IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as Liquidator of Reliance Insurance Company, Plaintiff, v. RELIANCE INSURANCE COMPANY, Defendant.	:	No. 269 M.D. 2001

RECEIVED AND FILED COMMONWEALTH COURT OF PA (PHILA)

2008 NOV -6 A 11:48

RE: ADMINISTRATIVE EXPENSES PAID BY THE LIQIUIDATOR FOR THE PERIOD OCTOBER 3, 2001 THROUGH DECEMBER 31, 2007

ORDER

AND NOW, this ________ day of _______________, 2008, upon consideration of the Petition for Approval of Administrative Expenses Paid by the Liquidator for the Period October 3, 2001 through December 31, 2007 ("Petition"), and the representations made therein, the Petition is granted. The administrative expenses incurred, authorized and paid by the Liquidator as set forth in both sections A. and B. of the Petition, as well as in Exhibit B, for the period of October 3, 2001 through December 31, 2007 are hereby approved as class (a) claims which were necessary, reasonable, and incurred in the best interest of the Estate.

____

Bonnie Brigance Leadbetter,
President Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in his official capacity as Liquidator
of Reliance Insurance Company,

Plaintiff,

v.

RELIANCE INSURANCE COMPANY,

Defendant.

No. 269 M.D. 2001

PETITION FOR APPROVAL OF ADMINISTRATIVE EXPENSES PAID BY THE LIQUIDATOR FOR THE PERIOD OCTOBER 3, 2001 THROUGH DECEMBER 31, 2007

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as Statutory Liquidator ("Liquidator") of Reliance Insurance Company ("Reliance or Estate"), by and through his undersigned counsel, hereby submits his Petition for Approval of Administrative Expenses Paid by the Liquidator for the Period October 3, 2001 through December 31, 2007 ("Petition").

BACKGROUND

1. Plaintiff, Insurance Commissioner of the Commonwealth of Pennsylvania, was appointed Statutory Liquidator of Reliance pursuant to this Court's Order dated October 3, 2001 ("Liquidation Order"). The Liquidation Order provided that

> 3. . . . the Liquidator or her designees (the "Liquidator") are directed to immediately take possession of Reliance's property, business and affairs as Liquidator, and to liquidate Reliance in accordance with Article V of the Insurance Department Act of 1921, as amended (40 P.S. §§211 et seq.) ("Act"),

and to take such action as the interest of the policyholders, creditors or the public may require.

4. The Liquidator is hereby VESTED with all the powers, rights, and duties authorized under the Act and other applicable law.

2. Section 221.23 of the Act provides that the Liquidator shall have the power "[t]o pay compensation to persons appointed and to defray all expenses of taking possession of, conserving, conducting, liquidating, disposing of or otherwise dealing with the business and property of the insurers."

3. The administrative expenses of the Estate which are expressly incurred and authorized or ratified by the Liquidator or his designees are class (a) claims as provided in 40 P.S. §221.44:

> (a) The costs and expenses of administration, including but not limited to the following; the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the liquidation; any necessary filing fees; the fees and mileage payable to witnesses; reasonable attorney's fees; the expenses of a guaranty association in handling claims[1].

Class (a) claims are the first priority of claims to be paid and, as required by §221.44, "[e]very claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment."

4. Beginning in June of 2003, the Liquidator began filing periodic status reports with this Court which provided information regarding administrative expenses incurred by the Estate and authorized by the Liquidator. The first such report was filed in June of 2003 and included expenses authorized and incurred for the fifteen month period from October 3, 2001 (the date of liquidation) through December 31, 2002. On August 7,

[1] Claims by the guaranty associations for administrative expenses will be submitted for approval pursuant to this Court's order of November 19, 2007, granting the Liquidator's Amended Petition regarding Administration of Guaranty Association claims.

2003, a report was filed with more specific detail regarding administrative expenses incurred and authorized from October 3, 2001 through June 30, 2003.[2] With the status report as of June 30, 2003, filed on November 10, 2003, the Liquidator began filing status reports with this Court on a quarterly basis. The most recent quarterly status report was filed on September 29, 2008. All of the status reports submitted to the Court can be reviewed on the Reliance website at www.reliancedocuments.com.

5. These reports have included a Statement of Cash Flow, also labeled as a Statement of Cash Receipts and Disbursements and Changes in Short and Intermediate Duration Investments ("Cash Flow Statements"). The Cash Flow Statements have provided specific totals regarding the administrative expenses of the Estate with additional detail, descriptions and explanations provided in the body of the status report. Significant additional information can be found in the quarterly status reports regarding the assets and liabilities related to the operating expenses incurred by Reliance and authorized by the Liquidator.

INDEPENDENT AUDITS

6. Ernst & Young has performed independent audits of certain cash and investment assets, including cash receipts and disbursements of the Estate, for each period from October 3, 2001 through December 31, 2007. The disbursements included in this Petition were subject to that independent audit and review process. These audits continue on an annual basis.

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[2] The financial statements included in the status reports filed for the first 15 months of the liquidation proceedings and the one year period ending 2003 may differ in some respects from Exhibit B attached to this Petition due to the reclassification of certain expenses and due to the transition from an accrual to a cash basis of accounting.

7. Ernst & Young issued an independent audit report ("Audit Report"), including an unqualified opinion, regarding certain assets of Reliance for each of the periods from October 3, 2001 through December 31, 2007. A sample Audit Report, for the year ending 2007, is attached as Exhibit A. Each Audit Report included a statement substantially similar to the following:

> . . . .
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States. . . . An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
>
> . . . .
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the certain assets (modified case basis) of Reliance Insurance (in Liquidation) at December 31, 200[x], and the cash receipts and disbursements and changes in short and intermediate duration investments (modified cash basis) for the year[s] ended December 31, 200[x] on the basis of accounting described in Note 1.

The Audit Report should be reviewed in its entirety, including the financial statements and related notes, as part of any review of Reliance's financial information.

ADMINISTRATIVE EXPENSES

8. The administrative expenses of Reliance relate to efforts by the Liquidator to recover, preserve and maximize the assets of the Estate for the benefit of all Reliance policyholders and claimants. The administrative expenses are incurred in the process of, inter alia, reviewing and determining the ultimate liabilities of the Estate, fulfilling the public policies and purposes of the Act and the liquidation process, and investigating and holding accountable those third parties responsible for the insolvency of Reliance.

9. Attached as Exhibit B to this Petition is the Annual Budget/Historical Comparison Report which indicates the total budget dollar amount estimated for each operating expense category for the year ending December 31, 2008 compared to the actual operating expenses for the years ended December 31, 2007, 2006, 2005, 2004, 2003, and for the fifteen months beginning October 3, 2001 and ending December 31, 2002. Exhibit B also reports the amounts incurred and paid by the Estate for loss and loss adjustment expenses. Attached as Exhibit C is a graph, which displays the actual operating expenses, by time period, summarized into the three major categories: a) Salaries, Benefits and Taxes; b) Outside Services; and c) All Other. Brief explanations regarding certain aspects of the expenses are provided below, by category.

