RLI CORP
Form 10-Q
July 28, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from to

Commission File Number: 001-09463

RLI Corp.

(Exact name of registrant as specified in its charter)

ILLINOIS	**37-0889946**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9025 North Lindbergh Drive, Peoria, IL	**61615**
(Address of principal executive offices)	(Zip Code)

(309) 692-1000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of July 11, 2014, the number of shares outstanding of the registrant s Common Stock was 43,023,504.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)	**For the Three-Month Periods Ended June 30,**			
		2014		**2013**
Net premiums earned	$	168,604	$	154,553
Net investment income		13,982		12,847
Net realized investment gains		10,431		3,742
Consolidated revenue	$	193,017	$	171,142
Losses and settlement expenses		73,345		65,607
Policy acquisition costs		55,156		51,502
Insurance operating expenses		13,534		11,885
Interest expense on debt		1,874		1,513
General corporate expenses		2,549		1,692
Total expenses	$	146,458	$	132,199
Equity in earnings of unconsolidated investees		5,864		4,633
Earnings before income taxes	$	52,423	$	43,576
Income tax expense		16,698		13,674
Net earnings	$	35,725	$	29,902
Other comprehensive earnings (loss), net of tax		19,934		(33,481)
Comprehensive earnings (loss)	$	55,659	$	(3,579)
Earnings per share:				
Basic:				
Basic net earnings per share	$	0.83	$	0.70
Basic comprehensive earnings (loss) per share	$	1.29	$	(0.08)
Diluted:				
Diluted net earnings per share	$	0.82	$	0.69
Diluted comprehensive earnings (loss) per share	$	1.27	$	(0.08)
Weighted average number of common shares outstanding				
Basic		43,001		42,628
Diluted		43,688		43,341
Cash dividends paid per common share	$	0.18	$	0.17

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

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Earnings

(Unaudited)

(in thousands, except per share data)		**For the Six-Month Periods Ended June 30, 2014**		**2013**
Net premiums earned	$	329,736	$	298,704
Net investment income		27,564		25,733
Net realized investment gains		16,932		7,426
Consolidated revenue	$	374,232	$	331,863
Losses and settlement expenses		144,361		127,055
Policy acquisition costs		110,207		101,838
Insurance operating expenses		26,067		24,454
Interest expense on debt		3,725		3,025
General corporate expenses		4,747		4,078
Total expenses	$	289,107	$	260,450
Equity in earnings of unconsolidated investees		9,289		8,132
Earnings before income taxes	$	94,414	$	79,545
Income tax expense		29,720		24,796
Net earnings	$	64,694	$	54,749
Other comprehensive earnings (loss), net of tax		37,671		(15,928)
Comprehensive earnings	$	102,365	$	38,821
Earnings per share:				
Basic:				
Basic net earnings per share	$	1.50	$	1.29
Basic comprehensive earnings per share	$	2.38	$	0.91
Diluted:				
Diluted net earnings per share	$	1.48	$	1.27
Diluted comprehensive earnings per share	$	2.34	$	0.90
Weighted average number of common shares outstanding				
Basic		42,993		42,587
Diluted		43,669		43,268
Cash dividends paid per common share	$	0.35	$	0.33

