% last year. The Company's short-term investments consist of U.S. Government and Agency backed money market funds and the highest rated commercial paper.

Under generally accepted accounting principles, equity and fixed income securities are carried at fair market value, except that a company that can demonstrate its ability to hold fixed income securities until their originally scheduled maturity is permitted to carry such securities at amortized cost. RLI Corp. has chosen to carry most of its fixed income securities at amortized cost as it believes it has constructed its fixed income portfolios to match expected liability payouts and thus has the ability and intention to hold such securities until their originally scheduled maturity dates. Consequently, fluctuations in the market value of most bonds are not reflected in the financial statements and do not affect shareholders' equity.

The Company's investment results are summarized in the following table:

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,				
(Dollars in thousands)	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>
Average invested assets (1)	$640,576	$570,901	$504,773	$442,717	$407,722
Investment income (2)(3)	23,937	24,558	23,681	22,029	20,133
Realized gains (losses) (3)	1,853	2,982	1,017	457	(3,595)
Change in unrealized appreciation/ depreciation (3)(4)	36,183	55,760	25,033	36,037	(5,749)
Annualized return on average invested assets	9.7%	14.6%	9.9%	13.2%	2.7%

</TABLE>

(1) Average of amounts at beginning and end of each year.
(2) Investment income, net of investment expenses, including non-debt interest expense.
(3) Before income taxes.
(4) Relates to available-for-sale fixed income and equity securities.

REGULATION

STATE REGULATION

As an insurance holding company, RLI Corp., as well as its insurance subsidiaries, are subject to regulation by the states in which the insurance subsidiaries are domiciled or transact business. Holding company registration in each insurer's state of domicile requires reporting to the state regulatory authority the financial, operations and management data of the insurers within the holding company system. All transactions within a holding company system affecting insurers must be fair, and the insurer's policyholder surplus following any transaction must be both reasonable in relation to its outstanding liabilities and adequate for its needs. Notice to regulators is required prior to the consummation of certain transactions affecting insurance subsidiaries of the holding company system.

Other regulations limit the amount of dividends and other distributions the subsidiaries can pay without prior approval of the insurance department in the states in which they are physically and/or commercially domiciled, and impose restrictions on the amount and type of investments they may have. Regulations designed to ensure financial solvency of insurers and to require fair and adequate treatment and service for policyholders are enforced by filing, reporting and examination requirements. Market oversight is conducted by monitoring trade practices, approving policy forms, licensing of agents and brokers, and requiring fair and equitable premiums and commission rates. Financial solvency is monitored by minimum reserve and capital requirements, periodic reporting procedures (annually, quarterly, or more frequently if necessary), and periodic examinations.

The quarterly and annual financial reports to the states utilize accounting principles which are different than the generally accepted accounting principles that show the business as a going concern. The statutory accounting principles used by regulators, in keeping with the intent to assure policyholder protection, are generally based on a liquidation concept. The National Association of Insurance Commissioners (NAIC) has recently developed a codified version of these statutory accounting principles, and its deployment in the states in the near future will foster more consistency among the states for accounting guidelines and reporting.

State regulatory authorities have relatively broad discretion with respect to granting, renewing and revoking brokers' and agents' licenses to transact business in the state. The manner of operating in particular states may vary according to the licensing requirements of the particular state, which may, among other things, require a firm to operate in the state through a corporation. In a few states, licenses are issued only to individual residents and locally-owned business entities. In such cases, the Company has arrangements with residents or business entities licensed to act in the state.

COMMERCIAL LINES DEREGULATION -- The NAIC and several state legislatures have taken up the issue of commercial lines deregulation in an attempt to streamline specific areas of insurance regulation. A growing contingent in the regulatory community has acknowledged that some regulatory procedures and practices may be cumbersome and inappropriate for commercial buyers of insurance. Specifically, the large, sophisticated, multi-state or multi-national businesses that employ their own teams of risk managers to evaluate, reduce and finance their loss exposures are less likely to need the form and rate protections that regulators provide consumers and small to medium business endeavors. And, while these large businesses may receive some benefit from the state financial regulation of licensed insurers, it has long been acknowledged that they do not need the protections addressed by the barriers to the surplus lines market and other nontraditional markets. Indisputably, deregulation of the licensed market will have an impact on the surplus lines insurance carriers, which have been free from form and rate requirements.

USE OF CREDIT REPORTS IN UNDERWRITING -- Gains in access to electronic commerce, and the means to gather information more rapidly, have spurred regulators to take a second look at the use of consumer credit reports in underwriting and rate making. In some states, regulators charged with protecting insurance consumers from unfair trade practices, are concerned that some consumers' risks may be underwritten based solely on their credit standing, and have sought to strengthen their laws and regulations to address this. This trend comes on the heels of Congress' re-tooling of the Fair Credit Reporting Act in 1997, which specifically addresses this issue, and permits the use of consumer credit reports in underwriting. The issue of federal preemption of state action in this arena has not been judicially addressed.

LEGISLATION AT FEDERAL LEVEL

Although the federal government generally does not directly regulate the insurance business, federal initiatives often have an impact on the business in a variety of ways. Current and proposed federal measures which may significantly affect the insurance business include federal preemption of state auto liability laws, tax reform measures, and Year 2000 legislation. The Company is also monitoring the following federal proposals:

NATURAL DISASTER ACT--Recent natural disasters including Hurricane Georges, continue to fuel concern regarding the best way to provide affordable insurance coverage for such events. Congress has yet to pass legislation, but proposals to set up a system for excess federal reinsurance to provide relief to the industry continue to be discussed. Two Initiatives, "The Natural Disaster Protection and Insurance Act of 1997" (H.R. 230), and "The Homeowners Insurance Availability Act of 1997" (H.R. 219), have been the primary tools for discussion and debate. The Company will continue to monitor the progress of this issue.

FINANCIAL SERVICES MODERNIZATION -- Both judicial decisions and action by the Office of the Comptroller of the Currency (OCC) have combined to grant national banks more authority to enter non-banking business, including insurance. The Barnett Bank decision, which permits the Comptroller of the Currency to preempt any state law which "significantly interferes" with a bank's ability to sell insurance products, has spawned the "Financial Services

Competition Act of 1997" (H.R. 10), (also known as "Financial Services Modernization Legislation"). This Act, designed to shrink the powers of the OCC, has been the subject of various revisions that would result in both positive and negative effects on the insurance industry. The bill also contains a provision that would create a National Association of Registered Agents and Brokers, which would permit insurance producers to obtain a national license, rather than a number of state licenses. Obviously, this legislation could have an important impact on many aspects of the insurance industry; the Company continues to monitor its progress.

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

The National Association of Insurance Commissioners (NAIC) facilitates the regulation of multi-state companies through uniform reporting requirements, standardized procedures for financial examinations, and uniform regulatory procedures embodied in model acts and regulations. Current developments address the reporting and regulation of the adequacy of capital and surplus.

The NAIC has developed Property-Casualty Risk-Based Capital (RBC) standards that relate an insurer's reported statutory surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated capital level to support asset (investment and credit) risk and underwriting (loss reserves, premiums written, and unearned premium) risk. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. The Company continues to monitor its subsidiaries' internal capital requirements and the NAIC's RBC developments. The Company has determined that its subsidiaries' capital levels are well in excess of the minimum capital requirements for all RBC action levels. Management believes that its capital levels are sufficient to support the level of risk inherent in its operations.

CORPORATE COMPLIANCE

The Company has developed a Code of Conduct and Compliance Manual which provides employees with guidance on complying with a variety of federal and state laws.

AGENCY LICENSES AND TRADEMARKS

Replacement Lens Inc. or its designated employees, must be licensed to act as resident or non-resident producers by regulatory authorities in the states in which it operates.

RLI Insurance Company obtained service mark registration of the letters "RLI" in 1998 in the U.S. Patent and Trademark Office. Such registration protects the mark nationwide from deceptively similar use by the Company's competitors. The duration of this registration is ten years unless renewed.

CLIENTELE

No significant part of the Company's or its subsidiaries' business is dependent upon a single client or upon a very few clients, the loss of any one of which would have a material adverse effect on the Company.

EMPLOYEES

The Company employs a total of 405 associates. Of the 405 total associates, 47 are part-time and 358 are full-time.

(d) Financial Information about Foreign and Domestic Operations and Export Sales.

For purposes of this discussion, foreign operations are not considered material to the Company's overall operations.

Item 2. PROPERTIES

The Company owns a two-story, 80,000 square foot building in Peoria, Illinois, which serves as the Corporate Headquarters for RLI Corp., RLI Insurance Company and Mt. Hawley Insurance Company. Two RLI Insurance Company Branch Offices also lease office space in this building.

Located on the same 15.0 acre campus is a 12,800 square foot building. Nearly 9,800 square feet of this building are used as warehouse storage for records and equipment. The remaining 3,000 square feet are used as office space.

Additionally, the Company owns two other buildings located near the headquarter building. One, a 19,000 square foot building, is leased to Maui Jim, Inc. and is used as their headquarters. The other, a 20,000 square foot building, was purchased in December of 1996. Currently used for warehousing and record storage, this building will provide space for future office expansion.

All other operations of RLI Corp. lease the office space which they need in various locations throughout the country.

Item 3. LEGAL PROCEEDINGS

The Company is involved in certain legal proceedings and disputes considered by management to be ordinary and incidental to the business or which have no foundation in fact. Management believes that valid defenses exist as to all such litigation and disputes, and is of the opinion that these will not have a material effect on the Company's consolidated financial statements.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted by the Company to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Refer to the Corporate Data on page 52 of the Annual Report to Shareholders for the year ended December 31, 1998 attached in Exhibit 13.

Item 6. SELECTED FINANCIAL DATA

Refer to the Selected Financial Data on pages 52 through 53 of the Annual Report to Shareholders for the year ended December 31, 1998 attached in Exhibit 13.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Refer to the Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 16 through 28 of the Annual Report to Shareholders for the year ended December 31, 1998 attached in Exhibit 13.

Item 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Refer to the Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 16 through 28 of the Annual Report to Shareholders for the year ended December 31, 1998 attached in Exhibit 13.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Refer to the consolidated financial statements and supplementary data included on pages 29 through 48 of the Annual Report to Shareholders for the year ended December 31, 1998 attached in Exhibit 13. (See Index to Financial Statements and Schedules attached on page 24.)

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There were no changes in accountants or disagreements with accountants on any matters of accounting principles or practices or financial statement disclosure.

PART III

Items 10 to 13.

Pursuant to General Instructions G(3) of Form 10-K, Items 10 to 13, inclusive, have not been restated or answered since the Company intends to file within 120 days after the close of its fiscal year with the Securities and Exchange Commission a definitive proxy statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, which proxy statement involves the election of directors. The information required in these items 10 to 13, inclusive, is incorporated by reference to that proxy statement.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1-2) Consolidated Financial Statements and Schedules. See Index to Financial Statements and Schedules attached.

(3) Exhibits. See Exhibit Index on pages 34-35.

(b) No reports on Form 8-K were filed during the last quarter of 1998.

(c) Exhibits. See Exhibit Index on pages 34-35.

(d) Financial Statement Schedules. The schedules included on attached pages 24 through 32 as required by Regulation S-X are excluded from the Company's Annual Report to Shareholders. See Index to Financial Statements and Schedules on page 24. There is no other financial information required by Regulation S-X which is excluded from the Company's Annual Report to Shareholders.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RLI Corp.
(Registrant)

By: /s/Joseph E. Dondanville

J. E. Dondanville
Vice President, Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: MARCH 3, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/Gerald D. Stephens

G. D. Stephens, President
(Principal Executive Officer)

Date: March 3, 1999
----
* * * * *

By: /s/Joseph E. Dondanville

J. E. Dondanville, Vice President,
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: March 3, 1999
----
* * * * *

By: /s/Gerald D. Stephens

G. D. Stephens, Director

Date: March 3, 1999
----
* * * * *

By: /s/ Bernard J. Daenzer

B. J. Daenzer, Director

Date: March 3, 1999
----
* * * * *

By: /s/Richard J. Haayen

R. J. Haayen, Director

Date: March 3, 1999
----
* * * * *

By: /s/William R. Keane

W. R. Keane, Director

Date: March 3, 1999
----
* * * * *

By: /s/Gerald I. Lenrow

G. I. Lenrow, Director

Date: MARCH 3, 1999
----
* * * * *

By: /s/Jonathan E. Michael

J.E. Michael, Director

Date: MARCH 3, 1999
----
* * * * *

By: /s/Edwin S. Overman

E. S. Overman, Director

Date: March 3, 1999
----
* * * * *

By: /s/Edward F. Sutkowski

E. F. Sutkowski, Director

Date: March 3, 1999
----
* * * * *

By: /s/Robert O. Viets

R. O. Viets, Director

Date: March 3, 1999
----
* * * * *

INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

<TABLE>
<CAPTION>

</TABLE>

Schedules other than those listed are omitted for the reason that they are not required, are not applicable or that equivalent information has been included in the financial statements, and notes thereto, or elsewhere herein.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
RLI Corp.:

Under date of January 14, 1999, we reported on the consolidated balance sheets of RLI Corp. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings and comprehensive earnings, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998, as contained in the 1998 annual report to shareholders. These consolidated financial statements and our report thereon are incorporated by reference in the annual report on Form 10-K for the year 1998. In connection with our audits of the aforementioned consolidated financial statements, we also have audited the related financial statement schedules as listed in the accompanying index. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules based on our audits.

In our opinion, the financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG LLP

Chicago, Illinois
January 14, 1999

RLI CORP. AND SUBSIDIARIES

SCHEDULE I--SUMMARY OF INVESTMENTS--OTHER THAN INVESTMENTS IN RELATED PARTIES

DECEMBER 31, 1998

<TABLE>
<CAPTION>

Column A	Column B	Column C	Column D
Type of Investment	Cost(1)	Fair Value	Amount at Which Shown in the Balance Sheet
<S>	<C>	<C>	<C>
Fixed maturities:			
Bonds:			
Held-to-maturity			
United States government and government agencies and authorities	$124,418,833	$128,814,165	$124,418,833
States, political subdivisions, and revenues	159,572,691	165,730,065	159,572,691
Total held-to-maturity	283,991,524	294,544,230	283,991,524
Trading			
U.S. governments	3,652,869	3,726,006	3,726,006
Foreign governments	0	0	0
Corporate	4,102,579	4,215,737	4,215,737
States, political subdivisions & revenues	401,934	406,398	406,398
Total trading	8,157,382	8,348,141	8,348,141
Available-for-sale			
U.S. governments	15,177,280	15,527,980	15,527,980
Corporates	9,149,952	8,892,633	8,892,633
States, political subdivisions, and revenues	11,858,113	12,095,780	12,095,780
Total available-for-sale	36,185,345	36,516,393	36,516,393
Total fixed maturities	328,334,251	339,408,764	328,856,058
Equity securities, available-for-sale:			
Common stock:			
Public utilities	41,687,469	80,064,940	80,064,940
Banks, trusts and insurance companies	11,957,163	36,701,934	36,701,934

Industrial, miscellaneous and all other	73,563,360	179,260,083	179,260,083
Preferred stock	159,495	493,412	493,412
Total equity securities	127,367,487	296,520,369	296,520,369
Short-term investments	51,917,333	51,917,333	51,917,333
Total investments	$507,619,071	$687,846,466	$677,293,760

</TABLE>

Note: See notes 1D and 2 of Notes to Consolidated Financial Statements, as attached in Exhibit 13.

(1) Original cost of equity securities and, as to fixed maturities, original cost reduced by repayments and adjusted for amortization of premiums or accrual of discounts.

RLI CORP. AND SUBSIDIARIES

SCHEDULE II--CONDENSED FINANCIAL INFORMATION OF REGISTRANT
(PARENT COMPANY)
CONDENSED BALANCE SHEETS

DECEMBER 31, 1998 AND 1997

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>
ASSETS		
Cash	$ 258,436	$ 135,663
Investments in subsidiaries/investees, at equity	304,713,805	264,146,254
Equity securities available-for-sale, at fair value (Cost--$6,528,441 in 1998 and $6,677,285 in 1997)	13,823,699	12,288,528
Investment in Rabbi Trust		6,432,355
Property and equipment	998,780	1,045,298
Other assets	736,815	418,040
Total assets	$320,531,535	$284,466,138
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable, current	$ 4,249,318	$ 1,996,859
Notes payable, short-term	19,575,000	7,500,000
Deferred compensation--Rabbi Trust		6,432,355
Income taxes payable--current	465,203	332,621
Income taxes payable--deferred	2,229,622	1,523,663
Other liabilities	53,738	128,200
Total liabilities	26,572,881	17,913,698
Shareholders' equity:		
Common stock ($1 par value, authorized 50,000,000 shares, issued 12,790,428 shares in 1998 and 10,229,673 shares in 1997)	12,790,428	10,229,673
Paid in Capital	71,092,631	74,587,595
Accumulated other comprehensive earnings net of tax	110,371,461	86,852,663
Retained earnings	163,324,161	140,431,791
Deferred compensation	3,460,606	
Unearned ESOP shares	(2,500,999)	
Treasury shares at cost (2,384,736 shares in 1998 and 1,994,272 shares in 1997)	(64,579,634)	(45,549,282)
Total shareholders' equity	293,958,654	266,552,440
Total liabilities and shareholders' equity	$320,531,535	$284,466,138

</TABLE>

See Notes to Consolidated Financial Statements, as attached in Exhibit 13.

RLI CORP. AND SUBSIDIARIES

SCHEDULE II--CONDENSED FINANCIAL INFORMATION OF REGISTRANT
(PARENT COMPANY)--(CONTINUED)
CONDENSED STATEMENTS OF EARNINGS AND COMPREHENSIVE EARNINGS
YEARS ENDED DECEMBER 31,

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Net investment income	$ 453,843	$ 454,906	$ 164,181
Selling, general, and administrative expenses	(3,914,954)	(4,118,010)	(3,559,113)
Interest expense on debt	(1,122,358)	(1,547,542)	(2,808,470)
	(4,583,469)	(5,210,646)	(6,203,402)
Income tax benefit	(1,383,099)	(1,675,135)	(2,186,013)
Net loss before equity in net earnings of subsidiaries	(3,200,370)	(3,535,511)	(4,017,389)
Equity in net earnings of subsidiaries/investees	31,438,961	33,706,994	29,713,110
Net earnings	$28,238,591	$30,171,483	$25,695,721
Other Comprehensive Earnings, net of tax			
Unrealized gains on securities:			
Unrealized holding gains arising during the period	$ 1,217,174	$ 1,859,712	$901,569
Less: Reclassification adjustment for (gains) losses included in Net Earnings	(122,659)	(81,383)	10,846
Other Comprehensive Earnings--parent only	1,094,515	1,778,329	912,415
Equity in Other Comprehensive Earnings of Subsidiaries/Investees	22,424,283	4,465,638	15,361,757
Other Comprehensive Earnings	23,518,798	36,243,967	16,274,172
Comprehensive Earnings	$ 51,797,389	$66,415,450	$41,969,893

</TABLE>

See Notes to Consolidated Financial Statements, as attached in Exhibit 13

RLI CORP. AND SUBSIDIARIES

SCHEDULE II--CONDENSED FINANCIAL INFORMATION OF REGISTRANT
(PARENT COMPANY)--(CONTINUED)
CONDENSED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31,

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Cash Flows from Operating Activities			
Losses before equity in net earnings of subsidiaries/investees	$(3,200,370)	$(3,535,511)	$(4,017,389)
Adjustments to reconcile net losses to net cash provided by operating activities:			
Other items, net	(576,103)	(1,792,215)	(55,262)
Change in:			
Affiliate balances payable	2,187,132	451,029	(207,668)
Interest Payable		(1,265,000)	
Federal income taxes	97,641	140,485	437,303
Deferred debt costs		805,701	123,164
Net cash used in operating activities	(1,491,700)	(5,195,511)	(3,719,852)
Cash Flows from Investing Activities			
Purchase of:			
Equity securities, available-for-sale	(31,122)	(135,001)	(387,395)
Property and equipment		(37,210)	
Unconsolidated investee ownership interest	(88,750)	(3,694,118)	
Sale of:			
Equity securities, available-for-sale	368,672	383,838	236,986
Cash dividends received-subsidiaries/investees	13,384,443	16,998,248	21,125,783

Net cash provided by investing activities	13,633,243	13,515,757	20,975,374
Cash Flows from Financing Activities			
Proceeds from issuance of debt	12,075,000	7,500,000	
Payments on debt			(2,800,000)
Fractional share paid	(16,099)	(1,211)	
CatEPut Payment	(1,212,500)		
Shares issued under stock option plan	60,638	161,356	
Unearned ESOP shares	(2,500,999)		
Treasury shares purchased	(14,858,394)	(20,738,547)	(3,040,671)
Treasury shares reissued			2,207,526
Cash dividends paid	(5,566,416)	(4,704,015)	(4,261,445)
Net cash used in financing activities	(12,018,770)	(17,782,417)	(7,894,590)
Net increase (decrease) in cash	122,773	(9,462,171)	9,360,932
Cash at beginning of year	135,663	9,597,834	236,902
Cash at end of year	$258,436	$135,663	$ 9,597,834

</TABLE>

Interest paid on outstanding debt for 1998, 1997, and 1996 amounted to $2,327,113, $2,809,903, and $2,834,192, respectively.
See Notes to Consolidated Financial Statements, as attached in Exhibit 13.

