

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

2009 AUG 18 P 2:40

RECEIVED AND FILED  
COMMONWEALTH COURT  
OF PA (PHILA)

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

**RE:** ADMINISTRATIVE EXPENSES PAID BY THE LIQUIDATOR  
FOR THE PERIOD JANUARY 1, 2008 THROUGH DECEMBER 31, 2008

**ORDER**

AND NOW, this \_\_\_\_\_ day of \_\_\_\_\_, 2008, upon consideration of the  
Petition for Approval of Administrative Expenses Paid by the Liquidator for the Period January  
1, 2008 through December 31, 2008 ("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

January 1, 2008 through December 31, 2008 are hereby approved as class (a) claims which were necessary, reasonable, and incurred in the best interest of the Estate.

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**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

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CLERK OF THE COMMONWEALTH COURT  
OF PENNSYLVANIA

**PETITION FOR APPROVAL OF ADMINISTRATIVE EXPENSES  
PAID BY THE LIQUIDATOR FOR  
THE PERIOD JANUARY 1, 2008 THROUGH DECEMBER 31, 2008**

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 January 1, 2008 through December 31, 2008 (“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.<sup>1</sup>

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. 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 June 29,

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<sup>1</sup> 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.

2009. All of the status reports submitted to the Court can be reviewed on the Reliance website at [www.reliancedocuments.com](http://www.reliancedocuments.com). The status reports for 2008 are listed on the website as document numbers 2145 filed June 6, 2008; 2173 filed September 30, 2008; 2218 filed December 18, 2008; and 2324 filed March 26, 2009.

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 an independent audit of certain cash and investment assets, including cash receipts and disbursements of the Estate, for the period from January 1, 2008 through December 31, 2008. This audit is performed on an annual basis and the disbursements included in this Petition were subject to that independent audit and review process.

7. Ernst & Young issued an independent audit report (“Audit Report”), including an unqualified opinion, regarding certain assets of Reliance for the period from January 1, 2008

through December 31, 2008.<sup>2</sup> The Audit Report, for the year ending 2008, is attached as Exhibit A and includes the following statements:

....

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 cash basis) of Reliance Insurance Company (in Liquidation) at December 31, 2008 and 2007, and the cash receipts and disbursements and changes in short and intermediate duration investments (modified cash basis) for the years ended in conformity with 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.

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<sup>2</sup> The financial statements presented in the Quarterly Status Reports may differ in some respects from the financial statements presented in the Audit Report due to the reclassification of certain items and due to the transition from an

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, 2009 compared to the actual operating expenses for the years ended December 31, 2008, 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. Exhibit C is the corresponding Operating Expense Analysis submitted with the December 31, 2008 Quarterly Status Report. Attached as Exhibit D 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. Operating Expenses**

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, 2008, Reliance had a total of 223 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, 2008, there were 34 consultants of which 31 were related to the IT business application systems. Staffing levels as of June 30, 2009 are 194 employees and 32 consultants. Attached as Exhibit E is a graph which summarizes the change in number of staff and consultants since the date of liquidation.

11. **IT Outsourcing Expenses:** Acxiom, a third party provider, maintains the IT technical 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 the help desk, desktops, on-site servers, and operational and disaster recovery. RCG IT, which is a wholly owned subsidiary of Reliance, continues to provide production support, maintenance, security and development services for Reliance's business application systems.

12. **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; (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. In 2008, Reliance recovered approximately \$44 million through legal actions. A detailed legal fee expense schedule is included in each Quarterly Status Report filed with the Court and attached as Exhibit F is the listing of Legal Fees and Expenses submitted with the December 31, 2008 Quarterly Status Report.

13. **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 and reinsurance 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 and attached as Exhibit G is listing of Professional Services Expenses submitted with the December 31, 2008 Quarterly Status Report.

14. **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. Negotiation with the landlords and workspace changes completed in the first quarter of 2008 will result in more than \$1 million in savings over the remaining life of the leases..

15. **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.

16. **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.

17. **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.

**B. Disbursements Netted With Receipts**

18. 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.

19. **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. During 2008, fees aggregating \$308,000 were deducted from the gross amount collected and the net proceeds were remitted to Reliance. For the time period January 1, 2008 through December 31, 2008, Reliance collected premiums totaling \$17.9 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.

20. **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. In 2008, Reliance paid subrogation fees totaling approximately \$1.3 million and collected subrogation proceeds totaling \$6.3 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.

