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IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE:

Reliance Insurance Company  
In Liquidation

NO. 1 REL 2001

RE: ADMINISTRATIVE EXPENSES PAID BY THE LIQUIDATOR  
FOR THE PERIOD JANUARY 1, 2010 THROUGH DECEMBER 31, 2010

**ORDER**

AND NOW, this \_\_\_\_\_ day of \_\_\_\_\_, 2011, upon consideration of the Petition for Approval of Administrative Expenses Paid by the Liquidator for the Period January 1, 2010 through December 31, 2010 ("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 C (excluding Guaranty Association expenses), for the period of January 1, 2010 through December 31, 2010 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

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IN RE:

Reliance Insurance Company  
In Liquidation

NO. 1 REL 2001

PETITION FOR APPROVAL OF ADMINISTRATIVE EXPENSES  
PAID BY THE LIQUIDATOR FOR THE PERIOD  
JANUARY 1, 2010 THROUGH DECEMBER 31, 2010

Michael F. Consedine, 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, 2010 through December 31, 2010 ("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.) (the "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 provide 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 28, 2011. 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 2010 are listed on the

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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.

website as document numbers 2573 filed June 8, 2010; 2621 filed September 30, 2010; 2655 filed December 22, 2010; and 2715 filed March 24, 2011.

5. These reports include 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 AUDIT**

6. Ernst & Young has performed an independent audit of certain cash and investment assets, including cash receipts and disbursements of the Estate from the beginning of the liquidation. 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, 2010 through December 31, 2010.<sup>2</sup> The Audit Report, for the year ending 2010, 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. . . .

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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.

....

... 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, 2010 and 2009, 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.

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 have been 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, 2011 compared to the actual operating expenses for the year ended December 31, 2010 and for each preceding year end back to 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, as well as Guaranty Association expenses. Exhibit C is the corresponding Operating Expense Analysis submitted with the December 31, 2010 Quarterly Status Report. Attached as Exhibit D is a graph, which displays the actual operating expenses, by time period, summarized into four major categories: a) Salaries, Benefits and Taxes; b) Outside Services; c) Legal; and d) 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, 2010, Reliance had a total of 160 employees in both the Philadelphia and New York City offices. Reliance also continues to use consultants to support operations, especially in the Information Technology ("IT") area. At December 31, 2010, there were 38 consultants of whom 35 were related to the IT business application systems. Staffing levels as of June 30, 2011 are 147 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 Services:** In late 2010 Reliance's outsourcing requirements were reduced, when Reliance completed expense reduction initiatives which included moving from a mainframe computer to a more cost effective in-house server environment. The IT services previously provided through a single third party vendor are now provided through a combination of other outsourcing arrangements and in-house resources at significantly reduced costs with

improved flexibility. RCG Global Services, 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.

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 two general categories of legal matters: Estate administration and general asset recovery. Litigation has been necessary in many matters to protect and recover Reliance assets, and Reliance has recovered significant amounts through such litigation. In 2010, Reliance recovered approximately \$11 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 (Excluding ALAE) submitted with the December 31, 2010 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 the listing of Professional Services Expenses submitted with the December 31, 2010

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. During the second quarter of 2011, the leases in Philadelphia and New York were extended for one year with significantly reduced workspace. These changes will result in a cost savings of \$700,000 in 2012.

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

16. **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**

17. 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.

18. **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 2010, fees aggregating



\$228,000 were deducted from the gross amount collected and the net proceeds were remitted to Reliance. For the time period January 1, 2010 through December 31, 2010, Reliance collected premiums totaling \$8 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.

19. **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 2010, Reliance paid subrogation fees totaling approximately \$249,000 and collected subrogation proceeds totaling \$5 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.

20. **Real Estate Expenses:** On April 26, 2010 this Court approved the sale of the last remaining piece of Virginia real estate, 3 acres in Loudoun County, VA, and the proceeds of \$474,215 were received. Real estate expenses in the amount of \$5,000 were recorded in the category of Other Operating Expenses.

21. **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 \$45,000 in 2010.

### **Recommendation**

22. The administrative expenses reported in both Section A and B above, as well as in Exhibit C 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 C (excluding Guaranty Association expenses), as proper class (a) claims which were necessary, reasonable, and incurred in the best interest of the Estate.