RLI CORP. AND SUBSIDIARIES

SCHEDULE III--SUPPLEMENTARY INSURANCE INFORMATION
SCHEDULE VI--SUPPLEMENTARY INFORMATION CONCERNING
PROPERTY-CASUALTY INSURANCE OPERATIONS

YEARS ENDED DECEMBER 31, 1998, 1997, AND 1996

<TABLE>
<CAPTION>

Column A Segment	Column B Deferred policy acquisition costs	Column C (1) Unpaid losses and settlement expenses, net	Column E (1) Unearned premiums, net	Column F Premiums earned	Column H Incurred Losses and settlement expenses Current year
<S>	<C>	<C>	<C>	<C>	<C>
Year ended December 31, 1998					
Property segment	$8,783,705	$29,634,175	$34,977,862	$52,281,163	$12,050,748
Surety segment	5,263,476	5,397,144	8,944,616	18,307,259	4,198,692
Casualty segment	8,462,960	212,230,257	38,320,680	71,735,513	51,882,019
RLI Insurance Group	$ 22,510,141	$247,261,576	$ 82,243,158	$142,323,935	$ 68,131,459
Year ended December 31, 1997					
Property segment	$10,484,486	35,794,786	41,230,427	62,028,216	$11,998,750
Surety segment	4,818,957	2,214,233	8,119,275	11,491,172	2,507,153
Casualty segment	6,681,142	210,543,568	29,516,110	68,365,057	47,265,353
RLI Insurance Group	$ 21,984,585	$248,552,587	$ 78,865,812	$141,884,445	$61,771,256
Year ended December 31, 1996					
Property segment	$ 6,182,136	44,045,187	37,776,691	48,181,678	$11,030,823
Surety segment	3,421,403	1,715,328	5,483,068	4,406,633	1,195,897
Casualty segment	7,060,064	202,045,556	32,816,802	78,067,784	57,498,010
RLI Insurance Group	$ 16,663,603	$247,806,071	$ 76,076,561	$130,656,095	$69,724,730

</TABLE>

NOTE 1: Investment income is not allocated to the segments, therefore net investment income (column G) has not been provided.

RLI CORP. AND SUBSIDIARIES

SCHEDULE III--SUPPLEMENTARY INSURANCE INFORMATION
SCHEDULE VI--SUPPLEMENTARY INFORMATION CONCERNING
PROPERTY-CASUALTY INSURANCE OPERATIONS
(CONTINUED)

YEARS ENDED DECEMBER 31, 1998, 1997, AND 1996

<TABLE>
<CAPTION>

Column A Segment	Column H Incurred Losses and settlement expenses Prior year	Column I Policy acquisition costs	Column J Other operating expenses	Column K Net Premiums written
<S>	<C>	<C>	<C>	<C>
Year ended December 31, 1998				
Property segment	$ (300,799)	$14,394,458	$6,335,787	$46,029,088
Surety segment	2,430,308	10,990,793	1,406,353	19,133,037
Casualty segment	(5,532,667)	18,895,582	8,783,745	80,539,155
RLI Insurance Group	$ (3,403,158)	$44,280,833	$16,525,885	$145,701,280
Year ended December 31, 1997				
Property segment	$ (95,228)	$20,366,636	$8,347,252	$65,482,315
Surety segment	(19,898)	7,304,618	1,173,349	14,127,068
Casualty segment	(404,696)	15,469,127	9,220,776	65,064,313
RLI Insurance Group	$ (519,822)	$43,140,381	$18,741,377	$144,673,696
Year ended December 31, 1996				
Property segment	$ (226,883)	$11,442,412	$ 7,104,879	$ 48,809,514
Surety segment	(24,597)	3,028,034	613,023	4,463,383
Casualty segment	(1,211,943)	15,085,944	8,723,430	79,084,743
RLI Insurance Group	$(1,463,423)	$29,556,390	$16,441,332	$132,357,640

</TABLE>

RLI CORP. AND SUBSIDIARIES

SCHEDULE IV--REINSURANCE

FOR THE YEARS ENDED 1998, 1997, AND 1996

<TABLE>
<CAPTION>

Column A	Column B Direct Amount	Column C Ceded to Other Companies	Column D Assumed From Other Companies	Column E Net Amount	Column F Percentage of Amount Assumed to Net

<S> <C> <C> <C> <C> <C>

1998					
Property	$115,926,412	$ 65,712,932	$2,067,683	$ 52,281,163	3.95%
Surety	29,149,915	11,157,925	315,269	18,307,259	1.72%
Casualty	129,919,370	58,398,009	214,152	71,735,513	.30%
RLI Insurance Group premiums earned	$274,995,697	$135,268,866	$2,597,104	$142,323,935	1.82%
1997					
Property	$132,599,094	$ 81,810,126	$11,239,248	$ 62,028,216	18.12%
Surety	20,311,217	9,079,051	259,006	11,491,172	2.25%
Casualty	115,658,960	47,308,406	14,503	68,365,057	.02%
RLI Insurance Group premiums earned	$268,569,271	$138,197,583	$11,512,757	$141,884,445	8.11%
1996					
Property	$135,260,684	$87,079,006	0	48,181,678	0%
Surety	6,222,892	1,857,187	40,928	4,406,633	.93%
Casualty	130,068,132	51,992,133	(8,215)	78,067,784	(.01)%
RLI Insurance Group premiums earned	$271,551,708	$140,928,326	$ 32,713	$130,656,095	.02%

</TABLE>

NOTES: Column B, "Gross Amount" includes only direct premiums earned.

RLI CORP. AND SUBSIDIARIES

SCHEDULE V--VALUATION AND QUALIFYING ACCOUNTS

YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>
<CAPTION>

Column A	Column B	Column C	Column D		Column E
	Balance at beginning of period	Amounts charged to expense	Amounts recovered (written-off)	Amounts commuted	Balance at end of period
<S>	<C>	<C>	<C>	<C>	<C>
1998 Allowance for insolvent reinsurers	$17,057,194	--	$(574,934)	$(6,839,313)	$9,642,947
1997 Allowance for insolvent reinsurers	$16,897,798	--	$ 159,396	--	$17,057,194
1996 Allowance for insolvent reinsurers	$16,336,146	$1,006,140	$ (444,488)	--	$16,897,798

</TABLE>

EXHIBIT INDEX

<TABLE>
<CAPTION>

EXHIBIT NO.	DESCRIPTION OF DOCUMENT	REFERENCE (PAGE)
<S>	<C>	<C>
2.1	Plan of Reorganization and Agreement	Incorporated by reference to the Company's

	of Merger	Quarterly Form 10-Q for the First Quarter ended March 31, 1993.
2.2	Articles of Merger	Incorporated by reference to the Company's Quarterly Form 10-Q for the Second Quarter ended June 30, 1993.
3.1	Articles of incorporation	Incorporated by reference to the Company's Quarterly Form 10-Q for the Second Quarter ended June 30, 1997.
3.2	By-Laws	Incorporated by reference to the Company's Quarterly Form 10-Q for the Second Quarter ended June 30, 1997.
4.1	Indenture dated July 28, 1993 between the Company and Norwest Bank Minnesota, National Association as Trustee	Incorporated by reference to the Company's Registration Statement on Form S-3 filed on July 21, 1993
10.1	Market Value Potential Plan	Incorporated by reference to the Company's Quarterly Form 10-Q for the Second Quarter ended June 30, 1997.
10.2	RLI Corp. Director Deferred Compensation Plan	Incorporated by reference to the Company's Registration Statement on Form 10-Q for the Second Quarter ended June 30, 1993.
10.3	The RLI Corp. Directors' Irrevocable Trust Agreement	Incorporated by reference to the Company's Registation Statement on Form 10-Q for the Second Quarter ended June 30, 1993.
10.4	Key Employee Excess Benefit Plan	Incorporated by reference to the Company's Annual Form 10-K/A for the year ended December 31, 1992.
10.5	RLI Corp. Incentive Stock Option Plan	Incorporated by reference to Company's Registration Statement on Form S-8 filed on March 11, 1996, File No. 333-01637
10.6	Directors' Stock Option Plan	Incorporated by reference to the Company's Registration Statement on Form S-8 filed on June 6, 1997, File No. 333-28625.
10.7	RLI Corp. Executive Deferred Compensation Agreement	Attached Exhibit 10.
10.9	Reinsurance Agreements between the Company and American Re-Insurance Company	Incorporated by reference to the Company's Annual Form 10-K/A for the year ended December 31, 1992.

</TABLE>

EXHIBIT INDEX

<TABLE>
<CAPTION>

EXHIBIT NO.	DESCRIPTION OF DOCUMENT	REFERENCE (PAGE)
<S>	<C>	<C>
10.10	Reinsurance Agreements between the Company and Lloyd's of London	Incorporated by reference to the Company's Annual Form 10-K/A for the year ended December 31, 1992.
10.11	Reinsurance Agreements between the Company and NAC Reinsurance Corp.	Incorporated by reference to the Company's Annual Form 10-K/A for the year ended December 31, 1992.
11.0	Statement re computation of per share earnings	Refer to the Notes to Consolidated Financial Statements--Note 1K "Earnings per share", on page 35 of the Annual Report to Shareholders attached in Exhibit 13.
13.1	Refer to the Annual Report to Share-holders for the year ended December 31, 1998, pages 20-49 and 53.	Attached Exhibit 13.
21.1	Subsidiaries of the Registrant	Attached page 36.
23.1	Consent of KPMG LLP	Attached page 47.
23.2	Consent of Kirkland & Ellis	Incorporated by reference to the Company's

		Registration Statement on Form S-3 filed July 21, 1993.
24.1	Powers of Attorney	Incorporated by reference to the Company's Registration Statement on Form S-3 filed on July 21, 1993.
27	Financial Data Schedule	Attached Exhibit 27.
28.1	Information from reports furnished to state insurance regulatory authorities	Attached page 48.

</TABLE>

Exhibit 10.7

RLI CORP. EXECUTIVE DEFERRED COMPENSATION AGREEMENT

THIS RLI CORP./EXECUTIVE DEFERRED COMPENSATION AGREEMENT is made in duplicate at Peoria, Illinois, effective on the Execution Date by and between RLI and the Executive.

I. RECITALS

A. BACKGROUND: THE CORPORATION

RLI is a holding company which, through its subsidiaries, is engaged in the Business, is possessed of the Accounting Year and reports its income and expense on the Accounting Basis.

B. MVP EXECUTIVE PLAN

The Executive is a participant under the Market Value Potential Executive Incentive Plan ("MVP Plan") incident to which the Executive may defer all or any part of the cash bonus ("MVP Bonus") otherwise distributable to the Executive. The Parties wish to supplement the MVP Plan with this Agreement which shall control the distribution of any MVP Bonus otherwise distributable to the Executive.

C. EXEMPTION FROM THE EXECUTIVE

INCOME RETIREMENT SECURITY ACT

RLI has established the RLI Corp. Executive Deferred Compensation Irrevocable Trust ("Trust") with an independent trustee ("Trustee") to which RLI may periodically transfer shares of RLI and other assets designed to fund the obligation of RLI to the Executive under this Agreement. Even though the Plan Benefit may be satisfied from property transferred to the Trustee under the Trust, this Agreement and the Plan Benefit are unfunded and are maintained primarily for the purpose of providing deferred compensation for the Executive.

If this Agreement is subject to the provisions of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), then subject to the filing of the statement described in ERISA Labor Reg. Section 2520.104-23, this Agreement shall be exempt from the participation, vesting, benefit accrual, funding and fiduciary provisions of ERISA.

II. AGREEMENTS

NOW, THEREFORE, the Parties agree as follows:

1. REMUNERATION: DIRECT

RLI shall pay upon demand all reasonable expenses incurred by the Executive incident to the Business.

Except as otherwise provided in the following sections, RLI shall pay the Executive for services rendered as an employee of RLI or an Affiliate a base salary ("Base Compensation") in an amount periodically determined to be appropriate by the Parties, payable not less often than annually.

2. REMUNERATION: BASE COMPENSATION DEFERRED

2.1 AMOUNT OF AND LIMITATIONS ON DEFERRED COMPENSATION

Subject to the limitations and the satisfaction of the conditions expressed in the following sections, the Executive may defer not to exceed one hundred percent (100%) of the Executive's Base Compensation attributable to services to be rendered in respect of the period beginning on the Execution Date.

2.1(a) CURRENT ACCOUNTING YEAR: DELIVERY AND IRREVOCABILITY OF DEFERRED COMPENSATION DIRECTION

Any Deferred Compensation Direction with respect to the period beginning on the Execution Date and ending on December 31, 1998, must be delivered to RLI prior to the expiration of the thirty (30) day period beginning on the Execution Date and shall be irrevocable.

2.1(b) SUBSEQUENT ACCOUNTING YEAR: DELIVERY AND IRREVOCABILITY OF DEFERRED COMPENSATION DIRECTION

Any Deferred Compensation Direction with respect to any Accounting Year beginning on or after January 1, 1999, must be delivered to RLI prior to January 1 of the subject Accounting Year and shall be irrevocable effective December 31 of the preceding Accounting Year.

2.1(c) INVESTMENT OF BASE COMPENSATION DEFERRED

RLI shall transfer to the Trustee either cash or such number of shares of RLI as shall be equal in value to the amount of the Base Compensation deferred not less often than monthly and in any event within the thirty (30) day period beginning on the close of the subject Accounting Year. RLI shall direct the Trustee to purchase additional shares of RLI with any cash dividend. The value of each share of RLI to be transferred shall be equal to the closing price of a share of RLI as of the close of the last business day of the referent month.

3. REMUNERATION: MVP BONUS DEFERRED

3.1 AMOUNT OF AND LIMITATIONS ON DEFERRED COMPENSATION

Subject to the limitations and the satisfaction of the conditions expressed in the following sections, the Executive may defer not to exceed one hundred percent (100%) of the Executive's MVP Bonus to the extent not then ascertainable, subject to forfeiture or attributable to services to be rendered in respect of the period beginning on the Execution Date.

3.1(a) CURRENT ACCOUNTING YEAR: DELIVERY AND IRREVOCABILITY OF DEFERRED COMPENSATION DIRECTION

Any Deferred Compensation Direction with respect to the period beginning on the Execution Date and ending on December 31, 1998, must be delivered to RLI prior to the expiration of the thirty (30) day period beginning on the Execution Date and shall be irrevocable.

3.1(b) SUBSEQUENT ACCOUNTING YEAR: DELIVERY AND IRREVOCABILITY OF DEFERRED COMPENSATION DIRECTION

Any Deferred Compensation Direction with respect to any Accounting Year beginning on or after January 1, 1999, must be delivered to RLI prior to January 1 of the subject Accounting Year and shall be irrevocable effective December 31 of the preceding Accounting Year.

3.1(c) INVESTMENT OF MVP BONUS DEFERRED

RLI shall transfer to the Trustee either cash or such number of shares of RLI as shall be equal in value to the amount of the MVP Bonus within the thirty (30) day period beginning on the date the amount of the MVP Bonus is finally determined. RLI shall direct the Trustee to purchase additional shares of RLI with any cash dividend. The value of each share of RLI to be transferred shall be equal to the closing price of a share of RLI as of the close of the last business day of the referent month.

3. DISTRIBUTION OF PLAN BENEFIT

3.2(a) PLAN BENEFIT DISTRIBUTION COMMENCEMENT DATE

Except as otherwise provided in the following paragraphs, the Plan Benefit shall commence to be distributed to the Executive not earlier than thirty (30) days after a Distribution Event.

If the Executive is the subject of an Unforeseeable Emergency that is caused by an event beyond the control of the Executive which Unforeseeable Emergency would result in severe financial hardship to the Executive but for the distribution of the Plan Benefit before the Distribution Event, then, subject to the satisfaction of the conditions expressed in the following paragraph, the Plan Benefit may be distributed to the Executive as, when and to the extent specified by the Executive Resources Committee.

The Executive Resources Committee must approve the payment period in respect of any distribution. No payment shall be made to the extent that a hardship may be relieved (i) through reimbursement or compensation by insurance or otherwise, (ii) by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or (iii) by cessation of deferrals under the Plan. No payment shall be made in excess of the amount reasonably required to satisfy the Unforeseeable Emergency determined with regard to any Federal or state income tax payable with respect to any distribution.

3.2(b) DISTRIBUTION PERIOD

Except as otherwise provided in Section 3.2(a) Plan Benefit Distribution Commencement Date with respect to an Unforeseeable Emergency and the following paragraphs, the Plan Benefit shall be distributed in sixty (60) substantially equal monthly installments.

If the Executive is the subject of a fraud, a theft, or an embezzlement from or with respect to either RLI or an Affiliate, RLI may suspend, reduce or otherwise alter any payment of the Executive's Plan Benefit in full or partial satisfaction of any direct or indirect damage sustained or reasonably foreseeable by RLI or any Affiliate with respect to any such act or omission. If any dispute arising with respect to this paragraph shall not be resolved by the Parties, such dispute shall be subject to arbitration in accordance with the Federal Arbitration Act 9 U.S.C. Section 1, et seq. from a location in the City of Peoria designated by the Parties.

Subject to the satisfaction of the conditions expressed in the following sentences, the Executive Resources Committee may, in its sole and unrestricted discretion, upon application of the Executive, or the Executive's beneficiary, periodically alter or amend the period over which the Plan Benefit shall be distributed. The Executive Resources Committee may require the presentation of such evidence as the Executive Resources Committee periodically determines to be appropriate. The decision of the Executive Resources Committee or the decision of the Executive Resources Committee not to review the application of the Executive or the Executive's beneficiary, shall not be the subject of any review by the Executive.

3.2(c) FORM OF DISTRIBUTION

The Plan Benefit shall be distributed in the form of RLI shares. Unless the shares have been registered under the Act, are otherwise exempt from the registration requirements of such Act, are the subject of a favorable no action letter issued by the Securities and Exchange Commission, or are the subject of an opinion of counsel acceptable to RLI to the effect that such shares are exempt from the registration requirements of the Act, certificates representing such shares shall contain a legend precluding the transfer of such shares except in accordance with the provisions of Rule 144 of the Act.

3.2(d) BENEFICIARY

The Plan Benefit shall be distributed to the Executive and then to such beneficiary as the Executive may periodically designate during the lifetime of such beneficiary. If the Executive fails to designate a beneficiary or the designated beneficiary dies before the Executive's Plan Benefit is fully distributed, the undistributed balance shall be distributed to the Executive's spouse, if living, and upon the death of the Executive's spouse, to the Executive's then living descendants, per stirpes, and upon the death of the last surviving descendant to the estate of the Executive.

4. CLAIM PROCEDURE

This Agreement shall be administered by the Executive Resources Committee.

4.1 FILING OF A CLAIM FOR A PLAN BENEFIT

The Executive may present a claim for any Plan Benefit in writing to the Executive Resources Committee. The Executive Resources Committee shall determine the validity of any claim. If all or any part of the claim is denied, a written notice of the denial will be provided to the Executive not later than sixty (60) days following the receipt or filing of such claim. The notice of denial must be expressed in a manner calculated to be understood by the Executive and include the following: (a) the specific reason or reasons for denial; (b) a specific reference to the pertinent Plan provisions on which the denial is based; (c) description of any additional material or information necessary for the Executive to perfect the claim; (d) an explanation of why such material or information is necessary; and, (e) an explanation of this review procedure.

4.2 APPEAL

Within ninety (90) days of the receipt by the Executive of written notice of denial, or such later time as will be deemed reasonable, taking into account the nature of any Plan Benefit claimed and any other circumstance, or if the claim has not been granted within a reasonable period of time, the Executive may file for a full review of the denial of the claim, including a hearing if deemed necessary by the Board of Directors of RLI. In connection with such review, the Executive may inspect pertinent documents and may submit issues and comments in writing.

The Board of Directors of RLI will deliver to the Executive a written decision on the review of the claim not later than sixty (60) days after the receipt of the request for such review, except that if there are special circumstances which require an extension of time for processing, the sixty (60) day period will be extended to one hundred twenty (120) days. A decision on review will be in writing and will include specific reasons for the decision, written in a manner calculated to be understood by the Executive and with specific references to the applicable provisions of this Agreement.

5. GENERAL CONDITIONS

5.1 ABSENCE OF FUNDING AND CREDITOR CLAIMS

Except as otherwise provided in the following sentence, this Agreement and the Plan Benefit are unfunded, are subject to the claims of the general creditors of RLI, may not be assigned, sold, anticipated, pledged or otherwise transferred and shall not be subject to any claim of the Executive, the Executive's spouse, their respective creditors, or their respective successors or assigns. The foregoing sentence shall not relieve RLI of its obligation to pay the Plan Benefit as, when and to the extent distributable pursuant to this Agreement.

5.2 ADDITIONAL DOCUMENTS REQUIRED

Each Party shall execute, acknowledge and deliver such additional documents, writings or assurances as the other may periodically require so as to give full force and effect to the terms and provisions of this Agreement.

5.3 AMENDMENT AND TERMINATION

Subject to the limitation expressed in the following sentence, this Agreement may be altered, amended or terminated by RLI upon the vote of its directors other than the Executive. No alteration, amendment or termination of this Agreement shall reduce any Plan Benefit existent prior to the date of any such alteration, amendment or termination.

5.4 BINDING EFFECT

The terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the Parties and their respective successors and assigns.

5.5 CHOICE OF LAW

The laws of the State of Illinois shall govern the validity, interpretation and administration of this Agreement.

5.6 COUNTERPARTS

This Agreement may be executed in any number of counterparts, each of which shall be deemed an original and all of which shall constitute but one and the same instrument.

5.7 INCAPACITATED BENEFICIARY

If any beneficiary is Incapacitated, the Trustee may distribute such beneficiary's Plan Benefit to such beneficiary's parent, guardian, conservator, or to any individual with whom such beneficiary is residing without responsibility for its expenditure.

5.8 INCORPORATION BY REFERENCE; SCHEDULES

The paragraphs under the heading "I. RECITALS:" and any Schedule referred to in this Agreement are a part of this Agreement.

5.9 INTERPRETIVE GUIDELINES

The words and phrases set off by quotation marks in the GLOSSARY have the meanings therein indicated. Any word or phrase which appears in this Agreement in parenthesis, set off by quotation marks and capitalized has the meaning denoted by its context. Whenever the words and phrases defined either in the GLOSSARY or elsewhere in this Agreement are intended to have their defined meanings, the first letter of such word or the first letters of all substantive words in such phrase shall be capitalized. When the context permits, a word or phrase used in the singular includes the plural, and when used in any gender, its meaning also includes all genders. Captions of Sections are inserted as a matter of convenience only and do not define, limit or extend the scope or intent of this Agreement or any provision hereof.