21. **Real Estate Expenses:** Reliance's last remaining holding, 3 acres in Loudoun County, VA, with a carrying value of \$500,000, will eventually be sold, unless condemned earlier by the County for fair value. Some real estate expenses were recorded in the category of

Other Operating Expenses (\$31 thousand), certain other expenses (approximately \$74 thousand) associated with the real estate transaction costs were netted against receipts.


22. **Subsidiaries:** Reliance 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. These costs totaled \$58,000 in 2008.

#### **Recommendation**

23. 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: 

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Office of Chief Counsel  
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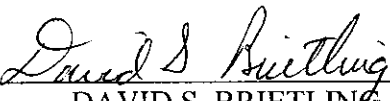
Dated: August 18, 2009

**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 Petition 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: August 18, 2009

  
\_\_\_\_\_  
DAVID S. BRIETLING  
Chief Liquidation Officer

**CERTIFICATE OF SERVICE**

I, Marilyn K. Kincaid, hereby certify that on or about this day, pursuant to the Court's Order of December 12, 2008, service of the foregoing was made on the attached Master Service List through the transmission of a Notice of Filing and through posting of a true and correct copy in PDF file format on the Reliance Documents website at [www.reliancedocuments.com](http://www.reliancedocuments.com).

Dated: August 18, 2009

  
MARILYN K. KINCAID

## Master Service List

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v.

Reliance Insurance Company

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

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(Counsel for Republic Western Insurance Company)

# Exhibit A

RELIANCE INSURANCE COMPANY  
(IN LIQUIDATION)

Financial Statements (Modified Cash Basis)

Years ended December 31, 2008 and 2007  
With Report of Independent Auditors

Reliance Insurance Company (in Liquidation)

Financial Statements  
(Modified Cash Basis)

Years ended December 31, 2008 and 2007

**Contents**

Report of Independent Auditors.....1

Audited Financial Statements

Statements of Certain Assets (Modified Cash Basis) .....2

Statements of Cash Receipts and Disbursements and Changes in Short and  
Intermediate Duration Investments (Modified Cash Basis) .....3

Notes to Financial Statements (Modified Cash Basis) .....4

## 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, 2008 and 2007, 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 Company (in Liquidation) at December 31, 2008 and 2007, 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*

June 19, 2009

Reliance Insurance Company (in Liquidation)

Statements of Certain Assets (Modified Cash Basis)

(In millions)

	December 31	
	2008	2007
<b>Certain assets</b>		
Investments (at fair value):		
Short and intermediate duration investments	\$ 1,532.3	\$ 1,328.5
Investments held in segregated accounts for secured creditors	22.8	35.7
Investments held for uncovered claimants	12.0	12.8
Real estate and real estate-related investments	0.5	0.6
Invested assets	1,567.6	1,377.6
Early access advances to guaranty associations	1,722.2	1,721.6
Total certain assets	<u>\$ 3,289.8</u>	<u>\$ 3,099.2</u>

*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)

	<b>Year ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Cash receipts:		
Reinsurance collections	\$ 452.7	\$ 317.8
Premium collections	17.6	18.7
Claims recoveries	5.0	12.8
Investment income received	66.4	64.5
Proceeds from sales of Symbol Technologies common stock	-	64.6
Other	28.9	8.3
Total cash receipts	<u>570.6</u>	<u>486.7</u>
Cash disbursements:		
Early access advances to guaranty associations	-	(200.0)
Asset distribution	(73.3)	-
Loss and loss adjustment expenses	(2.7)	(1.3)
Operating expenses	(82.7)	(92.7)
Total cash disbursements	<u>(158.7)</u>	<u>(294.0)</u>
Net change in short and intermediate duration investments from cash activity	411.9	192.7
Noncash items affecting short and intermediate duration investments:		
Change in fair value of short and intermediate duration investments	(208.1)	14.4
Net change in short and intermediate duration investments	203.8	207.1
Beginning balance—short and intermediate duration investments	<u>1,328.5</u>	<u>1,121.4</u>
Ending balance—short and intermediate duration investments	<u>\$1,532.3</u>	<u>\$1,328.5</u>

*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, 2008 and 2007

### 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, Union Pacific Insurance Company, Reliance Direct Insurance 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 class of creditors is 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.

## Reliance Insurance Company (in Liquidation)

### Notes to Financial Statements (Modified Cash Basis) (continued)

#### 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. At December 2008 and 2007, outstanding checks were \$3.0 million and \$1.9 million, respectively.