Respectfully submitted:

By: 

PRESTON BUCKMAN (I.D. #57570)  
Special Funds Counsel  
Pennsylvania Insurance Department  
Capitol Associates Building  
Office of Chief Counsel  
901 North 7<sup>th</sup> Street  
Harrisburg, PA 17102  
(717) 787-6009


Dated: July 26, 2011

**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: July 25, 2011

  
\_\_\_\_\_  
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: 7-27, 2011

  
MARILYN K. KINCAID

# EXHIBIT

A



FINANCIAL STATEMENTS  
(MODIFIED CASH BASIS)

Reliance Insurance Company  
(in Liquidation)  
Years Ended December 31, 2010 and 2009  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

**Reliance Insurance Company**  
**(in Liquidation)**

**Financial Statements (Modified Cash Basis)**

**Years Ended December 31, 2010 and 2009**

**Contents**

Report of Independent Auditors.....	1
<b>Audited Financial Statements</b>	
Statements of Certain Assets (Modified Cash Basis) .....	3
Statements of Cash Receipts and Disbursements and Changes in Short and Intermediate Duration Investments (Modified Cash Basis) .....	4
Notes to Financial Statements (Modified Cash Basis) .....	5





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## 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, 2010 and 2009, 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, 2010 and 2009, 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 24, 2011

Reliance Insurance Company  
(in Liquidation)

Statements of Certain Assets (Modified Cash Basis)  
(In Millions)

	December 31	
	2010	2009
<b>Certain assets</b>		
Investments (at fair value):		
Short and intermediate duration investments	\$ 1,969.2	\$ 2,158.6
Investments held in segregated accounts for secured creditors	6.5	15.7
Investments held for uncovered claimants	14.9	14.1
Real estate investments	-	0.5
Invested assets	1,990.6	2,188.9
Early access advances to guaranty associations	2,090.9	1,720.1
Total certain assets	\$ 4,081.5	\$ 3,909.0

*See accompanying notes.*

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	
	2010	2009
Cash receipts:		
Reinsurance collections	\$ 234.6	\$ 403.4
Premium collections	8.2	14.8
Claims recoveries	5.1	2.1
Investment income received	56.6	74.1
Settlement of third-party litigation	-	40.0
Proceeds from sale of affiliates	8.8	-
Other	30.8	20.7
Total cash receipts	344.1	555.1
Cash disbursements:		
Early access advances to guaranty associations	(371.3)	-
Asset distribution	(96.0)	(20.0)
Loss and loss adjustment expenses	(1.8)	(2.2)
Operating expenses	(101.0)	(70.9)
Total cash disbursements	(570.1)	(93.1)
Net change in short and intermediate duration investments from cash activity	(226.0)	462.0
Noncash items affecting short and intermediate duration investments:		
Change in fair value of short and intermediate duration investments	36.6	164.3
Net change in short and intermediate duration investments	(189.4)	626.3
Beginning balance – short and intermediate duration investments	2,158.6	1,532.3
Ending balance – short and intermediate duration investments	\$ 1,969.2	\$ 2,158.6

*See accompanying notes.*

Reliance Insurance Company  
(in Liquidation)

Notes to Financial Statements (Modified Cash Basis)

December 31, 2010 and 2009

**1. Significant Accounting Policies**

Reliance Insurance Company (“the Company”) was placed into rehabilitation by order of the Commonwealth Court of Pennsylvania (“the Court”) on May 29, 2001. On October 3, 2001, the Company was declared insolvent by order (“the Order”) of the Court. The Order of the Court appointed the Insurance Commissioner of Pennsylvania as Liquidator of the Company (“the Liquidator”). 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 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 asset is invested assets. 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 represents 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 GAAP. 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)**

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, obligations, or contingencies are recorded in the Statements of Certain Assets. These assets and liabilities, which have been included in financial statements previously filed with the 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 2010 and 2009, outstanding checks were \$2.3 million and \$3.4 million, respectively.

**Short and Intermediate Duration Investments**

The portfolio is comprised of short and intermediate duration investments invested in marketable bonds and notes, a short-term investment fund ("STIF"), and an equity index fund. The intermediate duration allocation 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 short duration allocation has a custom benchmark comprised of 85% Barclays Capital 1-3 U.S. Gov/Credit Index and 15% Barclays Capital Fixed Rate U.S. Mortgage Backed Securities.