5.10 NOTICES

Any notice, request, communication and demand hereunder shall be in writing and shall be deemed to have been duly given if delivered in person or sent by registered or certified mail, postage prepaid, to RLI at its principal place of business, or to such other address as RLI shall periodically designate by written notice, and in the case of the Executive, to the Executive's last known principal place of residence or to such other address as the Executive shall periodically designate by written notice.

5.11 RECEIPT AND RELEASE FOR PAYMENTS

Any payment to the Executive, any beneficiary or any guardian for either shall, to the extent thereof, be in full satisfaction of any claim hereunder against RLI. RLI may require the distributee, as a condition precedent to such payment, to execute a receipt and release thereof in such form as shall be determined by RLI.

5.12 WAIVER

The waiver by either Party of any breach of this Agreement, whether in a single instance or repeatedly, shall not be construed as a waiver of rights under this Agreement to terminate the same because of similar or additional breaches. Further such waiver shall not in any manner be construed as a waiver by any Party to strictly adhere to the terms and conditions of this Agreement, nor as a waiver of any claim for damages or other remedy by reason of any such breach.

6. DISPUTE RESOLUTION

Any claim, due, demand or dispute arising out of or with respect to this Agreement not otherwise resolved, shall be subject to arbitration in accordance with the Federal Arbitration Act 9 U.S.C, Section 1, et seq. from a location in the City of Peoria designated by RLI.

7. GLOSSARY

"Accounting Basis" means the accrual basis method of accounting.

"Accounting Year" means the twelve (12) consecutive month period beginning January 1, which shall change as, when and to the extent the fiscal year of RLI shall change.

"Act" means the Securities Act of 1933, as periodically amended.

"Affiliate" of any particular Person means any other Person controlling, controlled by or under common control with such particular Person, where "control" means the possession, directly or indirectly, of the power to direct the management and policies of a Person whether through the ownership of voting securities, contract or otherwise.

"Base Compensation" is defined under Section 1 REMUNERATION: DIRECT.

"Business" means the underwriting of specialty property and casualty insurance, and providing licensing services for agents and brokers.

"Business Organization" means a partnership, limited partnership, limited liability company, estate, trust, or any other form of for-profit activity or any combination of the foregoing.

"Capital Structure Change" means any stock dividend, stock split, reverse stock split, or any other change in the number of outstanding RLI shares occasioned by any reorganization, merger, consolidation, split-up, combination or exchange, or any combination of the foregoing.

"Change in Control" means:

(a) any transfer, sale of substantially all of the shares or assets of RLI, any exchange, reorganization, merger, recapitalization or other capital adjustment, or any combination of the foregoing, incident to which the shareholders before any such event shall own after such event less than fifty-one percent (51%) of the issued and outstanding shares of the surviving corporation, or less than fifty-one percent (51%) of the capital or profits interest of any surviving Business Organization; or

(b) any transaction or series of transactions after which a majority of the board of directors of the surviving corporation or a majority of the voting members of the surviving Business Organization may be elected or appointed without the consent of the Executive or any combination of the foregoing.

"Deferred Compensation Direction" means an instrument executed by the Executive specifying

(a) the amount, expressed in either a fixed dollar amount or a percentage, of the Base Compensation which the Executive elects to defer; (b) the amount, expressed in either a fixed dollar amount or a percentage, of the MVP Bonus which the Executive elects to defer; and (c) any other information as RLI may periodically request.

"Disability" means the inability of the Executive, by reason of accident or mental or physical illness reasonably expected to be of indefinite duration, to continue to provide the services expressed in this Agreement as conclusively determined by RLI.

"Distribution Event" means (a) the death of the Executive, (b) the Disability of the Executive, (c) the termination of the Executive's employment with either RLI or an Affiliate, or (d) a Change in Control.

"ERISA" is defined under I. RECITALS: C. EXEMPTION FROM THE EXECUTIVE INCOME RETIREMENT SECURITY ACT.

"Execution Date" means the date upon which this Agreement is signed by the last Party to sign this Agreement.

"Executive" means the undersigned.

"Executive Resources Committee" means a committee of the members of the Board of Directors of RLI other than the Executive.

"MVP Bonus" is defined under I. RECITALS: B. MVP EXECUTIVE PLAN.

"MVP Plan" is defined under I. RECITALS: B. MVP EXECUTIVE PLAN.

"Parties" means RLI and the Executive.

"Person" means any individual, partnership, corporation, unincorporated organization, limited liability company, a government or any department or agency thereof, or any combination of the foregoing.

"Plan Benefit" means the sum of (a) such number of shares of RLI transferred to the Trustee pursuant to the Executive's Deferred Compensation Direction, equitably adjusted for any Capital Structure Change; (b) any uninvested dividends; and (c) any cash or cash equivalents.

"RLI" means RLI Corp.

"Securities Act" means any provision of Section 10(b) of the Securities Exchange Act of 1934, as periodically amended.

"Trust" is defined under I. RECITALS: C. EXEMPTION FROM THE EXECUTIVE INCOME RETIREMENT SECURITY ACT.

"Trustee" is defined under I. RECITALS: C. EXEMPTION FROM THE EXECUTIVE INCOME RETIREMENT SECURITY ACT.

"Unforeseeable Emergency" means severe financial hardship to the Executive resulting from a sudden illness or accident of the Executive or of a dependent of the Executive, loss of the Executive's property due to a casualty, or other similar extraordinary or unforeseeable circumstance arising as a result of events beyond the control of a participant.

[The balance of this page is intentionally left blank. The next page begins with Section III. EXECUTION:.]

III. EXECUTION

Dated at Peoria, Illinois as of the day and year noted above, on the Execution Date noted below.

RLI:	Executive:
RLI Corp.	_______________________________
By:___________________________	
Its:_____________________	Dated:_________________________
Dated:________________________	

DEFERRED COMPENSATION ELECTION

1998 BASE COMPENSATION: I elect to defer:

(a) ___% (or $________) of my Base Compensation attributable to the period beginning on the Execution Date and otherwise payable to me during 1998; and,

(b) ___% (or $________) of my MVP Bonus, if any, attributable to the period beginning on the Execution Date and otherwise payable to me during 1999.

(c) ___% of my MVP Bonus, if any, attributable to the period beginning on the Execution Date and otherwise payable to me during 1999, exceeding $______________, not to exceed $_______________.

Dated:_____________, 1998. ___________________________________

Executive

Received this ____ day of _________, 1998
RLI Corp.

By:__________________________________
Its:__________________________

MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW

RLI Corp. (the Company) is a holding company that underwrites selected property and casualty insurance through its major subsidiaries collectively known as RLI Insurance Group (the Group). The Group has accounted for approximately 84% of consolidated revenue over the last two years by providing property and casualty coverages primarily for commercial risks. As a niche insurer, the Group offers products targeted to the needs of those insureds generally overlooked by traditional insurance markets.

The property and casualty insurance business is cyclical and influenced by many factors, including price competition, economic conditions, natural disasters, interest rates, state regulations, court decisions, and changes in the law. One of the unique and challenging features of the property and casualty insurance business is that products must be priced before costs are fully known, because premiums are charged before claims are incurred.

Property insurance results are subject to the variability introduced by natural and man-made disasters such as earthquakes, fires and hurricanes. The Company's major catastrophe exposure is to losses caused by earthquakes, since over 61% of the Company's 1998 total property premiums were written in California. The Company limits its net aggregate exposure to a catastrophic event by purchasing reinsurance and through extensive use of computer-assisted modeling techniques. These techniques provide estimates of the concentration of risks exposed to catastrophic events. Utilizing this approach, the Company attempts to limit its net aggregate exposure to a single catastrophic event to less than 10% of total shareholders' equity.

The casualty portion of the Company's business consists largely of commercial and personal umbrella, general liability, and commercial auto coverages. In addition, the Group provides directors & officers liability, employers' indemnity, and in-home business owners coverage. The casualty book of business is subject to the risk of accurately estimating losses and related loss reserves since the ultimate settlement of a casualty claim may take several years to fully develop. The casualty line may also be affected by evolving legislation and court decisions that define the extent of coverage and the amount of compensation due for injuries or losses.

The surety segment of RLI specializes in writing small- and medium-sized commercial and contract surety products, as well as those for the energy, petrochemical and refining industries. The commercial surety products usually involve a statutory requirement for bonds. This industry has historically maintained a relatively low loss ratio. Losses may fluctuate, however, due to adverse economic conditions that may affect the financial viability of an insured.

The contract surety market guarantees the construction work of a commercial contractor for a specific project. As such, this line has historically produced marginally higher loss ratios than the commercial surety line. Generally, losses occur due to adverse economic conditions, inclement weather conditions, or the deterioration of a contractor's financial condition.

The consolidated financial statements and related notes found on pages 29-48, and the "Forward Looking Statements" on page 28, should be read in conjunction with the following discussion.

SIGNIFICANT DEVELOPMENTS

In January 1999, RLI Insurance Company acquired Underwriters Indemnity Holdings, Inc. (UIH), located in Houston, Texas. UIH specializes in the marketing and underwriting of surety products for oil, gas, mining and other energy-related exposures.

RLI paid $40.7 million in cash in exchange for all outstanding shares of UIH subject to post-closing contingencies. Included in the transaction are both of UIH's operating subsidiaries, Underwriters Indemnity Company of Texas and Planet Indemnity Company of Colorado. The transaction was financed through short-term borrowings and will be accounted for under the purchase method of accounting. In 1998, UIH wrote $16.4 million of gross written premiums, with $7.2 million in surety writings and $9.2 million of assumed and direct property business. The organization has a history

of profitable underwriting, witnessed by its 79.4 combined ratio in 1998 and three-year average combined ratio of 79.9. Prior to the closing, UIH wrote business in 34 states. Book value at December 31, 1998, is estimated at $16 million. Both of UIH's operating companies are rated "A-" (Excellent) by A.M. Best.

YEAR ENDED DECEMBER 31, 1998, COMPARED TO YEAR ENDED DECEMBER 31, 1997

Consolidated gross sales -- gross premiums written, net investment income and realized investment gains --totaled $316.9 million, a 3.4% increase from 1997.

Consolidated revenue for 1998 was $168.1 million, down 0.8% from the previous year. Revenue was relatively flat due to a decrease in net realized investment gains of 37.9% as well as a 2.5% decline in net investment income.

	Year Ended December 31,		
Gross sales (in thousands)	1998	1997	1996
Gross premiums written	$291,073	$278,843	$276,802
Net investment income	23,937	24,558	23,681
Realized investment gains	1,853	2,982	1,017
Total gross sales	$316,863	$306,383	$301,500

Net after-tax earnings for the Company were $28.2 million ($2.65 per diluted share) in 1998, compared to $30.2 million ($2.66 per share) in 1997.

Pretax earnings (in thousands)	1998	1997
Insurance Group	$ 16,789	$ 18,751
Net investment income	23,937	24,558
Net realized investment gains	1,853	2,982
Equity in investee earnings	1,337	951

In accordance with Financial Accounting Standards Board (FASB) Statement No. 130, the Company reports comprehensive earnings as prominently as GAAP earnings information. Comprehensive earnings include not only traditional net income, but other changes to equity. The material adjustment applicable to the Company's net earnings is the inclusion of net unrealized gains and losses, after tax.

Diluted earnings per share

	Net	Comprehensive
1994	(0.49)	(0.87)
1995	0.81	2.77
1996	2.28	3.62
1997	2.66	5.76
1998	2.65	4.87
Total	$7.91	$16.15

As this chart indicates, comprehensive earnings per share for the last five years exceeded reported net earnings by 104.2% on a diluted basis. After adding back dividends and stock repurchases, shareholders' equity reached an unprecedented level of nearly $315 million, up more than 18% from 1997.

RLI INSURANCE GROUP

Gross written premiums in 1998 were $291.1 million, compared to $278.8 million in 1997. This modest increase reflected the Company's firm commitment to sound underwriting practices during an ongoing period of difficult pricing and market conditions in certain lines. The Group's pretax underwriting earnings for 1998 were $16.8 million, a 10.5% decrease from the $18.8 million reported in 1997. This decline can be attributed to losses from Hurricane Georges of $1.1 million and reserve strengthening of $2.6 million on the surety line, both third quarter events.

The Company's property segment gross written premiums were lower in 1998, at $113.6 million, compared to $139.5 million in 1997. Non-recurring premiums associated with the acquisition of the Hawaii residential insurance business in March of 1997 accounted for $10.7 million of this decline. While fire premiums were flat, difference in conditions premiums were down 19.1% from 1997. This decrease can be attributed to rate reductions on these lines of business while the Company continues to focus on controlling its total exposure to catastrophe risks.

The property segment contributed the largest share of the Group's pretax profits, generating $19.8 million in 1998, compared to

$21.4 million in 1997. These results were reflected in the property segment GAAP combined ratio of 62.1 for 1998, compared to 65.5 in 1997. Despite the drop in the combined ratio, Group profits decreased slightly due to $1.1 million in Hurricane Georges losses as well as a decline in revenue associated with Hawaii residential insurance.

Casualty gross written premiums improved 31.0% from 1997, reaching $148.7

million in 1998. This overall increase was the result of gains in the following products: commercial umbrella - $19.3 million; transportation - $16.1 million; and general liability - $3.6 million. The GAAP combined ratio for the casualty segment was 103.2, compared to 104.6 in 1997. This resulted from premium increases in the more profitable lines. Despite the lower ratio in 1998, management believes that loss reserves for this segment will be adequate and the investment income derived from reserved funds will provide significant future earnings potential. This belief is supported by favorable total reserve development over the last three years, as reported in note 6 of the financial statements.

The surety segment continued a trend of solid growth as gross written premiums increased to $28.8 million, which was an 11.5% improvement over 1997. The segment's combined ratio of 103.9 included a charge of $2.6 million related to unfavorable loss development from one specific contract surety producer. This particular book of business constituted only 8% of the total surety book. Excluding this adjustment, the combined ratio for the year would have fallen to 89.7, compared to 95.4 in 1997. Contri-buting to this decline was an improved expense ratio, which dropped to 67.7 in 1998, from 73.8 a year ago. Increased premium volumes paid back earlier infrastructure investments.

INVESTMENT INCOME

Net dividend and interest income decreased by 2.5% during 1998. Despite the growth in invested assets during the year, a focus on investing new cash flow in tax-exempt securities, as well as the general downturn in interest rates, caused the decline. On an after-tax basis, investment income actually increased slightly (0.3%). The Company realized $1.9 million in capital gains in 1998, compared to $3.0 million in 1997. Operating cash flows were $23.6 million in 1998. All cash flows in excess of current needs were used to fund the stock repurchase program and purchase both fixed income and equity securities. Fixed-income purchases continue to be comprised of high-grade, tax-exempt, U.S. government and agency and convertible debenture securities. Equity purchases remain consistent with the long-term strategy of investing in large-cap, value investments with attractive dividend yields.

<TABLE>
<CAPTION>

<S>	<C>	<C>	<C>
Pretax yield	1998	1997	1996
Taxable (on book value)	6.58%	6.91%	6.87%
Tax-exempt (on book value)	4.95%	5.00%	4.97%
Equities (on market value)	2.49%	2.96%	3.38%
After-tax yield	1998	1997	1996
Taxable (on book value)	4.27%	4.49%	4.47%
Tax-exempt (on book value)	4.69%	4.74%	4.71%
Equities (on market value)	2.14%	2.54%	2.90%

</TABLE>

Overall yields continued to decline during 1998, reflecting the general trend in the fixed income markets. At year end, the yields on the tax-exempt side were relatively unchanged from last year, while taxable yields fell rather significantly. As a result, the after-tax spread between these securities has widened, making the tax-exempt selections increasingly more attractive. Given the Company's tax position, the majority of fixed income purchases were made in this sector.

The Company's investment results for the last five years are shown in the following table:

<TABLE>
<CAPTION>

(in thousands)

Year	Average Invested Assets(1)	Investment Income(2)(3)	Realized Gains (Losses)(3)	Change in Unrealized Appreciation/ Depreciation (3)(4)	Annualized Return on Average Invested Assets	Tax Equivalent Annualized Return on Average Invested Assets
<S>	<C>	<C>	<C>	<C>	<C>	<C>
1994	407,722	20,133	(3,595)	(5,749)	2.7%	3.6%
1995	442,717	22,029	457	36,037	13.2%	14.1%
1996	504,773	23,681	1,017	25,033	9.9%	10.7%
1997	570,901	24,558	2,982	55,760	14.6%	15.5%
1998	640,576	23,937	1,853	36,183	9.7%	10.6%
5-yr. avg.	$513,338	22,868	543	29,453	10.3%	11.2%

</TABLE>

(1) Average of amounts at beginning and end of year.
(2) Investment income, net of investment expenses, including non-debt interest expense.
(3) Before income taxes.
(4) Relates to available-for-sale fixed maturity and equity securities.

The annualized return for 1998 was again enhanced by the strong performance of the equity portfolio, which generated pretax unrealized appreciation of $36.3 million.

INTEREST AND GENERAL CORPORATE EXPENSE

Interest expense on debt was $2.3 million in 1998, up from $1.5 million in 1997. This increase was largely the result of the Company's increased use of short-term borrowings to finance the stock repurchase program. General corporate expenses decreased 6.2% in 1998 as a result of lower executive compensation costs relating to the MVP program.

INCOME TAXES

The Company's effective tax rates for 1998 and 1997 were 25.1% and 27.3%, respectively. Effective rates are dependent upon components of pretax earnings and the related tax effects. The Company's pretax earnings included $10.5 million of investment income in 1998 that is wholly or partially exempt from federal income tax, compared to $9.1 million in 1997.

INVESTEE EARNINGS

The Company maintains a 44% interest in the earnings of Maui Jim, Inc., primarily a manufacturer of high-quality polarized sunglasses. In 1998, the Company recorded $1.3 million in earnings compared to $951,000 in 1997. Sales for Maui Jim grew 50% in 1998 on the strength of increased sunglass marketing efforts in several international territories. Profit margins also improved in 1998 as the cost of goods sold was favorably impacted by the dollar's performance against the yen.

MARKET RISK DISCLOSURE

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

1. Continually monitoring the fair market value of all financial assets;
2. Changing the character of future investment purchases as needed, and;
3. Maintaining a balance between its existing asset and liability portfolios.

The Company's primary risk exposures are to changes in interest rates and equity prices, as it had no derivative or foreign exchange risk as of December 31, 1998.

INTEREST RATE RISK

The Company's primary exposure to interest rate risk is with its fixed income investment portfolio, but on a smaller scale, it also incurs similar risk with its short-term debt instruments.

Modified duration analysis is used to measure the sensitivity of the fixed income portfolio to changes in interest rates, providing a measure of price percentage volatility. The Company attempts to minimize interest rate risk by matching the duration of its assets to that of its liabilities. The Company limits the impact of changes in interest rates on its financial statements by designating a majority of the fixed income holdings as held-to-maturity. This designation is chosen for the securities for which the Company has the intent and ability to hold to stated maturity. These securities are carried at amortized cost and, except for declines that are other than temporary, changes in fair market value are not reflected on the financial statements. As of December 31, 1998, the Company had classified 86% of its fixed income portfolio as held-to-maturity.

The balance of the Company's fixed income portfolio is classified in a manner that affects its financial statements. As of December 31, 1998, 14% of the Company's fixed income portfolio was classified as either available-for-sale or trading (see note 2).

Interest rate risk could also impact the Company's income statement due to its impact on interest expense. The Company's debt obligations are short term in nature, with no long-term debt outstanding as of December 31, 1998. As a result, the Company assumes interest rate risk in its ability to refinance these short-term debt obligations. Any rise in interest rates will cause interest expense to increase, assuming debt is maintained at current levels.

EQUITY PRICE RISK

Equity price risk is the potential that the Company will incur economic loss due to a decline of common stock prices. Beta analysis is used to measure the sensitivity of the Company's equity portfolio to changes in the value of the S&P 500 index (an index representative of the broad equity market). As measured from December 31, 1981 to December 31, 1998, the Company's equity portfolio has a beta of approximately 0.70 in comparison to the S&P 500. This low beta statistic reflects the Company's long-term emphasis on maintaining a conservative, value-oriented, dividend-driven investment philosophy for its equity portfolio. Historically, dividend-paying common stocks have demonstrated superior down-market performance characteristics.

Additional risk management techniques include:

1. Restricting individual security weightings to less than 3% of the equity portfolio's market value, and;
2. Reducing exposure to sector risk by limiting the market value to be invested in any one industry sector to 25% of the equity portfolio.

Equity securities are classified as available-for-sale, with unrealized gains and losses excluded from net earnings, but recorded as a component of comprehensive earnings and shareholders' equity, net of deferred income taxes.

SENSITIVITY ANALYSIS

The tables at right detail information on the market risk exposure for the Company's financial instruments as of December 31, 1998. Listed on each table is year-end market value for the Company's assets and the expected reduction in market value, given the stated hypothetical events. This sensitivity analysis assumes that the composition of the Company's assets remains constant over the period being measured and that interest rate changes are reflected uniformly across the yield curve. The analysis does not consider any action the Company would undertake in response to changes in market conditions. For purposes of this disclosure, securities are divided into two categories: those held for trading purposes and those held for non-trading purposes. The examples given are not predictions of future market events, but rather illustrations of the impact such events may have on the market value of the Company's investment portfolio.

As of December 31, 1998, the Company's fixed income portfolio had a market value of $339.4 million. This sensitivity analysis uses scenarios of interest rates increasing 100 and 200 basis points from their December 31, 1998 levels, with all other variables held constant. Such scenarios would result in decreases in the market value of the fixed income portfolio of $12.8 million and $24.7 million, respectively. Due to the Company's use of the held-to-maturity designation for a majority of the fixed income portfolio, the balance sheet impact of these scenarios would be much lower. The income statement would only be affected by holdings designated as trading.

As of December 31, 1998, the Company's equity portfolio had a market value of $296.5 million. This base sensitivity analysis uses market scenarios of the S&P 500 index declining 10 percent and 20 percent. These scenarios would result in approximate decreases in the market value of the equity portfolio of $20.2 million and $40.3 million, respectively. As the Company designates all common stocks as available-for-sale, these market value declines would impact the Company's balance sheet.