A. <u>Operating Expenses</u>

10. **Salaries, Benefits and Taxes:** This expense category includes total compensation for all Reliance employees, including the performance and retention incentive program as well as severance for terminated employees, along with related benefits and payroll taxes. At December 31, 2007, Reliance had a total of 271 employees in both the Philadelphia and New York City offices. Reliance also continues to use consultants to support the operations, especially in the Information Technology ("IT") area. At December 31, 2007, there were 43 consultants of which 32 were related to the IT business application systems. Staffing levels as of September 30, 2008 are 232 employees and 40 consultants. Attached as Exhibit D is a graph which summarizes the change in number of staff and consultants since the date of liquidation.

11. **IT Outsourcing Expenses:** Since entering liquidation, Reliance has developed new computer systems related to liquidation operations and claims processing in the following areas: proof of claim ("POC") processing, notice of determination ("NOD") issuance and tracking, NOD objection and litigation management, large deductible tracking, asset distribution

modeling, and data exchanges with the guaranty associations ("GAs"). Reliance also implemented an imaging system (currently storing over 60 million imaged pages) and enhanced its legacy claims and reinsurance systems to ensure timely and accurate review and recording of paid and outstanding loss information and generation of reinsurance notices, updates and billings.

12. In late 2005, Reliance entered into a five year outsourcing agreement with Acxiom, a third party provider, to create and maintain a more efficient and cost effective IT infrastructure necessary to execute Reliance's business application systems. The Acxiom outsourcing arrangement covers data center and network equipment, software and services, plus support services for help desk, desktops, on-site servers, and operational and disaster recovery. RCG IT, which is a wholly owned subsidiary of Reliance, continues to provide consultants for production support, maintenance, security and development services for Reliance's business application systems.

13. **Legal Fees and Expenses:** Legal fees and expenses include payments to law firms, consultants, document management firms, and other litigation and legal support service providers. The legal expenses of the Reliance Estate can be divided into three general categories of legal matters: (1) Estate administration, including certain limited aspects of the NOD objection process; (2) general asset recovery; and (3) third party actions against parties liable for injuring Reliance, its policyholders, creditors and the public generally. Litigation has been necessary in many matters to protect and recover Reliance assets, and Reliance has recovered significant amounts through such litigation. Since January 2003 through the second quarter of 2008, Reliance has recovered in excess of $287 million through legal actions, a portion of which

benefits the GAs. A detailed legal fee expense schedule is included in each quarterly status report filed with the Court.

14. **Professional Services Expenses:** The professional services expenses include payments to or for investment managers, London market broker services, document imaging services, auditing services, actuarial services, and permanent and temporary staffing services which provide resources for the IT, claims, reinsurance and accounting departments as needed. This category also contains entries for professional services provided to Reliance by the Pennsylvania Insurance Department, either directly by the professional staff of the Office of Liquidations, Rehabilitations and Special Funds, or through specialized consultants hired to assist the Liquidator in administering the liquidation of Reliance. A detailed professional service expense schedule is included in each quarterly status report filed with the Court.

15. **Rent:** Rent expense includes the cost of office space in New York and Philadelphia plus the cost of storing archived documents. Reliance reconfigures workspace wherever possible in order to reduce costs by consolidating space requirements. From the date of liquidation through the end of 2007, Reliance has negotiated new or amended leases several times, reducing space significantly and saving millions of dollars from the terms of the original leases.

16. **Equipment:** Equipment includes the cost of purchase and maintenance of computer equipment, software, office equipment and furniture used by Reliance. Where possible, any surplus equipment or furniture has been sold.

17. **Other Operating:** Other operating includes expenses for liability and property insurance, voice and data communications, office supplies, employee travel, postage and mailing, and bank charges.

18. **Losses and Loss Adjustment Expenses:** Loss and loss adjustment expenses represent amounts incurred by the Estate for processing and determining certain creditor claims, POCs, NODs, and for the majority of the related objection process. Additionally included in this category are the following three items: a) counsel fees incurred in defense of policy holder claims during rehabilitation but not reported, verified, processed and paid until after the liquidation date, b) checks issued prior to October 3, 2001 which cleared the bank subsequent to the liquidation date, and c) loss payments approved by the Court, such as those advanced for workers' compensation and accident/health benefits shortly after liquidation when the claim files were in transition from the third party administrators to the GAs.

B. Disbursements Netted With Receipts

19. In addition to the expenses described above, Reliance has also incurred fees and expenses directly associated with the collection of receivables and the disposal of assets. These expenses have been netted against the gross proceeds collected and, as such, are not captured or reported as individual expenses on Exhibit B or the quarterly status reports. A brief explanation of each expense and the related assets is provided below.

20. **Premium Collection Fees:** Certain smaller outstanding premium balances owed to Reliance were referred to collection agencies. The fees earned by the collection agencies were primarily based on a percentage of the premiums they collected. Fees aggregating $6.1 million were deducted from the gross amount collected and the net proceeds were remitted to Reliance. Through December 31, 2007 Reliance has collected premiums totaling $209 million. This total includes not only the premiums brought in through collection agencies, but also the premiums collected by routine billings, through negotiations by Reliance staff and through legal actions.

21. **Subrogation Fees:** In addition to the larger subrogation recoveries pursued directly by Reliance, Reliance has contracted with certain third parties to collect amounts owed by insurers and others as subrogation for losses paid by Reliance or the GAs. In some cases, fees associated with the collection process were deducted directly from the proceeds, while in other cases Reliance received the gross collection proceeds and then paid the associated collection fees. Through December 31, 2007 Reliance has paid subrogation fees totaling approximately $11.3 million and collected subrogation proceeds totaling $154 million. The total proceeds include not only the subrogation recoveries collected by outside vendors, but also those recoveries collected by Reliance staff and through legal actions.

22. **Real Estate Expenses:** As of the date of liquidation, Reliance had various real estate investments with a carrying value of $102 million. Virtually all of the real estate investments were sold for amounts in excess of original carrying value, with proceeds exceeding $158 million. Although some real estate expenses were recorded in the category of Other Operating Expenses ($5.8 million), certain other expenses (approximately $2.1 million) associated with the real estate sales were netted against proceeds. Broker fees were also netted against proceeds at settlement. In accordance with Court orders issued early in the liquidation proceedings, all real estate transactions have been approved by the Court.

23. **Subsidiaries:** Since the date of liquidation, Reliance has successfully disposed of numerous subsidiaries and affiliates and continues to analyze the best strategy and timing for maximizing the value of the remaining subsidiaries. Reliance has incurred costs to maintain subsidiaries in good standing in advance of their sale and has also incurred costs directly related to their sales. These costs have aggregated $6.6 million through December 31, 2007. In comparison, subsidiary sale proceeds have totaled over $78 million.