##### 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% Barclays Capital Intermediate U.S. Gov/Credit Index and 30% Barclays Capital Fixed rate U.S. Mortgage Backed Securities. The Core Plus portfolio includes high yield, international and emerging markets securities which are limited to a maximum of 25% of the portfolio. These securities comprised 8.83% and 11.75% of the portfolio at December 31, 2008 and December 31, 2007, respectively. 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.

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**1. Significant Accounting Policies (continued)**

**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.

**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, 2008 and 2007, 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 owed to 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.

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**1. Significant Accounting Policies (continued)**

**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.
- (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.

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**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):

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Cash and cash equivalents	\$ 259.3	\$ 134.7
U.S. government, agencies, and government sponsored entities	149.8	242.6
Mortgage-backed and asset-backed securities	581.7	513.8
Corporate bonds	384.3	313.8
Emerging market bonds	33.6	42.0
Municipal bonds	7.4	3.5
Equity index mutual fund	116.2	78.1
Total	<u>\$ 1,532.3</u>	<u>\$ 1,328.5</u>

Reliance has contracts with several professional investment managers to manage their short and intermediate duration investments. Reliance has established investment policies which define criteria for the credit quality and duration of its portfolios. The average duration of their investment portfolio is approximately 2.63 years as of December 31, 2008.

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 \$22.0 and \$24.5 million as of December 31, 2008 and 2007, respectively, are excluded from the accompanying statements of certain assets (modified cash basis).

## Reliance Insurance Company (in Liquidation)

### Notes to Financial Statements (Modified Cash Basis) (continued)

#### 3. Fair Value Measurements

Recent guidance issued by accounting standard setters and regulators with respect to financial statements prepared in accordance with GAAP clarifies the definition of fair value for financial reporting, establishes framework for measuring fair value, and requires additional disclosures about the use of fair value measurements.

Various inputs are used in determining the fair value of the Estate's unrestricted investments. These inputs are summarized in three broad levels as follows:

**Level 1 Inputs** – Quoted prices in active markets for identical securities without adjustment. The Level 1 assets primarily include cash and cash equivalents, U.S. Treasury securities and investments in mutual funds.

**Level 2 Inputs** – Other significant observable inputs other than Level 1 inputs (including quoted prices for similar securities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data). The Level 2 assets of the Liquidating Company are primarily corporate and assets-backed debt securities (including mortgage-backed fixed income securities), and government agency debt. The value of these securities is determined using pricing quotes from third-party pricing services. These third-party pricing services use pricing matrices with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

**Level 3 Inputs** – Significant unobservable inputs, including the Estate's own assumptions in determining the fair value of investments. At December 31, 2008 and 2007, the Estate's only investments in Level 3 assets valued at fair value was real estate and real estate related investments of \$0.5 million and \$0.6 million, respectively.

#### 4. 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.

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**4. Early Access Advances to Guaranty Associations (continued)**

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 reclassified and no longer recorded as assets when the Commonwealth Court of Pennsylvania approves the distributions to the guaranty associations.

Statutory deposits represent amounts that were on deposit with various state insurance departments prior to October 3, 2001. The following summarizes the components of early access advances for the six largest states and all other states as of December 31, 2008 (in millions):

	<b>Statutory Deposits</b>	<b>Early Access Advances</b>	<b>Other Deemed Early Access Advances</b>	<b>Total</b>
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	134.9	514.0	19.3	668.2
<b>Total</b>	<b>\$ 421.5</b>	<b>\$ 1,275.0</b>	<b>\$ 25.7</b>	<b>\$ 1,722.2</b>

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):

	<b>Statutory Deposits</b>	<b>Early Access Advances</b>	<b>Other Deemed Early Access Advances</b>	<b>Total</b>
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
<b>Total</b>	<b>\$ 420.8</b>	<b>\$ 1,275.0</b>	<b>\$ 25.8</b>	<b>\$ 1,721.6</b>

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**5. Asset Distribution**

On January 17, 2008, the Court approved the Liquidator's Petition for First Interim Distribution, allowing a 20% distribution to all class (b) claimants whose Notice of Determination ("NOD") has been approved by the Court. Distribution amounts for claims under aggregate policies were subject to an adjustment calculated pursuant to the Order issued by the Court on November 19, 2007 approving the Liquidator's Petition to address claims under aggregate policies. At December 31, 2008 distributions totaling \$73.8 million had been issued, of which \$73.3 million have been recorded as cash disbursements in 2008. Distribution payments will continue to be issued on a quarterly basis to claimants whose NODs are subsequently approved by the Court.