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

<TABLE>
<CAPTION>

Table 1 (in thousands)
Effect of a 100 basis point increase in interest rates and a 10% decline in the S&P 500:

<S>	12/31/98 Market Value <C>	Interest Rate Risk <C>	Equity Risk <C>
Held for trading purposes			
Fixed maturity securities	$ 8,348	$ (241)	-
Total trading	8,348	(241)	-
Held for non-trading purposes			
Fixed income securities	331,060	(12,518)	-
Equity securities	296,521	-	(20,163)
Total non-trading	627,581	(12,518)	(20,163)
Total trading & non-trading	$635,929	$(12,759)	($20,163)

</TABLE>

<TABLE>
<CAPTION>

Table 2 (in thousands)
Effect of a 200 basis point increase in interest rates and a 20% decline in the S&P 500:

<S>	12/31/98 Market Value <C>	Interest Rate Risk <C>	Equity Risk <C>
Held for trading purposes			
Fixed maturity securities	$ 8,348	$ (455)	-
Total trading	8,348	(455)	-
Held for non-trading purposes			
Fixed maturity securities	331,060	(24,280)	-
Equity securities	296,521	-	(40,327)
Total non-trading	627,581	(24,280)	(40,327)

Total trading & non-trading	$635,929	(24,735)	(40,327)

</TABLE>

<TABLE>
<CAPTION>

Table 3 (in thousands)
Effect of a 100 basis point decrease in interest rates and a 10% increase in the S&P 500:

	12/31/98 Market Value	Interest Rate Risk	Equity Risk
<S>	<C>	<C>	<C>
Held for trading purposes			
Fixed maturity securities	$ 8,348	$224	-
Total trading	8,348	224	-
Held for non-trading purposes			
Fixed maturity securities	331,060	10,148	-
Equity securities	296,521	-	20,163
Total non-trading	627,581	10,148	20,163
Total trading & non-trading	$635,929	10,372	20,163

</TABLE>

<TABLE>
<CAPTION>

Table 4 (in thousands)
Effect of a 200 basis point decrease in interest rates and a 20% increase in the S&P 500:

	12/31/98 Market Value	Interest Rate Risk	Equity Risk
<S>	<C>	<C>	<C>
Held for trading purposes			
Fixed maturity securities	$ 8,348	$ 473	-
Total trading	8,348	473	-
Held for non-trading purposes			
Fixed maturity securities	331,060	21,644	-
Equity securities	296,521	-	40,327
Total non-trading	627,581	21,644	40,327
Total trading & non-trading	$635,929	$22,117	$40,327

</TABLE>

The income statement will also be impacted by interest expense. As of December 31, 1998, the Company had $39.6 million in short-term debt obligations. Assuming this debt level remains constant, a hypothetical 100 basis point increase in interest rates would increase the Company's annual pretax interest expense by $0.4 million and a 200 basis point increase would increase annual pretax interest expense by $0.8 million. Conversely, falling interest rates would result in equivalent reductions in interest expense. These numbers are not included in the previous tables.

OUTLOOK FOR 1999

In 1999, the Company will continue to pursue profitable opportunities for top-line growth. There is an ongoing process of evaluating various avenues for growth such as the acquisition of underwriting talent in certain product lines, strategic alliances with producers on existing products, or through acquisition. The implementation of the combined casualty reinsurance program is expected to bolster investment earnings as well as improve underwriting results over time. The materiality or viability of future new ventures or products is not known at this time. Specific details regarding events in the Group's various business segments follow.

PROPERTY

The Company expects further softening of earthquake rates during 1999. Exposure will remain constant while reduced reinsurance costs will serve to mitigate the bottom-line impact of lost premiums.

The Company's fire book of business posted improved results in the final two quarters of 1998, which management believes to reflect the effect of new leadership established in that line last year.

CASUALTY

Several initiatives launched in 1997 began to generate substantial revenue in 1998. Offices for writing commercial casualty business in Dallas, Los Angeles, New York, Atlanta and San Francisco led the growth.

Management is confident that these initiatives involving product lines such as commercial umbrella, general liability, executive products, and commercial auto, will produce satisfactory growth results into the near future.

Profitability has improved as the product mix has shifted more heavily toward the lines with lower combined ratios. The Company's assiduous attention towards underwriting profit will continue and be supported by the recently implemented combined casualty treaty.

SURETY
Gross written premiums are expected to continue to increase, primarily due to the acquisition of Underwriters Indemnity, a producer of surety bonds for the energy, petrochemical and refining industries. The transaction is also expected to create cross-selling opportunities for existing RLI products. Increased revenues should continue to drive down the expense ratio during 1999.

CAPITAL MANAGEMENT
In July 1997, the Company implemented a 1.8 million share common stock repurchase program. In 1998, the Company repurchased 390,464 shares at a total cost of $15.5 million. Including 1997, 1,349,402 shares were purchased at a total cost of $48.2 million. Adjusting for the June 1998 5-for-4 stock split, over 650,000 shares remain authorized for repurchase at year-end 1998. It is anticipated that the program will continue as market conditions and the Company's capital requirements warrant.

The repurchase program has been funded by the use of the Company's line of credit facility, reverse repurchase agreements, and operating cash flow. It is anticipated that future repurchases will be funded in a similar fashion. Depending upon the Company's capital needs and prevailing market conditions, the Company may issue a longer-term debt instrument, and repay the outstanding short-term debt.

In the fourth quarter of 1998, RLI declared a cash dividend to be paid in January 1999 of $0.13 per share, representing the 90th consecutive dividend payment for the Company. Since the inception of cash dividends in 1976, the Company has increased the annual dividend every year. In its annual "Handbook of Dividend Achievers," Moody's ranks RLI 177th in dividend growth out of 10,000 U.S. public companies over the last decade. No changes in the Company's dividend policy is anticipated in 1999.

YEAR ENDED DECEMBER 31, 1997, COMPARED TO YEAR ENDED DECEMBER 31, 1996

Consolidated gross sales -- gross premiums written, net investment income and realized investment gains--totaled $306.4 million, a 1.6% increase from 1996. Consolidated revenue for 1997 was $169.4 million, up 9.1% from the previous year. The increase in revenue was attributable in part to increased realized investment gains of nearly $3.0 million, compared to $1.0 million in 1996. Also, an 8.6% increase in net earned premiums reflected the addition of the Hawaii residential insurance program at a higher net retention than many of the Company's other lines.

<TABLE>
<CAPTION>

<S>	Year Ended December 31, <C>	<C>
Gross sales (in thousands)	1997	1996
Gross premiums written	$278,843	$276,802
Net investment income	24,558	23,681
Realized investment gains	2,982	1,017
Total gross sales	$306,383	$301,500

</TABLE>

Net after-tax earnings for the Company were a record $30.2 million ($2.66 per diluted share) in 1997, compared to $25.7 million ($2.28 per share) in 1996.

<TABLE>
<CAPTION>

<S>	<C>	<C>
Pretax earnings (in thousands)	1997	1996
Insurance Group	$18,751	$16,397
Net investment income	24,558	23,681
Net realized investment gains	2,982	1,017
Equity in investee earnings	951	231

</TABLE>

RLI INSURANCE GROUP
Gross written premiums in 1997 were $278.8 million, compared to $276.8 million in 1996. This modest increase reflected the Company's firm commitment to sound underwriting practices during this period of unusually arduous pricing and market conditions. The Group's pretax underwriting earnings for 1997 were $18.8 million, a 14.6% increase over the $16.4 million reported in 1996 as a result of this focus on underwriting profit.

The Company's property segment gross written premiums were basically flat in 1997 at $139.5 million, compared to $138.1 million in 1996. There were, however, significant changes in the product mix of this segment. While existing product gross premiums were down due to rate reductions and increased competitor capacity, the reductions in net written premiums were mitigated through better use of reinsurance. Fire and difference in conditions gross written premiums were down 16% and 12% respectively from 1996, compared to declines in net written premiums of only 3% and 7%. Meanwhile, the Group bolstered its overall premium production in this segment with the addition of the Hawaii residential insurance program. Including the assumption of $10.7 million of unearned premium upon acquisition, gross and net premiums written for this program were $19.5 million and $19.1 million, respectively, for the year ended 1997.

The property segment contributed the largest share of the Group's pretax profits, increasing to $21.4 million in 1997, compared to $18.8 million in 1996. These results were reflected in the property segment GAAP combined ratio of 65.5 for 1997. The combined ratio increase from 60.9 in 1996 reflected the incremental acquisition costs associated with the assumption of Hawaii homeowner in-force business from the Hawaii Property Insurance Association. Such costs were not associated with the continued production of these premiums in 1998. These increased expenses were offset by a lower property segment loss ratio of 19.2 in 1997, compared to 22.4 in the previous year.

Casualty gross written premiums declined 10.7% from 1996, to $113.5 million in 1997. Much of this decline was due to discontinuing certain production source relationships in the general liability area as a result of prolonged declines in profitability. Despite premium declines, the casualty segment GAAP combined ratio was 104.6 for 1997. While lower premiums have negatively influenced the expense ratio component of this indicator, the loss ratio for 1997 was 68.5, compared to 72.1 in 1996. Even at this level, management believes that loss reserves for this segment will be adequate and that the investment income derived from these reserved funds will provide significant future earnings potential. Such optimism was warranted by the favorable total reserve development in 1997 on prior accident years' reserves, as indicated in note 6 of the financial statements.

The surety segment provided the most notable premium growth among existing products, increasing to $25.8 million, a 123% increase over the $11.6 million for the prior year. Much of this growth was achieved specifically through the increased writing of contract bonds, which added $12.5 million of additional premium in 1997. The surety segment profit picture also improved dramatically as pretax underwriting profits came in at $0.5 million, compared to an underwriting loss of $0.4 million in 1996. This was largely the result of the anticipated payoff in premium writings from production investments made over the last several years. The combined ratio for this segment fell to 95.4 in 1997 from 109.2 in 1996, mostly from the expense ratio improvement of 8.8 points.

INVESTMENT INCOME

Net dividend and interest income increased 3.7% during 1997 due to growth in invested assets. The Company realized $3.0 million in capital gains in 1997, compared to $1.0 million in 1996. Operating cash flows were $35.0 million in 1997, compared to $48.9 million in 1996. All cash flows in excess of current needs were used to fund our common stock repurchase program, purchase equity securities, and acquire fixed-income instruments composed of high grade, tax-exempt, U.S. government and agency and convertible debenture securities.

Yields for 1997 rose during the first half of the year and remained fairly stable throughout the third quarter. A significant bond price rally during the fourth quarter brought yields in the Treasury market close to their historic lows. Tax-exempt yields were up slightly as the Company extended its portfolio duration to gain additional yield and minimize the effect of declining interest rates. The taxable segment of the portfolio remained fairly stable during the year with the overall yield unchanged.

INTEREST AND GENERAL CORPORATE EXPENSE

Interest expense on debt was $1.5 million in 1997, down 44.9% from $2.8 million in 1996. This decline was the direct result of the Company's call for redemption and subsequent conversion of all of its outstanding convertible debentures during July 1997. General corporate expenses increased 27.3% in 1997, as a result of accrued executive bonuses relating to the MVP program and recognition of the expense of issuing directors' stock options.

INCOME TAXES

The Company's effective tax rates for 1997 and 1996 were 27.3% and 27.1%, respectively. Effective rates are dependent upon components of pretax earnings and the related tax effects. The Company's pretax earnings included $9.1 million of investment income in 1997 that was wholly or partially exempt from federal income tax, compared to $8.0 million in 1996.

ACCOUNTING STANDARDS

In June 1997, the FASB issued Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information" (Statement 131). Statement 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements according to a management approach. The Company has adopted Statement 131 and applied the criteria for segment identification and follows the requirements of the pronouncement in the MD&A as well as note 11 to the financial statements.

In February 1998, the FASB issued Statement No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" (Statement 132). Statement 132 revises employers' disclosures about pension and other post-retirement benefit plans. It does not change the measurement or recognition of those plans. Statement 132 standardizes the disclosure requirements for pensions and other postretire-ment benefits to the extent practicable, requires additional information on changes in the benefit

obligations and fair values of plan assets that will facilitate financial analysis, and eliminates certain other disclosures that are no longer useful. This Statement was adopted in 1998.

In June 1998, the FASB issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (Statement 133). Statement 133 addresses the accounting for and disclosure of derivative instruments. This Statement standardizes the accounting for derivative instruments by requiring that an entity recognize those items as assets or liabilities in the statement of financial position and measure them at fair value. This Statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999.

LEGISLATION

STATE REGULATION

As an insurance holding company, RLI Corp. and its insurance subsidiaries are subject to regulation by the states in which they are domiciled or transact business. Holding company registration in each insurer's state of domicile requires reporting to the state regulatory authority the financial, operations and management data of the insurers within the holding company system. All transactions within a holding company system affecting insurers must be fair, and the insurer's policyholder surplus following any transaction must be both reasonable in relation to its outstanding liabilities and adequate for its needs. Notice to regulators is required prior to the consummation of certain transactions affecting insurance subsidiaries of the holding company system.

Other regulations limit the amount of dividends and other distributions the subsidiaries can pay without prior approval of the insurance department in the states in which they are physically and/or commercially domiciled, and impose restrictions on the amount and type of investments they may have. Regulations designed to ensure financial solvency of insurers and to require fair and adequate treatment and service for policyholders are enforced by filing, reporting and examination requirements. Market oversight is conducted by monitoring trade practices, approving policy rates and forms, licensing of agents and brokers, and requiring fair and equitable premiums and commission rates. Financial solvency is monitored by minimum reserve and capital requirements, periodic reporting procedures (annually, quarterly, or more frequently if necessary), and periodic examinations.

The quarterly and annual financial reports to the states utilize accounting principles which are different than the generally accepted accounting principles that show the business as a going concern. The statutory accounting principles used by regulators, in keeping with the intent to assure policyholder protection, are generally based on a liquidation concept. The National Association of Insurance Commissioners (NAIC) has recently developed a codified version of these statutory accounting principles, and its deployment in the states in the near future will foster more consistency among the states for accounting guidelines and reporting.

State regulatory authorities have relatively broad discretion with respect to granting, renewing and revoking brokers' and agents' licenses to transact business in the state. The manner of operating in particular states may vary according to the licensing requirements of the particular state, which may, among other things, require a firm to operate in the state through a corporation. In a few states, licenses are issued only to individual residents and locally-owned business entities. In such cases, the Company has arrangements with residents or business entities licensed to act in the state.

COMMERCIAL LINES DEREGULATION -- The NAIC and several state legislatures have taken up the issue of commercial lines deregulation in an attempt to streamline specific areas of insurance regulation. A growing contingent in the regulatory community has acknowledged that some regulatory procedures and practices may be cumbersome and inappropriate for commercial buyers of insurance. Specifically, the large, sophisticated, multi-state or multi-national businesses that employ their own teams of risk managers to evaluate, reduce and finance their loss exposures are less likely to need the form and rate protections that regulators provide consumers and small- to medium-sized businesses. And while these large businesses may receive some benefit from the state financial regulation of licensed insurers, it has long been acknowledged that they do not need the protections addressed by the barriers to the surplus lines market and other nontraditional markets. Indisputably, deregulation of the licensed market will have an impact on the surplus lines insurance carriers, which have been free from form and rate requirements.

USE OF CREDIT REPORTS IN UNDERWRITING -- Gains in access to electronic commerce, and the means to gather information more rapidly, have spurred regulators to take a second look at the use of consumer credit reports in underwriting and rate making. In some states, regulators charged with protecting insurance consumers from unfair trade practices are concerned that some consumers' risks may be underwritten based solely on their credit standing, and have sought to strengthen their laws and regulations to address this. This trend comes on the heels of Congress' retooling of the Fair Credit Reporting Act in 1997, which specifically addresses this issue, and permits the use of consumer credit reports in underwriting. The issue of federal preemption of state action in this arena has not been judicially addressed.

FEDERAL LEGISLATION

Although the federal government generally does not directly regulate the insurance business, federal initiatives often have an impact on the business in a variety of ways. Current and proposed federal measures that may significantly affect the insurance business include federal preemption of state auto liability laws, tax reform measures, and Y2K legislation. The Company is also monitoring the following federal proposals:

NATURAL DISASTER ACT -- Recent natural disasters, including Hurricane Georges, continue to fuel concern regarding the best way to provide affordable insurance coverage for such events. Congress has yet to pass legislation, but proposals to set up a system for excess federal reinsurance to provide relief to the industry continue to be discussed. Two initiatives, "The Natural Disaster Protection and Insurance Act of 1997" (H.R. 230), and "The Homeowners Insurance Availability Act of 1997" (H.R. 219), have been the primary tools for discussion and debate. The Company will continue to monitor the progress of this issue.

FINANCIAL SERVICES MODERNIZATION -- Both judicial decisions and action by the Office of the Comptroller of the Currency (OCC) have combined to grant national banks more authority to enter non-banking business, including insurance. The Barnett Bank decision, which permits the Comptroller of the Currency to preempt any state law that "significantly interferes" with a bank's ability to sell insurance products, has spawned the "Financial Services Competition Act of 1997" (H.R. 10, also known as "Financial Services Modernization Legislation"). This Act, designed to shrink the powers of the OCC, has been the subject of various revisions that would result in both positive and negative effects on the insurance industry. The Act also contains a provision that would create a National Association of Registered Agents and Brokers, which would permit insurance producers to obtain a national license rather than a number of state licenses. This legislation could have an important impact on many aspects of the insurance industry; the Company continues to monitor its progress.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the primary sources of the Company's liquidity have been funds generated from insurance premiums (operating activities) and investment income and maturing investments (investment activities). In addition, the Company has occasionally received funds from financing activities, such as short-term borrowings, the sale of Company treasury stock to its Employee Stock Ownership Plan, and the issuance of common stock or convertible debentures.

The Company maintains a $30.0 million secured revolving line of credit with one financial institution. The facility has a three-year term. At December 31, 1998, the Company had $19.6 million in outstanding debt from this facility. Additionally, the Company was party to two reverse repurchase transactions totaling $20.0 million. All funds were used to repurchase RLI stock. Management believes that cash generated from operations, investments, and cash available from financing activities will provide sufficient liquidity to meet the Company's anticipated needs over the next 12 to 24 months.

In 1996, the Company entered into an innovative catastrophe reinsurance and loss financing program with Centre Reinsurance (Centre Re). The program, called Catastrophe Equity Puts (CatEPuts-SM-), augments the Company's traditional reinsurance by integrating its loss financing needs with a pre-negotiated sale of securities linked to exchange-traded shares. For a more detailed description of CatEPuts, see note 5.

During 1998, the Company generated net operating cash flow of $23.6 million. Financing activities included the borrowing of $9.6 million from the line of credit and an additional $5.1

million from reverse repurchase agreements. All borrowings, as well as a portion of operational cash flow, were utilized to repurchase shares of the Company's stock. During 1998, 390,464 shares were repurchased at a total cost of $15.5 million. The remainder of excess operating cash flow was added to the Company's investment portfolio.

The Company's fixed income portfolio continues to be biased toward U.S.

government and agency securities due to their high liquidity and almost risk-free nature. As part of its investment strategy, the Company attempts to avoid exposure to default risk by holding, almost exclusively, securities ranked in the top two grades of investment quality by Standard & Poor's and Moody's (i.e., AAA or AA). Virtually all of the Company's fixed income portfolio consists of securities rated A or better, with 96% rated AA or better. Most of the Company's fixed-income portfolio is noncallable. Those securities containing call features have been factored into the overall duration objectives of the portfolio and will not affect efforts to match assets with anticipated liabilities.

The Company follows a program of matching assets to anticipated liabilities to ensure its ability to hold securities until maturity. Anticipated liabilities are factored against ultimate payout patterns and the resulting payout streams are funded with the purchase of fixed-income securities of like maturity. Management believes that both liquidity and interest rate risk can best be minimized by such asset/liability matching.

The Company intends to hold approximately 86% of the securities in its fixed income port-folio until their contractual maturity. These securities are classified as held-to-maturity and are carried at amortized cost. Smaller portions of the fixed income portfolio are classified as available-for-sale (11%) or trading (3%) and are carried at fair market value. As of December 31, 1998, the Company maintained $44.9 million in fixed income securities within the available-for-sale and trading classifications. Although it is likely that the majority of these securities will be held by the Company to maturity, they provide an additional source of liquidity and can be used to address potential future changes in the Company's asset/liability structure.

The Company's equity portfolio increased by $45.1 million during 1998, to $296.5 million. The Company had net purchases during the year of $8.6 million of common stock, with a pretax portfolio appreciation of $36.0 million. Capital gains of $1.2 million on this portfolio were realized during the year. The securities within the equity portfolio remain invested in large-cap issues with strong dividend performance. The strategy remains one of value investing, with security selection taking precedence over market timing. A buy-and-hold strategy is used, minimizing the impact of both transactional costs and taxes.

The National Association of Insurance Commissioners (NAIC) continues its work on developing a model investment law. This law would regulate insurance Company investments. The Company's current investment portfolio appears to be in compliance with the proposed model investment law. Management does not feel the proposed model law will affect its current strategies.

OTHER MATTERS

The Year 2000 (Y2K) issue is a result of computerized systems, including both hardware and software systems, using a two-digit format, as opposed to four digits, to indicate the year in date fields. Such computer systems may be unable to interpret dates beyond the year 1999, which could cause a system failure or other computer errors, leading to disruptions in operations.

In 1997, the Company began work on a five-phase program for Y2K compliance. Phase I was to identify those primary and mission-critical business systems, those essential to continuing operations, which presented Y2K issues. This phase was a four-month process beginning in August 1997. Phase II was to form a committee by business unit to identify all secondary and general infrastructure issues which would need

to be addressed for Y2K compliance. This phase began in December 1997 and was completed in April 1998, with the evaluation and initial identification of secondary Y2K exposures which needed attention. Phase III was the modification and testing of mission-critical systems identified in Phase I. Phase III included changes to the Company's property and casualty systems, accounts receivable, custom business processing, general ledger, accounts payable, external business interfaces, digital image processing and accounting interface systems. The status of Phase III completion is discussed below. Phase IV, which began in May 1998, included the development of plans to address secondary infrastructure issues, line of business strategies to address exposures associated with the Company's insurance products and a process to survey key vendors and business partners. This phase is scheduled to be completed within the first quarter of 1999. Phase V is designed to refine operational and contingency plans for Y2K cut-over. This phase is scheduled to begin in the first quarter of 1999 and carry through the first quarter of the year 2000. Items carried through the first quarter of the year 2000 are considered non-critical and incidental to the Company's operations.