Reliance Insurance Company  
(in Liquidation)

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

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

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. Such investments are reported at net realizable value (fair value less costs to sell). Net realizable value is determined by actual sales contract prices. On April 29, 2010, Reliance sold its one real estate investment for \$0.5 million.

**Investments Held in Segregated Accounts for 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 but unpaid interest is reported in the accompanying Statements of Certain Assets. 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 (the "Act"), 40 P.S. Section 221.23a.

**Investments Held for Uncovered Claimants**

Investments held for uncovered claimants, which consists primarily of short and intermediate term investments at December 31, 2010, are held pursuant to a settlement agreement entered into as of February 10, 2006 ("Settlement Agreement") with various state guaranty associations. Such investments are reported at fair value. 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):

	December 31	
	2010	2009
Cash and cash equivalents	\$ 84.8	\$ 1,014.4
U.S. Treasury securities	390.2	164.4
U.S. government, agencies, and government-sponsored entities	189.4	65.2
Mortgage-backed and asset-backed securities	650.9	310.6
Corporate bonds	513.7	424.4
Emerging market bonds	12.7	31.5
Equity index mutual fund	127.5	148.1
Total	\$ 1,969.2	\$ 2,158.6

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 its investment portfolio is approximately 2.98 years and 1.96 years as of December 31, 2010 and 2009, respectively.

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 \$24.9 million and \$20.3 million as of December 31, 2010 and 2009, respectively, are excluded from the accompanying statements of certain assets (modified cash basis).

**3. Fair Value Measurements**

The fair value measurements and disclosures topic of the Financial Accounting Standards Board's Accounting Standards Codification with respect to financial statements prepared in accordance with GAAP clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value measurements.

Reliance Insurance Company  
(in Liquidation)

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

**3. Fair Value Measurements (continued)**

Various inputs are used in determining the fair value of the Estate's invested assets. 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. At December 31, 2010 and 2009, the Estate's investments in Level 1 assets totaled \$609.0 million and \$1,342.6 million, respectively.
- 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 Company are primarily corporate and asset-backed debt securities (including mortgage-backed fixed income securities), emerging market bonds, municipal bonds, and U.S. government, agency and government-sponsored 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. At December 31, 2010 and 2009, the Estate's investments in Level 2 assets totaled \$1,381.6 million and \$845.8 million, respectively.
- Level 3 Inputs – Significant unobservable inputs, including the Estate's own assumptions in determining the fair value of investments. At December 31, 2010 and 2009, the Estate's only investments in Level 3 assets, if reported at fair value on a recurring basis, would be real estate and real estate-related investments of \$0.0 million and \$0.5 million, respectively.

**4. Early Access Advances to Guaranty Associations**

During 2003, 2004, 2005, 2007 and 2010, the 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. The following summarizes the components of early access advances for the six largest states and all other states as of December 31, 2010 (in millions):

	<b>Statutory Deposits</b>	<b>Early Access Advances</b>	<b>Other Deemed Early Access Advances</b>	<b>Total</b>
California	\$ 280.6	\$ 153.7	\$ 2.2	\$ 436.5
Florida	4.8	198.2	0.4	203.4
New York	0.3	311.7	1.1	313.1
Texas	-	112.7	0.6	113.3
New Jersey	1.0	73.1	0.2	74.3
Pennsylvania	-	131.3	0.5	131.8
Other states	134.2	665.5	18.8	818.5
<b>Total</b>	<b>\$ 420.9</b>	<b>\$ 1,646.2</b>	<b>\$ 23.8</b>	<b>\$ 2,090.9</b>

Reliance Insurance Company  
(in Liquidation)

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

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

The following summarizes the components of early access advances for the six largest states and all other states as of December 31, 2009 (in millions):

	Statutory Deposits	Early Access Advances	Other Deemed Early Access Advances	Total
California	\$ 280.6	\$ 99.3	\$ 2.3	\$ 382.2
Florida	4.8	172.0	0.5	177.3
New York	0.3	243.3	1.1	244.7
Texas	—	81.4	0.6	82.0
New Jersey	0.9	68.9	0.2	70.0
Pennsylvania	—	96.2	0.6	96.8
Other states	134.0	513.9	19.2	667.1
<b>Total</b>	<b>\$ 420.6</b>	<b>\$ 1,275.0</b>	<b>\$ 24.5</b>	<b>\$ 1,720.1</b>

**5. Asset Distribution**

On March 29, 2010, the Court approved the Liquidator's Petition for Second Interim Distribution, allowing a 30% 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 Court Orders issued on November 19, 2007 and February 23, 2010 approving the Liquidator's Petition to address claims under aggregate policies. Distributions totaling \$190.7 million had been issued through December 31, 2010, of which \$96.0 million and \$20.0 million have been recorded as cash disbursements in 2010 and 2009, respectively. Distribution payments will continue to be issued on a quarterly basis to claimants whose NODs are subsequently approved by the Court.