**6. Operating Expenses**

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

	<b>Year ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Salaries	\$ 36.7	\$ 39.2
Employee benefits and taxes	6.5	6.9
IT outsourcing expenses	8.6	9.7
Legal fees and expenses	5.1	9.6
Professional services expenses	7.2	7.4
Rent	3.2	3.4
Equipment	1.9	0.6
Other operating expenses	1.8	2.1
Subtotal	<u>71.0</u>	<u>78.9</u>
Guaranty association expenses	11.7	13.8
Total operating expenses	<u>\$ 82.7</u>	<u>\$ 92.7</u>

The Company made payments for IT services of \$5.0 and \$5.3 million to a wholly owned subsidiary in 2008 and 2007, respectively.

Reliance Insurance Company (in Liquidation)

Notes to Financial Statements (Modified Cash Basis) (continued)

**7. Commitments**

As of December 31, 2008, Reliance leases office space under operating leases primarily expiring in 2009 and 2011.

The minimum future rental payments under noncancelable operating leases as of December 31, 2008, are as follows (in millions):

2009	\$ 1.8
2010	1.0
2011	0.9
Total	<u>\$ 3.7</u>

**8. 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.

**9. Subsequent Event**

On December 12, 2008, the Commonwealth Court of Pennsylvania approved a settlement agreement that resolved all outstanding disputes between Reliance and its former outside auditor, Deloitte & Touche, LLP and appointed actuary, which required Deloitte & Touche, LLP to pay \$40 million to Reliance. This cash was received by Reliance on February 3, 2009, and was recognized as a cash receipt in 2009.

# Exhibit B

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

	2009 Budget	2008 Actual	2007 Actual	2006 Actual	2005 Actual	2004 Actual	2003 Actual	15 Mo. Ended 12/31/2002 Actual
Salaries	\$ 33,447	\$ 36,720	\$ 39,195	\$ 40,070	\$ 41,179	\$ 45,898	\$ 46,399	\$ 54,096
Benefits & Payroll Taxes	6,962	6,496	6,943	6,720	6,840	7,599	7,609	8,293
Total Salaries, Benefits and Taxes	40,409	43,216	46,139	46,790	48,019	53,497	54,008	62,389
IT Services	8,361	8,621	9,664	11,153	15,738	14,325	19,197	20,872
Legal Fees	2,551	5,146	9,637	7,574	10,367	18,542	12,995	20,633
Professional and Other Services	6,528	7,205	7,353	9,655	9,954	10,464	17,727	45,035
Rent	3,444	3,156	3,394	3,922	4,989	7,118	7,721	12,945
Equipment	1,173	1,909	648	582	3,103	4,062	5,837	6,830
Other Operating	2,226	1,729	2,094	2,349	3,135	4,180	4,632	19,540
Total Operating Expenses	\$ 64,692	\$ 70,983	\$ 78,930	\$ 82,025	\$ 95,305	\$ 112,187	\$ 122,119	\$ 188,243
Loss / LAE	\$ 3,300	\$ 2,700	\$ 1,300	\$ 800	\$ 3,900	\$ 5,100	\$ 13,019	\$ 148,300