Recommendation

24. The administrative expenses reported in both Section A and B above, as well as in Exhibit B and described in this report, as well as in the quarterly status reports filed with this Court, have been incurred and authorized by the Liquidator in the best interest of the Estate, its policyholders and creditors. The Liquidator has incurred these administrative expenses in the process of taking possession of Reliance's property, business and affairs, and liquidating Reliance pursuant to the Act, the Liquidation Order and other orders issued by this Court. The administrative expenses incurred and paid by the Liquidator have been proper, necessary and reasonable in order to conserve, conduct, liquidate, dispose of or otherwise deal with the business and property of Reliance, as authorized by 40 P.S. §221.23.

WHEREFORE, the Liquidator respectfully requests that this Court enter an Order approving the administrative expenses reported in both Section A and B above, as well as in Exhibit B, as proper class (a) claims which were necessary, reasonable, and incurred in the best interest of the Estate.

Respectfully submitted:

By: [signature]

PRESTON BUCKMAN (I.D. #57570)
Special Funds Counsel
Pennsylvania Insurance Department
Capitol Associates Building
Governor's Office of General Counsel
901 North 7th Street
Harrisburg, PA 17102
(717) 787-6009
Counsel for Reliance Insurance Company

Dated: 11/3/08

VERIFICATION

I, David S. Brietling, have been retained by the Insurance Commissioner of the Commonwealth of Pennsylvania, and am responsible for the on-site insurance and financial operations of Reliance Insurance Company (in Liquidation) as Chief Liquidation Officer. I am also responsible for coordinating the activities of the Pennsylvania Insurance Department's Reliance liquidation team. I am authorized by the Insurance Commissioner to make this verification on behalf of the Liquidator of Reliance Insurance Company. I hereby verify that the facts set forth in the foregoing Report are true and correct to the best of my knowledge, information and belief.

I understand that this Verification is made subject to the penalties of 18 P.S. §4904 relating to unsworn falsification to authorities.

Date: November 3, 2008

David S. Brietling

DAVID S. BRIETLING
Chief Liquidation Officer

CERTIFICATE OF SERVICE

I, Marilyn K. Kincaid , of Reliance Insurance Company (In Liquidation), on behalf of the Statutory Liquidator of Reliance Insurance Company, herby certify that on or about this day, pursuant to the Court's Order of April 1, 2004, service of the foregoing was made on the attached Master Service List through transmission via facsimile or first class mail of a Notice of Filing and through posting of a true and correct copy in PDF file format on the Reliance Documents website (www.reliancedocuments.com).

Dated: November 6, 2008

Marilyn K Kincaid

Marilyn K. Kincaid
Liquidation Team-Legal
Reliance Insurance Company (In Liquidation)
Three Parkway
Philadelphia, PA 19102
Telephone: (215) 864-4205
Facsimile: (215) 864-4105
On behalf of the Statutory Liquidator of
Reliance Insurance Company

Master Service List

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania

v.

Reliance Insurance Company

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

Jerome R. Richter
Ann B. Laupheimer
Blank Rome LLP
One Logan Square
Philadelphia, PA 19103
(215) 569-5500
(Attorneys for Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania)

Amy L. Weber, Esquire
Deputy Chief Counsel
Preston M. Buckman, Esquire
Special Funds Counsel
Commonwealth of Pennsylvania
Insurance Department
Office of the Chief Counsel
Capitol Associates Building
901 North 7th Street
Harrisburg, PA 17102
(717) 787-6009
(Attorneys for the Pennsylvania Insurance Department)

Marilyn K. Kincaid, Esquire
Reliance Insurance Company (in Liquidation)
Three Parkway
Philadelphia, PA 19102
(215) 864-4205
(Attorney for Reliance Insurance Company (in Liquidation))

Brian P. Flaherty, Esq.
Wolf, Block, Schorr & Solis-Cohen LLP
1650 Arch Street
22nd Floor
Philadelphia, PA 19103
Phone: (215) 977-2048
Fax: (215) 405-2948
(Attorneys for Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania)

Hillary C. Steinberg
James Michael Matour
Hangley Aronchick Segal & Pudlin, P.C.
One Logan Square
Philadelphia, PA 19103
(215) 568-6200
(Attorneys for Reliance Group Holdings, Inc.)

Jeffrey B. Rotwitt
Obermayer Rebmann Maxwell & Hippel
1 Penn Center, 19th Floor
Philadelphia, PA 19103-1895
(215) 665-3000
(Attorneys for Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania)

William Charles Bensley
George Whittaker Howard
Edward M. Nass
Howard Brenner & Nass, P.C.
1608 Walnut Street, Suite 1700
Philadelphia, PA 19103
(215) 546-8200
(Attorneys for Francine and Ted Forman)

Brad S. Karp
Paul, Weiss, Rifkind, Wharton & Garrison
1285 Avenue of the Americas
New York, NY 10019
(212) 373-3000
(Attorneys for Reliance Group Holdings, Inc.)

Robert H. Levin
Adelman Lavine Gold & Levin, P. C.
Four Penn Center, Suite 900
Philadelphia, PA 19103-2808
(215) 568-7515
(Attorneys for Committee of Policyholders)

Richard D. Batchelder, Jr.
Ropes & Gray
One International Place
Boston, MA 02110-2624
(617) 951-7000
(Attorneys for Miami Cruiseline Holdings LLC)

Frank F. McGinn
Bartlett Hackett Feinberg, P.C.
155 Federal Street
9th Floor

Boston, MA 02110
(617) 422-0200
(Attorneys for Flatley Company)

Thomas J. Madigan
Pepper Hamilton LLP
One Mellon Center
500 Grant Street, 50th Floor
Pittsburgh, PA 15219-2502
(412) 454-5000
(Attorneys for O'Brien-Kreitzberg
& Associates, Inc.)

Douglas B. Provencher
Provencher & Flatt, LLP
823 Sonoma Avenue
Santa Rosa, CA 95404
(707) 284-2380
(Attorneys for Great Western Collection
Bureau)

Terence R. Savage
Employment Development Department
State of California
800 Capitol Mall, Legal Office
Sacramento, CA 95814
(916) 654-8410
(Attorneys for Employment Development
Department, State of California)

R. Nicholas Gimbel
McCarter & English, LLP
Mellon Bank Center
1735 Market Street
Suite 700
Philadelphia, PA 19103
Phone: (215) 979-3800
Fax: (215) 979-3899
(Attorneys for Brand Scaffold Services, Inc.,
Magellan Ins. Co. Ltd., and Sun Life Assurance
Company of Canada)

Anderson, Kill & Olick P.C.
1600 Market Street, Suite 2500
Philadelphia, PA 19103
(215) 568-4202
-and-
Marvin L. Wilenzik
Elliott Reihner Siedzikowski & Egan, P.C.
925 Harvest Drive
P.O. Box 3010
Blue Bell, PA 19422
(215) 977-1050
(Attorneys for Synagro Technologies, Inc.)