Reliance Insurance Company  
(in Liquidation)

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

**6. Operating Expenses**

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

	<b>Year Ended December 31</b>	
	<b>2010</b>	<b>2009</b>
Salaries	\$ 29.5	\$ 33.4
Employee benefits and taxes	5.4	6.7
IT services	9.0	9.2
Legal fees and expenses	2.1	4.0
Professional services expenses	4.9	6.1
Rent	2.9	3.1
Other operating expenses	1.7	2.1
Subtotal	55.5	64.6
Guaranty association expenses	45.5	6.3
Total operating expenses	\$ 101.0	\$ 70.9

The Company made payments for IT services of \$4.8 million to a wholly owned subsidiary in 2010 and 2009.

**7. Commitments**

As of December 31, 2010, Reliance leases office space under operating leases primarily expiring in 2011.

The minimum future rental payments under noncancelable operating leases as of December 31, 2010, are as follows (in millions):

2011	\$ 1.7
Total	\$ 1.7

Subsequent to December 31, 2010, Reliance has substantially completed extensions to its operating leases, with aggregate commitments of \$1.0 million through 2012.

Reliance Insurance Company  
(in Liquidation)

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

**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**

Reliance evaluated its financial statements for subsequent events through June 24, 2011, the date the financial statements were available to be issued. Reliance is not aware of any subsequent events, other than those already disclosed, which would require recognition or disclosure in the financial statements.

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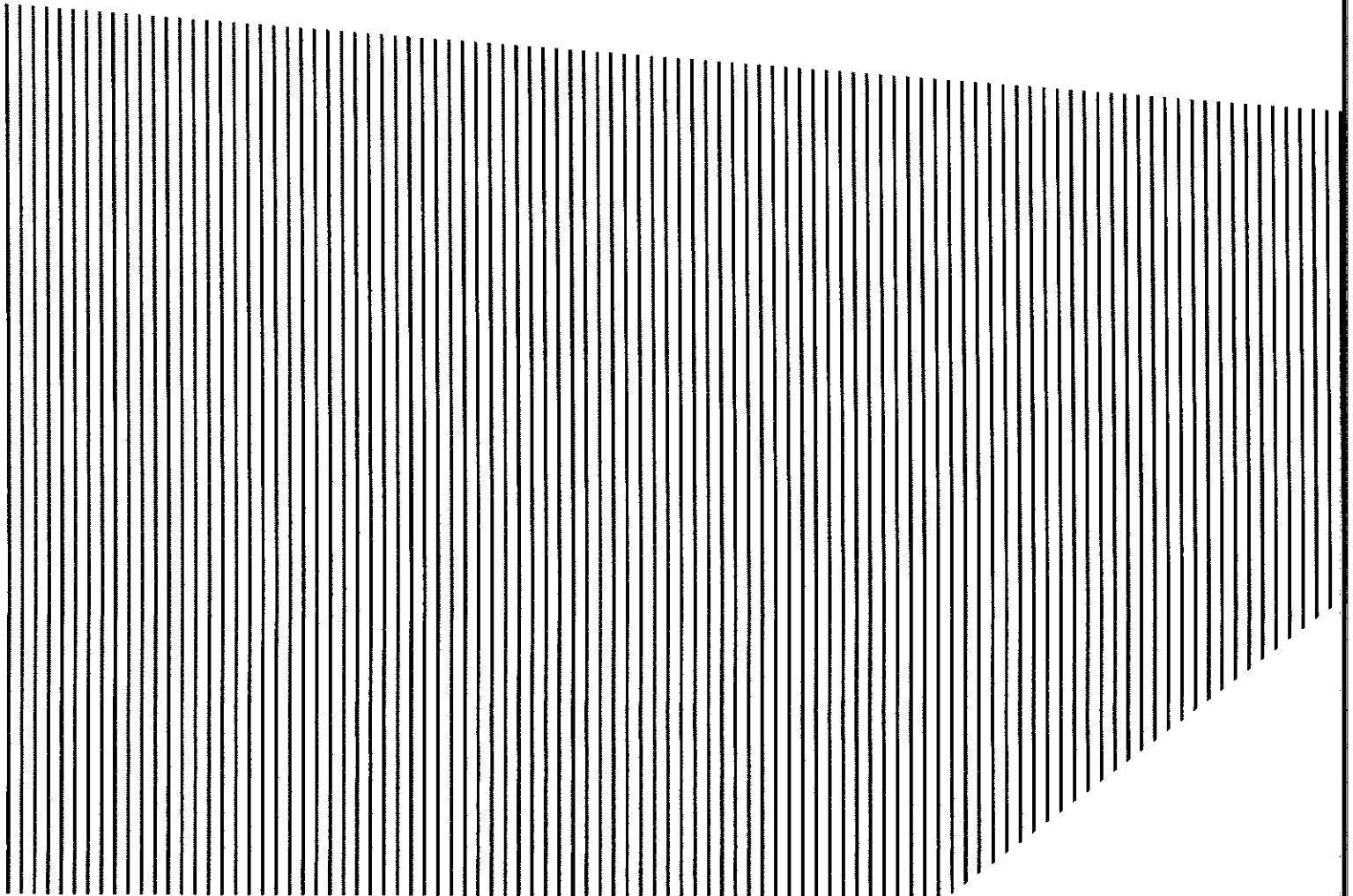
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**EXHIBIT**

