

**ONTARIO SUPERIOR COURT OF JUSTICE  
- COMMERCIAL LIST**

**IN THE MATTER OF  
RELIANCE INSURANCE COMPANY**

**AND IN THE MATTER OF THE  
INSURANCE COMPANIES ACT, S.C. 1991, C.47, AS AMENDED**

**AND IN THE MATTER OF THE  
WINDING-UP AND RESTRUCTURING ACT, R.S.C. 1985, C.W-11, AS AMENDED**

**B E T W E E N:**

**THE ATTORNEY GENERAL OF CANADA**

Applicant

- and -

**RELIANCE INSURANCE COMPANY**

Respondent

**REPORT OF KPMG INC., THE LIQUIDATOR OF  
RELIANCE INSURANCE COMPANY**

**June 20, 2003**

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**I. THE MOTION**

1. This report is respectfully filed in support of a motion by KPMG Inc., the liquidator (the "Liquidator") of the insurance business of Reliance Insurance Company in Canada ("Reliance (Canada)") for an Order:

- (a) extending the date for the Policy Payments, payment of Defence Costs and Meridian Payments (as hereinafter defined) to December 31, 2003, or such later date as this Court may order; and
- (b) approving a first interim distribution to policyholders and claimants of 25% of their valid and allowed loss claims (the "First Distribution").

## **A. Overview**

### **Extension of Payments**

2. Pursuant to orders of this Court, the Liquidator has paid policyholders and claimants the following benefits since the commencement of the liquidation of Reliance (Canada):

- (a) defence costs (“Defence Costs”);
- (b) valid claims up to the greater of \$25,000 or the amount, if any, of the voluntary compensation payment of the Property and Casualty Insurance Compensation Corporation (“PACICC”) that may be paid under its Memorandum of Operations (the “Policy Payments”); and
- (c) valid claims under the Meridian program up to the greater of \$5,000 or the amount, if any, of PACICC’s voluntary payment (the “Meridian Payments”),

(collectively, the “Payments”).

A copy of the order appointing the Liquidator and authorizing the Payments is attached as Schedule “A” (the “Appointment Order”). This Court has extended the date for making the Payments from time to time, the latest extension being to June 30, 2003.

3. As set out in the Liquidator’s Report dated March 21, 2003, (the “March Report”), the Liquidator entered into a memorandum of understanding with respect to a reinsurance transaction (the “Assumption Arrangement”) that would result in a purchaser (the “Purchaser”) assuming all the policy liabilities of Reliance (Canada) at one hundred percent. The Assumption Arrangement would confer a substantial benefit on the policyholders by providing immediate access to their full benefits. However, the completion of the Assumption Arrangement is subject to a number of conditions and negotiations, the outcome of which is uncertain. A copy of the March Report is attached as Schedule “B”.

4. To avoid disruption to potential transactions and hardship to policyholders, the Liquidator recommends that the Court authorize it to continue the Payments until December 31, 2003, or such later date as the Court considers appropriate.

### **First Distribution**

5. Although the Liquidator remains confident that, whether or not the Assumption Arrangement ultimately closes, all policyholders will receive full payment on all valid claims, the Liquidator is not in a position to make full payment at this time. To alleviate hardship to policyholders whose claims are not satisfied by the Payments, the Liquidator proposes to make an interim distribution of 25% of valid policyholder loss claims.

## **II. BACKGROUND**

### **A. General Background**

6. General background of Reliance (Canada) and this liquidation is set out in the March Report at paragraphs 2 through 7.

7. Attached as Schedule "C" is a copy of the loan and services agreement between PACICC and the Liquidator dated the 3<sup>rd</sup> day of December 2001 (the "Loan Agreement") which was approved by this Court in the Appointment Order. The Loan Agreement provides that the amounts paid by the Liquidator to policyholders on PACICC-covered claims are deemed to be loaned to PACICC, the aggregate amount of such payments being the "Amount Outstanding" from time to time under the Loan Agreement. Interest accrues on the Amount Outstanding at the prime rate.

### **B. Reliance (Canada)'s Insurance business**

8. Prior to March, 2001, Reliance (Canada) was authorized to transact the following classes of insurance:

- property
- accident and sickness

- aircraft
- automobile
- boiler and machinery
- fidelity
- liability
- surety

9. Under the classes of liability insurance, Reliance (Canada) specialized in providing coverage for, among other things:

- (a) professional liability, such as for lawyers, engineers, architects, and dentists and for hospital programs and the health care industry;
- (b) directors' and officers' liability, for which Reliance (Canada) was a significant source in Canada;
- (c) pollution and environmental liability; and
- (d) product liability.

