

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN,
Insurance Commissioner of the
Commonwealth of Pennsylvania,

Plaintiff,

v.

RELIANCE INSURANCE CO.,

Defendant.

No. 269 M.D. 2001

RECEIVED AND FILED
PHILADELPHIA
COMMONWEALTH COURT
OF PENNSYLVANIA
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STATUS REPORT AS OF NOVEMBER 15, 2001 OF M. DIANE KOKEN,
INSURANCE COMMISSIONER OF THE COMMONWEALTH OF
PENNSYLVANIA IN HER CAPACITY AS
LIQUIDATOR OF RELIANCE INSURANCE COMPANY

I. INTRODUCTION

This is a periodic status report ("Report") of M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania ("Commissioner"), in her capacity as Liquidator ("Liquidator") of Reliance Insurance Company ("Reliance" or the "Company").

II. REPORT

The purpose of this Report is to inform the Court on an interim basis of certain developments and issues related to the liquidation of Reliance.

A. Financial Matters

1. Bear Stearns Secured Credit Facility

After obtaining Court approval, Reliance executed the secured credit facility agreements with Bear Stearns on October 10, 2001. Given the present loan to value rates

and market value of the Symbol Technologies stock, Reliance is able to borrow up to \$50 million dollars under the credit facility. Reliance has not drawn on the available credit and will borrow only if necessary to meet current obligations.

B. Statutory Deposits

As the Court has already been informed, the Rehabilitator was unable to obtain release of statutory deposits for the purpose of paying claims in most states holding these statutory deposits. The Liquidation Order gave the Liquidator the discretion to cease paying workers compensation and personal injury protection claims in those states maintaining statutory deposits, but the Liquidator did not exercise this discretion prior to the November 2, 2001 expiration of all policies of insurance. See Liquidation Order, ¶¶ 17, 18.

The Liquidation Order makes release of statutory deposits less significant to the Liquidator. Generally, the local state official holding the statutory deposits will either turn the deposits over to the local guaranty association or, in states holding relatively small deposits, use the deposits to fund ancillary receiverships. The Liquidator will eventually file an early access plan with the Court and will, at that time, address the statutory deposits as they relate to making estate funds available to the guaranty associations.

C. Sale of Reliance Life Insurance Company

On October 26, 2001, the Liquidator filed the Emergency Petition to Approve the Sale of Reliance Life Insurance Company ("RLIC"). See Emergency Petition to Approve the Sale of Reliance Life Insurance Company (filed, Oct. 26, 2001). RLIC is a life insurance company organized under Delaware law and regulated by the Delaware Department of Insurance ("DDI").

As set forth in the Emergency Petition, before the entry of the Rehabilitation Order on May 29, 2001, Reliance agreed to sell RLIC to Combined Insurance Company of America ("Combined"), an affiliate of Aon Corporation ("Aon"), pursuant to the terms of a Stock Purchase Agreement attached to the Emergency Petition. Combined's efforts to comply with the regulatory requirements of the DDI delayed the closing of the RLIC transaction for several months.

In early October, 2001, the DDI scheduled a hearing on the RLIC transaction for October 31, 2001, and informed Reliance it would be required to present proof that the transaction had been submitted to the Commonwealth Court of Pennsylvania for approval. The DDI's notice was unclear as to whether Commonwealth Court approval was required prior to October 31. The Liquidator promptly filed the Emergency Petition to facilitate the regulatory review of the DDI and the closing of the RLIC transaction. This Court approved the RLIC transaction on October 29, 2001.

On October 31, 2001, a hearing on the RLIC transaction was held by the DDI in Dover, Delaware. The parties provided the DDI with all requested documentation including (1) this Court's October 29 Order approving the terms of the Stock Purchase Agreement; (2) the Liquidator's further endorsement of the RLIC transaction; and (3) all documents requested by the DDI from Combined and Aon. Based on the report of the hearing official, the RLIC transaction was approved by the DDI, with a closing to take place in late November or early December. The RLIC transaction will bring approximately \$ 10.3 million in cash into Reliance's estate.