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

RLI Corp. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands, except share data)		June 30, 2014		December 31, 2013
ASSETS				
Investments				
Fixed income				
Available-for-sale, at fair value	$	1,534,622	$	1,440,052
Held-to-maturity, at amortized cost		650		651
Equity securities, at fair value		436,462		418,654
Short-term investments, at cost		18,489		23,232
Cash		27,234		39,469
Total investments and cash	$	2,017,457	$	1,922,058
Accrued investment income		15,229		15,710
Premiums and reinsurance balances receivable		203,499		152,509
Ceded unearned premium		72,396		60,407
Reinsurance balances recoverable on unpaid losses		339,104		354,924
Deferred policy acquisition costs		68,190		61,508
Property and equipment		42,935		40,261
Investment in unconsolidated investees		64,487		49,793
Goodwill and intangibles		74,407		74,876
Other assets		11,292		8,264
TOTAL ASSETS	$	2,908,996	$	2,740,310
LIABILITIES AND SHAREHOLDERS EQUITY				
Liabilities:				
Unpaid losses and settlement expenses	$	1,127,073	$	1,129,433
Unearned premiums		444,453		392,081
Reinsurance balances payable		62,402		47,334
Funds held		59,398		61,656
Income taxes-deferred		81,963		57,801
Bonds payable, long-term debt		149,604		149,582
Accrued expenses		40,199		59,596
Other liabilities		24,509		13,861
TOTAL LIABILITIES	$	1,989,601	$	1,911,344
Shareholders Equity				
Common stock ($1 par value, 100,000,000 shares authorized)				
(65,953,718 shares issued, 43,023,504 shares outstanding at 6/30/14)				
(65,912,638 shares issued, 42,982,424 shares outstanding at 12/31/13)	$	65,954	$	65,913
Paid-in capital		211,774		208,705
Accumulated other comprehensive earnings		173,698		136,027
Retained earnings		860,968		811,320
Deferred compensation		11,626		11,562
Less: Treasury shares at cost				
(22,930,214 shares at 6/30/14 and 12/31/13)		(404,625)		(404,561)
TOTAL SHAREHOLDERS EQUITY	$	919,395	$	828,966
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	2,908,996	$	2,740,310

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

RLI Corp. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	For the Six-Month Periods Ended June 30, **2014**		**2013**	
Net cash provided by operating activities	$	38,528	$	26,781
Cash Flows from Investing Activities				
Investments purchased	$	(311,402)	$	(295,508)
Investments sold		217,403		145,314
Investments called or matured		49,932		77,436
Net change in short-term investments		15,462		33,134
Net property and equipment purchased		(4,921)		(8,167)
Investment in equity method investee		(5,301)		
Net cash used in investing activities	$	(38,827)	$	(47,791)
Cash Flows from Financing Activities				
Cash dividends paid	$	(15,046)	$	(14,062)
Stock plan share issuance		2,760		1,545
Excess tax benefit from exercise of stock options		350		1,970
Net cash used in financing activities	$	(11,936)	$	(10,547)
Net decrease in cash	$	(12,235)	$	(31,557)
Cash at the beginning of the period	$	39,469	$	44,314
Cash at June 30	$	27,234	$	12,757

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. As such, these unaudited condensed consolidated interim financial statements should be read in conjunction with our 2013 Annual Report on Form 10-K. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2014 and the results of operations of RLI Corp. and subsidiaries for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the operating results for a full year.

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

B. ADOPTED ACCOUNTING STANDARDS

We have not adopted any new accounting standards as there have been no accounting standard updates which would impact our financial statements.

C. PROSPECTIVE ACCOUNTING STANDARDS

There are no prospective accounting standards which would impact our financial statements as of June 30, 2014.

D. INTANGIBLE ASSETS

In accordance with GAAP guidelines, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and intangibles totaled $74.4 million at June 30, 2014.

Goodwill resulting from acquisitions completed prior to 2011 totaled $26.2 million and is attributable to our surety segment. Goodwill and intangible assets resulting from the Contractors Bonding and Insurance Company (CBIC) acquisition in April 2011 totaled $32.2 million. The CBIC-related assets include goodwill attributable to our casualty and surety segments of $5.3 million and $15.1 million, respectively, and an indefinite-lived intangible asset in the amount of $8.8 million. Annual impairment testing was performed on each of these goodwill and indefinite-lived intangible assets during the second quarter of 2014. Based upon these reviews, none of the assets were impaired. In addition, as of June 30, 2014, there were no triggering events that occurred that would suggest an updated review was necessary. Definite-lived intangible assets related to the CBIC acquisition totaled $3.0 million, net of amortization, as of June 30, 2014.

The remaining $16.0 million of goodwill and intangibles relates to our purchase of Rockbridge Underwriting Agency (Rockbridge) in November 2012. Of this amount, $12.4 million is recorded as goodwill attributable to our casualty segment. The remaining $3.6 million relates to definite-lived intangible assets, net of amortization, as of June 30, 2014. Annual impairment testing was performed on this goodwill asset in the fourth quarter of 2013. Based upon this review, the asset was not impaired. In addition, as of June 30, 2014, there were no triggering events that occurred that would suggest an updated review was necessary.