# Exhibit C

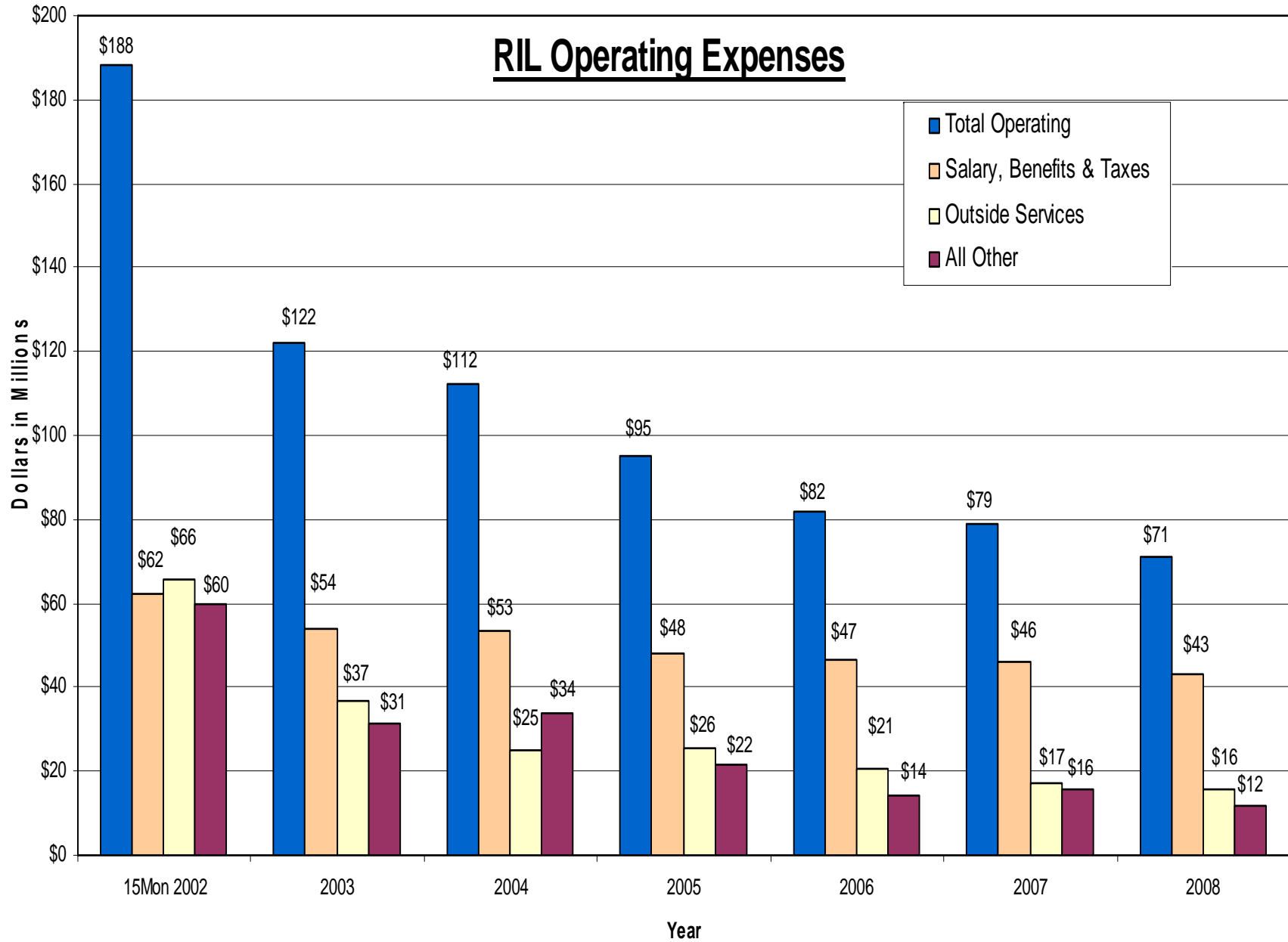
RELIANCE INSURANCE COMPANY (IN LIQUIDATION)  
 OPERATING EXPENSE ANALYSIS - UNAUDITED

	Year to Date December 2008		Actual to Budget Variance	% Change		Year to Date December 2007		Variance to Prior Year	% Change
	Actual	Budget				Actual			
<b>Salaries</b>									
Regular Salaries	\$28,299,280	\$28,210,838	\$88,442	0.31%		\$30,325,249	(\$2,025,969)	-6.68%	
Performance-Retention	6,821,080	6,839,047	(17,967)	-0.26%		7,194,165	(373,085)	-5.19%	
Severance	1,599,352	1,765,738	(166,386)	-9.42%		1,676,078	(76,726)	-4.58%	
<b>Total Salaries</b>	<b>36,719,712</b>	<b>36,815,623</b>	<b>(95,911)</b>	<b>-0.26%</b>		<b>39,195,492</b>	<b>(2,475,780)</b>	<b>-6.32%</b>	
<b>Employee Benefits</b>									
Health and Disability Benefits	2,146,843	2,280,500	(133,657)	-5.86%		2,195,478	(48,635)	-2.22%	
SIP-Contributions and Fees	2,141,097	2,205,000	(63,903)	-2.90%		2,350,165	(209,068)	-8.90%	
Other Benefits	36,299	54,008	(17,709)	-32.79%		66,947	(30,648)	-45.78%	
<b>Total Employee</b>	<b>4,324,239</b>	<b>4,539,508</b>	<b>(215,269)</b>	<b>-4.74%</b>		<b>4,612,590</b>	<b>(288,351)</b>	<b>-6.25%</b>	
<b>Payroll Taxes</b>	<b>2,172,061</b>	<b>2,258,939</b>	<b>(86,878)</b>	<b>-3.85%</b>		<b>2,330,538</b>	<b>(158,477)</b>	<b>-6.80%</b>	
<b>Total Salaries, Benefits and Taxes</b>	<b>43,216,012</b>	<b>43,614,070</b>	<b>(398,058)</b>	<b>-0.91%</b>		<b>46,138,620</b>	<b>(2,922,608)</b>	<b>-6.33%</b>	
<b>IT Services</b>	<b>8,620,571</b>	<b>8,994,913</b>	<b>(374,342)</b>	<b>-4.16%</b>		<b>9,664,273</b>	<b>(1,043,702)</b>	<b>-10.80%</b>	
<b>Legal Fees</b>	<b>5,146,312</b>	<b>6,517,715</b>	<b>(1,371,403)</b>	<b>-21.04%</b>		<b>9,637,336</b>	<b>(4,491,024)</b>	<b>-46.60%</b>	
<b>Professional and Other</b>	<b>7,205,159</b>	<b>8,202,660</b>	<b>(997,501)</b>	<b>-12.16%</b>		<b>7,353,308</b>	<b>(148,149)</b>	<b>-2.01%</b>	
<b>Rent</b>									
Corporate Home Office Record Archiving Services	2,260,023	2,346,369	(86,346)	-3.68%		2,612,437	(352,414)	-13.49%	
Other Rent Items	809,107	811,200	(2,093)	-0.26%		731,679	77,428	10.58%	
	86,739	190,165	(103,426)	-54.39%		50,371	36,368	72.20%	