Jeremy J.O. Harwood, Esquire
Blank Rome LLP
23rd Floor
405 Lexington Avenue
New York, NY 10174
(212-885-5149)
-and-
Joseph M. Donley, Esquire
William E. Cox, Esquire
Kittredge, Donley, Elson, Fullem & Embick
400 Market Street, Suite 200
Philadelphia, PA 19106
(215-829-9900)
(Attorneys for Steamship Mutual Underwriting
Association (Bermuda) Ltd.)

Thomas V. White, Esquire
Joseph P. Rusnak, Esquire
Tune, Entrekin & White, P.C.
AmSouth Center, Suite 1700
315 Deaderick Street
Nashville, TN 37238
(615) 244-2770
(Attorneys for Home Builders Association of
Tennessee Self-Insured Trust)

Michele Smolin, Esquire
McDonald, Hopkins, Burke & Haber
600 Superior Avenue E
Cleveland, OH 44114-2653
(216) 348-5400
(Attorneys for United Church of Christ Insurance
Board)

Lisa Luborsky, Esquire
Britt, Hankins & Moughan
Two Penn Center Plaza, Suite 515
1500 John F. Kennedy Blvd.
Philadelphia, PA 19102-1888
(215) 569-6918
(Attorneys for the Pennsylvania Property and
Casualty Insurance Guaranty Association)

Frederick P. Santarelli, Esquire
Elliott Greenleaf & Siedzikowski, P.C.
925 Harvest Drive
P.O. Box 3010
Blue Bell, PA 19422
(215) 977-1050
(Attorneys for Estate of Leo Frances Tenczynski)

Janice Marie Savinis, Esquire
Savinis, D'Amico & Kane, LLC
Suite 3626, Gulf Tower
707 Grant St.
Pittsburgh, PA 15219
(Attorney for Harold W. Thomas)

Francine L. Semaya, Esquire
Cozen O'Connor
45 Broadway, 16th Floor
New York, NY 10006
(212-908-1270)
(Attorneys for Allied Holdings and Client Assurance Pool)

Richard F. McMenamin, Esquire
David L. Harbaugh, Esquire
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
(215-963-5596)
(Attorneys for Fuji Bank Limited and The Tribune Company)

Eric P. Wilenzik, Esquire
Elliott Reihner Siedzikowski & Egan, P.C.
925 Harvest Drive
Blue Bell, PA 19422
(215-977-1000)
(Attorneys for Brandywine Realty Trust)

Sarah H. Zinn, Esquire
Hogan & Hartson, LLP
555 13th Street, N.W.
Washington, D.C. 20004-1109
(202) 637-6459
(Attorneys for National Structured Settlements Trade Association, General Electric Capital Assurance Co., First Colony Life Ins. Co., Federal Home Life Ins. Co., and GE Life and Annuity Assurance Co.)

David W. Cranshaw, Esquire
Morris, Manning & Martin, LLP
1600 Atlanta Financial Center
3343 Peachtree Road, N.E.
Atlanta, GA 30326
(404-233-7000)
(Attorneys for ChoicePoint and its division ChoicePoint Commercial Specialist)

P. Kevin Brobson, Esquire
Buchanan Ingersoll
One South Market Square
213 Market Street, 3rd Floor
Harrisburg, PA 17101
(717-237-4800)
(Attorneys for Magellan Reinsurance Company, Ltd. and RBH Reinsurance Ltd.)

Bruce R. Hoffman, Esquire
Law Office of Bruce R. Hoffman, LLC
574 Sea Island Parkway
Saint Helena Island, SC 29920-4205
(843-838-5290)
(Pro Se)

R. Jane Lynch, Esquire
Cox, Castle & Nicholson LLP
2049 Century Park East, Suite 2800
Los Angeles, CA 90067
(310-277-4222)
(310-277-7889) fax
(Attorneys for Lake at Las Vegas Joint Venture)

Kevin E. Wolff, Esquire
Robert J. Re, Esquire
McElroy, Deutsch & Mulvaney, LLP
1300 Mount Kemble Avenue
P.O. Box 2075
Morristown, NJ 07962-2075
(973-425-8717)
(Attorneys for Celanese Americas Corporation, Elwood Insurance Limited, and Celwood Insurance Company (f/k/a Hoechst Celanese Insurance Company, Ltd.)

Michael B. Dubin, Esquire
Semanoff, Ormsby, Greenberg & Torchia
Suite 200 Jenkins Court
610 Old York Road
Jenkintown, PA 19046
(215-887-0200)
(215-887-5356) fax
(Attorneys for Integrated Health Services, Inc.)

Deborah Fuchs Cohen, Esquire
Eric Jonathan Rothschild, Esquire
Pepper Hamilton LLP
3000 Two Logan Square
18th and Arch Streets
Philadelphia, PA 19103
(215) 981-4470
(Attorney for Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania)

Leonard P. Goldberger, Esquire
Amy Elizabeth Vulpio, Esquire
White and Williams LLP
1800 One Liberty Place
Philadelphia, PA 19103-7395
(215) 864-6376
(Attorneys for Insurance Company of North America)

Harold S. Horwich, Esquire

Bingham McCutchen
One State Street
Hartford, CT 06103
(860) 240-2700
(Attorneys for St. Joseph's Medical Center)

Susan J. Guerrieri, Esquire
Stephen C. Baker, Esquire
John B. Dempsey, Esquire
Drinker Biddle & Reath LLP
One Logan Square
18th and Cherry Streets
Philadelphia, PA 19103-6996
(215) 988-2700
(Attorneys for Mawson & Mawson, Inc.)

Joseph F. Orso, III, Esquire
Casale & Bonner, P.C.
Suite 202
33 West Third Street
Williamsport, PA 17701
(570) 326-7044
(Attorneys for Richard Ruhl)

Arthur Makadon, Esquire
Geoffrey A. Kahn, Esquire
Ballard Spahr Andrews & Ingersoll, LLP
1735 Market Street, 51st Floor
Philadelphia, PA 19103
(215) 665-8500
(Attorneys for Deloitte & Touche LLP)

Douglas Y. Christian, Esquire
Ballard Spahr Andrews & Ingersoll
1735 Market Street, 51st Floor
Philadelphia, PA 19103-7599
(215) 864-8404
(Attorneys for American Longshore Mutual Association)

Lisa M. Salazar, Esquire
McCarter & English LLP
Mellon Bank Center, Suite 700
1735 Market Street
Philadelphia, PA 19103-7501
(215) 979-3800
(Attorneys for Robert M. Steinberg)

Robert E. Kelly, Jr., Esquire
Anthony W. Parker, Esquire
Kelly, Parker & Cohen LLP
Commerce Towers
10th Floor
300 North Second Street
Harrisburg, PA 17106-2003
717-920-2220
(Attorneys for Petitioner South Carolina School Boards Insurance Trust)

Joseph M. Hennelly, Jr., Esquire
Hennelly & Steadman, PLC
Goldworthy House
322 West Roosevelt
Phoenix, AZ 85003
(602) 230-7000
(Attorneys for Mark D. Tharp as Arizona's Special Ancillary Receiver of Reliance)

Rowe W. Snider, Esquire
Steven T. Whitmer, Esquire
Julie L. Young, Esquire
Lord, Bissell & Brook
111 S. Wacker Drive
Chicago, Illinois 60606
(312) 443-0700
(Attorneys for NCIGF)

Paul G. Witko, Deputy Attorney General
State of New Jersey
Office of the Attorney General
Department of Law and Public Safety
Division of Law
Station Plaza #4, 2nd Floor
22 South Clinton Ave.
P.O. Box 117
Trenton, NJ 08625-0117
(609) 777-3512
(Attorney for New Jersey Workers Compensation Bureau)

Malcolm C. Lindquist, Esquire
Lane Powell Spears Lubersky
1420 Fifth Ave.
Suite 4100
Seattle, WA 98101
(206) 223-7101
(Attorney for Labor Ready, Inc.)