10. Some of Reliance (Canada)'s policies were "claims made." This means that claims must be reported during the policy period or within a defined period thereafter. However, a substantial portion of its policies were "occurrence" based. This means that the policies covered liabilities incurred during the policy period that may not become manifest for years. This kind of business is called "long tail". The policyholders themselves have no way of predicting what claims they may incur.

11. In October, 2000, Reliance (Canada) voluntarily stopped writing new policies and restricted its activities to dealing with claims on existing and terminated policies, and collecting receivables. Effectively, the company began winding down its business. As at the beginning of the liquidation, excluding the Meridian program, there were 16 policies still in force with all other policies having expired or been cancelled, and over 1400 claims. In addition, like all insurance companies, Reliance (Canada) had "incurred but not reported" claims for which

Reliance (Canada) will ultimately be put on notice and to which it will have to respond, primarily on the occurrence based policies.

### **III. EXTENSION OF PAYMENTS**

#### **A. Meridian Payments**

12. As discussed in the March Report, the Liquidator entered into an agreement with St. Paul Guarantee Insurance Company, formerly London Guarantee Insurance Company (“St. Paul Guarantee”) pursuant to which St. Paul Guarantee would assume Reliance (Canada)’s liabilities under the Meridian program.

13. As the Liquidator reported, the consent of the reinsurers of the Meridian program is a condition of the Meridian transaction. While the majority of the Meridian Reinsurers are Canadian registered reinsurers, their decision makers are located in London, England. The Liquidator retained U.K. insurance counsel, Kendall Freeman (formerly D.J. Freeman), and is using the services of Reliance (Canada)’s reinsurance broker in London, AON, to assist in dealing with the Meridian Reinsurers. The Liquidator has met with the Meridian Reinsurers, has provided them with all information they have requested concerning the transaction and has been responsive to all concerns they have raised to date. Notwithstanding these efforts, the Meridian Reinsurers have not yet consented. The Liquidator is considering all options, including seeking assistance of this Court, and other negotiated resolutions.

14. The Liquidator recommends that this Court extend the date to which the Liquidator may make Meridian Payments to December 31, 2003. The Liquidator makes this recommendation because:

- (a) Assuming the Meridian Transaction closes, it would be counterproductive to interrupt payments. There would be significant costs both in communicating with the approximately 12,600 Meridian policyholders remaining to explain the interruption in the payment stream and with restarting payments after the transaction closes, which costs St. Paul Guarantee has not covenanted to pay; and

- (b) Even if the Meridian Transaction does not ultimately close, the Liquidator remains of the view that the cost of cancelling the Meridian policies is likely to exceed the cost of running them off. Therefore, it is still more beneficial to the estate to continue to make the Meridian Payments as part of a running off of the business.

15. As set out in the March Report, the Liquidator is confident, based on the information presently available to it, that the estate of Reliance (Canada) will pay all valid claims in full. However, for the reasons discussed more fully below, the Liquidator is not yet in a position to pay all policyholders 100%. The Liquidator is of the view that it is appropriate to continue the Meridian Payments at the present level whether or not the Meridian Transaction closes because the administrative costs of reducing and adjusting those payments would more than offset any cost differential if the ultimate dividend rate is less than 100%.

#### **B. Policy Payments and Defence Costs**

16. As also discussed in the March Report, the Liquidator sought qualified insurers to assume the liabilities under the balance of the policies (the “Policy Liabilities”) in exchange for the transfer of assets. The Liquidator engaged Scotia Capital Inc. and KPMG Corporate Finance Inc. as co-advisers in this process. The U.S. Liquidator has been extensively involved in the process as well.

17. In the March Report, the Liquidator advised this Court that, on November 21, 2002, it entered into a memorandum of understanding in respect of the Assumption Arrangement with the Purchaser. The Purchaser stipulated that the terms of the memorandum, including the Purchaser’s identity, are to be kept confidential at this time.