<b>Total Rent</b>	<b>3,155,869</b>	<b>3,347,734</b>	<b>(191,865)</b>	<b>-5.73%</b>		<b>3,394,487</b>	<b>(238,618)</b>	<b>-7.03%</b>
<b>Equipment</b>								
Computer								
Equipment	965,999	676,570	289,429	42.78%		273,913	692,086	252.67%
Office								
Machine Rent & Data	22,031	29,644	(7,613)	-25.68%		23,666	(1,635)	-6.91%
Processing	921,249	437,509	483,740	110.57%		350,821	570,428	162.60%
<b>Total</b>	<b>1,909,279</b>	<b>1,143,723</b>	<b>765,556</b>	<b>66.94%</b>		<b>648,400</b>	<b>1,260,879</b>	<b>194.46%</b>
<b>Other</b>								
Travel	180,983	280,937	(99,954)	-35.58%		245,639	(64,656)	-26.32%
Professional								
Dues &	38,437	53,276	(14,839)	-27.85%		42,187	(3,750)	-8.89%
Insurance	677,638	1,088,600	(410,962)	-37.75%		1,013,460	(335,822)	-33.14%
Voice and Data								
Communication	269,195	285,560	(16,365)	-5.73%		246,131	23,064	9.37%
Supplies and Subscriptions								
Postage, Freight &	188,881	239,622	(50,741)	-21.18%		216,899	(28,018)	-12.92%
Bank Charges	121,940	120,300	1,640	1.36%		114,835	7,105	6.19%
Real Estate	31,486	34,000	(2,514)	-7.39%		56,668	(25,182)	-44.44%
Taxes, BBA and Other	36,096	45,000	(8,904)	-19.79%		44,615	(8,519)	-19.09%
<b>Total Other</b>								
<b>Operating</b>	<b>1,729,344</b>	<b>2,295,695</b>	<b>(566,351)</b>	<b>-24.67%</b>		<b>2,093,673</b>	<b>(364,329)</b>	<b>-17.40%</b>
<b>Subtotal</b>	<b>70,982,546</b>	<b>74,116,510</b>	<b>(3,133,964)</b>	<b>-4.23%</b>		<b>78,930,097</b>	<b>(7,947,551)</b>	<b>-10.07%</b>
<b>Guaranty Association Expenses</b>	<b>11,745,509</b>	<b>27,019,527</b>	<b>(15,274,018)</b>	<b>-56.53%</b>		<b>13,763,227</b>	<b>(2,017,718)</b>	<b>-14.66%</b>
<b>Operating Expenses</b>	<b>\$82,728,055</b>	<b>\$101,136,037</b>	<b>(\$18,407,982)</b>	<b>-18.20%</b>		<b>\$92,693,324</b>	<b>(\$9,965,269)</b>	<b>-10.75%</b>