The Company has identified three major areas as critical for successful Y2K compliance: (1) accounting and premium processing systems, (2) terms and conditions of existing insurance contracts, and (3) third-party relationships. Y2K compliance and progress is regularly reviewed by the Company's MIS steering committee, audit committee and the board of directors.

In accordance with Phase I of the program, the Company completed an internal review of all primary and mission-critical systems and contacted related software suppliers to determine major areas of exposure by December 1997. As an element of Phase III, in November 1998 the Company successfully completed the modification, testing and implementation of Y2K-compliant core property and casualty systems, accounts receivable, custom business processing, general ledger, accounts payable and accounting interfaces. The Company's new reinsurance system, implemented in early 1998, was already identified as Y2K compliant. Business transactions are presently being processed and premiums are being earned on in-force policies with Y2K expiration dates. Digital image processing upgrades were completed in January 1999. External business interfaces have been addressed within core systems efforts but may require additional modification for any subsequent changes implemented by external parties. These activities concluded Phase III efforts.

As a component of Phase IV, the Company completed the development of strategies by line of business, which it feels will effectively manage Y2K related exposures and coverages. This exposure is divided into two distinct areas: business partners and insurance coverage issues for our policyholders/customers.

In August 1998, all significant vendors and business partners were surveyed for compliance efforts and responses are being evaluated by the Company's internal audit and compliance unit for further steps and action, prior to the end of the first quarter of 1999. Of the responses received from vendors and business partners, a significant number state that they are Y2K compliant or intend to be Y2K compliant by December 31, 1999. The Company will continue to make efforts to ensure its business partners and vendors are Y2K compliant; however, the ultimate state of compliance of these providers is beyond the Company's control and could impact the Company's operations and financial results in future periods.

The types of insurance that may be the subject of claims arising from Y2K losses include property, directors & officers liability, miscellaneous professional liability, and other casualty coverages. Although uncertainty exists with respect to the nature and intent of Y2K liability, it is anticipated that if Y2K claims are received, the majority will stem from directors & officers and miscellaneous professional liability policies, in terms of both frequency and severity. The Company has formulated a Y2K questionnaire to be completed at the time of initial policy application and renewal. Each application is individually underwritten, and responses on the Y2K questionnaire are a component of the underwriter's determination whether to offer coverage and, if so, to what extent. A Y2K exclusion is available for underwriters' use if needed. Additionally, a Y2K team of underwriters and claims personnel has been assembled to prepare for the proper handling of Y2K claims. All claims will be handled on an individual basis in accordance with policy terms and conditions.

As an element of Phase V, the Company has system-contingency services contracted through a major third-party provider and is presently refining support related to potential Y2K issues.

In addition, the Company plans to develop a Y2K operational support plan for the millennium weekend, including on-site staff and on-call support, by the third quarter of 1999. Exposure and risk management of new or developing Y2K exposures will continue through the first quarter of 2000.

The Company has incurred $1.2 million in expenses over the last two years to complete the core system modifications for Y2K. It required over 26,000 hours of technical staff effort and changes to systems representing 12.5 million lines of program code. It is estimated that the Company will incur an additional $300,000 of expense in 1999 to upgrade telephone systems, corporate e-mail solutions, and to ensure the necessary services are in place for contingency efforts.

FORWARD LOOKING STATEMENTS

Forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 appear throughout this report. These statements relate to the Company's expectations, hopes, beliefs, intentions, goals or strategies regarding the future and are based on certain underlying assumptions by the Company. Such assumptions are, in turn, based on information available and internal estimates and analyses of general economic conditions, competitive factors, conditions specific to the property and casualty insurance industry, claims development and the impact thereof on the Company's loss reserves, the adequacy of the Company's reinsurance programs, developments in the securities market and the impact on the Company's investment portfolio, regulatory changes and conditions, and other factors. Actual results could differ materially from those in forward-looking statements. The Company assumes no obligation to update any such statements. You should review the various risks, uncertainties and other factors listed from time to time in the Company's Securities and Exchange Commission filings.

<TABLE>
<CAPTION>

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, 1998	1997
<S>	<C>	<C>
Assets		
Investments:		
Fixed maturities:		
Held-to-maturity, at amortized cost (fair value--$294,544 in 1998 and $296,808 in 1997)	$283,992	$290,034
Trading, at fair value (amortized cost-- $8,157 in 1998 and $9,419 in 1997)	8,348	9,546
Available-for-sale, at fair value (amortized cost-- $36,185 in 1998 and $33,642 in 1997)	36,516	34,120
Equity securities available-for-sale, at fair value (cost-- $127,367 in 1998 and $118,637 in 1997)	296,521	251,460
Short-term investments, at cost which approximates fair value	51,917	18,697
Total investments	677,294	603,857
Cash	--	--
Accrued investment income	6,457	6,348
Premiums and reinsurance balances receivable, net of allowances for insolvent reinsurers of $6,669 in 1998 and $10,728 in 1997	46,667	36,718
Ceded unearned premiums	59,780	49,677
Reinsurance balances recoverable on unpaid losses and settlement expenses, net of allowances for insolvent reinsurers of $3,096 in 1998 and $5,998 in 1997	168,261	155,711
Deferred policy acquisition costs, net	22,510	21,985
Property and equipment, at cost, net of accumulated depreciation of $20,954 in 1998 and $20,735 in 1997	12,200	12,388
Investment in unconsolidated investee	13,457	13,615
Other assets	6,059	11,442
Total assets	$1,012,685	$911,741
Liabilities and shareholders' equity		
Liabilities:		
Unpaid losses and settlement expenses	$415,523	$404,263
Unearned premiums	142,023	128,543
Reinsurance balances payable	32,161	24,390
Income taxes-- current	2,124	2,702
Income taxes-- deferred	48,421	36,340
Notes payable, short-term	39,644	24,901
Other liabilities	38,830	24,050
Total liabilities	718,726	645,189
Shareholders' equity:		
Common stock ($1 par value, authorized 50,000,000 shares, issued 12,790,428 shares in 1998 and 10,229,673 shares in 1997)	12,790	10,230
Paid-in capital	71,093	74,586
Accumulated other comprehensive earnings net of tax	110,372	86,853
Retained earnings	163,324	140,432
Deferred compensation	3,461	--
Unearned ESOP shares, at cost (70,400 shares)	(2,501)	--
Treasury stock, at cost (2,384,736 shares in 1998 and 1,994,272 shares in 1997)	(64,580)	(45,549)
Total shareholders' equity	293,959	266,552
Total liabilities and shareholders' equity	$1,012,685	$911,741

</TABLE>
The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
<CAPTION>

CONSOLIDATED STATEMENTS OF EARNINGS
AND COMPREHENSIVE EARNINGS

(in thousands, except per share data)	Years ended December 31, 1998	1997	1996
<S>	<C>	<C>	<C>
Net premiums earned	$142,324	$141,884	$130,656
Net investment income	23,937	24,558	23,681
Net realized investment gains	1,853	2,982	1,017
	168,114	169,424	155,354

Losses and settlement expenses	64,728	61,251	68,261
Policy acquisition costs	44,281	43,140	29,556
Insurance operating expenses	16,526	18,742	16,442
Interest expense on debt	2,280	1,548	2,808
General corporate expenses	3,915	4,172	3,278
	131,730	128,853	120,345
Equity in earnings of unconsolidated investee	1,337	951	231
Earnings before income taxes	37,721	41,522	35,240
Income tax expense (benefit):			
Current	10,065	11,698	6,038
Deferred	(583)	(347)	3,506
	9,482	11,351	9,544
Net earnings	$ 28,239	$ 30,171	$ 25,696
Other comprehensive earnings, net of tax	$24,259	$37,682	$16,525
Unrealized gains on securities:			
Unrealized holding gains arising during the period	23,519	36,244	16,274
Less: Reclassification adjustment for gains included in net earnings	(740)	(1,438)	(251)
Other comprehensive earnings	23,519	36,244	16,274
Comprehensive earnings	51,758	66,415	41,970
Earnings per share:			
Basic			
Net earnings per share from operations	$2.58	$2.71	$2.54
Realized gains, net of tax	0.11	0.19	0.06
Basic net earnings per share	$2.69	$2.90	$2.60
Basic comprehensive earnings per share	$4.92	$6.38	$4.25
Diluted			
Net earnings per share from operations	$2.54	$2.50	$2.22
Realized gains, net of tax	0.11	0.16	0.06
Diluted net earnings per share	$2.65	$2.66	$2.28
Diluted comprehensive earnings per share	$4.87	$5.76	$3.62
Weighted average number of common shares outstanding:			
Basic	10,514	10,402	9,871
Diluted	10,638	11,714	12,105

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
<CAPTION>

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except per share data)	Common Stock	Paid-in Capital	Accumulated Other Compre-hensive Earnings	Retained Earnings	Deferred Compensation	Unearned ESOP shares	Treasury Stock at Cost	Total Shareholders' Equity
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance, January 1, 1996	$ 8,453	$ 23,832	$ 34,335	$ 95,378			$ (3,390)	$ 158,608
Net earnings				25,696				25,696
Other comprehensive earnings, net of tax			16,274					16,274
Treasury shares reissued (108,825 shares)			1,656				552	2,208
Treasury shares purchased (145,265 shares)							(3,041)	(3,041)
Adjustment to accounting for business combination (see note 1B)		6,204		(1,571)				4,633
Dividends declared ($.44 per share)				(4,339)				(4,339)

Balance, December 31, 1996	$ 8,453	$ 31,692	$ 50,609	$ 115,164			$ (5,879)	$ 200,039
Net earnings				30,171				30,171
Other comprehensive earnings, net of tax			36,244					36,244
Net change from conversion of convertible debentures	1,769	43,485						45,254
Treasury shares purchased (1,204,625 shares)							(39,670)	(39,670)
Shares issued from exercise of stock options	8	154						162
Other capital items, including CatEPuts amortization		(745)						(745)
Dividends declared ($.47 per share)				(4,903)				(4,903)
Balance, December 31, 1997	$ 10,230	$ 74,586	$ 86,853	$ 140,432			$ (45,549)	$ 266,552
Net earnings				28,239				28,239
Other comprehensive earnings, net of tax			23,519					23,519
Treasury shares purchased (390,464 shares)							(15,570)	(15,570)
5-for-4 stock split	2,558	(2,574)						(16)
Adjustment to accounting for deferred compensation plans					3,461		(3,461)	0
Shares issued from exercise of stock options	2	60						62
Other capital items, including CatEPuts amortization		(979)						(979)
Unearned ESOP shares purchased						(2,501)		(2,501)
Dividends declared ($.51 per share)				(5,347)				(5,347)
Balance, December 31, 1998	$12,790	$71,093	$110,372	$163,324	$3,461	$(2,501)	$(64,580)	$293,959

</TABLE>
The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
<CAPTION>
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
(in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Cash Flows from Operating Activities			
Net earnings	$28,239	$30,171	$25,696
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Provision for insolvencies	--	--	1,006
Net realized investment losses (gains)	(1,853)	(2,982)	(1,018)
Depreciation	2,070	2,290	2,455
Other items, net	(4,525)	(327)	6,379
Change in:			
Accrued investment income	(109)	(512)	19
Premiums and reinsurance balances receivable (net of direct write-offs and commutations)	(9,949)	7,470	1,913
Reinsurance balances payable	7,771	691	(14,045)
Ceded unearned premium	(10,103)	4,028	(3,515)
Reinsurance balances recoverable on unpaid losses	(12,550)	2,284	28,682
Deferred policy acquisition costs	(526)	(5,321)	(857)
Unpaid losses and settlement expenses	11,260	(1,538)	(13,185)
Unearned premiums	13,480	(1,239)	3,768
Income taxes:			
Current	(578)	567	4,624
Deferred	(583)	(347)	3,506
Changes in investment in unconsolidated investee:			
Undistributed earnings	(1,337)	(951)	(231)
Dividends received	1,495	--	3,750
Net proceeds from trading portfolio activity	1,376	738	--
Net cash provided by operating activities	23,578	35,022	48,947
Cash Flows from Investing Activities			
Purchase of:			
Fixed maturities, held-to-maturity	(29,793)	(56,645)	(29,682)
Fixed maturities, available-for-sale	(8,898)	(8,890)	(11,792)
Equity securities, available-for-sale	(15,790)	(10,609)	(11,649)
Short-term investments, net	(7,799)	--	(19,940)
Property and equipment	(2,529)	(2,745)	(3,409)

Unconsolidated investee ownership interest	--	(3,694)	--
Proceeds from sale of:			
Fixed maturities, available-for-sale	772	8,386	8,298
Equity securities, available-for-sale	8,207	5,780	2,579
Short-term investments, net	--	22,127	--
Property and equipment	646	195	795
Proceeds from call or maturity of:			
Fixed maturities, held-to-maturity	34,596	29,083	17,381
Fixed maturities, available-for-sale	5,511	1,304	2,860
Net cash used in investing activities	(15,077)	(15,708)	(44,559)
Cash Flows from Financing Activities			
Proceeds from issuance of debt	14,744	24,900	--
Payments on debt	--	--	(2,800)
Fractional shares paid	(16)	(1)	--
Shares issued under stock option plan	62	162	--
Treasury shares reissued	--	--	,208
Unearned ESOP shares	(2,501)	--	--
Treasury shares purchased	(15,570)	(39,670)	(3,041)
Cash dividends paid	(5,220)	(4,705)	(4,262)
Net cash used in financing activities	(8,501)	(19,314)	(7,895)
Net decrease in cash	0	0	(3,507)
Cash at beginning of year	0	0	3,507
Cash at end of year	$ 0	$ 0	$ 0

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. DESCRIPTION OF BUSINESS: RLI Corp. is a holding company that, through its subsidiaries, underwrites selected property and casualty insurance products.

The property and casualty insurance segment, RLI Insurance Group (the Group), is composed of two insurance companies. RLI Insurance Company, the principal subsidiary, writes multiple lines of insurance on an admitted basis in all 50 states, the District of Columbia and Puerto Rico. Mt. Hawley Insurance Company, a subsidiary of RLI Insurance Company, writes multiple lines of insurance on an admitted basis in Kansas and surplus lines insurance in the remaining 49 states, the District of Columbia, Puerto Rico, the Virgin Islands and Guam.

B. PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION: The accompanying consolidated financial statements were prepared in conformity with generally accepted accounting principles (GAAP), which differ in some respects from those followed in reports to insurance regulatory authorities. The consolidated financial statements include the accounts of RLI Corp. and its subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated. Certain reclassifications were made to the prior years' financial statements to conform with the classifications used in 1998.

On December 1, 1996, RLI Vision Corp., the Company's wholly-owned optical goods distributor, merged with Hester Enterprises, Inc., the manufacturer of Maui Jim sunglasses. The Company retained a 34% minority interest in the combined entity, renamed Maui Jim, Inc. The Company accounted for this merger as a non-monetary exchange of ownership interests with no gain or loss recognized.

As a result of the merger, the Company began presenting its minority interest in Maui Jim, Inc. under the equity method of accounting beginning December 1, 1996. Additionally in 1996, for comparative purposes, the Company restated prior period financial information to present its 100% ownership in RLI Vision Corp. under the equity method. This restatement was a change in presentation only and had no impact on earnings. In January 1997, the Company paid $3.7 million for an additional 10% ownership interest in Maui Jim, Inc., bringing the Company's total minority interest in Maui Jim, Inc. to 44%.

On May 4, 1995, RLI Vision Corp. acquired through merger Target Industries, Inc., a wholesale optical goods distributor of contact lenses, Rx spectacles, frames and sunglasses, located in Cohasset, Mass. As consideration, RLI Corp. issued 391,875 shares of its common stock. This business combination was accounted for as a pooling-of-interests. The consolidated financial statements and related financial information for periods prior to the combination were, at the time, restated to include the accounts and results of operations of Target Industries, Inc., including Target Industries, Inc. stand-alone net income for the year ended December 31, 1994, of $0.2 million.

As a result of the aforementioned merger with Hester Enterprises, Inc., the accounting for the merger with Target Industries, Inc. as a pooling-of-interests was no longer applicable. Accordingly, the 1996 financial statements reflect an adjustment to shareholders' equity of $4.6 million to recognize the change from pooling-of-interests to purchase accounting, and a charge to earnings of $0.7 million, or $.04 per diluted share, for cumulative goodwill amortization from May 4, 1995, through November 30, 1996. Prior period financial information was not restated to reflect this change in accounting due to immateriality.

Prior years' share and per share data have been restated to reflect the 5-for-4 stock split that occurred on June 19, 1998.

C. SUBSEQUENT EVENT: In January 1999, RLI Insurance Company acquired Underwriters Indemnity Holdings, Inc. (UIH), located in Houston, Texas. UIH specializes in the marketing and underwriting of surety products for oil, gas, mining and other energy-related exposures.

RLI paid $40.7 million in cash in exchange for all outstanding shares of UIH, subject to post-closing contingencies. Included in the transaction

are both of UIH's operating subsidiaries, Underwriters Indemnity Company of Texas and Planet Indemnity Company of Colorado. The transaction was financed through short-term borrowings and will be accounted for under the purchase method of accounting.

D. INVESTMENTS: In compliance with FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies its investments in all debt securities and those equity securities with readily determinable fair values into one of three categories: held-to-maturity, trading, or available-for-sale.

HELD-TO-MATURITY SECURITIES

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and carried at amortized cost. Except for declines that are other than temporary, changes in the fair value of these securities are not reflected in the financial statements. The Company has classified approximately 86% of its portfolio of debt securities as held-to-maturity.

TRADING SECURITIES

Debt and equity securities purchased for short-term resale are classified as trading securities. These securities are reported at fair value with unrealized gains and losses included in earnings. The Company has classified approximately 3% of its portfolio of debt securities as trading.

AVAILABLE-FOR-SALE SECURITIES

All other debt and equity securities not included in the above categories are classified as available-for-sale and reported at fair value. Unrealized gains and losses on these securities are excluded from net earnings but are recorded as a separate component of comprehensive earnings and shareholders' equity, net of deferred income taxes. All of the Company's equity securities and approximately 11% of debt securities are classified as available-for-sale.

Short-term investments are carried at cost, which approximates fair value.

The Company continuously monitors the values of its investments in fixed maturities and equity securities on an ongoing basis. If this review shows that a decline in fair value is other than temporary, the Company's carrying value in the investment is reduced to its estimated realizable value through an adjustment to earnings. Realized gains and losses on disposition of investments are based on specific identification of the investments sold.

Interest on fixed maturities and short-term investments is credited to earnings as it accrues. Dividends on equity securities are credited to earnings on the ex-dividend date.

E. REINSURANCE: Ceded unearned premiums and reinsurance balances recoverable on unpaid losses and settlement expenses are reported separately as assets, instead of being netted with the appropriate liabilities, since reinsurance does not relieve the Company of its legal liability to its policyholders.

The Company continuously monitors the financial condition of its reinsurers. The Company's policy is to periodically charge to earnings an estimate of unrecoverable amounts from troubled or insolvent reinsurers. During 1996, the Company provided $1,006,140 for uncollectible reinsurance balances. No additional charges occurred in 1997 or 1998. The Company believes that current reserve levels for uncollectible reinsurance are sufficient to cover the related exposure.

F. UNPAID LOSSES AND SETTLEMENT EXPENSES: The liability for unpaid losses and settlement expenses represents estimates of amounts needed to pay reported and unreported claims and related expenses. The estimates are based on certain actuarial and other assumptions related to the ultimate cost to settle such claims. Such assumptions are subject to occasional changes due to evolving economic, social and political conditions. All estimates are periodically reviewed and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments are reflected in the results of operations in the period in which they are determined. Due to the inherent uncertainty in estimating reserves for losses and settlement expenses, there can be no assurance that the ultimate liability will not exceed recorded amounts, with a resulting adverse effect on the Company. Based on the current assumptions used in calculating reserves, management believes that the Company's overall reserve levels at December 31, 1998, are adequate to meet its future obligations.

G. REVENUE RECOGNITION: Insurance premiums are recognized ratably over the term of the contracts, net of ceded reinsurance. Unearned premiums are calculated on the monthly pro rata basis.

H. POLICY ACQUISITION COSTS: The costs of acquiring insurance premiums -- principally commissions and brokerage, sales compensation, premium taxes, and other direct underwriting expenses -- net of reinsurance commissions received, are amortized over the life of the policies in order to properly match policy acquisition costs to the related premium revenue. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and settlement expenses and certain other costs expected to be incurred as the premium is earned.

I. PROPERTY AND EQUIPMENT: Property and equipment are depreciated on a straight-line basis for financial statement purposes over periods ranging from three to 10 years for equipment and up to 40 years for buildings and improvements.

J. INCOME TAXES: The Company files a consolidated income tax return. Tax provisions are computed and apportioned to the subsidiaries on the basis of their taxable income.

K. EARNINGS PER SHARE: Pursuant to disclosure requirements contained in FASB Statement 128, the following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the financial statements:

(in thousands, except per share data)
For the year ended December 31, 1998

<TABLE>
<CAPTION>

<S>	Income (Numerator) <C>	Shares (Denominator) <C>	Per Share Amount <C>
Basic EPS			
Income available to common shareholders	28,239	10,514	2.69
Incentive stock options	--	124	
Diluted EPS			
Income available to common share-holders and assumed conversions	28,239	10,638	2.65

</TABLE>

Conversion of the Company's $46.0 million convertible debenture occurred in July 1997. See note 4 for further discussion and related disclosures.