The aforementioned definite-lived intangible assets are amortized against future operating results based on their estimated useful lives. Amortization of intangible assets resulting from the acquisitions of CBIC and Rockbridge was $0.3 for the second quarter of 2014, and $0.5 million for the six months ended June 30, 2014.

E. EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock or common stock equivalents were exercised or converted into common stock. When inclusion of common stock equivalents increases the earnings per share or reduces the loss per share, the effect on earnings is anti-dilutive. Under these circumstances, the diluted net earnings or net loss per share is computed excluding the common stock equivalents.

The following represents a reconciliation of the numerator and denominator of the basic and diluted EPS computations contained in the unaudited condensed consolidated interim financial statements.

	For the Three-Month Period Ended June 30, 2014			For the Three-Month Period Ended June 30, 2013		
(in thousands, except per share data)	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**	**Income (Numerator)**	**Shares (Denominator)**	**Per Share Amount**
Basic EPS						
Income available to common shareholders	$ 35,725	43,001	$ 0.83	$ 29,902	42,628	$ 0.70
Effect of Dilutive Securities						
Stock options		687			713	
Diluted EPS						
Income available to common shareholders	$ 35,725	43,688	$ 0.82	$ 29,902	43,341	$ 0.69

(in thousands, except per share data)	For the Six-Month Period Ended June 30, 2014 Income (Numerator)	Shares (Denominator)	Per Share Amount	For the Six-Month Period Ended June 30, 2013 Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	$ 64,694	42,993	$ 1.50	$ 54,749	42,587	$ 1.29
Effect of Dilutive Securities						
Stock options		676			681	
Diluted EPS						
Income available to common shareholders	$ 64,694	43,669	$ 1.48	$ 54,749	43,268	$ 1.27

F. COMPREHENSIVE EARNINGS

Our comprehensive earnings include net earnings plus unrealized gains/losses on our available-for-sale investment securities, net of tax. In reporting comprehensive earnings on a net basis in the statement of earnings, we used the federal statutory tax rate of 35 percent. The following table illustrates the changes in the balance of each component of accumulated other comprehensive earnings for each period presented in the unaudited condensed consolidated interim financial statements.

(in thousands)	For the Three-Month Periods Ended June 30, 2014	2013	For the Six - Month Periods Ended June 30, 2014	2013
Unrealized Gains/Losses on Available-for-Sale Securities				
Beginning balance	$ 153,764	$ 160,723	$ 136,027	$ 143,170
Other comprehensive earnings before reclassifications	26,714	(30,824)	48,674	(10,557)
Amounts reclassified from accumulated other comprehensive earnings	(6,780)	(2,657)	(11,003)	(5,371)
Net current-period other comprehensive earnings	$ 19,934	$ (33,481)	$ 37,671	$ (15,928)
Ending balance	$ 173,698	$ 127,242	$ 173,698	$ 127,242

The sale or other-than-temporary impairment of an available-for-sale security results in amounts being reclassified from accumulated other comprehensive earnings to current period net earnings. The effects of reclassifications out of accumulated other comprehensive earnings by the respective line items of net earnings are presented in the following table.

(in thousands) Component of Accumulated Other Comprehensive Earnings	Amount Reclassified from Accumulated Other Comprehensive Earnings For the Three-Month Periods Ended June 30, 2014	2013	For the Six-Month Periods Ended June 30, 2014	2013	Affected line item in the Statement of Earnings
Unrealized gains and losses on available-for-sale securities	$ 10,431	$ 4,087	$ 16,928	$ 8,263	Net realized investment gains
					Other-than-temporary impairment (OTTI) losses on investments
	$ 10,431	$ 4,087	$ 16,928	$ 8,263	Earnings before income taxes
	(3,651)	(1,430)	(5,925)	(2,892)	Income tax expense
	$ 6,780	$ 2,657	$ 11,003	$ 5,371	Net earnings

2. INVESTMENTS

Our investments include fixed income debt securities and common stock equity securities. As disclosed in our 2013 Annual Report on Form 10-K, we present our investments in these classes as available-for-sale and held-to-maturity. When available, we obtain quoted market prices to determine fair value for our investments. If a quoted market price is not available, fair value is estimated using a secondary pricing source or using quoted market prices of similar securities. We have no investment securities for which fair value is determined using Level 3 inputs as defined in note 3 to the unaudited condensed consolidated interim financial statements, Fair Value Measurements.