**B**



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

	Budget 2011	Actual								15 Mo. Ended 12/31/2002 Actual
		2010	2009	2008	2007	2006	2005	2004	2003	
Salaries	\$ 25,349	\$ 29,479	\$ 33,443	\$ 36,720	\$ 39,195	\$ 40,070	\$ 41,179	\$ 45,898	\$ 46,399	\$ 54,096
Benefits & Payroll Taxes	5,159	5,472	6,681	6,496	6,943	6,720	6,840	7,599	7,609	8,293
Total Salaries, Benefits and Taxes	30,508	34,951	40,124	43,216	46,139	46,790	48,019	53,497	54,008	62,389
IT Services	6,999	8,987	9,186	10,508	10,289	11,654	18,679	18,218	23,138	27,166
Legal Fees	1,567	2,077	3,932	5,146	9,637	7,574	10,367	18,542	12,995	20,633
Professional and Other Services	4,797	4,910	6,192	7,205	7,353	9,655	9,954	10,464	17,727	45,035
Rent	2,824	2,874	3,111	3,156	3,394	3,922	4,989	7,118	7,721	12,945
Other Operating	1,773	1,671	2,149	1,751	2,117	2,429	3,297	4,350	6,529	20,076
Subtotal	48,468	55,469	64,695	70,983	78,930	82,025	95,305	112,187	122,119	188,243
Guaranty Association Expenses	6,820	45,482	6,257	11,746	13,763	38,762	34,403	65,075	37,658	869
Total Operating Expenses	\$ 55,288	\$ 100,951	\$ 70,952	\$ 82,728	\$ 92,693	\$ 120,786	\$ 129,709	\$ 177,263	\$ 159,777	\$ 189,112
Loss/LAE	\$ 1,271	\$ 1,801	\$ 2,224	\$ 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 2010		Actual to Budget Variance	%	Change	Year to Date December 2009		Variance to Prior Year	%	Change
	Actual	Budget				Actual				
<b>Salaries</b>										
Regular Salaries	\$21,525,910	\$21,680,294	(\$154,384)	-0.71%		\$24,783,488	(\$3,257,578)	-13.14%		
Performance-Retention Incentives	5,649,585	5,657,284	(7,699)	-0.14%		6,304,516	(654,931)	-10.39%		
Severance	2,303,596	2,204,449	99,147	4.50%		2,354,971	(51,375)	-2.18%		
<b>Total Salaries</b>	<b>29,479,091</b>	<b>29,542,027</b>	<b>(62,936)</b>	<b>-0.21%</b>		<b>33,442,975</b>	<b>(3,963,884)</b>	<b>-11.85%</b>		
<b>Employee Benefits</b>										
Health and Disability Benefits	1,950,110	2,105,500	(155,390)	-7.38%		1,948,065	2,045	0.10%		
SIP-Contributions and Fees	1,775,666	1,854,000	(78,334)	-4.23%		2,733,734	(958,068)	-35.05%		
Other Benefits	19,466	26,120	(6,654)	-25.47%		13,408	6,058	45.18%		
<b>Total Employee Benefits</b>	<b>3,745,242</b>	<b>3,985,620</b>	<b>(240,378)</b>	<b>-6.03%</b>		<b>4,695,207</b>	<b>(949,965)</b>	<b>-20.23%</b>		
<b>Payroll Taxes</b>	<b>1,726,842</b>	<b>1,813,745</b>	<b>(86,903)</b>	<b>-4.79%</b>		<b>1,985,938</b>	<b>(259,096)</b>	<b>-13.05%</b>		
<b>Total Salaries, Benefits and Taxes</b>	<b>34,951,175</b>	<b>35,341,392</b>	<b>(390,217)</b>	<b>-1.10%</b>		<b>40,124,120</b>	<b>(5,172,945)</b>	<b>-12.89%</b>		