James W. Kutz, Esquire
Kimberly M. Colonna, Esquire
McNees Wallace & Nurick, LLC
100 Pine St, P.O. Box 1166
Harrisburg, PA 17108-1166
(717) 232-8000
(Attorneys for Earth Tech, Inc.)

Guy A. Cellucci, Esquire
White and Williams LLP
1800 One Liberty Place
Philadelphia, PA 19103-7395
(215) 864-7000
(Attorneys for Hartford Fire Insurance Co., Hartford Specialty Co., and the Hartford Financial Services Group, Inc.)

Brian T. Guthrie, Esquire
Daniel W. Krane, Esquire
Drinker Biddle & Reath LLP
One Logan Square
18th and Cherry Streets
Philadelphia, PA 19103-6996
(215) 988-2700
(Attorneys for Lexington Insurance Co.)

Edward G. Biester, Esquire
Duane Morris LLP
3030 South 17th Street
Philadelphia, PA 19103
(215) 979-1000
(Attorneys for Florida Workers' Compensation Insurance Guaranty Association Incorp.)

Lawrence Licitra, Esquire
Julie Pollack, Esquire
Swiss Reinsurance America Corporation
175 King Street
Armonk, NY 10504
(914) 828-8000
(Attorneys for Swiss Reinsurance America Corp.)

Daryn E. Rush, Esquire
Gibbons PC
1700 Two Logan Square
18th & Arch Streets
Philadelphia, PA 19103-2769
215-446-6220
(Attorneys for Travelers Casualty and Surety Co.)

John C. Connell, Esq.
Jerrold S. Kulback, Esq.
Archer & Greiner, PC
One Centennial Square
Haddonfield, NJ 08033
(856) 795-2121
(Attorneys for New Mexico Mutual Casualty Company and Southwest Casualty Company)

Kimberly A. LaMaina
Skadden, Arps, Slate, Meagher & Flom, LLP
One Rodney Square
Wilmington, DE 19801
(302) 651-3184
(Attorneys for Zenith Insurance Company)

Jeffrey B. Cohen
John Menke
Joseph Krettek
Pension Benefit Guaranty Corporation
Office of the General Counsel
1200 K Street, N.W.
Washington, D.C. 20005
(202) 326-4020
(Attorneys for Pension Benefit Guaranty Corporation)

Francis Patrick Newell
Harkins Cunningham LLP
2800 One Commerce Square
2005 Market Street
Philadelphia, PA 19103
(215) 851-6700
(Attorney for Celanese and the Celanese Reinsurers)

Jeff Farkas
Laura Torrado
Bear Stearns Investment Products Inc.
383 Madison Avenue
New York, NY 10179
(212) 272-3330
(Non-Attorney Representative of Bear Stearns)

Michael Winschuh
Dennis Comstock
VonWin Capital, L.P.
60 Madison Avenue, Suite 201
New York, NY 10011
(212) 889-1601
(Attorneys for VonWin Capital)

Dale Stohr
Angelo, Gordon & Co.
245 Park Avenue, 26th Floor
New York, NY 10167
(212) 692-2034

James W. Schacht
Navigant Consulting, Inc.
175 West Jackson Blvd., Suite 500
Chicago, IL 60604
(312) 583-5700

Michael J. Cawley
Wilson, Elser, Moskowitz, Eldelmen & Dicker LLP
The Curtis Center
Suite 1130 East
Independence Square West
Philadelphia, PA 19106
(215) 627-6900
(Attorney for British Aviation Insurance Group Ltd.)

Laura L. McGrogry, Chief Counsel
Legal Division
Industrial Commission of Arizona
P.O. Box 19070
Phoenix, AZ 85005-9070
(Counsel for the Arizona Workers Compensation Guaranty Association)

Arthur F. McNulty
Chief Counsel
Pennsylvania Insurance Department
Office of Chief Counsel
1341 Strawberry Square
Harrisburg, PA 17120
(717) 783-1975
(Counsel for Joel S. Ario,
Insurance Commissioner of the
Commonwealth of Pennsylvania)

Jonathan Neiss
Contrarian Capital Management, LLC
411 West Putnam Avenue, Suite 225
Greenwich, CT 06830
(203) 862-8255

Joseph J. Bellew
Cozen O'Connor
Suite 1400, 1201 North Market Street
Wilmington, DE 19801-1147
(302) 295-2025
(Attorney for Hudson News Co., Hudson News
Distributors. LLC, Magazine Distributors, Inc., and
MET News Liquidating Trust)

David L. Neale
Tania M. Moyron
Levene, Neale, Bender, Rankin & Brill LLP
10250 Constellation Blvd.
Suite 1700
Los Angeles, California 90067
(310) 229-1234

Timothy P. Law, Esq.
John Norig Ellison, Esq.
Reed Smith
2500 One Liberty Place
1650 Market Street
Philadelphia, PA 19103-7301
(215) 851-8100
(Counsel for Conoco, Inc. and Harlem River Park Houses, Inc.)

Nancy K. Tordai, Esq.
Hanson Peters Nye
1000 Hart Road, Suite 300
Barrington, Illinois 60010
(847) 277-9988

Frank P. DeGiulio
Palmer Biezup & Henderson
620 Chestnut Street
956 Public Ledger Building
Philadelphia, PA 19106
(215) 625-9900

Exhibit A

Financial Statements (Modified Cash Basis)

Reliance Insurance Company (in Liquidation)
Years Ended December 31, 2007 and 2006
With Report of Independent Auditors

Reliance Insurance Company (in Liquidation)

Financial Statements
(Modified Cash Basis)

Years Ended December 31, 2007 and 2006

Contents

ERNST & YOUNG

Ernst & Young LLP
Two Commerce Square
Suite 4000
2001 Market Street
Philadelphia, PA 19103-7096

Phone: (215) 448-5000
Fax: (215) 448-4069
www.ey.com

Report of Independent Auditors

Audit Committee
Reliance Insurance Company (in Liquidation)

We have audited the accompanying statements of certain assets (modified cash basis) of Reliance Insurance Company (in Liquidation) (the Company) as of December 31, 2007 and 2006, and the related statements of cash receipts and disbursements and changes in short and intermediate duration investments (modified cash basis) for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the accompanying financial statements have been prepared on a modified cash basis of accounting accepted by the Pennsylvania Department of Insurance, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the certain assets (modified cash basis) of Reliance Insurance (in Liquidation) at December 31, 2007 and 2006, and the cash receipts and disbursements and changes in short and intermediate duration investments (modified cash basis) for the years then ended, in conformity with the basis of accounting described in Note 1.