The following tables show the amortized cost, unrealized gains/losses, fair value and contractual maturities for our available-for-sale and held-to-maturity securities.

Available-for-Sale Securities

The amortized cost and fair value of available-for-sale securities at June 30, 2014 and December 31, 2013 were as follows:

Available-for-sale

(in thousands)

	6/30/2014			
Asset Class	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency	$ 3,883	$ 99	$ (1)	$ 3,981
Corporate	550,687	28,919	(797)	578,809
Mtge/ABS/CMBS*	375,116	11,242	(2,918)	383,440
Non-U.S. govt. & agency	13,853	1,064		14,917
U.S. government	31,571	168	(10)	31,729

Municipal		510,516		13,111		(1,881)		521,746
Total Fixed Income	**$**	**1,485,626**	**$**	**54,603**	**$**	**(5,607)**	**$**	**1,534,622**
Equity	**$**	**218,797**	**$**	**217,731**	**$**	**(66)**	**$**	**436,462**

Available-for-sale

(in thousands)

	12/31/2013							
Asset Class		**Cost or Amortized Cost**		**Gross Unrealized Gains**		**Gross Unrealized Losses**		**Fair Value**
U.S. agency	$	10,513	$	22	$	(237)	$	10,298
Corporate		511,748		22,302		(8,012)		526,038
Mtge/ABS/CMBS*		350,187		8,188		(7,650)		350,725
Non-U.S. govt. & agency		13,306		437		(65)		13,678
U.S. government		17,086		217				17,303
Municipal		528,209		6,495		(12,694)		522,010
Total Fixed Income	**$**	**1,431,049**	**$**	**37,661**	**$**	**(28,658)**	**$**	**1,440,052**
Equity	**$**	**218,848**	**$**	**200,081**	**$**	**(275)**	**$**	**418,654**

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

The following table presents the amortized cost and fair value of available-for-sale debt securities by contractual maturity dates as of June 30, 2014:

	6/30/2014			
AFS (in thousands)		**Amortized Cost**		**Fair Value**
Due in one year or less	$	11,557	$	11,628
Due after one year through five years		211,437		221,664
Due after five years through 10 years		618,409		642,994
Due after 10 years		269,107		274,896
Mtge/ABS/CMBS*		375,116		383,440
Total available-for-sale	$	1,485,626	$	1,534,622

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

Held-to-Maturity Debt Securities

The carrying value and fair value of held-to-maturity securities was $0.7 million at June 30, 2014 and December 31, 2013. Held-to-maturity securities are carried on the unaudited condensed consolidated balance sheets at amortized cost and changes in the fair value of these securities, other than impairment charges, are not reported on the financial statements. Unrecognized gains on our held-to-maturity securities were less than $0.1 million at June 30, 2014 and December 31, 2013. As of June 30, 2014, the carrying value and fair value of all debt securities held-to-maturity had a contractual maturity date of one year or less.

Unrealized Losses

We conduct and document periodic reviews of all securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The following tables are used as part of our impairment analysis and illustrate the total value of securities that were in an unrealized loss position as of June 30, 2014 and December 31, 2013. The tables segregate the securities based on type, noting the fair value, cost (or amortized cost), and unrealized loss on each category of investment as well as in total. The tables further classify the securities based on the length of time they have been in an unrealized loss position. As of June 30, 2014 unrealized losses, as shown in the following tables, were 0.3 percent of total invested assets. Unrealized losses decreased in 2014, as interest rates declined during the first half of the year.