18. The memorandum of understanding for the Assumption Arrangement contemplated that a number of steps would be completed by certain dates, several of which were met. One of those steps was that the parties enter into definitive agreements by February 28, 2003. To date, no definitive agreements have been finalized. The process has taken longer than the Liquidator originally anticipated given, among other things, current market conditions, changes in



management at the assuming insurer, the necessity of negotiating changes to the structure to address certain regulatory concerns, and issues which result from the fact that Reliance (Canada) is a branch and not a subsidiary. The Liquidator remains of the view that a transfer of the Policy Liabilities to another carrier on appropriate terms will produce a substantial benefit to the policyholders and the estate in comparison to a more traditional liquidation. Therefore, the Liquidator does not propose to terminate discussions with the Purchaser even though the issues that have arisen are difficult and the Liquidator is not, at this point, optimistic that they will be resolved.

19. The Liquidator also considers it appropriate and in the best interest of the estate to continue Policy Payments and payment of Defence Costs. The payment of Defence Costs would facilitate the transaction to transfer the Policy Liabilities by easing any potential concerns of the Purchaser with respect to the standards of claims adjudication. Payment of Defence Costs also significantly reduces immediate hardship to policyholders.

20. The Liquidator does not recommend any change to the Policy Payments, subject to the changes which will arise from the approval of the first distribution. The Liquidator remains confident that, whether a transaction is consummated or not, all valid claims against Reliance (Canada) will be paid in full. However, as discussed below, there are uncertainties. The Liquidator is of the view that the present Policy Payment level balances the interests of all parties. The Liquidator recommends that the Policy Payments continue on the same basis until December 31, 2003 or such later date as this Court may order if they exceed the first distribution.

#### **IV. FIRST DISTRIBUTION**

##### **A. Scheme of Distribution**

21. Section 161 of the *Winding-up and Restructuring Act* sets out the scheme of priorities in the liquidation of insurance companies. Since Reliance carried on business in Canada as a branch, regard must be had to the foreign insurance company provisions, subsections 161(6) through (9). Because Reliance (Canada) wrote only property and casualty insurance and not life

insurance, subsections 161(7) and (8) are not relevant to the First Distribution. For purposes of this distribution, the relevant priorities are:

- (a) costs of the liquidation;
- (b) policyholders for loss claims. The policies in force at the commencement of the liquidation have not been cancelled, so it is not necessary to address the ranking of unearned premium at this time; and
- (c) ordinary creditors.

## **B. Financial Status of the Estate**

### **Assets**

#### *Vested Assets*

22. Reliance operated within Canada on a branch basis, with the approval of the Superintendent of Financial Institutions. The conditions for the Superintendent's approval of the operation of a branch in Canada include the vesting in trust with the Superintendent of assets having a prescribed value (the "Vested Assets"), and filings, at least annually, of financial information disclosing both assets for which the branch is entitled to take credit under the *Insurance Companies Act*, and liabilities that it is required to report as liabilities of the branch, also under the *Insurance Companies Act*.

23. As at the commencement of the liquidation the Vested Assets consisted of cash or near cash in the amount of approximately \$171 million. The Liquidator has been making the Payments and paying the costs and expenses of the liquidation. It has collected reinsurance and subrogation proceeds. As at March 31, 2003, the cash or near cash was approximately \$161 million.

*Reinsurance*

24. The other major asset of Reliance (Canada) is reinsurance, consisting of:
- (a) reinsurance for which Reliance (Canada) was entitled to take credit under the *Insurance Companies Act* in calculating its required assets covering only the liabilities of Reliance (Canada) (“Canadian Reinsurance”);
  - (b) reinsurance entered into through Reliance’s head office, which reinsures both Reliance (Canada) policies and policies written through the U.S. operations (“International Reinsurance”) for which Reliance (Canada) was not entitled to take credit under the *Insurance Companies Act*.
25. As at March 31, 2003 approximately 51% of Reliance (Canada)’s gross case reserves were reinsured. Of this amount, approximately 89% is Canadian Reinsurance and 11% is International Reinsurance. However, these percentages change as the composition of the case reserves changes. The Liquidator estimates that, over time, the International Reinsurance will likely account for at least 20% of the reinsurance, the balance being Canadian. These percentages do not reflect our estimates for uncollectible reinsurance due to credit, collection or contractual risk. Over 88% of the reinsurance is with reinsurers rated “A” or higher.
26. The Liquidator has collected approximately \$5.4 million in reinsurance since the beginning of the liquidation. The U.S. Liquidator has collected International Reinsurance in the amount of \$4.1 million on behalf of Reliance (Canada), which has not yet been remitted. In addition, reinsurance receivables (amounts billed to reinsurers), net of a provision for uncollectible reinsurance, were \$9.5 million as at March 31, 2003. Reinsurance recoverables (amounts referable to reported claims not yet billed and to IBNR), net of a provision for uncollectible reinsurance, were \$61.7 million.