# Exhibit D

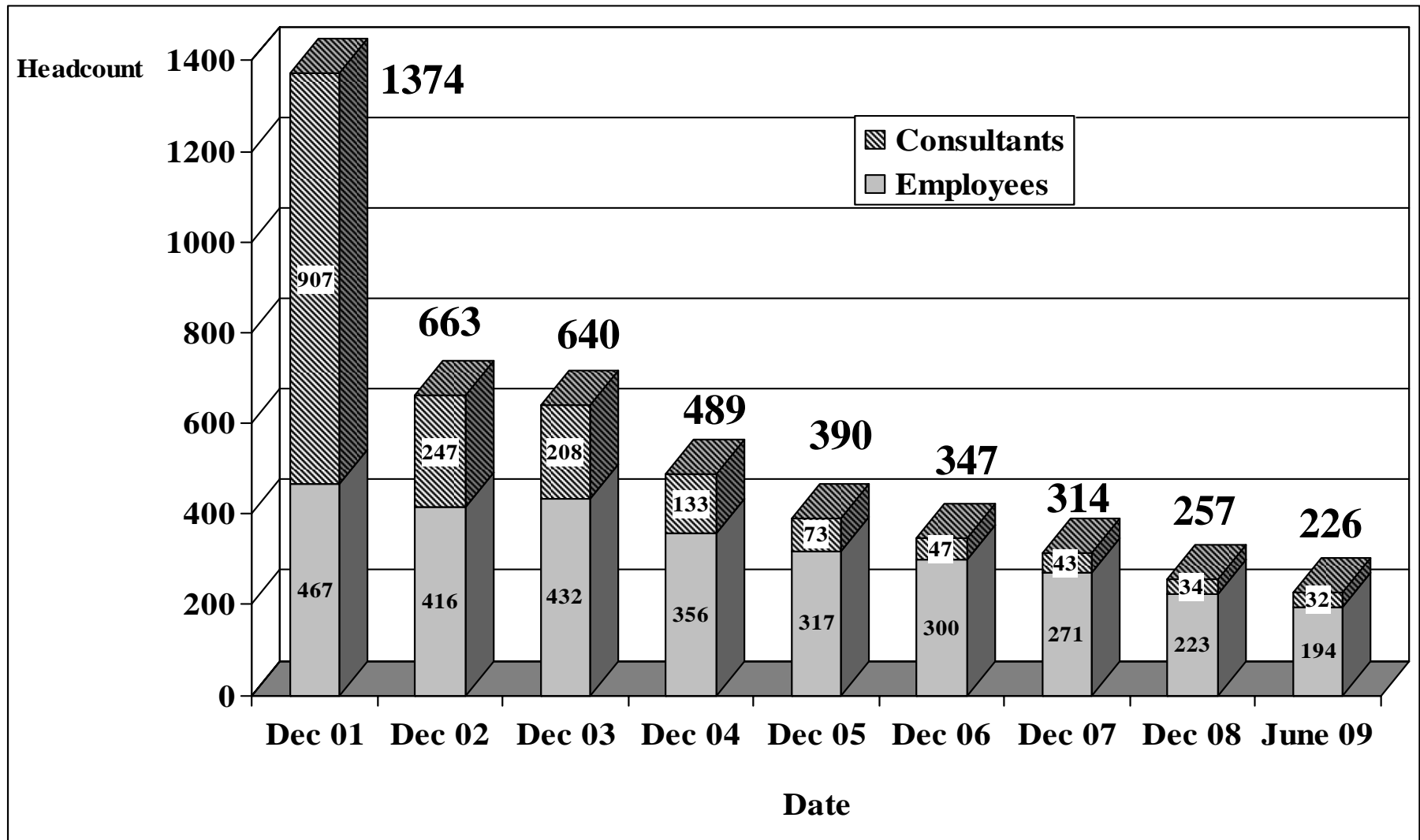
## RIL Operating Expenses



# Exhibit E

# Reliance In Liquidation

## Headcount



# Exhibit F

**RELIANCE INSURANCE COMPANY (IN LIQUIDATION)**  
**LEGAL FEES AND EXPENSES**  
**FOR THE PERIOD JANUARY 1, 2008 TO DECEMBER 31, 2008 - UNAUDITED**