D. Ancillary and Foreign Receivership Proceedings

1. Proceedings in Other States

Ancillary receiverships have been initiated against Reliance in the following states and territories: Arkansas, North Carolina, Massachusetts, Oregon and Puerto Rico. The Liquidator anticipates that an ancillary receivership proceeding will be commenced in New York in the coming weeks. The Liquidator is presently reviewing the issues raised by the appointment of these ancillary receivers and will report to the Court further as these matters develop.

2. Reliance-Canada

Since May 29, 2001, the Rehabilitator and now Liquidator has had ongoing discussions with Canadian insurance regulators regarding the financial condition of Reliance's Canadian branch ("Reliance-Canada" or the "Branch"). In response to the October 3 Liquidation Order, Canadian insurance regulators have requested that Reliance consent to placing the Branch into the Canadian equivalent of liquidation. A hearing on the issue before the Canadian insurance regulators was originally scheduled for November 13, 2001, but was adjourned, with certain conditions, until December 3, 2001. The Liquidator shall inform the Court of further developments.

E. Sale of Reliance-Brasil to QBE Insurance Corporation

Reliance National Brasil Seguros S.A. ("Reliance-Brasil") is a 99.9% owned subsidiary of Reliance National (Barbados) Insurance Ltd., which in turn is a wholly owned subsidiary of Reliance Insurance Company (in Liquidation). Reliance-Brasil was acquired by Reliance in July, 1999 and in the Fall of 2000, Reliance began attempts to market Reliance-Brasil.

The Investment Committee and Reliance's operations management have advised the Liquidator that the sale of Reliance-Brasil would be in the best interests of the Company's estate and its policyholders, claimants and creditors. Based on these recommendations, the Liquidator authorized Reliance to market Reliance-Brasil. Once proposed terms are finalized with a prospective buyer, the Liquidator will shortly file a petition with the Court detailing the Reliance-Brasil transaction and requesting Court approval for the sale.

F. Reinsurance

As previously reported, reinsurance receipts have been below forecast since the date of the Rehabilitation Order. Following the Order of Liquidation on October 3, 2001, receipts have only marginally improved. The Liquidator is in the process of identifying situations in which it may be necessary to initiate arbitration proceedings against delinquent reinsurers.

G. Termination of Active Policies

1. Cancellation Notices

In mid-October, 2001, Reliance developed and sent a cancellation notice to all in-force policyholders and relevant agents alerting them to the terms of ¶ 17 of the Order of Liquidation. Paragraph 17 provides that all policies and contracts of insurance issued by Reliance are terminated for all purposes effective thirty days from October 3, 2001. The

notice advised that "in no event will coverage be provided after midnight on November 2, 2001." The notice also advised policyholders how to obtain information about the liquidation of Reliance and that a mailing within 30-60 days would provide information and procedures for perfecting a claim against the estate of Reliance. See Section II.G.1.

During the week of October 29 to November 2, 2001, a general notice of cancellation was also published in USA Today, and newspapers in the Pittsburgh, Harrisburg and greater Philadelphia regions.

The Liquidator has identified a number of specific types of policies requiring action subsequent to the initial notification of termination of coverage: (1) Reliance notified approximately 108,000 previous policyholders who purchased claims made coverage with tail or extended reporting period provisions; (2) Reliance notified master policyholders of car warranty coverage, so that these policyholders may in turn notify warranty certificate holders; (3) Reliance notified the broker for kidnap and ransom coverage so that the insureds may be advised as well; and (4) Reliance continues to extract from its records and archives the addresses of policyholders of perpetual fire coverage, written between 1817 and 1950. To provide additional notice to perpetual fire policyholders, the Liquidator included a reference to perpetual fire coverage in the general termination notice published in the Pennsylvania and national newspapers.