(in thousands, except per share data)
For the year ended December 31, 1997

<TABLE>
<CAPTION>

<S>	Income (Numerator) <C>	Shares (Denominator) <C>	Per Share Amount <C>
Basic EPS			
Income available to common shareholders	30,171	10,402	2.90
Effect of dilutive securities			
Convertible debentures	1,012	1,230	
Incentive stock options	--	82	

Diluted EPS			
Income available to common share-holders and assumed conversions	31,183	11,714	2.66

(in thousands, except per share data)
For the year ended December 31, 1996

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS			
Income available to common shareholders	25,696	9,871	2.60
Effect of dilutive securities			
Convertible debentures	1,874	2,212	
Incentive stock options	--	22	
Diluted EPS			
Income available to common share-holders and assumed conversions	27,570	12,105	2.28

L. COMPREHENSIVE EARNINGS: FASB Statement No. 130, "Reporting Comprehensive Income," was adopted by the Company in 1997. The primary difference between reporting the Company's net and comprehensive earnings is that comprehensive earnings include unrealized gains/losses net of tax. Traditional reporting of net earnings directly credits or charges shareholders' equity with unrealized gains/losses, rather than including them in earnings. In reporting the components of comprehensive earnings on a net basis in the income statement, the Company has used a 35% tax rate. Other comprehensive income, as shown, is net of tax expense of $12.7 million, $19.5 million, and $8.8 million, respectively, for 1998, 1997, and 1996.

M. FAIR VALUE DISCLOSURES: The following methods were used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value. Fixed maturities and equity securities are valued using quoted market prices, if available. If a quoted market price is not available, fair value is estimated using independent pricing services or quoted market prices of similar securities. Fair value disclosures for investments are included in note 2. Due to the relatively short-term nature of cash, short-term

investments, accounts receivable, accounts payable and short-term debt, their carrying amounts are reasonable estimates of fair value. Fair value of long-term debt is based on quoted market prices if available or quoted market prices of similar issues.

N. STOCK BASED COMPENSATION: The Company grants to officers and directors stock options for a fixed number of shares with an exercise price equal to the fair market value of the shares at the date of grant. The Company accounts for stock option grants in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," and accordingly recognizes no compensation expense for the stock option grants. See note 8 for further discussion and related disclosures.

O. RISKS AND UNCERTAINTIES: Certain risks and uncertainties are inherent to the Company's day-to-day operations and to the process of preparing its financial statements. The more significant risks and uncertainties, as well as the Company's methods for mitigating, quantifying, and minimizing such, are presented below and throughout the notes to the consolidated financial statements.

CATASTROPHE EXPOSURES

The Company's past and present insurance coverages include exposure to catastrophic events. Catastrophic events such as earthquakes, floods, and windstorms are covered by certain of the Company's property policies. The Company has a concentration of such coverages in California (61.0% of gross property premiums written during 1998). Using computer-assisted modeling techniques, the Company quantifies and monitors its exposure to catastrophic events. The Company limits its risk to such catastrophes through the purchase of reinsurance. Utilizing the above, the Company attempts to limit its net aggregate exposure to a single catastrophic event to less than 10% of shareholders' equity.

ENVIRONMENTAL EXPOSURES

The Company is subject to environmental claims and exposures through its commercial umbrella, general liability and discontinued assumed reinsurance lines of business. Although exposure to environmental claims exists in these lines of business, management has sought to mitigate or control the extent of this exposure through the following methods: 1) the Company's policies include pollution exclusions that have been continually updated to further strengthen the exclusion; 2) the Company's policies primarily cover moderate hazard risks; and 3) the Company began writing this business after the industry became aware of the potential pollution liability exposure.

The Company has made loss and settlement expense payments on environmental liability claims and has loss and settlement expense reserves for others. The Company includes this historical environmental loss experience with the remaining loss experience in the applicable line of business to project ultimate incurred losses and settlement expenses and related "incurred but not reported" loss and settlement expense reserves.

Although historical experience on environmental claims may not accurately reflect future environmental exposures, the Company has used this experience to record loss and settlement expense reserves in the exposed lines of business. See further discussion of environmental exposures in note 6.

REINSURANCE

Reinsurance does not discharge the Company from its primary liability to policyholders, and to the extent that a reinsurer is unable to meet its obligations, the Company would be liable. The Company continuously monitors the financial condition of prospective and existing reinsurers. As a result, the Company currently attempts to purchase reinsurance from a limited number of financially strong reinsurers. The Company provides a reserve for reinsurance balances deemed uncollectible.

FINANCIAL STATEMENTS

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported financial statement balances as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. The most significant of these amounts is the liability for unpaid losses and settlement expenses. Management continually updates its estimates as additional data becomes available and adjusts the financial statements as deemed necessary. Other estimates such as the recoverability of reinsurance balances, deferred tax assets and deferred policy acquisition costs are constantly monitored, evaluated, and adjusted. Although recorded estimates are supported by actuarial computations and other supportive data, the estimates are ultimately based on management's expectations of future events.

EXTERNAL FACTORS

The Company's insurance subsidiaries are highly regulated by the states in which they are incorporated, and by the states in which they do business. Such regulations, among other things, limit the amount of dividends, impose restrictions on the amount and types of investments, and regulate rates insurers may charge for various products. The Company is also subject to insolvency and guarantee fund assessments for various programs designed to ensure policyholder indemnification. The Company generally accrues the full amount of the assessment upon notification.

The National Association of Insurance Commissioners (NAIC) has developed Property-Casualty Risk-Based Capital (RBC) standards that relate an insurer's reported statutory surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated capital level to support asset (investment and credit) risk and underwriting (loss reserves, premiums written, and unearned premium) risk. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. The Company continuously monitors its subsidiaries' internal capital requirements and the NAIC's RBC developments. The Company has determined that its capital levels are well in excess of the minimum capital requirements for all RBC action levels, and that its capital levels are sufficient to support the level of risk inherent in its operations.

2. INVESTMENTS

A summary of net investment income is as follows:

<TABLE>
<CAPTION>

Investment Income (in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Interest on fixed maturities	$ 19,479	$ 19,659	$18,862
Dividends on equity securities	6,718	6,361	5,715
Interest on short-term investments	1,296	1,531	1,573

Gross investment income	27,493	27,551	26,150
Less investment expenses	3,556	2,993	2,469
Net investment income	$23,937	$24,558	$23,681

</TABLE>

Pretax net realized investment gains (losses) and net changes in unrealized gains (losses) on investments for the years ended December 31 are summarized as follows:

<TABLE>
<CAPTION>

Realized/unrealized gains (in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Net realized investment gains (losses)			
Fixed maturities			
Held-to-maturity	$ 34	$ 27	$ 11
Trading	179	117	--
Available-for-sale	(9)	175	24
Equity securities	1,148	2,037	361
Other	501	626	621
	1,853	2,982	1,017
Net changes in unrealized gains (losses) on investments			
Fixed maturities			
Held-to-maturity	3,779	4,030	(6,577)
Available-for-sale	(147)	100	(751)
Equity securities	36,330	55,660	25,785
	39,962	59,790	18,457
Net realized investment gains and changes in unrealized gains (losses) on investments	$41,815	$62,772	$19,474

</TABLE>

Following is a summary of the disposition of fixed maturities for the years ended December 31, with separate presentations for sales and calls/maturities.

Sales

<TABLE>
<CAPTION>

(in thousands)	Proceeds From Sales	Gross Realized Gains	Losses	Net Realized Gain (Loss)
1998				
<S>	<C>	<C>	<C>	<C>
Available-for-sale	772	--	--	--
Trading	9,358	131	(17)	114
1997				
Available-for-sale	8,386	259	(84)	175
Trading	4,354	16	(25)	(9)
1996				
Available-for-sale	8,298	84	(59)	25

</TABLE>

Calls/Maturities

<TABLE>
<CAPTION>

(in thousands)	Proceeds From Sales	Gross Realized Gains	Losses	Net Realized Gain (Loss)
1998				
<S>	<C>	<C>	<C>	<C>
Held-to-maturity	34,596	46	(12)	34
Available-for-sale	5,511	1	(10)	(9)
Trading	70	--	--	--
1997				
Held-to-maturity	29,083	48	(20)	28
Available-for-sale	1,304	--	--	--
Trading	55	--	--	--
1996				
Held-to-maturity	17,381	11	(1)	10
Available-for-sale	2,860	--	(1)	(1)

</TABLE>

The following is a schedule of amortized costs and estimated fair values of investments in fixed maturities and equity securities as of December 31, 1998 and 1997.

<TABLE>
<CAPTION>

(in thousands)	Amortized Cost	Estimated Fair Value	Gross Unrealized Gains	Losses
1998				
<S>	<C>	<C>	<C>	<C>

Held-to-maturity				
U.S. governments	$ 124,419	$ 128,814	$ 4,395	--
States, political subdivisions & revenues	159,573	165,730	6,173	(16)
Total held-to-maturity	$ 283,992	$ 294,544	$ 10,568	$ (16)
Trading				
U.S. governments	$ 3,652	$ 3,726	$ 80	$ (6)
Corporate	4,103	4,216	113	--
States, political subdivisions & revenues	402	406	4	--
Total trading	$ 8,157	$ 8,348	$ 197	$ (6)
Available-for-sale				
U.S. governments	$ 15,177	$ 15,528	$ 351	--
Corporate	9,150	8,893	255	(512)
States, political subdivisions & revenues	11,858	12,095	241	(4)
Fixed maturities	36,185	36,516	847	(516)
Equity securities	127,367	296,521	170,357	(1,203)
Total available-for-sale	$ 163,552	$ 333,037	$ 171,204	$ (1,719)
Total	$ 455,701	$ 635,929	$ 181,969	$ (1,741)

</TABLE>

<TABLE>
<CAPTION>

(in thousands) 1997	Amortized Cost	Estimated Fair Value	Gross Unrealized Gains	Losses
<S>	<C>	<C>	<C>	<C>
Held-to-maturity				
U.S. governments	$ 153,767	$ 156,388	$ 2,963	$ (342)
States, political subdivisions & revenues	136,267	140,420	4,167	(14)
Total held-to-maturity	$ 290,034	$ 296,808	$ 7,130	$ (356)
Trading				
U.S. governments	$ 3,655	$ 3,713	$ 61	$ (3)
Foreign governments	441	448	7	--
Corporate	4,919	4,978	59	--
States, political subdivisions & revenues	404	407	3	--
Total trading	$ 9,419	$ 9,546	$ 130	$ (3)
Available-for-sale				
U.S. governments	$ 20,248	$ 20,465	$ 299	$ (82)
Corporate	6,342	6,473	308	(177)
States, political subdivisions & revenues	7,052	7,182	137	(7)
Fixed maturities	33,642	34,120	744	(266)
Equity securities	118,637	251,460	133,273	(450)
Total available-for-sale	$ 152,279	$ 285,580	$ 134,017	$ (716)
Total	$ 451,732	$ 591,934	$ 141,277	$ (1,075)

</TABLE>

The amortized cost and estimated fair value of fixed-maturity securities at December 31, 1998, by contractual maturity, are shown as follows.

<TABLE>
<CAPTION>

(in thousands)	Amortized Cost	Estimated Fair Value
<S>	<C>	<C>
Held-to-maturity		
Due in one year or less	$ 26,479	$ 26,921
Due after one year through five years	94,322	97,537
Due after five years through ten years	99,686	104,227
Due after ten years	63,505	65,859
	$ 283,992	$ 294,544
Trading		
Due in one year or less	$ 201	$ 203
Due after one year through five years	5,666	5,748
Due after five years through ten years	2,290	2,397
Due after ten years	--	--
	$ 8,157	$ 8,348
Available-for-sale		
Due in one year or less	$ 6,004	$ 6,105
Due after one year through five years	20,781	21,221
Due after five years through ten years	6,310	6,028
Due after ten years	3,090	3,162
	$ 36,185	$ 36,516

</TABLE>

Expected maturities may differ from contractual maturities due to call provisions present on some existing securities. Management believes the impact of any calls should be slight and intends to follow its policy of matching assets against anticipated liabilities.

At December 31, 1998, the net unrealized appreciation of available-for-sale fixed maturities and equity securities totaled $110.4 million. This amount was net of deferred taxes of $59.1 million. At December 31, 1997, the net unrealized appreciation of available-for-sale fixed maturities and equity securities totaled $86.9 million. This amount is net of deferred taxes of $46.4 million.

The Company is party to a securities lending program whereby fixed-income securities are loaned to third parties, primarily major brokerage firms. As of December 31, 1998 and 1997, fixed maturities with a fair value of $25.1 million and $91.1 million, respectively, were loaned. Agreements with custodian banks facilitating such lending generally require 102% of the value of the loaned securities to be separately maintained as collateral for each loan. Pursuant to FASB Statements 125 and 127, an invested asset and a corresponding liability have been recognized for this collateral amount. To further minimize the credit risks related to this lending program, the Company monitors the financial condition of counter parties to these agreements.

As required by law, certain fixed maturities and short-term investments amounting to $13.8 million at December 31, 1998, were on deposit with either regulatory authorities or banks.

Additionally, the Company has certain fixed maturities held in trust amounting to $8.3 million at December 31, 1998. These funds cover net premiums, losses, and expenses related to a property and casualty insurance program.

The Company does not invest in derivative securities or collateralized mortgage obligations (CMOs).

3. POLICY ACQUISITION COSTS

Policy acquisition costs deferred and amortized to income for the years ended December 31 are summarized as follows:

<TABLE>
<CAPTION>

(in thousands)	1998	1997	1996
Deferred policy acquisition costs, beginning of year	$21,985	$16,664	$ 15,807
Deferred:			
Direct commissions	55,035	57,034	46,740
Premium taxes	4,489	4,382	4,034
Other direct underwriting expenses	20,335	16,340	14,194
Ceding commissions	(33,644)	(27,812)	(31,055)
Net deferred	46,215	49,944	33,913
Amortized	45,690	44,623	33,056
Deferred policy acquisition costs, end of year	$22,510	$21,985	$ 16,664
Policy acquisition costs:			
Amortized to expense	45,690	44,623	33,056
Period costs:			
Ceding commission - contingent	(6,604)	(4,400)	(5,275)
Other	5,195	2,917	1,775
Total policy acquisition costs	$44,281	$43,140	$ 29,556

</TABLE>

4. DEBT

On July 28, 1993, the Company issued $46.0 million of 6.0% convertible debentures that were to mature July 15, 2003, and pay interest semi-annually. The Company received $45.1 million in net proceeds from the issue ($46.0 million principal less $0.9 million of underwriting costs incurred) of which $30.5 million was contributed to the insurance subsidiaries to increase underwriting capacity and facilitate expansion of their business. The balance was retained for general corporate purposes, including debt service and the payment of dividends. All convertible debentures, unless previously redeemed, were convertible at the option of the holder at any time before maturity into RLI Corp. common stock at an adjusted conversion price of $20.80 per share. The Company retained the option to redeem the convertible debentures, in whole or in part, on or after July 15, 1997, at specified redemption prices, plus accrued interest to redemption date. On June 20, 1997, the Company announced that it was calling for redemption all convertible debentures. The entire issue was to be redeemed for cash on July 22, 1997, at 103% of its principal amount, plus accrued interest. Holders of the debenture had the option to convert, at any time prior to the close of business on July 21, 1997, the debentures at an exchange rate of 48.0769 shares of RLI common stock for each $1,000 principal amount of convertible debt. On July 22, 1997, the entire $46.0 million was converted into RLI common stock. This conversion created an additional 2,211,499 new shares of RLI common stock.

During the first quarter of 1996, the Company paid off its short-term borrowings of $2.8 million, using excess funds from operations.

During 1997 and 1998, the Company utilized its short-term credit facilities and engaged in three reverse repurchase transactions to partially fund the Company's common stock repurchase program.

Interest paid on outstanding debt for 1998, 1997, and 1996 amounted to $2.3 million, $2.8 million, and $2.8 million, respectively.

The Company maintains a $30.0 million secured, revolving line of credit from one financial institution. As of December 31, 1998, the Company had $19.6 million in outstanding short-term borrowings. Additionally, the Company was party to three reverse repurchase transactions totaling $20.0 million.

5. REINSURANCE

In the ordinary course of business, the insurance subsidiaries assume and cede premiums with other insurance companies. A large portion of the reinsurance is effected under reinsurance contracts known as treaties and, in some instances, by negotiation on each individual risk. In addition, there are excess of loss and catastrophe reinsurance contracts that protect against losses over stipulated amounts arising from any one occurrence or event. The arrangements provide greater diversification of business and serve to limit the maximum net loss on catastrophes and large and unusually hazardous risks.

Through the purchase of reinsurance, the Company generally limits the loss on any individual risk to $1.0 million. Additionally, through extensive use of computer-assisted modeling techniques, the Company monitors the

concentration of risks exposed to catastrophic events (predominantly earthquakes). The Company seeks to limit its estimated net aggregate exposure to a single catastrophic event to less than 10% of shareholders' equity.

In 1996, the Company entered into an innovative catastrophe reinsurance and loss financing program with Centre Reinsurance (Centre Re). The program, called Catastrophe Equity Puts (CatEPuts), augments the Company's traditional reinsurance by integrating its loss financing needs with a pre-negotiated sale of securities linked to exchange-traded shares. CatEPuts allows the Company to put up to $50.0 million of its convertible preferred shares to Centre Re at a pre-negotiated rate in the event of a catastrophic loss, provided the loss does not reduce GAAP equity to less than $55.0 million. CatEPuts is a three-year program and is designed to enable the Company to continue operating after a loss of such magnitude that its reinsurance capacity is exhausted. If the Company exercises its option to put preferred shares to Centre Re, then Centre Re, in turn, has the option to reinsure certain business written by the Company on a prospective basis. This agreement is scheduled for renewal in October 1999.

Premiums written and earned along with losses and settlement expenses incurred for the years ended December 31 are summarized as follows:

<TABLE>
<CAPTION>

(in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Written			
Direct	$ 288,135	$ 265,850	$ 276,707
Reinsurance assumed	2,938	12,993	94
Reinsurance ceded	(145,372)	(134,170)	(144,444)
Net	$ 145,701	$ 144,673	$ 132,357
Earned			
Direct	$ 274,996	$ 268,569	$ 271,552
Reinsurance assumed	2,597	11,513	33
Reinsurance ceded	(135,269)	(138,198)	(140,929)
Net	$ 142,324	$ 141,884	$ 130,656
Losses and settlement expenses incurred			
Direct	$ 112,325	$ 96,379	$ 109,528
Reinsurance assumed	6,887	5,960	10
Reinsurance ceded	(54,484)	(41,088)	(41,277)
Net	$ 64,728	$ 61,251	$ 68,261

</TABLE>

At December 31, 1998, the Company had prepaid reinsurance premiums and reinsurance recoverables on paid and unpaid losses and settlement expenses with American Re-Insurance Company (rated A+ "Superior" by A.M. Best Company) that amounted to $80.4 million. All other reinsurance balances recoverable, when considered by individual reinsurer, are less than 10% of shareholders' equity.

6. UNPAID LOSSES AND SETTLEMENT EXPENSES

The following table reconciles the Company's liability for unpaid losses and settlement expenses (LAE) for the three years ended December 31, 1998. Since reserves are based on estimates, the ultimate net cost may vary from the original estimate. As adjustments to these estimates become necessary, they are reflected in current operations. As part of the reserving process, historical data is reviewed and consideration is given to the anticipated impact of various factors such as legal developments and economic conditions, including the effects of inflation. Changes in reserves from the prior years' estimates are calculated based on experience as of the end of each succeeding year (loss and LAE development).

<TABLE>
<CAPTION>

(in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Unpaid losses and LAE at beginning of year:			
Gross	$404,263	$ 405,801	$418,986
Ceded	(155,711)	(157,995)	(186,678)
Net	248,552	247,806	232,308
Increase (decrease) in incurred losses and LAE:			
Current accident year	68,131	61,771	69,724
Prior accident years	(3,403)	(520)	(1,463)
Total incurred	64,728	61,251	68,261
Loss and LAE payments for claims incurred:			
Current accident year	(14,762)	(11,284)	(11,026)
Prior accident years	(54,927)	(49,023)	(41,143)
Total paid	(69,689)	(60,307)	(52,169)
Insolvent reinsurer charge off	7,911	(627)	607
Loss reserves commuted	(4,240)	429	(1,201)
Net unpaid losses and LAE at end of year	$247,262	$ 248,552	$247,806
Unpaid losses and LAE at end of year:			
Gross	415,523	404,263	405,801
Ceded	(168,261)	(155,711)	(157,995)
Net	$247,262	$ 248,552	$247,806

</TABLE>

During the three years, overall development on prior accident-year loss and settlement expense reserves was insignificant to operating results and recorded loss and settlement expense reserves.

The Company is subject to environmental claims and exposures through its commercial umbrella, general liability, and discontinued assumed reinsurance lines of business. Within these lines, the Company's environmental exposures include environmental site cleanup, asbestos removal, and mass tort liability. The majority of the exposure is in the excess layers of the Company's commercial umbrella and assumed reinsurance books of business.

The following table represents inception-to-date paid and unpaid environmental claims data (including incurred but not reported losses) for the periods ended 1998, 1997 and 1996:

<TABLE>
<CAPTION>

	Inception-to-date December 31,		
(In thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Loss and LAE payments for claims incurred			
Gross	$14,690	$ 11,570	$ 8,267
Ceded	(9,140)	(7,646)	(5,761)
Net	$ 5,550	$ 3,924	$ 2,506
Unpaid losses and LAE at end of year			
Gross	$12,360	$ 14,880	$17,596
Ceded	(5,876)	(8,842)	(11,150)
Net	$ 6,485	$ 6,038	$ 6,446

</TABLE>

Although the Company's environmental exposure is limited as a result of entering the liability lines after the industry had already recognized it as a problem, management cannot determine the Company's ultimate liability with any reasonable degree of certainty. This ultimate liability is difficult to assess due to evolving legislation on such issues as joint and several liability, retroactive liability, and standards of cleanup. Additionally, the Company participates primarily in the excess layers, making it even more difficult to assess the ultimate impact.

7. INCOME TAXES

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are summarized in the following table.