<b>IT Outside Services</b>										
Computer Equipment	906,561	629,026	277,535	44.12%		787,737	118,824	15.08%		
Data Processing Software	570,538	583,912	(13,374)	-2.29%		564,095	6,443	1.14%		
<b>IT Services</b>	<b>8,986,722</b>	<b>9,447,940</b>	<b>(461,218)</b>	<b>-4.88%</b>		<b>9,186,434</b>	<b>(199,712)</b>	<b>-2.17%</b>		
<b>Legal Fees</b>	<b>2,076,624</b>	<b>3,459,000</b>	<b>(1,382,376)</b>	<b>-39.96%</b>		<b>3,931,830</b>	<b>(1,855,206)</b>	<b>-47.18%</b>		
<b>Professional and Other Services</b>	<b>4,910,146</b>	<b>5,946,014</b>	<b>(1,035,868)</b>	<b>-17.42%</b>		<b>6,192,194</b>	<b>(1,282,048)</b>	<b>-20.70%</b>		
<b>Rent</b>										
Corporate Home Office	2,111,735	2,137,536	(25,801)	-1.21%		2,124,821	(13,086)	-0.62%		
Record Archiving Services	737,081	822,230	(85,149)	-10.36%		947,112	(210,031)	-22.18%		
Other Rent Items	25,016	68,440	(43,424)	-63.45%		39,238	(14,222)	-36.25%		
<b>Total Rent</b>	<b>2,873,832</b>	<b>3,028,206</b>	<b>(154,374)</b>	<b>-5.10%</b>		<b>3,111,171</b>	<b>(237,339)</b>	<b>-7.63%</b>		
<b>Other Operating</b>										
Travel	115,127	170,232	(55,105)	-32.37%		145,743	(30,616)	-21.01%		
Professional Dues & Conferences	34,760	42,637	(7,877)	-18.47%		38,079	(3,319)	-8.72%		
Insurance	952,519	1,011,001	(58,482)	-5.78%		1,013,763	(61,244)	-6.04%		
Voice and Data Communication	246,842	227,180	19,662	8.65%		260,492	(13,650)	-5.24%		
Supplies and Subscriptions	128,324	167,595	(39,271)	-23.43%		160,084	(31,760)	-19.84%		
Postage, Freight & Express	44,122	58,267	(14,145)	-24.28%		97,116	(52,994)	-54.57%		
Office Machine Rent & Repair	14,223	15,720	(1,497)	-9.52%		13,789	434	3.15%		
Bank Charges	86,936	126,300	(39,364)	-31.17%		124,624	(37,688)	-30.24%		
Real Estate	5,408	23,700	(18,292)	-77.18%		2,735	2,673	97.73%		
Taxes, BBA and Other	42,512	53,569	(11,057)	-20.64%		292,671	(250,159)	-85.47%		
<b>Total Other Operating</b>	<b>1,670,773</b>	<b>1,896,201</b>	<b>(225,428)</b>	<b>-11.89%</b>		<b>2,149,096</b>	<b>(478,323)</b>	<b>-22.26%</b>		
<b>Subtotal</b>	<b>55,469,272</b>	<b>59,118,753</b>	<b>(3,649,481)</b>	<b>-6.17%</b>		<b>64,694,845</b>	<b>(9,225,573)</b>	<b>-14.26%</b>		
<b>Guaranty Association Expenses</b>	<b>45,481,730</b>	<b>45,000,000</b>	<b>481,730</b>	<b>1.07%</b>		<b>6,257,497</b>	<b>39,224,233</b>	<b>626.84%</b>		
<b>Total Operating Expenses</b>	<b>\$100,951,002</b>	<b>\$104,118,753</b>	<b>(\$3,167,751)</b>	<b>-3.04%</b>		<b>\$70,952,342</b>	<b>\$29,998,660</b>	<b>42.28%</b>		
<b>Loss/LAE</b>	<b>\$1,800,690</b>	<b>\$1,657,474</b>	<b>\$143,216</b>	<b>8.64%</b>		<b>\$2,223,794</b>	<b>(\$423,104)</b>	<b>-19.03%</b>		