*Summary*

27. In summary, as at March 31, 2003, Reliance (Canada)'s assets consisted of:

	Millions
Cash or near cash	\$161.3
Reinsurance receivables and recoverables net of estimate for uncollectible reinsurance	\$ 71.2
Miscellaneous	<u>\$ 10.0</u>
Total	<u>\$242.5</u>

**Liabilities**

28. In its solicitation letter provided to prospective purchasers, the Liquidator disclosed that the total policy liabilities according to the books and records of Reliance (Canada) were approximately \$132 million, including IBNR, as at June 30, 2001. A copy of the solicitation letter is attached as Schedule "D".

29. The Liquidator has performed further actuarial and claims reviews but is of the view that it would not be in the best interest of the estate to share those results at the present time since the Purchaser is expected to arrive at its own conclusions. In this report, the Liquidator will provide as much information concerning the liabilities as possible without prejudicing the sale, and will describe the process it has followed to reach its views concerning the proposed distribution.

*No Call for Claims to Date*

30. The Liquidator has not undertaken a call for claims to date and is not recommending one at this time because the Liquidator believes such a call would be expensive and counterproductive, given the long tail nature of Reliance (Canada)'s policies. Policyholders would have no choice but to file contingent claims of a magnitude that would make the claims meaningless. At the conclusion of the process, the Liquidator would still have to rely on

actuarial projections to reach a view as to the total claims exposure of the estate, and would certainly have to do so to make a distribution in a reasonable time frame.

*Loss Claims*

31. There are basically three categories of loss claims:

- (a) Claims that are settled or otherwise resolved (the “Resolved Claims”). As at March 31, 2003:
  - (i) approximately 8,670 claims having a total value of \$22.6 million have been resolved, through settlement or otherwise, since the beginning of the liquidation;
  - (ii) of those, approximately 8,660 claims, having a value of approximately \$12.1 million, have been paid in full in accordance with the court authorized payments;
  - (iii) the remaining 10 claims either do not qualify for PACICC coverage or exceed PACICC limits. Policy Payments have been made on account of these claims but a balance of \$10.5 million remains outstanding.
- (b) claims which have been reported but not yet resolved (the “Reported Claims”). As at March 31, 2003, there were outstanding approximately 757 Reported Claims with outstanding gross case reserves of approximately \$51.5 million. Case reserves are adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement; and
- (c) the provision for claims incurred but not yet reported and for deficiencies in Reported Claims (“IBNR”).

*Liability Claims Projection Process*

32. The Liquidator has undertaken an extensive review of the policy liabilities, including retaining the services of the consulting actuary who acted for Reliance (Canada) for more than

12 years before it was wound up. The projections have been further reviewed by the Liquidator's own actuaries.

33. Actuarial projections typically consider:

- (a) the current level of reserves;
- (b) the history of claims development;
- (c) the nature of the liabilities underwritten and the terms of the policies;
- (d) industry experience and current developments with respect to similar kinds of policies and liabilities; and
- (e) the potential for adverse deviation, a provision against claims developing negatively in comparison to past experience.

34. Actuaries then reach a view as to the total policy liabilities to which the insurer will be exposed, including a provision for IBNR. While the actuaries generally provide a single best estimate, there is clearly a range for valuing the total liabilities, depending on the degree of certainty to be achieved. For instance, in some circumstances, it would be within accepted actuarial standards to indicate a best estimate with a 55% degree of confidence, meaning that the liabilities would exceed the estimate 45% of the time and be less 54% of the time. More conservative assumptions would lead to higher confidence levels. In going concern situations, this may be considered appropriate.