(in thousands)	June 30, 2014 < 12 Mos.	June 30, 2014 12 Mos. & Greater	June 30, 2014 Total	December 31, 2013 < 12 Mos.	December 31, 2013 12 Mos. & Greater	December 31, 2013 Total
U.S. Government						
Fair value	$ 4,423	$	$ 4,423	$	$	$
Cost or amortized cost	4,433		4,433			
Unrealized Loss	$ (10)	$	$ (10)	$	$	$
U.S. Agency						
Fair value	$ 1,883	$	$ 1,883	$ 5,760	$	$ 5,760
Cost or amortized cost	1,884		1,884	5,997		5,997
Unrealized Loss	$ (1)	$	$ (1)	$ (237)	$	$ (237)
Non-U.S. Government						
Fair value	$	$	$	$ 1,825	$	$ 1,825
Cost or amortized cost				1,890		1,890
Unrealized Loss	$	$	$	$ (65)	$	$ (65)
Mortgage-backed						
Fair value	$ 7,349	$ 79,004	$ 86,353	$ 118,283	$	$ 118,283
Cost or amortized cost	7,392	81,396	88,788	124,034		124,034
Unrealized Loss	$ (43)	$ (2,392)	$ (2,435)	$ (5,751)	$	$ (5,751)
ABS/CMBS*						
Fair value	$ 16,557	$ 16,457	$ 33,014	$ 54,115	$	$ 54,115
Cost or amortized cost	16,659	16,838	33,497	56,014		56,014
Unrealized Loss	$ (102)	$ (381)	$ (483)	$ (1,899)	$	$ (1,899)
Corporate						
Fair value	$ 51,213	$ 32,233	$ 83,446	$ 190,470	$ 2,245	$ 192,715
Cost or amortized cost	51,414	32,829	84,243	198,250	2,477	200,727
Unrealized Loss	$ (201)	$ (596)	$ (797)	$ (7,780)	$ (232)	$ (8,012)
Municipal						
Fair value	$ 22,079	$ 117,639	$ 139,718	$ 309,407	$ 943	$ 310,350
Cost or amortized cost	22,132	119,467	141,599	322,095	949	323,044
Unrealized Loss	$ (53)	$ (1,828)	$ (1,881)	$ (12,688)	$ (6)	$ (12,694)
Subtotal, fixed income						
Fair value	$ 103,504	$ 245,333	$ 348,837	$ 679,860	$ 3,188	$ 683,048
Cost or amortized cost	103,914	250,530	354,444	708,280	3,426	711,706
Unrealized Loss	$ (410)	$ (5,197)	$ (5,607)	$ (28,420)	$ (238)	$ (28,658)
Equity securities						
Fair value	$ 9,372	$	$ 9,372	$ 2,394	$	$ 2,394
Cost or amortized cost	9,438		9,438	2,669		2,669
Unrealized Loss	$ (66)	$	$ (66)	$ (275)	$	$ (275)
Total						
Fair value	$ 112,876	$ 245,333	$ 358,209	$ 682,254	$ 3,188	$ 685,442
Cost or amortized cost	113,352	250,530	363,882	710,949	3,426	714,375

Unrealized Loss	$ (476)	$ (5,197)	$ (5,673)	$ (28,695)	$ (238)	$ (28,933)

*Asset-backed & commercial mortgage-backed

The following table shows the composition of the fixed income securities in unrealized loss positions at June 30, 2014 by the National Association of Insurance Commissioners (NAIC) rating and the generally equivalent Standard & Poor s (S&P) and Moody s ratings. The vast majority of the securities are rated by S&P and/or Moody s.

NAIC Rating	Equivalent S&P Rating	Equivalent Moody s Rating	Amortized Cost	(dollars in thousands) Fair Value	Unrealized Loss	Percent to Total
1	AAA/AA/A	Aaa/Aa/A	$ 321,030	$ 315,595	$ (5,435)	96.9%
2	BBB	Baa	9,251	9,226	(25)	0.4%
3	BB	Ba	15,137	15,048	(89)	1.6%
4	B	B	8,371	8,316	(55)	1.0%
5	CCC or lower	Caa or lower	655	652	(3)	0.1%
6						
		Total	$ 354,444	$ 348,837	$ (5,607)	100.0%

Cash and Short-term Investments

Cash consists of uninvested balances in bank accounts. We had a cash balance of $27.2 million at the end of the second quarter of 2014, compared to $39.5 million at the end of 2013. Short-term investments are carried at cost, which approximates fair value. The balance at June 30, 2014 was $18.5 million compared to $23.2 million at December 31, 2013.