# EXHIBIT

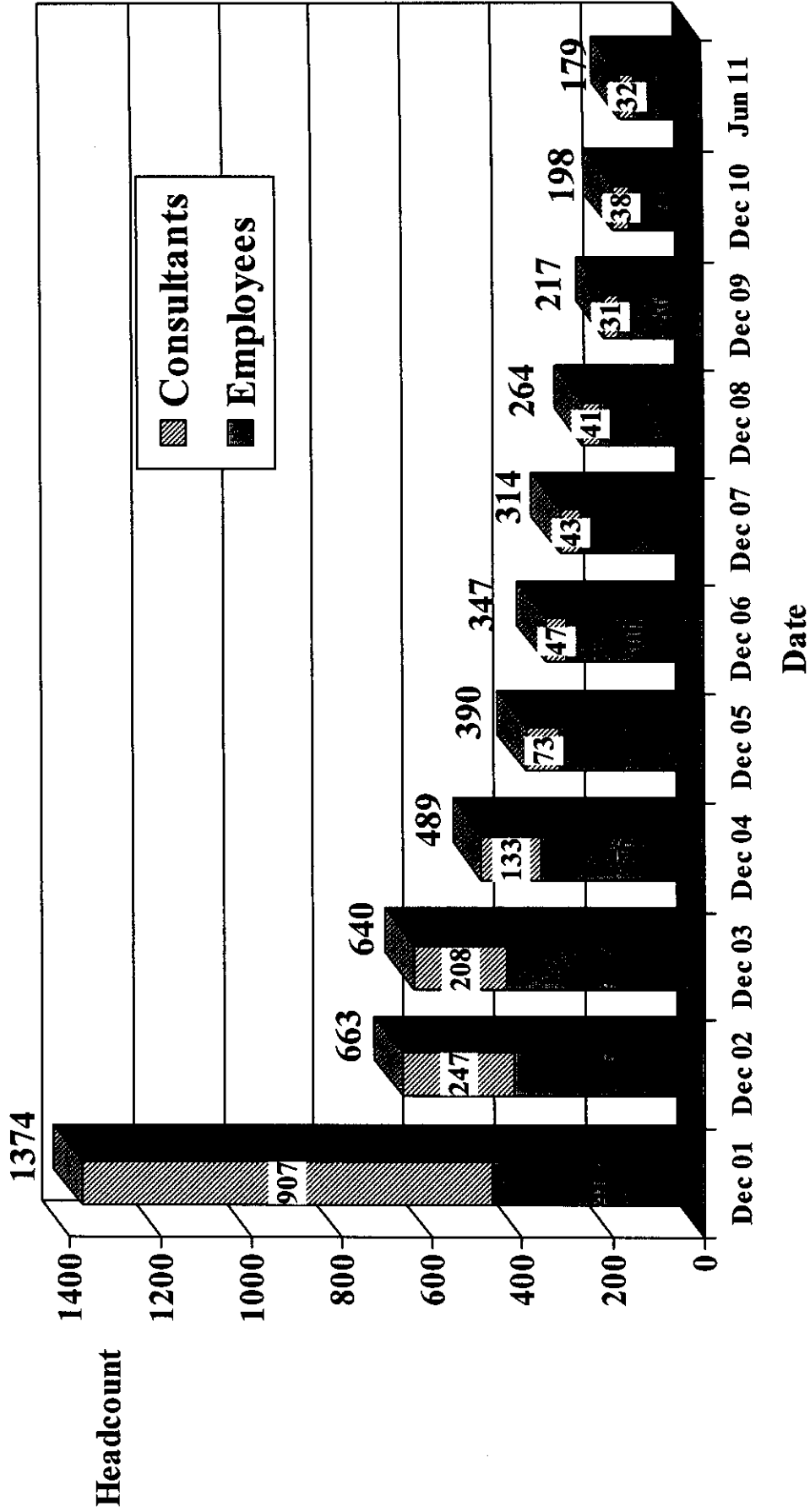
# D



**EXHIBIT**

**E**

# Reliance In Liquidation Headcount



# EXHIBIT

# F



**RELIANCE INSURANCE COMPANY (IN LIQUIDATION)  
PROFESSIONAL SERVICE EXPENSES  
FOR THE PERIOD JANUARY 1, 2010 TO DECEMBER 31, 2010 - UNAUDITED**

**VENDOR NAME**

ABERDEEN ASSET MANAGEMENT INC.	\$123,546
BMS INTERMEDIARIES, LTD.	689,721
BNY MELLON CASH INVESTMENT STRATEGIES	279,033
CALLAN ASSOCIATES INC.	98,113
CERIDIAN CORPORATION	69,412
CHARLES PRINCIPE	14,844
COMMONWEALTH OF MASSACHUSETTS	9,598
DIANE H. CHAIT	9,642
DIRECT CONSULTING	143,791
DORANNE BIGELOW & ASSOCIATES INC	112,118
ERNST & YOUNG	301,143
FEDERATED INVESTORS INC	91,367
FILEX DOCUMENT IMAGING SERVICES, INC.	167,369
JP MORGAN INVESTMENT MANAGEMENT INC	222,393
KATHLEEN STAPOLA	7,324
MARYELLEN R. DURNING	33,158
PA. DEP'T. - LIQUIDATION CONSULTANTS	53,263
PA. DEP'T. - OFFICE OF LIQUIDATIONS	151,727
PRICEWATERHOUSE COOPERS, LLP.	44,590
PYRAMIS GLOBAL ADVISORS TRUST COMPANY	799,708
RCG INFORMATION TECHNOLOGY INC	35,686
ROY MELANDER	136,553
STANDISH MELLON ASSET MANAGEMENT COMPANY LLC	249,154
SUSAN ALTSCHULER	58,101
THE BANK OF NEW YORK MELLON	311,096