35. The Liquidator has asked the actuaries to confirm their best estimate of the policy liabilities in accordance with accepted actuarial standards. The Liquidator has carefully reviewed the assumptions underlying the actuarial estimates. The Liquidator has introduced further elements of conservatism for purposes of reaching its recommendations with respect to this distribution, including:

- (a) All costs for the completion of the liquidation have been estimated on a very conservative basis;

- (b) Reserves have been taken for certain policies at their full limits, and notwithstanding that claims have not been asserted at limits; and
- (c) As the Liquidator advised the court in the March Report, two major sources of uncertainty remain in the estate: reinsurance recoverables and non-booked claims. These are discussed in the March Report at paragraphs 26 through 31. To deal with these uncertainties in this distribution, the Liquidator is ascribing no value to the receivables, including the reinsurance recoverables, and is building into the assumptions very conservative values for the non-booked claims.

36. Based on the foregoing and in light of the remaining uncertainties described above, the Liquidator recommends a distribution of 25% of valid policyholder loss claims. This distribution level is highly conservative. There is no realistic scenario under which this distribution would prejudice any party. Since some of the Resolved Claims that exceed Policy Payments are substantial, the Liquidator considers that this dividend is appropriate and represents a fair balancing of interests.

### **C. Calculation of Dividends**

37. If the First Distribution is approved by the Court, each claimant's dividend will be calculated by deducting from the amount to which it would otherwise be entitled any Policy Payments or Meridian Payments it received before the date of the distribution, in accordance with paragraph 12 of the Appointment Order. In effect, those payments are treated as advances on the distribution. In the future, the Liquidator will pay the higher of the Meridian Payments or Policy Payments on valid policyholder claims.

38. PACICC-compensated claims are deemed to be assigned to PACICC under paragraph 15 of the Appointment Order. However, the Liquidator has made the PACICC payments, which were treated as a loan to PACICC under the Loan Agreement. The First Distribution will, therefore, reduce the Amount Outstanding.

**V. RECOMMENDATIONS**

39. Based on the past history of Reliance (Canada), the experience since the commencement of the liquidation, and the extensive work performed by the actuaries, the Liquidator remains of the view that Reliance (Canada) will pay all valid policyholder claims in full. However, the Liquidator is not now in a position to pay all claims in full. Accordingly, the Liquidator recommends that:

- (a) the Payments be extended to December 31, 2003 or such other date as this Court may order; and
- (b) this Court approve the First Distribution of 25% on all valid and allowed loss claims, to be calculated as set out above.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

**KPMG INC.**, solely in its capacity as the  
Liquidator of Reliance Insurance Company -  
Canadian Branch

Per:   
Robert G. Sanderson, President





Court File No. 01-CL-4313

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

**COMMERCIAL LIST**

THE HONOURABLE ) MONDAY THE 3<sup>RD</sup> DAY  
 )  
MR. JUSTICE FARLEY ) OF DECEMBER, 2001  
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- and -

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Respondent

**ORDER**

THIS APPLICATION made by the Applicant was heard this day without a jury at Toronto, in the presence of counsel for the Applicant, for the Respondent, for KPMG Inc., and for the Property and Casualty Insurance Compensation Corporation ("PACICC"), no one opposing.

ON READING the Notice of Application and the evidence filed by the parties, and on hearing submissions of counsel for the parties:

1. THIS COURT ORDERS that the service of the Notice of Application and the materials herein be and it is hereby good and sufficient notice thereof and that any further service of the Notice of Application and materials herein be and it is hereby dispensed with.

2. THIS COURT ORDERS that KPMG Inc. be and is hereby appointed as provisional liquidator (the "Liquidator") of the insurance business in Canada of the Respondent, including the assets in Canada of the Respondent, together with its other assets held in Canada under the control of its chief agent, including, without limitation, all amounts received or receivable in respect of its insurance business in Canada ("Reliance (Canada)").

3. THIS COURT ORDERS that the giving of security by the Liquidator upon its appointment as liquidator be dispensed with.

4. THIS COURT ORDERS that all moneys belonging to Reliance (Canada) received by or on behalf of the Liquidator and its agents shall be paid into a chartered bank to the account of the Liquidator immediately after the receipt thereof and an account or accounts shall be opened immediately, provided, however, that the Liquidator shall have the discretion to deposit funds to and use the bank accounts currently in the name of or operated by Reliance (Canada).

5. THIS COURT ORDERS that any cheques or drafts in respect of policies, issued by Reliance (Canada) prior to the making of the winding-up order herein and which are presented for payment thereafter, may be paid out of the estate and effects of Reliance (Canada).