(In thousands)	1998	1997	1996
Deferred tax assets:			
Tax discounting of claim reserves	$ 15,388	$ 14,775	$ 12,875
Unearned premium offset	5,757	5,521	5,326
Other, net	2,551	3,016	492
	23,696	23,312	18,693
Less valuation allowance	(300)	(300)	(300)
Total deferred tax assets	$ 23,396	$ 23,012	$ 18,393
Deferred tax liabilities:			
Net unrealized appreciation of securities	$ 59,113	$ 46,448	$ 26,932
Deferred policy acquisition costs	7,879	7,695	5,832
Books/tax depreciation	1,328	1,606	1,350
Other, net	3,497	3,603	1,450
Total deferred tax liabilities	71,817	59,352	35,564
Net deferred tax asset (liability)	$ (48,421)	$ (36,340)	$ (17,171)

Management feels it is more likely than not that a portion of the Company's deferred tax assets will not be realized. Therefore, an allowance has been established for certain deferred tax assets that have an indefinite reversal pattern. Management also believes the Company's remaining deferred tax assets will be fully realized through deductions against future taxable income.

Income tax expense attributable to income from operations for the years ended December 31, 1998, 1997, and 1996 differed from the amounts computed by applying the U.S. federal tax rate of 35% to pretax income from continuing operations as demonstrated in the following table.

(In thousands)	1998	1997	1996
Provision for income taxes at the statutory federal tax rates	$ 13,202	$ 14,533	$ 12,334
Increase (reduction) in taxes resulting from:			
Dividends received deduction	(1,409)	(1,322)	(1,216)
Dividends paid deduction	(231)	(236)	(258)
Tax exempt interest income	(2,271)	(1,876)	(1,567)
State income tax provision	170	160	132
Other items, net	21	92	119
	$ 9,482	$ 11,351	$ 9,544

The Company has recorded its deferred tax assets and liabilities using the statutory federal tax rate of 35%. Management believes when these deferred items reverse in future years, the Company's taxable income will be taxed at an effective rate of 35%.

Net federal and state income taxes paid in 1998, 1997, and 1996 amounted to $10.6 million, $11.1 million, and $1.4 million, respectively.

The Internal Revenue Service (IRS) has examined the Company's income tax returns

through the tax year ended December 31, 1990. The IRS is currently examining the Company's income tax returns through the tax year ended December 31, 1994. Management believes any tax implication from examinations of these years should not materially impact the Company's consolidated financial position or results of operations.

8. EMPLOYEE BENEFITS

PENSION PLAN

The Company maintains a noncontributory defined benefit pension plan covering substantially all employees meeting age and service requirements. The plan provides a benefit based on a participant's service and the highest five consecutive years' average compensation out of the last 10 years. The Company funds pension costs as accrued, except that in no case will the Company contribute amounts less than the minimum contribution required under the Employee Retirement Income Security Act of 1974 or more than the maximum tax deductible contribution for the year. The plan reached the full funding limitation in 1986 and remained fully funded through 1993. During 1998, 1997, and 1996, the Company made the maximum tax deductible contribution allowed, totaling $422,489, $453,146, and $413,977, respectively, to adequately meet the funding requirements of the plan.

The Company has made various amendments to the plan in order to comply with certain Internal Revenue Code changes.

The financial status of the plan for each of the three years ended December 31 is illustrated in the following tables:

<TABLE>
<CAPTION>

	For the year ended December 31, 1998	1997	1996
<S>	<C>	<C>	<C>
Components of pension cost			
Service cost	$ 530,886	$ 414,301	$ 419,349
Interest cost	336,573	291,324	270,965
Expected return on plan assets	(427,320)	(354,166)	(320,036)
Recognized prior service cost	3,051	3,051	3,051
Recognized net loss	--	1,353	14,608
Amortization of transition (asset) obligation	(32,566)	(32,566)	(32,566)
Pension cost	$ 410,624	$ 323,297	$ 355,371
Accumulated benefit obligation	$3,854,111	$ 3,222,460	$3,096,953

</TABLE>

<TABLE>
<CAPTION>

	For the year ended December 31, 1998	1997	1996
<S>	<C>	<C>	<C>
Change in plan assets			
Fair value of plan assets at January 1	$4,157,321	$ 3,328,525	$3,253,386
Actual return on plan assets	600,966	852,855	403,266
Employer contribution	422,489	453,146	413,977
Benefit payments	(463,901)	(477,205)	(742,104)
Fair value of plan assets at December 31	$4,716,875	$ 4,157,321	$3,328,525
Change in projected benefit obligation			
Projected benefit obligation at January 1	$4,416,028	$ 4,039,460	$3,835,535
Service cost	530,886	414,301	419,349
Interest cost	336,573	291,324	270,965
Actuarial losses	518,388	148,148	255,715
Benefit payments	(463,901)	(477,205)	(742,104)
Projected benefit obligation at December 31	$5,337,974	$ 4,416,028	$4,039,460
Funded status	$ (621,099)	$ (258,707)	$ (710,935)
Unrecognized net loss	458,391	113,649	465,543
Unamortized prior service cost	3,214	6,265	9,316
Unrecognized transition (asset) obligation	(169,347)	(201,913)	(234,479)
(Accrued) prepaid at December 31	$ (328,841)	$ (340,706)	$ (470,555)
Amounts recognized in the statement of financial position consist of:			
Accrued benefit liability	$(328,841)	$ (340,706)	$ (470,555)
Net amount recognized	$(328,841)	$ (340,706)	$ (470,555)
Rates			
Discount rate	7.00%	7.25%	7.50%
Compensation increase	6.00%	6.00%	6.00%
Expected return on plan assets	10.00%	10.00%	10.00%

</TABLE>

At December 31, 1998, plan assets at fair value are comprised of approximately 95% equity securities and 5% invested cash.

EMPLOYEE STOCK OWNERSHIP AND BONUS AND INCENTIVE PLANS

The Company has both an Employee Stock Ownership Plan (ESOP) and an officer performance incentive plan. In 1996, the Company adopted a new approach for evaluating the funding of these plans. Called the Market Value Potential (MVP) plan, the new program is designed to ensure that the interests of the Company's associates correspond with those of our shareholders. Beginning in 1997, the Company established an additional provision allowing for employee bonus participation.

MVP requires that the Company generate a return on equity in excess of its cost of capital before either the funding of the ESOP or the payment of associate bonuses. Under MVP, funds in excess of the cost of capital are first designated to fund the Company's ESOP up to the maximum allowable contribution of 15% of eligible wages. MVP in excess of the ESOP funding is then shared by the associates.

Associates can receive a maximum of 1% of the excess on an after-tax basis, while officers can receive a maximum of approximately 8% of the excess on an after-tax basis. All remaining funds are reinvested in the Company for the benefit of the shareholders. MVP further limits the officer payout in a given year to 50% (60% prior to 1998) of the combination of bonuses earned in the previous fiscal year plus any unpaid balance carried forward from prior years. The remaining balance is at risk and is retained by the Company. This amount is posted to a participant's "bank account" and is subject to achieving the MVP target return in the succeeding fiscal year.

The following table illustrates the amount earned, the percentage of MVP earned, and the subsequent amount paid for each year:

<TABLE>
<CAPTION>

(In thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Earned (current year)			
Executives	$ 2,960	$ 5,390	$ 2,810
Percent of MVP	7.70%	7.91%	7.07%
Employees	$ 388	$ 689	--
Percent of MVP	1.00%	1.00%	
Paid (subsequent year)			
Executives	$ 2,127	$ 3,858	$ 1,686
Employees	$ 388	$ 689	--

</TABLE>

In addition to the executive amount paid in 1998, an additional $547,000 was deferred towards Company stock plans as discussed below.

The Company's ESOP covers substantially all employees meeting eligibility requirements. ESOP contributions are determined annually by the Company's board of directors, subject to the achievement of MVP targets, and are expensed in the year earned. During 1998, the Company leveraged the ESOP and purchased a total of 70,400 shares at an average price of $35.58 per share ($2.5 million) in the third quarter in advance of the actual contribution to the plan. These purchases were internally financed with the Company and resulted in ESOP-related expense of $2.9 million for the year compared to $2.6 million in 1997 and $2.8 million in 1996. At its December 1998 meeting, the board approved a contribution subject to a favorable MVP result. Contributions were authorized in 1997 and 1996, as well.

During 1998, the ESOP purchased 61,802 shares on the open market at an average price of $38.54 ($2.4 million) During 1997, the ESOP purchased 79,801 shares of the Company's common stock on the open market at an average price of $26.62 ($2.1 million). During 1996, the ESOP purchased 95,625 shares of the Company's treasury stock at an average price of $20.30 ($1.9 million). In 1997 and 1996, shares held by the ESOP were treated as outstanding in computing the Company's earnings per share. At December 31, 1998, unearned leveraged shares were not considered outstanding for calculating earnings per share. Dividends on earned ESOP shares are passed through to the participants.

DEFERRED COMPENSATION

The Company maintains a Rabbi Trust for deferred compensation plans for directors, key employees and executive officers through which company shares are purchased. During 1998, the Emerging Issues Task Force reached its consensus on issue 97-14 relative to Rabbi Trusts. This prescribed an accounting treatment where the employer stock in the plan is classified and accounted for in equity, in a manner consistent with the accounting for treasury stock. This increased the Company's treasury stock by $3.5 million in 1998. The deferred compensation obligation is classified as an equity instrument. This treatment was applied prospectively by the Company in 1998.

The expense associated with funding these plans is recognized through salary, bonus, and ESOP expenses for key employees and executive officers as disclosed in prior notes. The expense recognized from the directors deferred plan was $175,900, $158,600, and $139,075 in 1998, 1997 and 1996, respectively. In 1998, the Rabbi Trusts purchased 15,521 shares of the Company's common stock on the open market at an average price of $37.20 ($577,409). In 1997, the Rabbi Trusts purchased 9,679 shares of the Company's common stock on the open market at an average price of $31.62 ($306,027). In 1996, the Rabbi Trusts purchased 13,200 shares of the Company's treasury stock, at an average price of $20.18 ($266,339) and 5,375 shares of the Company's common stock on the open market at an average price of $25.70 ($138,138). At December 31, 1998, the Trusts' assets were valued at $5.9 million.

STOCK OPTION PLAN

During 1995, the Company adopted and the shareholders approved a tax-favored incentive stock option plan (the Incentive Plan). During 1997, the shareholders approved the Outside Directors' Stock Option Plan (the Directors' Plan). The Company accounts for the plan in accordance with APB Opinion No. 25, under which no compensation cost has been recognized.

Had compensation cost for the plan been determined consistent with FASB Statement No. 123, "Accounting for Stock-Based Compensation," the Company's net income and earnings per share would have been reduced to the following pro forma amounts:

<TABLE>
<CAPTION>

(in thousands, except per share data)	1998	1997	1996
<S>	<C>	<C>	<C>
Net income: As reported	$ 28,239	$ 30,171	$ 25,696
Pro forma	27,592	29,789	25,462
Diluted EPS:As reported	$ 2.65	$ 2.66	$ 2.28
Pro forma	$ 2.59	2.63	2.26

</TABLE>

These pro forma amounts may not be representative of the effects of FASB Statement No. 123 on pro forma net income for future years because options vest over several years and additional awards may be granted in the future.

Under the Incentive Plan, an officer may be granted an option to purchase shares at 100% of the grant date fair market value (110% if the optionee and affiliates own 10% or more of the shares), payable as determined by the Company's board of directors. An option may be granted only during the 10-year period ending in May 2005. An optionee must exercise an option within 10 years (five years if the optionee and affiliates own 10% or more of the shares) from the grant date. Full vesting of options granted occurs at the end of five years.

Under the Directors' Plan, shares granted do not qualify as tax-favored incentive stock options. Directors may be granted non-qualified options to purchase shares at 100% of the grant date fair market value. An optionee must exercise an option within 10 years from the grant date. Full vesting occurs at the end of three years, except in the case of death, disability, or termination of Director status, at which time all options become fully vested and exercisable.

Additionally, subject to the Directors' Plan's approval by shareholders, the Directors' Plan included a grant of 30,000 shares (3,750 per Director) effective on May 2, 1996. Shareholder approval occurred at the May 1997 shareholder meeting. As a result, 1996 plan data, as provided, has been restated to include the impact of this grant.

The Company may grant options for up to 1,562,500 shares under the Incentive Plan and 250,000 shares under the Directors' Plan. Through December 31, 1998, the Company has granted 425,351 options under these plans. Under both plans, the option exercise price equals the stock's fair market value on the date of grant.

A summary of the status of the plans at December 31, 1998, 1997 and 1996, and changes during the years then ended are presented in the following table and narrative:

<TABLE>

<CAPTION>

	1998 Number of Shares	1998 Weighted-Average Exercise Price	1997 Number of Shares	1997 Weighted-Average Exercise Price	1996 Number of Shares	1996 Weighted-Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Outstanding at beginning of year	277,347	$21.15	181,626	$17.72	82,032	$16.48
Granted	134,252	42.06	104,500	26.87	104,563	18.63
Exercised	3,231	18.77	8,779	18.38	--	--
Forfeited	23,294	32.22	--	--	4,969	16.48
Outstanding at end of year	385,074	27.78	277,347	21.14	181,626	17.72
Exercisable at end of year	112,652	19.46	50,413	17.45	15,688	16.48
Weighted-avg. fair value of options granted during year		$12.49		$ 8.78		$ 6.25

</TABLE>

The fair market value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 1998, 1997 and 1996, respectively: risk-free interest rates of 5.66%, 6.64% and 6.82%; expected dividend yields of 2.87%, 3.10% and 3.15%; expected lives of 10 years; and expected volatility of 23.79%, 26.30% and 27.35%.

Information on the range of exercise prices for options outstanding as of December 31, 1998, is as follows:

<TABLE>
<CAPTION>

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Outstanding as of 12/31/98	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable as of 12/31/98	Weighted-Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>
$ 0.00 - $16.88	69,595	6.1	$16.48	42,840	$16.48
$16.89 - $21.10	90,926	7.2	$18.36	45,462	$18.35
$21.11 - $37.98	102,801	8.3	$26.88	24,350	$26.79
$37.99 - $42.20	121,752	9.3	$42.04	--	--
	385,074	8.0	$27.78	112,652	$19.46

</TABLE>

POST-RETIREMENT BENEFITS OTHER THAN PENSION

The Company does not provide post-retirement or post-employment benefits to employees and therefore does not have any liability under FASB Statement No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions" or FASB Statement No. 112, "Employers' Accounting for Post-employment Benefits."

9. STATUTORY INFORMATION AND DIVIDEND RESTRICTIONS

The Company's insurance subsidiaries maintain their accounts in conformity with accounting practices prescribed or permitted by state insurance regulatory authorities that vary in certain respects from GAAP. Reconciliations of net income and shareholders' equity (statutory surplus), as reported in conformity with statutory reporting practices to that reported in the accompanying financial statements on the basis of GAAP, are shown as follows:

<TABLE>
<CAPTION>

	Year ended December 31,		
Net Income (Loss) (in thousands)	1998	1997	1996
<S>	<C>	<C>	<C>
Consolidated net income (loss), statutory basis	$29,404	$26,897	$29,486
Proposition 103 liability	--	--	2,500
Deferred policy acquisition costs	526	5,321	857
Deferred income tax benefit (expense)	583	347	(3,506)
Net income of non-insurance operations,			

interest expense on debt and general corporate expense	(1,859)	(2,328)	(3,605)
Other	(415)	(66)	(36)
As reported in accompanying financial statements	$28,239	$30,171	$25,696

Shareholders' Equity (in thousands)	December 31, 1998	1997
Consolidated surplus, statutory basis	$314,484	$265,526
Deferred policy acquisition costs	22,510	21,985
Non-admitted assets	3,399	2,738
Subsidiary ownership in RLI Corp.	(9,894)	(11,412)
Deferred tax liability	(48,421)	(36,340)
Statutory liability for reinsurance	525	881
Equity of non-insurance companies	10,504	22,427
Other	852	747
As reported in accompanying financial statements	$293,959	$266,552

Dividend payments to the Company from its principal insurance subsidiary are restricted by state insurance laws as to the amount that may be paid without prior notice or approval of the regulatory authorities of Illinois and California. The maximum dividend distribution is limited by Illinois and California law to the greater of: 10% of RLI Insurance Company's policyholder surplus as of December 31 of the preceding year, or the net income of RLI Insurance Company for the 12-month period ending December 31 of the preceding year. Therefore, the maximum dividend distribution that can be paid by RLI Insurance Company during 1999 without prior notice or approval amounts to $31.4 million -- 10% of RLI Insurance Company's 1998 policyholder surplus. The actual amount paid to the Company during 1998 was $11.8 million.

10. COMMITMENTS AND CONTINGENT LIABILITIES

The Company is involved in certain legal proceedings and disputes considered by management to be ordinary and incidental to the business, or which have no foundation in fact. Management believes that valid defenses exist as to all such litigation and disputes and is of the opinion that these will not have a material effect on the Company's financial statements.

In November 1988, California voters approved Proposition 103, which requires insurance rates for certain lines of business to be rolled back 20% from the rates in effect in November 1987. During 1996, the Company reached a settlement with the California Department of Insurance resolving its total liability for refunds and interest under Proposition 103. The settlement required the Company to pay $3.0 million in refunds and interest. In the second quarter of 1996, the Company recorded a pretax charge of $0.5 million to record the difference between the actual settlement and the amount previously accrued. During 1998 and 1997, the Company issued refund checks to policyholders. As of December 31, 1998, there was no liability and all remaining funds have been remitted to the state of California.

The Company leases regional office facilities and automobiles under operating leases expiring in various years through 2003. Minimum future rental payments under noncancellable operating leases are as follows:

1999	$1,359,072
2000	1,149,961
2001	1,044,436
2002	692,817
2003	229,251
Total minimum future rental payments	$4,475,537

11. INDUSTRY SEGMENT INFORMATION

The following table summarizes the Company's segment data as specified by FASB Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information." As prescribed by the pronouncement, reporting is based on the internal structure and reporting of information as it is used by Company management.

The segments of the property/casualty operations of the Company include property, casualty and surety. The property segment is comprised of insurance products providing physical damage coverage for commercial risks. These risks are exposed to a variety of perils including earthquakes, fires and hurricanes. Losses are developed in a relatively short period of time. The casualty segment includes liability products where loss and related settlement expenses must be estimated, as the ultimate disposition of claims may take several years to fully develop. Policy coverage is more significantly impacted by evolving legislation and court decisions. The surety segment offers a selection of small- and medium-sized commercial products related to the statutory requirement for bonds on construction projects. The results of this segment are characterized by relatively low loss ratios. However, expense ratios tend to be higher due to the high volume of transactions at lower premium levels. The investment income segment is the by-product of the interest and dividend income streams from the Company's investments in fixed income and equity securities. Interest and general corporate expenses include the cost of debt and other director and shareholder relation costs incurred for the benefit of the corporation, but not attributable to the operations of other segments. Investee earnings represent the Company's share in Maui Jim, Inc. earnings. The Company owns approximately 44% of the unconsolidated investee, which operates in sunglass and optical goods industries.

The following table provides data on each of the Company's segments as used by company management. The net earnings of each segment are before taxes, and include revenues (if applicable), direct product or segment costs (such as commissions, claims costs, etc.), as well as allocated support costs from various overhead departments. While depreciation and amortization charges have been included in these measures, the related assets are not allocated for management use and, therefore, are not included in this schedule.

<TABLE>
<CAPTION>

(in thousands)	Net Earnings			Revenues			Depreciation and Amortization		
	1998	1997	1996	1998	1997	1996	1998	1997	1996
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Property	$19,800	$21,410	$ 18,831	$ 52,281	$ 62,028	$ 48,182	$1,048	$ 927	$739
Casualty	(2,292)	(3,185)	(2,028)	71,736	68,365	78,068	993	904	1,427
Surety	(719)	526	(406)	18,307	11,491	4,406	280	169	113
Net investment income	23,937	24,558	23,681	23,937	24,558	23,681	81	91	69
Realized gains	1,853	2,982	1,017	1,853	2,982	1,018			
General corporate and interest on debt	(6,195)	(5,720)	(6,086)				113	99	831
Equity in earnings of unconsolidated investee	1,337	951	231						
Total segment earnings before income taxes	37,721	41,522	35,240						
Income taxes	9,482	11,351	9,544						
Total	$28,239	$30,171	$25,696	$168,114	$169,424	$155,355	$2,515	$2,190	$3,179

</TABLE>

12. UNAUDITED INTERIM FINANCIAL INFORMATION

Selected quarterly information is as follows:

<TABLE>
<CAPTION>

(in thousands, except per share data)	First	Second	Third	Fourth	Year
<S>	<C>	<C>	<C>	<C>	<C>
1998					
Net premiums earned	$34,915	$35,085	$35,951	$36,373	$142,324
Net investment income	5,945	5,741	6,180	6,071	23,937
Net realized investment gains	573	66	32	1,182	1,853
Earnings before income taxes	9,422	10,393	7,137	10,769	37,721
Net earnings	6,976	7,625	5,578	8,060	28,239
Basic earnings per share(1)	$0.66	$0.72	$0.53	$0.78	$2.69
Basic operating earnings per share(1)(2)	$0.62	$0.72	$0.53	$0.71	$2.58
Diluted earnings per share(1)	$0.65	$0.71	$0.53	$0.77	$2.65
Diluted operating earnings per share(1)(2)	$0.62	$0.71	$0.53	$0.70	$2.54
1997					
Net premiums earned	$33,066	$35,974	$35,895	$36,949	$141,884
Net investment income	6,022	5,999	6,247	6,290	24,558
Net realized investment gains	560	1,734	545	143	2,982
Earnings before income taxes	8,870	11,005	10,850	10,797	41,522
Net earnings	6,557	7,982	7,898	7,734	30,171
Basic earnings per share(1)	$0.68	$0.84	$0.71	$0.69	$2.90
Basic operating earnings per share(1)(2)	$0.64	$0.72	$0.67	$0.68	$2.71
Diluted earnings per share(1)	$0.59	$0.72	$0.68	$0.68	$2.66
Diluted operating earnings per share(1)(2)	$0.56	$0.62	$0.65	$0.67	$2.50

</TABLE>

(1) Since the weighted-average shares for the quarters are calculated independently of the weighted-average shares for the year, and due to the exclusion of the antidilutive effects as discussed in note 1K, quarterly earnings per share may not total to annual earnings per share.
(2) Operating earnings per share is calculated by reducing net earnings by the after-tax impact of net realized investment gains.