W. FRANKLIN MARTIN JR.	11,341
WESTERN ASSET MANAGEMENT COMPANY	506,239
WORLDWIDE CLAIMS MANAGEMENT SERVICES, INC.	161,950
TOTAL OTHER VENDORS UNDER \$5,000	18,167
<b>TOTAL PROFESSIONAL SERVICE EXPENSES</b>	<b><u><u>\$4,910,146</u></u></b>

# EXHIBIT

# G

**RELIANCE INSURANCE COMPANY (IN LIQUIDATION)  
LEGAL FEES AND EXPENSES (EXCLUDING ALAE)  
FOR THE PERIOD JANUARY 1, 2010 TO DECEMBER 31, 2010 - UNAUDITED**

**VENDOR NAME**

YOSS, LLP.	\$9,274
ALLEN KUEHNLE STOVALL & NEUMAN LLP	31,841
BLANK ROME LLP	434,280
BRAVERMAN KASKEY	51,310
CLARK THOMAS & WINTERS	6,464
DEUTSCH, KERRIGAN & STILES LLP	11,429
DUANE MORRIS LLP	307,266
FOX, ROTHSCHILD LLP	50,460
G ALAN BAILEY ESQUIRE	5,966
JONATHAN ROSEN	16,750
MARTIN D. HABER ESQ.	20,000
OBERMAYER REBMANN MAXWELL & HIPPEL, LLP.	36,836
PEPPER HAMILTON LLP.	944,174
PETER H BICKFORD ESQ	7,648
ROSENN JENKINS & GREENWALD LLP	12,235
SCRIBNER, HALL & THOMPSON, LLP.	41,512
STRADLEY, RONON, STEVENS, & YOUNG LLP	38,881
VERITEXT NEW YORK REPORTING CO	6,277
WALSH COLUCCI LUBELEY EMRICH & WALSH PC	5,044
TOTAL VENDORS UNDER \$5,000	38,977
<b>TOTAL LEGAL FEES AND EXPENSES (EXCLUDING ALAE)</b>	<b><u><u>\$2,076,624</u></u></b>