**VENDOR NAME**

ADORNO & YOSS, LLP.	\$	150,231
AMS CONSTRUCTION COMPANY INC		62,500
ANDREW S. WALSH		11,205
AVALON CONSULTING, LLC.		19,589
BLANEY MCMURTRY LLP		42,016
BLANK ROME LLP		1,751,171
BRAVERMAN KASKEY		76,403
CLARK THOMAS & WINTERS		10,672
DEUTSCH, KERRIGAN & STILES LLP		70,520
DOCUMENT TECHNOLOGIES, LLC.		62,579
EDWARD S. FINKELSTEIN		10,695
ELIZABETH M. THOMPSON		17,515
ESQUIRE DEPOSITION SERVICES, LLC.		19,867
FOX, ROTHSCHILD LLP		276,382
FRIDAY ELDREDGE & CLARK LLP		7,651
FULBRIGHT & JAWORSKI, LLP.		46,299
G ALAN BAILEY ESQUIRE		8,094
GOLKOW TECHNOLOGIES INC		36,894
INVESTIGATION CONSULTANT/EXPERT NO. 10		162,202
INVESTIGATION CONSULTANT/EXPERT NO. 2		229,336
INVESTIGATION CONSULTANT/EXPERT NO. 3		98,726
INVESTIGATION CONSULTANT/EXPERT NO. 4		9,075
INVESTIGATION CONSULTANT/EXPERT NO. 7		14,365
MARKS ADR LLC		29,620
MARTIN D. HABER ESQ.		11,400
OBERMAYER REBMANN MAXWELL & HIPPEL, LLP.		56,189
PEPPER HAMILTON LLP.		1,083,009
RIKER DANZIG SCHERER HYLAND & PERRETTI LLP		10,901
ROSENN JENKINS & GREENWALD LLP		27,514
RUSSELL M. NIGRO, ESQ.		6,548
STRADLEY, RONON, STEVENS, & YOUNG LLP		340,424
THE MCS GROUP, INC.		66,681
WALSH COLUCCI LUBELEY EMRICH & WALSH PC		15,140
WILLIAM E. BAILEY		10,575
WINKLER & WINKLER, LLC.		40,609
WOLF BLOCK SCHORR & SOLIS-COHEN LLP.		215,734
TOTAL VENDORS UNDER \$5,000		37,983
<b>TOTAL LEGAL FEES AND EXPENSES</b>	<b>\$</b>	<b>5,146,312</b>

# Exhibit G

**RELIANCE INSURANCE COMPANY (IN LIQUIDATION)  
PROFESSIONAL SERVICE EXPENSES  
FOR THE PERIOD JANUARY 1, 2008 TO DECEMBER 31, 2008 - UNAUDITED**

**VENDOR  
NAME**

ABERDEEN ASSET MANAGEMENT INC.	\$	765,055
AON RECOVERY INC		7,219
ARRAYA SOLUTIONS INC		28,668
BMS INTERMEDIARIES, LTD.		1,624,526
CALLAN ASSOCIATES INC.		93,375
CERIDIAN EMPLOYER SERVICES		69,500
COMMONWEALTH OF MASSACHUSETTS		19,195
DEBRA KELLER WRIGHT		26,000
DIANE H. CHAIT		24,453
DIRECT CONSULTING		231,603
DORANNE BIGELOW & ASSOCIATES, INC.		95,135
ERNST & YOUNG		216,994
FILEX DOCUMENT IMAGING SERVICES, INC.		207,624
FREDERICK M. ZAUDERER ESQ		7,251
FUJITSU COMPUTER SYSTEMS CORPORATION		20,000
J MURPHY & ASSOCIATES INC		33,475
JP MORGAN CHASE BANK		5,012
KIM NEDELKA		6,600
MARY PAT COTTY		24,262
MARYELLEN R. DURNING		50,301
MELLON GLOBAL SECURITIES SERVICES		225,226
NICHOLAS F WILLERT		13,774
PA. DEP'T. - LIQUIDATION CONSULTANTS		234,076
PA. DEP'T. - OFFICE OF LIQUIDATIONS		383,588
PRICEWATERHOUSE COOPERS, LLP.		214,736
PYRAMIS GLOBAL ADVISORS TRUST COMPANY		762,448
RCG IT (GARTNER GROUP)		40,660
REINSURANCE SOLUTIONS INTERNATIONAL, L.L.C		171,067
ROY MELANDER		136,113
SPECIALTY RISK SERVICES LLC		99,775
STANDISH MELLON ASSET MANAGEMENT, LLC.		137,065
STRATEGEMS CONSULTING		21,076
SUSAN ALTSCHULER		74,751
THE BANK OF NEW YORK		10,669
VISION SOLUTIONS INC		10,000
WEIDENHAMMER SYSTEMS CORPORATION		12,236
WESTERN ASSET MANAGEMENT COMPANY		698,552
WORLDWIDE CLAIMS MANAGEMENT SERVICES, IN		397,266
TOTAL OTHER VENDORS UNDER \$5,000		5,834
<b>TOTAL PROFESSIONAL SERVICE EXPENSES</b>	<b>\$</b>	<b><u>7,205,159</u></b>