Evaluating Investments for OTTI

The fixed income portfolio contained 205 securities in an unrealized loss position as of June 30, 2014. The $5.6 million in associated unrealized losses for these 205 securities represents 0.4 percent of the fixed income portfolio s cost basis. Of these 205 securities, 111 have been in an unrealized loss position for 12 consecutive months or longer. All fixed income securities in the investment portfolio continue to pay the expected coupon payments under the contractual terms of the securities. Any credit-related impairment related to fixed income securities we do not plan to sell and for which we are not more likely than not to be required to sell is recognized in net earnings, with the non-credit related impairment recognized in comprehensive earnings. Based on our analysis, our fixed income portfolio is of high credit quality and we believe we will recover the amortized cost basis of our fixed income securities. We continually monitor the credit quality of our fixed income investments to assess if it is probable that we will receive our contractual or estimated cash flows in the form of principal and interest. There were no other-than-temporary impairment (OTTI) losses recognized in net earnings or other comprehensive earnings in the periods presented on the fixed income portfolio.

As of June 30, 2014, we held two common stock securities that were in an unrealized loss position. The unrealized loss on these securities was less than $0.1 million. Based on our analysis, we believe each security will recover in a reasonable period of time and we have the intent and ability to hold them until recovery. No equity securities have been in an unrealized loss position for 12 consecutive months or longer. There were no OTTI losses recognized in the periods presented on the equity portfolio.

3. FAIR VALUE MEASUREMENTS

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Fair value is defined as the price in the principal market that would be received for an asset to facilitate an orderly transaction between market participants on the measurement date.

We determined the fair value of certain financial instruments based on their underlying characteristics and relevant transactions in the marketplace. GAAP guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also describes three levels of inputs that may be used to measure fair value.

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

Pricing Level 1 is applied to valuations based on readily available, unadjusted quoted prices in active markets for identical assets. These valuations are based on quoted prices that are readily and regularly available in an active market.

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

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

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

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

Mortgage-backed Securities (MBS)/Commercial Mortgage-backed Securities (CMBS) and Asset-backed Securities (ABS): The pricing vendor evaluation methodology includes principally interest rate movements and new issue data. Evaluation of the tranches (non-volatile, volatile or credit sensitivity) is based on the pricing vendors interpretation of accepted modeling and pricing conventions. This information is then used to determine the cash flows for each tranche, benchmark yields, prepayment assumptions and to incorporate collateral performance. To evaluate MBS and CMBS volatility, an option adjusted spread model is used in combination with models that simulate interest rate paths to determine market price information. This process allows the pricing vendor to obtain evaluations of a broad universe of securities in a way that reflects changes in yield curve, index rates, implied volatility, mortgage rates and recent trade activity. MBS/CMBS and ABS with corroborated, observable inputs are classified as Level 2. All of our MBS/CMBS and ABS are deemed Level 2.

Common Stock: Exchange traded equities have readily observable price levels and are classified as Level 1 (fair value based on quoted market prices). All of our common stock holdings are deemed Level 1.

For the Level 2 securities, as described above, we periodically conduct a review to assess the reasonableness of the fair values provided by our pricing services. Our review consists of a two pronged approach. First, we compare prices provided by our pricing services to those provided by an additional source. Second, we obtain prices from securities brokers and compare them to the prices provided by our pricing services. In both comparisons, when discrepancies are found, we compare our prices to actual reported trade data for like securities. Based on this assessment, we determined that the fair values of our Level 2 securities provided by our pricing services are reasonable.

For common stock, we receive prices from a nationally recognized pricing service. Prices are based on observable inputs in an active market and are therefore disclosed as Level 1. Based on this assessment, we determined that the fair values of our Level 1 securities provided by our pricing service are reasonable.

Due to the relatively short-term nature of cash, short-term investments, accounts receivable and accounts payable, their carrying amounts are reasonable estimates of fair value.

Assets measured at fair value in the accompanying unaudited condensed consolidated interim financial statements on a recurring basis are summarized below:

	As of June 30, 2014		
	Fair Value Measurements Using		
	Quoted Prices in Active Markets for	Significant Other Observable	Significant