This report is intended solely for the information and use of the Company, the Pennsylvania Department of Insurance, and the Commonwealth Court of Pennsylvania to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

July 3, 2008

Reliance Insurance Company (in Liquidation)

Statements of Certain Assets (Modified Cash Basis)

(In millions)

	December 31	
	2007	**2006**
Certain assets		
Investments (at fair value):		
Short and intermediate duration investments	**$ 1,328.5**	$ 1,121.4
Symbol Technologies common stock	–	63.8
Investments held in segregated accounts for secured creditors	**35.7**	43.2
Investments held for uncovered claimants	**12.8**	12.1
Real estate and real estate-related investments	**0.6**	0.7
Invested assets	**1,377.6**	1,241.2
Early access advances to guaranty associations	**1,721.6**	1,519.4
Total certain assets	**$ 3,099.2**	$ 2,760.6

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

Reliance Insurance Company (in Liquidation)

Statements of Cash Receipts and Disbursements and Changes in Short and Intermediate Duration Investments (Modified Cash Basis)

(In millions)

	Year Ended December 31 2007	2006
Cash receipts:		
Reinsurance collections	**$ 317.8**	$ 269.2
Premium collections	**18.7**	15.9
Claims recoveries	**12.8**	14.1
Investment income received	**64.5**	52.4
Proceeds from sales of Symbol Technologies common stock	**64.6**	25.8
Proceeds from sales of real estate, affiliates, and other investments	–	17.7
Settlement with former parent	–	21.0
Settlement with directors and officers	–	52.1
Other	**8.3**	4.0
Total cash receipts	**486.7**	472.2
Cash disbursements:		
Early access advances to guaranty associations	**(200.0)**	–
Loss and loss adjustment expenses	**(1.3)**	(0.8)
Operating expenses	**(92.7)**	(120.8)
Loan to wholly owned subsidiary	–	(18.0)
Total cash disbursements	**(294.0)**	(139.6)
Net change in short and intermediate duration investments from cash activity	**192.7**	332.6
Noncash items affecting short and intermediate duration investments:		
Change in fair value of short and intermediate duration investments	**14.4**	0.3
Total noncash activity	**14.4**	0.3
Net change in short and intermediate duration investments	**207.1**	332.9
Beginning balance—short and intermediate duration investments	**1,121.4**	788.5
Ending balance—short and intermediate duration investments	**$ 1,328.5**	$ 1,121.4

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

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis)

December 31, 2007 and 2006

1. Significant Accounting Policies

Reliance Insurance Company (the Company) was placed into rehabilitation by order of the Commonwealth Court of Pennsylvania on May 29, 2001. On October 3, 2001, the Company was declared insolvent by order (the Order) of the Commonwealth Court of Pennsylvania. The Order of the Commonwealth Court appointed the Insurance Commissioner of Pennsylvania as Liquidator of the Company. Representatives of the Liquidator oversee the daily operations of the Company. The Order applies to all former subsidiaries of Reliance Insurance Company that were previously merged into Reliance Insurance Company, including Reliance National Indemnity Company, Reliance National Insurance Company, United Pacific Insurance Company, Reliance Direct Company, Reliance Surety Company, Reliance Universal Insurance Company, United Pacific Insurance Company of New York, and Reliance Insurance Company of Illinois. The entity is now known as Reliance Insurance Company (In Liquidation) (Reliance) or (the Estate).

The principal activities since the date of the Order consist of the collection and marshalling of assets and determination of claims. The largest assets are reinsurance receivables and recoverables due for losses ceded under reinsurance agreements. All creditor claims submitted to Reliance must be evaluated through the proof of claim process to determine and assign the proper class priority and dollar value. The largest classes of creditors are claims for losses under policies issued prior to liquidation. Ultimately, the net assets of Reliance are expected to be distributed to creditors.

The following represent the significant accounting policies affecting Reliance that are used in preparing the accompanying modified cash basis financial statements. These policies differ from accounting principles generally accepted in the United States (GAAP) and, as a result, the accompanying modified cash basis financial statements are materially different from GAAP basis financial statements.

Basis of Accounting

Reliance's financial statements are prepared using a modified cash basis of accounting accepted by the Pennsylvania Department of Insurance, which differs from accounting principles generally accepted in the United States. The financial statements are on a cash basis with adjustments to the carrying amount of investments to fair value and other adjustments, and are therefore considered to be prepared on a modified cash basis of accounting. Only specific assets that are within the possession of the Liquidator and other certain amounts on deposit with or advanced to regulators or guaranty associations are recorded as assets in the accompanying Statements of Certain Assets.

1. Significant Accounting Policies (continued)

Basis of Accounting (continued)

Under this basis of accounting, Reliance does not reflect the amounts of certain assets, such as reinsurance recoverables and receivables, premium receivables, loans to or investments in subsidiary or affiliated companies, and certain other assets in the accompanying Statements of Certain Assets. In addition, no liabilities or obligations are recorded in the Statements of Certain Assets. These assets and liabilities, which have been included in financial statements previously filed with Commonwealth Court, are excluded from the accompanying Statements of Certain Assets due to the significant and variable nature of the estimates used to establish these values.

The preparation of financial statements requires the use of estimates and assumptions by management that affect amounts reported in these financial statements and accompanying notes. Actual results may vary from these estimates.

Cash Disbursements

Cash disbursements for which checks have been issued but are outstanding at the balance sheet date are not recorded as deductions to the total of certain assets (short and intermediate duration investments). Check disbursements are recorded as deductions to certain assets only when presented to the bank.

Short and Intermediate Duration Investments

Short and intermediate duration investments consist primarily of a portfolio (Core Plus) of marketable bonds and notes, a short-term investment fund (STIF), and an equity index fund. The Core Plus portfolio has a custom benchmark comprised of 70% Lehman Brothers Intermediate Gov/Credit Index and 30% Lehman Brothers Mortgage Index. The Core Plus portfolio includes high yield, international and emerging markets securities which are limited to a maximum of 25% of the portfolio. At December 31, 2007, these securities comprised 11.75% of the portfolio. Such investments are reported at fair value using recognized national pricing services. However, under the modified cash basis of accounting, no accrued but unpaid interest income is reported in the accompanying Statements of Certain Assets related to such investments.