6. THIS COURT ORDERS that the amount recoverable from, due or owed by any reinsurer to Reliance (Canada) shall be paid to the Liquidator and shall not be reduced as a result of this Order or the winding-up order, notwithstanding any terms or contractual agreement to the

contrary, and that any payment made directly by a reinsurer to an insured or other creditor or claimant of Reliance (Canada) or Reliance Insurance Company shall not diminish or reduce or affect such reinsurer's obligation to Reliance (Canada).

7. THIS COURT ORDERS that the Liquidator is authorized to cure such defaults and effect such arrangements as may be required to reinstate such reinsurance affecting the operations of Reliance (Canada), as the Liquidator deems to be in the interest and for the protection of policyholders, creditors and claimants of Reliance (Canada).

8. THIS COURT ORDERS that the Liquidator may pay all valid policyholder claims, including claims in respect of unearned premiums, to the amount of \$25,000 or the amount, if any, of the voluntary compensation payment of PACICC which may be paid under the terms of its Memorandum of Operations (the "PACICC Voluntary Compensation Payment") until April 30, 2002 or such later date as this Court may order, subject to paragraph 9 hereof, and such payments shall be deemed for all purposes to have been payments made on account of claims in the course of the liquidation of Reliance (Canada).

9. THIS COURT ORDERS that the Liquidator may pay all valid claims including claims in respect of unearned premiums under the Meridian and other warranty and surety programs to the amount of \$5,000 or the amount, if any, of the PACICC Voluntary Compensation Payment until January 31, 2002 or such later date as this Court may order, and such payments shall be deemed for all purposes to have been payments made on account of claims in the course of the liquidation of Reliance (Canada).

10. THIS COURT ORDERS that the Liquidator may, after consultation with the Inspectors, make such other payments as the Liquidator in the Liquidator's discretion deems advisable in the circumstances in respect of policies of Reliance (Canada) and such payments

shall be deemed for all purposes to have been payments made on account of claims in the course of the liquidation of Reliance (Canada).

11. THIS COURT ORDERS that in addition to the payments referred to in paragraphs 8 and 10, until April 30, 2002 or such later date as this Court may order, the Liquidator may pay and continue to pay all reasonable legal and other costs, incurred to and including April 30, 2002, which Reliance (Canada) is obligated to pay for defending any insureds against losses under Reliance (Canada)'s policies in accordance with the applicable policy ("Defence Costs"), subject to the applicable terms and limits of such policies. For greater certainty, all payments of Defence Costs shall be deemed for all purposes to have been payments made on account of claims in the course of the liquidation of Reliance (Canada) and to form part of the expenses of the liquidation as a first charge on the assets of the estate. However, if the applicable policy so provides, such payments shall be taken into account in determining the amount which would otherwise be distributed to the respective policyholders and claimants, or otherwise paid on account of Defence Costs, as the case may be, at such time as any further distributions or similar arrangements are made in respect of their policies.

12. THIS COURT ORDERS that any payments made by the Liquidator pursuant to paragraphs 5, 8, 9, 10 and 11 hereof, other than payments made pursuant to clerical errors (the "Payments"):

- (a) shall be deemed to be payments made on account of claims in the liquidation of Reliance (Canada) and shall be deducted from the amount which would otherwise be distributed at such time as further distributions or similar arrangements are made in respect of such claims;
- (b) shall be deemed to have been made in accordance with this Order;

- (c) in respect of any policy shall not obligate the Liquidator to make further payments in respect thereof; and
- (d) which may have exceeded the ultimate amount which the Liquidator determines is available for distribution to the respective policyholders and claimants, or available for payment of Defence Costs, as the case may be, (collectively, the “Overpayments”) shall be deemed not to be preferences and shall not be repayable by the recipients or policyholders.

Neither the Liquidator nor the Liquidator’s agents, advisers or employees shall be liable to any person in respect of the Overpayments.

13. THIS COURT ORDERS that PACICC, which shall designate from time to time one or more persons as its representative, and the Insurance Commissioner of the Commonwealth of Pennsylvania in her capacity as Liquidator of the Respondent or her designee are appointed inspectors (collectively the "Inspectors") to assist and advise the Liquidator in the winding-up of Reliance (Canada).

14. THIS COURT ORDERS that the Inspectors may apply to this Court on motion for directions concerning any matter relating to the liquidation of Reliance (Canada).