2. Accident and Health Insurance Business

In Section II.D of the Special Supplementary Status Report Dated October 12, 2001 Of M. Diane Koken, Insurance Commissioner Of The Commonwealth Of Pennsylvania In Her Capacity As The Court Appointed Liquidator Of Reliance Insurance Company ("Status

Report”), filed on October 15, 2001, the Liquidator explained her efforts to have Combined assume, prior to their November 2, 2001 termination, those accident and health insurance policies covered by the Coinsurance Agreement between Reliance and Combined. The Liquidator further reported her efforts to negotiate an agreement with the National Organization of Life and Health Insurance Guaranty Associations (“NOLHGA”) and its participating members, to permit Reliance’s continued payment of accident and health insurance claims, without the creation of preferences, until such time as the affected guaranty associations were able to assume the payment of these claims.

On October 26, 2001, the Liquidator filed the Emergency Petition to Extend the Termination Date of Certain Policies of Insurance, to Approve a Settlement Agreement and to Authorize Early Access Arrangements Similar to Those Permitted under Paragraph 18 of the Liquidation Order. The purpose of the Emergency Petition was (1) to extend the termination date of the accident and health insurance policies covered by Reliance’s Coinsurance Agreement with Combined to afford Combined time to obtain the regulatory approvals necessary to assume these policies; (2) to approve the Settlement Agreement between Combined and Reliance with regard to the assumed policies and the Coinsurance and Claims Servicing Agreements between Reliance and Combined; and (3) to authorize the Liquidator to enter into early access arrangements with NOLHGA and its members similar to the arrangements the Court authorized in ¶ 18 of the Liquidation Order with regard to workers compensation and personal injury protection claims. On October 29, 2001, this Court granted the Emergency Petition.

Since October 29, 2001, and pursuant to the authorization of the Court, the Liquidator entered into an early access agreement with NOLHGA and its participating members covering the continued payment of accident and health insurance claims. The Early Access Agreement addresses the payments related to the Settlement Agreement involving Combined, and payments made by Reliance from October 3 through November 18, 2001, and provides for an additional sixty day period in which Reliance may continue to pay accident and health insurance claims if a participating association (1) certifies that it does not have sufficient funds at its immediate disposal to pay accident and health insurance claims; (2) takes all necessary steps in assessing its members; and (3) repays the Liquidator upon the collection of assessments. Early access payments made by Reliance under the agreement to participating associations are discretionary and subject to return if the Liquidator determines the funds are necessary for the payment of higher priority claims, pro-rata distributions for equal priority claims, or constitute an overpayment.

Combined has continued to pursue the regulatory approvals needed to permit the assumption of the accident and health insurance policies subject to the Coinsurance Agreement. Once the regulatory process has been successfully completed, Combined will formally assume the relevant accident and health insurance policies and issue assumption certificates to the affected policyholders. A notice of transfer has previously been provided to holders of the policies to be assumed by Combined.

H. Human Resources Issues

1. Reliance Insurance Company Retirement Plan

Reliance sponsored the Reliance Insurance Company Retirement Plan for the benefit of its eligible employees. The Retirement Plan is a defined benefit pension plan which promises certain retirement benefits to its participants.

Upon the commencement of the Rehabilitation, the Rehabilitator's staff consulted with pension actuarial professionals from Ernst & Young and AON regarding the financial condition of the Retirement Plan. Based on this actuarial review, it was determined that, while the Retirement Plan was under the control of the previous management, its assets were insufficient to satisfy its liabilities and was underfunded. Correction of the insufficiency would have required a large distribution of funds from the estate of Reliance to the Retirement Plan. The statutory scheme governing the Rehabilitator (and now the Liquidator) requires that she give priority to the payment of policyholder claims over other creditors, including the Retirement Plan. See 40 P.S. § 221.44. The financial condition of Reliance made it impossible for the Rehabilitator (and now the Liquidator) to contribute to the Retirement Plan, a creditor with a lower statutory priority than the Reliance policyholders.