Real Estate Investments

Real estate investments include direct ownership of real estate, as well as investments in limited partnerships that own real estate. Such investments are reported at net realizable value (fair value less costs to sell). Net realizable value is determined by management based upon comparable values of similar properties, or actual sales contract prices.

1. Significant Accounting Policies (continued)

Investments Held in Segregated Accounts—Secured Creditors

Investments held in segregated accounts, which consist primarily of short-term fixed maturity investments, secure specific obligations of Reliance, including liabilities arising from large deductible collections and losses on certain assumed reinsurance contracts. Such investments are reported at fair value. However, under the modified cash basis of accounting, no accrued or unpaid interest is reported in the accompanying financial statements. Funds collected on large deductible policies, which are not assets of the Estate, will be administered and paid to the guaranty associations and creditors in accordance with Insurance Department Act of 1921, 40 P.S. §221.23a (Act).

Investments Held for Uncovered Claimants

Investments held for uncovered claimants, which consists primarily of intermediate term investments at December 31, 2007 and short-term investments in 2006, are held pursuant to a settlement agreement entered into as of February 10, 2006 (Settlement Agreement) with various state guaranty associations. Pursuant to the Settlement Agreement, Reliance reduced the large deductible reimbursements otherwise due and owing each of the various state guaranty associations and established a fund for the exclusive benefit of uncovered (not covered by a guaranty association) class (b) claimants.

Priority of Claims and Distribution to Creditors

Reliance will distribute funds to creditors in accordance with Section 221.44 of the Act, which governs asset distributions from insolvent insurance estates. The following summarizes the classes of creditors under the Act:

(a) The costs and expenses of administration, including but not limited to the actual and necessary costs of preserving or recovering the assets of the insurer, compensation for all services rendered in the liquidation, reasonable attorney's and other expenses and fees.

(b) All claims under policies for losses wherever incurred, including third-party claims, and all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies, shall have the next priority.

(c) Claims of the Federal government.

(d) Debts due to employees for services performed to the extent that they do not exceed $1,000 and represent payment for services performed within one year before the filing of the petition for liquidation.

1. Significant Accounting Policies (continued)

Priority of Claims and Distribution to Creditors (continued)

(e) Claims under nonassessable policies for unearned premium or other premium refunds and claims of general creditors.

(f) Claims of any state or local government.

(g) Claims filed late and certain other special claims.

(h) Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies.

(i) The claims of shareholders or other owners.

Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class.

2. Short and Intermediate Duration Investments

The estimated fair values of short and intermediate duration investments by major category are summarized as follows (in millions):

	December 31	
	2007	**2006**
Cash and cash equivalents	**$ 134.7**	$ 347.9
U.S. government, agencies, and government-sponsored entities	**242.6**	187.6
Mortgage-backed securities	**502.3**	288.8
Corporate bonds	**296.7**	231.6
Asset-backed securities	**11.5**	65.5
Municipal bonds	**3.5**	–
International bonds	**17.1**	–
Emerging market bonds	**42.0**	–
Equity index mutual fund	**78.1**	–
Total	**$ 1,328.5**	$ 1,121.4

2. Short and Intermediate Duration Investments (continued)

Reliance has contracts with several professional investment managers to manage short and intermediate duration investments. Reliance has established investment policies which define criteria for the credit quality and duration of its portfolios. During 2007, following recommendations from our investment advisory consultant, revised investment guidelines were implemented and three new bond managers were selected to replace the existing bond managers. The recommendations included an allocation to an equity index fund. These changes were implemented during the third quarter 2007. The average duration of the fixed maturity investment portfolio is approximately 3.15 years as of December 31, 2007.

Certain cash and investments that are not available for distribution to creditors and are held for the benefit of large deductible policyholders in the amount of $24.5 million and $27.6 million as of December 31, 2007 and 2006, respectively, are excluded from the accompanying statements of certain assets (modified cash basis).

3. Early Access Advances to Guaranty Associations

During 2003, 2004, 2005 and 2007, the Commonwealth Court approved Early Access petitions in accordance with Section 221.36 of the Act which provides a mechanism for early distribution of assets to various state guaranty associations to assist those associations in fulfilling their obligation to pay certain policy claims of the Company. The related agreements executed by the guaranty associations provide that they agree to return assets under certain circumstances to ensure pro rata distributions amongst members of the same class of creditors of Reliance.

Payments made to various state guaranty associations under Early Access petitions are recorded as assets in the accompanying Statements of Certain Assets as they represent payments made in advance of distributions to other claimants. Guaranty association advances will be adjusted from the Statement of Certain Assets (modified cash basis) as the guaranty associations' claims are approved by the court.

3. Early Access Advances to Guaranty Associations (continued)

Statutory deposits represent amounts that were on deposit with various state insurance departments prior to October 3, 2001. Investment income is recorded as an addition to statutory deposits only upon notification by the various state insurance departments. The following summarizes the components of early access advances for the six largest states and all other states as of December 31, 2007 (in millions):

	Statutory Deposits	Early Access Advances	Other Deemed Early Access Advances	Total
California	**$ 280.6**	**$ 99.3**	**$ 2.7**	**$ 382.6**
Florida	**4.8**	**172.0**	**0.6**	**177.4**
New York	**0.3**	**243.3**	**1.1**	**244.7**
Texas	**–**	**81.3**	**1.0**	**82.3**
New Jersey	**0.9**	**68.9**	**0.2**	**70.0**
Pennsylvania	**–**	**96.2**	**0.8**	**97.0**
Other states	**134.2**	**514.0**	**19.4**	**667.6**
Total	**$ 420.8**	**$ 1,275.0**	**$ 25.8**	**$ 1,721.6**

The following summarizes the components of early access advances for the six largest states and all other states as of December 31, 2006 (in millions):

	Statutory Deposits	Early Access Advances	Other Deemed Early Access Advances	Total
California	$ 280.6	$ 89.6	$ 2.7	$ 372.9
Florida	4.8	143.5	0.6	148.9
New York	0.3	173.5	1.1	174.9
Texas	–	75.3	1.0	76.3
Massachusetts	56.3	5.9	0.3	62.5
Pennsylvania	–	78.5	0.8	79.3
Other states	77.8	508.7	18.1	604.6
Total	$ 419.8	$ 1,075.0	$ 24.6	$ 1,519.4

4. Operating Expenses

Operating expenses are comprised of the following (in millions):

	Year Ended December 31	
	2007	**2006**
Salaries	**$ 39.2**	$ 40.1
Employee benefits and taxes	**6.9**	6.7
IT outsourcing expenses	**9.7**	11.2
Legal fees and expenses	**9.6**	7.6
Professional services expenses	**7.4**	9.6
Rent	**3.4**	3.9
Equipment	**0.6**	0.6
Other operating expenses	**2.1**	2.3
Subtotal	**78.9**	82.0
Guaranty association expenses	**13.8**	38.8
Total operating expenses	**$ 92.7**	$ 120.8

The Company made payments for IT services of $5.3 million and $6.7 million to a wholly owned subsidiary in 2007 and 2006, respectively.