REPORT OF INDEPENDENT AUDITORS
THE BOARD OF DIRECTORS AND SHAREHOLDERS

RLI Corp.

We have audited the accompanying consolidated balance sheets of RLI Corp. and Subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings and comprehensive earnings, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RLI Corp. and Subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

January 14, 1999

KPMG
Certified Public Accountants
303 East Wacker Drive
Chicago, Illinois 60601

STATEMENT OF FINANCIAL REPORTING RESPONSIBILITY

The management of RLI Corp. and Subsidiaries is responsible for the preparation and for the integrity and objectivity of the accompanying financial statements and other financial information in this report. The financial statements have been prepared in accordance with generally accepted accounting principles and include amounts that are based on management's estimates and judgments.

The accompanying financial statements have been audited by KPMG LLP (KPMG), independent certified public accountants, selected by the audit committee and approved by the shareholders. Management has made available to KPMG all the Company's financial records and related data, including minutes of directors' meetings. Furthermore, management believes that all representations made to KPMG during its audit were valid and appropriate.

Management has established and maintains a system of internal controls throughout its operations that are designed to provide assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use, and the execution and recording of transactions in accordance with management's authorization. The system of internal controls provides for appropriate division of responsibility and is documented by written policies and procedures that are updated by management as necessary. Certain aspects of these systems and controls are tested periodically by the Company's internal auditor. As part of its audit of the financial statements, which is performed in accordance with generally accepted auditing standards, KPMG considers certain aspects of the system of internal controls to the extent necessary to form an opinion on the financial statements and not to provide assurance on the system of internal controls. Management considers the recommendations of its internal auditor and independent public accountants concerning the Company's internal controls and takes the necessary actions that are cost effective in the circumstances to respond appropriately to the recommendations presented. Management believes that as of December 31, 1998, the Company's system of internal controls was adequate to accomplish the objectives described herein.

The audit committee is comprised solely of four non-employee directors and is charged with general supervision of the audits, examinations and inspections of the books and accounts of RLI Corp. and Subsidiaries. It also recommends to the board of directors the firm of independent public accountants to be engaged to audit the annual consolidated financial statements, and it meets regularly with those independent public accountants and with management, both separately and together. The independent public accountants and the internal auditor have ready access to the audit committee.

Gerald D. Stephens, CPCU
President, RLI Corp.

Joseph E. Dondanville, CPA
Vice President, Chief Financial Officer, RLI Corp.

GLOSSARY

CAPACITY -- The amount of insurance that a company can write on a single risk.

CATEPUTS-SM- -- An innovative financing arrangement that provides for the issuance of the company's convertible preferred shares at a pre-negotiated rate to restore surplus to a sufficient level and to continue writing business in the event of a catastrophic loss.

CEDE -- To buy or effect reinsurance.

COMBINED RATIO -- A measurement commonly used to express underwriting profit (less than 100) or loss (more than 100). It is a combination of the expense ratio and the loss ratio.

COMMERCIAL PROPERTY INSURANCE -- Coverage for commercial or business entities for financial loss from damage to real and personal property, and interruption of the business resulting from such damage.

COMPREHENSIVE EARNINGS -- As defined at RLI, this equates to the sum of net after-tax earnings and net after-tax unrealized gains (losses) on investments.

COMPREHENSIVE GENERAL LIABILITY INSURANCE -- Liability coverage for all premises and operations, other than personal, for all general liability hazards, unless excluded.

CONSOLIDATED REVENUE -- As defined at RLI, consists of net premiums earned, net investment income and realized gains (losses).

CONTRACT BOND -- A guarantee of the faithful performance of a construction contract and the payment of all related labor and material bills.

DIFFERENCE IN CONDITIONS (DIC) INSURANCE --Coverage for property causes of loss normally excluded in standard commercial or personal property policies, particularly flood and earthquake.

DIRECTORS AND OFFICERS LIABILITY INSURANCE -- Insurance that protects the personal assets of an organization's directors and officers from claims brought by employees, shareholders, regulatory agencies or other outside third parties alleging wrongful acts in the discharge of their duties.

EXCESS INSURANCE -- A policy or bond covering the insured against certain hazards, which applies only to loss or damage in excess of a stated amount.

EXPENSE RATIO -- The percentage of the premium used to pay all the costs of acquiring, writing and servicing business.

FIRE INSURANCE -- Property insurance on which the predominant peril is fire, but also includes wind and other allied lines.

FOCUSED PRODUCT MANAGEMENT -- A business approach to managing individual products by assigning responsibility for each product to a dedicated team of individuals drawn from the various support functions based on their expertise in that product.

GROSS SALES -- As defined at RLI, consists of gross premiums written, net investment income and realized gains (losses).

IBNR -- Incurred But Not Reported losses; as defined at RLI, is the difference between actuarially determined expected ultimate losses and loss adjustment expenses and currently reported loss and loss adjustment expenses.

INLAND MARINE INSURANCE -- Property coverage for perils arising from transportation of goods or covering types of property that are more mobile in nature, as well as other unusual property hazards.

LOSS RATIO -- The proportion which losses incurred bear to the earned premiums.

MARKET VALUE POTENTIAL (MVP) -- An internal asset allocation plan. The amount by which an investment, acquisition or program generates a return in excess of the cost of assigned capital is defined as MVP.

POLICYHOLDER SURPLUS -- The residual difference between assets and liabilities for the benefit of policyholders.

PRIMARY INSURER -- A company providing coverage up to a specified amount against specific perils. Other insurers may write coverage above, or IN EXCESS, of the specified amount.

PRODUCER -- Term commonly applied to an agent, solicitor, broker, or entity marketing insurance coverages, such as wholesale brokers (who market to retail agents) and retail agents (who market to insureds).

PRODUCTS LIABILITY INSURANCE -- Protection provided against claims arising from the use of covered products manufactured, sold, handled or distributed by the insured.

PROFESSIONAL LIABILITY INSURANCE -- Insures against claims for damages because of professional misconduct or failure to exercise ordinary care in the performance of a professional service.

PROPERTY AND CASUALTY INSURANCE -- All forms of insurance coverage except for life insurance and accident/health insurance.

REINSURER/REINSURANCE -- A company that accepts part or all of the risk of loss covered by another insurer. Insurance for insurers.

RESERVES -- Funds set aside by an insurer for meeting obligations when due.

RETENTION -- The amount of liability retained on a given risk. If an insurer buys $40,000 of reinsurance on a $50,000 risk, it has RETAINED a $10,000 potential liability.

RISK MANAGEMENT -- The use of appropriate insurance, avoidance of risk, loss control, risk retention, self-insuring, and other techniques that minimize the risks of a business, individual or organization.

STANDARD LINES VS. SPECIALTY LINES -- Those insurance coverages or target market segments which are commonly insured through large, admitted insurers using standard forms and pricing are in contrast to unique insurance coverages or selected market niches that are only served by a single insurer or a select group of insurers, often with unique coverage forms and pricing approach.

SURETY BOND -- An instrument providing for compensation should there be a failure to perform any specific acts within a stated period.

TRANSPORTATION INSURANCE -- Coverage provided to entities in the business of transporting people or goods by land conveyance. For RLI, this specifically involves motor vehicle transportation and focuses on automobile liability and physical damage, with incidental public liability, umbrella and excess liability, and motor truck cargo insurance.

UMBRELLA LIABILITY POLICY -- Either a commercial or personal policy which provides liability coverage for limits in excess of those covered by underlying or primary liability insurance policies, as well as coverage for some claims not covered by those policies.

UNDERWRITING PROFIT -- That portion of the earnings after deducting incurred losses and expenses from earned premiums.

UNREALIZED GAINS -- The result of an increase in market value of an asset which is not recognized in the traditional statement of income. The difference between an asset's market and book values.

WEST COAST PROPERTY -- As defined at RLI, consists of property insurance business written by the Company's branch offices in San Francisco and Los Angeles.

INVESTOR INFORMATION

ANNUAL MEETING

The annual meeting of shareholders will be held at 2:00 p.m., CST, on May 6, 1999, at the company's offices at 9025 North Lindbergh Drive, Peoria, Ill.

TRADING AND DIVIDEND INFORMATION

RLI common stock trades on the New York Stock Exchange under the symbol RLI. The following table sets forth the high and low sale prices, as well as the closing prices, for the common stock for the indicated periods as reported by the NYSE. The table also indicates cash dividends as declared by the company.

<TABLE>
<CAPTION>

	Stock Price			Dividends
1998	High	Low	Close	Declared
1st Quarter	44.20	36.60	43.20	$.12
2nd Quarter	45.45	39.30	40.69	.13
3rd Quarter	45.63	31.56	38.00	.13
4th Quarter	38.06	30.69	33.25	.13

	Stock Price			Dividends
1997	High	Low	Close	Declared
1st Quarter	29.30	25.50	25.50	$.11
2nd Quarter	29.40	24.40	29.15	.12
3rd Quarter	36.05	27.60	36.00	.12

4th Quarter	40.20	32.60	39.85	.12

</TABLE>

RLI Corp. normally pays dividends four times a year, usually on January 15, April 15, July 15 and October 15. The company has paid and increased dividends for 23 consecutive years. RLI dividends qualify for the enterprise zone dividend subtraction modification for Illinois state income tax returns.

STOCK OWNERSHIP

At December 31, 1998, RLI stock ownership was as follows:

<TABLE>
<CAPTION>

	Shares	%
<S>	<C>	<C>
Insiders	904,694	8.8
ESOP	1,274,279	12.3
Institutions	6,328,116	61.2
Other public	1,828,203	17.7
Total Outstanding	10,335,292	100.0

</TABLE>

DIVIDEND REINVESTMENT PLANS

An Automatic Dividend Reinvestment and Stock Purchase Plan is offered to shareholders of RLI on a voluntary basis. Shareholders may also have their dividends deposited directly into their checking, savings or money market accounts. If you wish to sign up for either Plan, send your request to "Shareholder Services" at the following transfer agent and registrar address.

SHAREHOLDER INQUIRIES

Shareholders of record requesting information concerning individual account balances, stock certificates, dividends, stock transfers, tax information or address corrections should contact the transfer agent and registrar at:

Norwest Bank Minnesota, N.A.
Shareholder Services
P.O. Box 64854
St. Paul, MN 55164-0854
Phone: (800) 468-9716 or (651) 450-4064
Fax: (651) 450-4033

Email: SHAREOWNER@AOL.COM

REQUESTS FOR ADDITIONAL INFORMATION

Additional copies of this report and the Annual Report to the Securities and Exchange Commission, Form 10-K, are available without charge to any shareholder. Additionally, "Street Name" shareholders can have their names placed on a mailing list to receive copies of annual reports, quarterly reports, and other shareholder materials. Simply contact the treasurer at our corporate headquarters.

CONTACTING RLI

CORPORATE HEADQUARTERS
9025 North Lindbergh Drive
Peoria, IL 61615-1431
(309) 692-1000
(800) 331-4929
Fax: (309) 692-1068
Internet: http://www.rlicorp.com

FINANCIAL INFORMATION
For investor relations requests and management's perspective on specific issues, contact RLI Treasurer Mike Price at (309) 693-5880 or at mprice@rlicorp.com.

SELECTED FINANCIAL DATA

<TABLE>
<CAPTION>

The following is selected financial data of RLI Corp. and Subsidiaries for the eleven years ended December 31, 1998:

(amounts in thousands, except per share data)	1998	1997	1996	1995	1994	1993
Operating Results						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Gross sales	$ 316,863	306,383	301,500	293,922	295,966	266,480
Total revenue	$ 168,114	169,424	155,354	155,954	156,722	143,100
Net operating earnings (loss)(1)	$ 27,035	28,233	25,035	7,648	(2,403)	14,118

Net earnings (loss)	$ 28,239	30,171	25,696	7,950	(4,776)	15,948
Comprehensive earnings (loss)(2)	$ 51,758	66,415	41,970	31,374	(8,513)	21,175
Net cash provided from operating activities	$ 23,578	35,022	48,947	24,649	27,041	73,629
Net premiums written to statutory surplus	46%	54%	64%	76%	108%	94%
GAAP combined ratio	88.2	86.8	87.4	107.5	116.9	97.2
Statutory combined ratio	88.4	90.4	89.1	106.5	116.9	87.9(7)
Financial condition						
Total investments	$ 677,294	603,857	537,946	471,599	413,835	401,609
Total assets	$1,012,685	911,741	845,474	810,200	751,086	667,650
Unpaid losses and settlement expenses	$ 415,523	404,263	405,801	418,986	394,966	310,767
Long-term debt	$ --	--	46,000	46,000	52,255	53,000
Total shareholders' equity	$ 293,959	266,552	200,039	158,608	131,170	140,706
Statutory surplus	$ 314,484	265,526	207,787	172,313	136,125	152,262
Share Information						
Net operating earnings (loss) per share:						
Basic (4)	$ 2.58	2.71	2.54	0.78(6)	(0.25)(6)	1.49
Diluted(4)	$ 2.54	2.50	2.22	0.78(6)	(0.25)(6)	1.42
Net earnings (loss) per share:						
Basic(4)	$ 2.69	2.90	2.60	0.81(6)	(0.49)(6)	1.68(8)
Diluted(4)	$ 2.65	2.66	2.28	0.81(6)	(0.49)(6)	1.60(8)
Comprehensive earnings (loss) per share(2)						
Basic(4)	$ 4.92	6.38	4.25	3.20(6)	(0.87)(6)	2.23(8)
Diluted(4)	$ 4.87	5.76	3.62	2.77(5)(6)	(0.87)(6)	2.10(8)
Cash dividends declared per share	$ 0.51	0.47	0.44	0.41	0.36	0.34
Book value per share	$ 28.44	24.70	20.46	16.16	13.37	14.60
Closing stock price	$ 33.25	39.85	26.70	20.00	13.12	16.96
Stock split	125%			125%		
Weighted average shares outstanding:						
Basic(4)	10,514	10,402	9,871	9,812	9,733	9,499
Diluted(4)	10,638	11,714	12,105	9,812	9,732	10,451
Common shares outstanding	10,335	10,793	9,777	9,814	9,812	9,639

(amounts in thousands, except per share data)	1992	1991	1990	1989	1988
Operating Results					
<S>	<C>	<C>	<C>	<C>	<C>
Gross sales	$ 220,048	215,498	181,216	149,230	143,785
Total revenue	$ 117,582	102,343	92,958	89,984	104,279
Net operating earnings (loss)(1)	$ 15,599	15,986	14,998	7,960	6,927
Net earnings (loss)	$ 16,207	16,800	14,267	8,200	7,254
Comprehensive earnings (loss)(2)	$ 18,548	22,430	11,952	11,105	8,296
Net cash provided from operating activities	$ 43,619	22,918	45,388	22,801	27,742
Net premiums written to statutory surplus	110%	95%	112%	96%	131%
GAAP combined ratio	91.4	85.2	85.1	97.8	96.1
Statutory combined ratio	95.8	91.6	92.2	99.5	98.3
Financial condition					
Total investments	$ 281,113	237,932	213,160	177,025	165,957
Total assets	$ 526,351	483,572	432,380	402,906	372,492
Unpaid losses and settlement expenses	$ 268,043	244,667	235,807	230,524	217,231
Long-term debt	$ 7,000	7,000	7,000	7,000	7,000
Total shareholders' equity	$ 117,393	99,678	79,851	70,276	64,026
Statutory surplus	$ 100,585	88,605	70,410	68,571	60,152
Share Information					
Net operating earnings (loss) per share:					
Basic (4)	$ 1.74	1.81	1.70	0.89	0.74
Diluted(4)	$ 1.74	1.81	1.70	0.89	0.74
Net earnings (loss) per share:					
Basic(4)	$ 1.81	1.90	1.61	0.91	0.78
Diluted(4)	$ 1.81	1.90	1.61	0.91	0.78
Comprehensive earnings (loss) per share(2)					
Basic(4)	$ 2.07	2.54	1.35	1.24	0.89
Diluted(4)	$ 2.07	2.54	1.35	1.24	0.89
Cash dividends declared per share	$ 0.32	0.30	0.27	0.24	0.22
Book value per share	$ 13.04	11.27	9.03	7.95	6.85
Closing stock price	$ 15.84	10.56	9.28	5.44	4.88
Stock split					
Weighted average shares outstanding:					
Basic(4)	8,949	8,842	8,842	8,986	9,344
Diluted(4)	8,949	8,842	8,842	8,986	9,344
Common shares outstanding	9,002	8,842	8,842	8,842	9,344

(1) For all periods presented, net operating earnings represent the Company's net earnings reduced by after-tax realized gains. For 1993, the financial impact of FASB Statement No. 109 has also been deducted in arriving at operating earnings.

(2) See note 1.L to the consolidated financial statements.

(3) Share and per share data have been restated to reflect the 5-for-4 stock split that occurred June 19, 1998.

(4) See note 1.K to the consolidated financial statements.

(5) For 1995, diluted earnings per share on a GAAP basis were anti-dilutive. As such, GAAP diluted and basic earnings per share were equal. Diluted comprehensive earnings per share, however, were not anti-dilutive. The number of diluted shares used for this calculation was 9,619.

(6) The combined effects of the Northridge Earthquake -- including losses, expenses and the reduction in revenue due to the reinstatement of reinsurance coverages -- reduced 1994 after-tax earnings by $25.0 million ($2.57 per basic share, $2.10 per diluted share) and 1995 after-tax earnings by $18.6 million ($1.90 per basic share, $1.54 per diluted share). See note 1.C to the consolidated financial statements for further details.

(7) Contingent commission income recorded during 1993, from the cancellation of a multiple-year, retrospectively-rated reinsurance contract, reduced the statutory expense and combined ratio 10.3 points.

(8) Basic and diluted earnings per share include $.18 and $.16 per share, respectively, from the initial application of FASB Statement No. 109 "Accounting for Income Taxes."

</TABLE>

Exhibit 21.1

Subsidiaries of the Registrant

The following companies are subsidiaries of the Registrant as of December 31, 1998.

<TABLE>
<CAPTION>

NAME	JURISDICTION OF INCORPORATION	PERCENTAGE OWNERSHIP
<S>	<C>	<C>
	Illinois	100%
RLI Aviation, Inc.	Illinois	100%
Replacement Lens Inc.	Illinois	100%
Mt. Hawley Insurance Company	Kansas	100%
RLI Insurance Ltd.	Bermuda	100%
RLI Insurance Agency Ltd.	Canada	100%
RLI Mortgage Services, LLC	Illinois	50%
RLI Texas Corp.	Texas	100%

</TABLE>

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
RLI Corp.:

We consent to incorporation by reference in the registration statement on Form S-8 (No. 333-1637), Form S-8 (No. 333-28625) and Form S-3 (No. 33-61788) of RLI Corp. of our reports dated January 14, 1999, relating to the consolidated balance sheets of RLI Corp. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of earnings and comprehensive earnings, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998, and all related schedules, which reports aaare incorporated by reference in, or appear in (with respect to the schedules), and 1998 annual report on Form 10-K of RLI Corp.

KPMG, LLP

Chicago, Illinois
March 24, 1999

<TABLE> <S> <C>

<ARTICLE> 5
<LEGEND>
THIS FINANCIAL DATA SCHEDULE CONTAINS THE CONSOLIDATED FINANCIAL STATEMENTS IN THE RLI CORP. ANNUAL REPORT TO SHAREHOLDERS FOR THE PERIOD ENDED DECEMBER 31, 1998, ATTACHED AS EXHIBIT 13 TO RLI CORP.'S FORM 10K AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
</LEGEND>
<RESTATED>
<MULTIPLIER> 1,000

<S>	<C>	
<PERIOD-TYPE>	YEAR	
<FISCAL-YEAR-END>		DEC-31-1998
<PERIOD-END>		DEC-31-1998
<CASH>		0
<SECURITIES>		677,294
<RECEIVABLES>		221,385
<ALLOWANCES>		0
<INVENTORY>		0
<CURRENT-ASSETS>		1,000,485
<PP&E>		20,954
<DEPRECIATION>		(8,754)
<TOTAL-ASSETS>		1,012,685
<CURRENT-LIABILITIES>		670,305
<BONDS>		0
<PREFERRED-MANDATORY>		0
<PREFERRED>		0
<COMMON>		12,790
<OTHER-SE>		281,169
<TOTAL-LIABILITY-AND-EQUITY>		1,012,685
<SALES>		0
<TOTAL-REVENUES>		168,114
<CGS>		0
<TOTAL-COSTS>		125,535
<OTHER-EXPENSES>		3,915
<LOSS-PROVISION>		0
<INTEREST-EXPENSE>		2,280
<INCOME-PRETAX>		37,721
<INCOME-TAX>		9,482
<INCOME-CONTINUING>		28,239
<DISCONTINUED>		0
<EXTRAORDINARY>		0
<CHANGES>		0
<NET-INCOME>		28,239
<EPS-PRIMARY>		2.69
<EPS-DILUTED>		2.65

</TABLE>

Exhibit 28.1

Information from reports furnished to state insurance regulatory authorities - Reconciliation of reserves for unpaid losses and settlement expenses.

The domestic insurance subsidiaries of the Company are required to file annual statements with state insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities (statutory basis). The differences between the net liability reported in the accompanying consolidated financial statements in accordance with generally accepted accounting principles (GAAP) and that reported in the annual statutory statements are as follows:

<TABLE>
<CAPTION>

<S>	<C> At December 31, 1998 (In Thousands)
Net liability reported on a statutory basis	$247,498
Adjustments:	
Interest imputed on commutation settlements	(236)
Net liability reported on a GAAP basis	$247,262
Reconciliation of the GAAP net liability:	
Gross unpaid losses and settlement expenses	$415,523
Reinsurance balances recoverable on unpaid losses and settlement expenses	(168,261)
Net liability reported on a GAAP basis	$247,262

</TABLE>