Immediately upon learning of the issues relating to the Retirement Plan, the Rehabilitator, and now-Liquidator, conducted conferences with the Pension Benefit Guaranty Corporation ("PBGC"), a Federal agency that insures benefits payable from defined benefit pension plans, to advise them of this situation. The pension actuaries advised the Liquidator that contributions of \$12,800,000 and \$2,200,000 were payable to the

Retirement Plan on September 17, 2001 and October 15, 2001, respectively. The PBGC was advised in advance that the contributions could not be made. Consistent with federal law and with the consent and cooperation of the Liquidator, the PBGC will take control of the Retirement Plan, including its assets and the payment of pension liabilities (up to a federally mandated limit), by early 2002. The Liquidator has prepared notices to be sent on November 16, 2001 to the Retirement Plan's participants to advise them that the contributions were not made, as well as to advise them of the imminent takeover by the PBGC. Plan participants are being provided with an information contact at the Company. Additional information will be made available to affected persons as it becomes available.

2. Other Benefit Issues

Reliance is working with Ernst & Young to develop a new retirement benefit to commence in 2002, which will be competitive to the industry and will assist in retaining valuable employees.

I. Claims Procedures

1. Requests for Information

The Liquidator and Reliance are receiving a huge volume of inquiries from insureds, claimants, lawyers, third party administrators, and the general public regarding the liquidation in general and proof of claims procedures in particular. The Liquidator and Reliance are taking all reasonable steps to provide prompt answers to these inquiries. The Reliance Clearinghouse telephone number (215-569-5566), facsimile number (215-832-5566) and email address (Reliance@BlankRome.com), as well as the Reliance Documents web site (www.reliancedocuments.com), have proved to be valuable resources in disseminating

information to interested parties and the general public. The Liquidator continues promptly to address these requests for public information.

2. Proof of Claim Procedures

The Liquidator is developing a proposal for the filing of proofs of claims and requirements for perfecting a claim against the estate of Reliance, consistent with the provisions of the Insurance Department Act of 1921, 40 P.S. §§ 221.38. A proof of claim form is also being developed. The database of potential claimants and creditors consists of approximately 1.5 million names and addresses. Potential creditors are being advised that they can expect to receive a proof of claim form within sixty to ninety days from the October 3 Liquidation Order.

J. Guaranty Association Issues

1. Initial Liquidation Meeting

Throughout rehabilitation, the Rehabilitator communicated regularly with the NCIGF to make sure that member guaranty associations were informed of important developments. These regular communications have continued and increased in frequency with the entry of the Liquidation Order. Since October 3, 2001, Reliance has cooperated with the guaranty associations to transition claims files from the Company and its third party administrators to the guaranty associations. In addition, pursuant to ¶ 18 of the Liquidation Order and at the request of the guaranty associations, Reliance continued to fund, on an interim basis for 30 days from the date of the Liquidation Order, workers compensation indemnity claims.

K. Legal Issues

1. Transfer of Matters to Guaranty Associations

Reliance is cooperating with the NCIGF and the 52 state and territorial guaranty associations to transfer pending and new claims litigation matters. Beginning on October 8, 2001, Reliance provided outside claims counsel with preliminary instructions regarding the transfer of these claims litigation matters.

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2. Pre-Liquidation Settlements

Several parties have filed petitions regarding the enforcement of settlement agreements that were reached prior to entry of the Liquidation Order, but which had not been funded by Reliance by October 3, 2001. The Liquidator has submitted responses to these petitions. The Liquidator anticipates that additional petitions may be filed raising the issue of the enforceability of pre-liquidation settlements.

Respectfully submitted,

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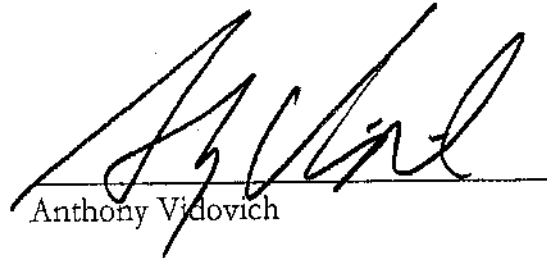
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Dated: November 15, 2001

CERTIFICATE OF SERVICE

I, Anthony Vidovich, hereby certify that this day a true and correct copy of the foregoing was served on all persons listed on the attached Master Service List by U.S. Mail, postage prepaid.

Dated: November 14, 2001



Anthony Vidovich

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v.

Reliance Insurance Company

No. 269 M.D. 2001 (Commonwealth Court of Pennsylvania)

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