5. Commitments

As of December 31, 2007, Reliance leases office space under operating leases primarily expiring in 2009 and 2011.

The minimum future rental payments under noncancelable operating leases having remaining terms in excess of one year as of December 31, 2007 are as follows (in millions):

2008	$ 2.0
2009	2.1
2010	1.0
2011	0.9
Total	$ 6.0

6. Litigation

Reliance is a party to litigation both as a plaintiff and as a defendant. The ultimate effect of litigation on the financial condition of Reliance is uncertain and cannot be reasonably estimated but may be material.

7. Subsequent Events

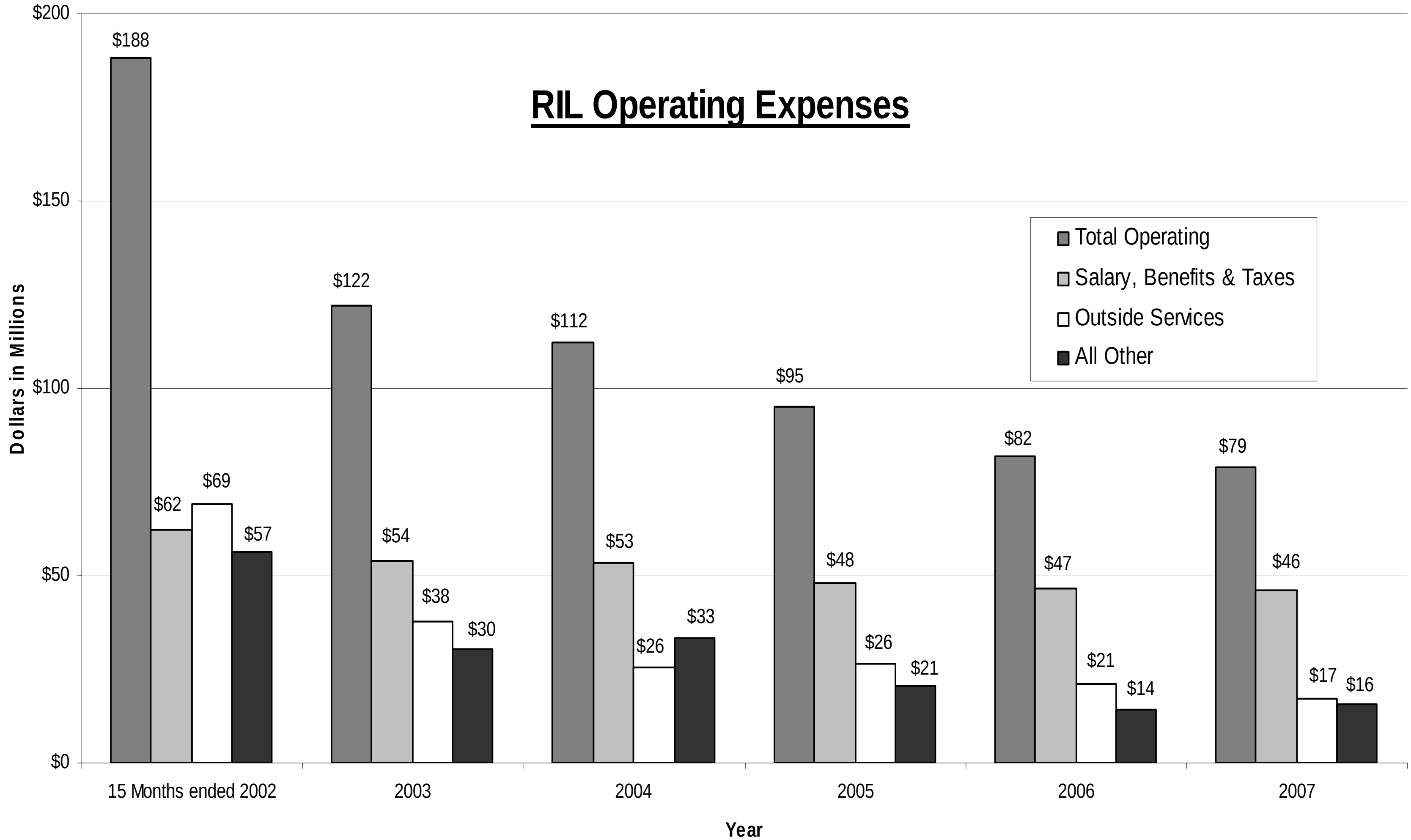
At the end of the period, Reliance was in negotiation with two of its larger reinsurers, to commute certain reinsurance obligations. The commutation with Munich Reinsurance America, Inc. was settled and paid in January 2008 for $143 million and the commutation with SCOR Reinsurance Company was settled and paid in April 2008 for $20.6 million. Additionally, there was a cash distribution of 20% of each allowed class (b) Notices of Determination (NOD) approved by the Court in January 2008. This disbursement was paid out on March 4, 2008 for a total of $58.2 million.

Exhibit B

RELIANCE INSURANCE COMPANY (IN LIQUIDATION)
OPERATING EXPENSES - UNAUDITED
ANNUAL BUDGET / HISTORICAL COMPARISON REPORT
(In Thousands)

	2008 Budget	2007 Actual	2006 Actual	2005 Actual	2004 Actual	2003 Actual	15 Mo. Ended Dec. 31, 2002 Actual
Salaries	$ 36,816	$ 39,195	$ 40,070	$ 41,179	$ 45,898	$ 46,399	$ 54,096
Benefits & Payroll Taxes	6,798	6,943	6,720	6,840	7,599	7,609	8,293
Total Salaries, Benefits and Taxes	43,614	46,139	46,790	48,019	53,497	54,008	62,389
IT Services	8,995	9,664	11,153	15,738	14,325	19,197	20,872
Legal Fees	6,518	9,637	7,574	10,367	18,542	12,995	20,633
Professional and Other Services	8,203	7,353	9,655	9,954	10,464	17,727	45,035
Rent	3,348	3,394	3,922	4,989	7,118	7,721	12,945
Equipment	1,144	648	582	3,103	4,062	5,837	6,830
Other Operating	2,296	2,094	2,349	3,135	4,180	4,632	19,540
Total Operating Expenses	$ 74,117	$ 78,930	$ 82,025	$ 95,305	$ 112,187	$ 122,119	$ 188,243
Loss/LAE	$ 2,070	$ 1,300	$ 800	$ 3,900	$ 5,100	$ 13,019	$ 148,300

Exhibit C



RIL Operating Expenses
Dollars in Millions
Year
$200
$150
$100
$50
$0
15 Months ended 2002
2003
2004
2005
2006
2007
Total Operating
Salary, Benefits & Taxes
Outside Services
All Other
$188
$62
$69
$57
$122
$54
$38
$30
$112
$53
$26
$33
$95
$48
$26
$21
$82
$47
$21
$14
$79
$46
$17
$16

Exhibit D

Reliance In Liquidation Headcount