15. THIS COURT ORDERS that each claim in respect of which PACICC makes a PACICC Voluntary Compensation Payment (a “Compensated Claim”) shall be deemed to be and shall hereby be assigned in its entirety to PACICC without specific assignment or further steps required. PACICC shall be entitled to assert each Compensated Claim in the Liquidation. Reliance (Canada) is hereby deemed to have acquiesced to the assignment of Compensated Claims provided for herein and to have received a copy of the deed of assignment. PACICC and the Liquidator shall be deemed to be and shall hereby be released and forever discharged from

any and all claims, actions, losses and liabilities which any person has or may have at present or in the future with respect to each Compensated Claim.

16. THIS COURT ORDERS that, notwithstanding the provisions of paragraph 15, the Liquidator may make funds in the estate available to PACICC from time to time to be used by PACICC to make PACICC Voluntary Compensation Payments pursuant to the terms and conditions of the loan and services agreement made effective as of the date hereof between the Liquidator and PACICC, which is hereby approved.

17. THIS COURT ORDERS that the Liquidator is authorised and empowered to act as administrator of insurance coverage on behalf of third parties who assume all or part of the insurance risk, and to be paid the fees earned by Reliance (Canada), pursuant to the terms of the contracts between Reliance (Canada) and such third parties.

18. THIS COURT ORDERS that the Liquidator is entitled forthwith to possession of all of Reliance (Canada)'s books, accounts, securities, documents, papers, computer programs and data, registers and records of any kind ("Books and Records") and that Reliance (Canada), its present and former shareholders, directors, officers, employees, salespeople and agents, accountants, auditors, solicitors, trustees, and every person having knowledge of this Order and having possession or control of such Books and Records, do forthwith deliver over to the Liquidator or to the Liquidator's agent all such Books and Records.

19. THIS COURT ORDERS that all persons, including, without limitation, employees, brokers, legal counsel, insurance agents, third party administrators, or salespeople having access to or knowledge of the affairs of Reliance (Canada) do co-operate with the Liquidator in providing information or documents necessary or incidental to the liquidation of Reliance (Canada).

20. THIS COURT ORDERS that any entity which has custody or control of any data processing information and records (including but not limited to source documents, all types of electronically stored information, master tapes or any other recorded information) relating to Reliance (Canada), shall transfer custody and control of such records in a form readable by the Liquidator to the Liquidator as of the date of this Order, unless instructed to the contrary by the Liquidator.

21. THIS COURT ORDERS that any entity furnishing claims processing or data processing services to Reliance (Canada) shall maintain such services and transfer any such accounts to the Liquidator as of the date of this Order, unless instructed to the contrary by the Liquidator.

22. THIS COURT ORDERS that Reliance (Canada) and its Chief Agent, officers, trustees, employees, consultants, agents, and legal counsel shall: surrender peacefully to the Liquidator the premises where Reliance (Canada) conducts its business; deliver all keys or access codes thereto and to any safe deposit boxes; advise the Liquidator of the combinations or access codes of any safe or safekeeping devices of Reliance (Canada) or any password or authorization code or access code required for access to data processing equipment; and shall deliver and surrender peacefully to the Liquidator all of the assets, books, records, files, credit cards, and other property of Reliance (Canada) in their possession or control, wherever located, and otherwise advise and cooperate with the Liquidator in identifying and locating any of the foregoing.

23. THIS COURT ORDERS that all persons, firms, corporations and other entities having agreements, whether written or oral, with Reliance (Canada) for the supply of goods or services, be and they are hereby enjoined from terminating, accelerating, suspending, modifying, determining or cancelling such agreements without the written consent of the Liquidator or leave

of this Court, and that all such parties shall continue to comply with their obligations under such agreements or otherwise on terms currently provided so long as the Liquidator pays the normal prices or charges for such goods or services incurred after the date of this Order in accordance with usual payment terms or as may hereafter be negotiated by the Liquidator from time to time.

24. THIS COURT ORDERS that all persons, firms, corporations and other entities be and they are hereby enjoined from disturbing or interfering with the occupation, possession or use by the Liquidator of any premises occupied or leased by Reliance (Canada) as at November 8, 2001 except upon further Order of this Court. From November 8, 2001 and for the period of time that the Liquidator occupies any leased premises, the Liquidator shall pay occupation rent to each lessor based upon the regular monthly base rent that was previously paid by Reliance (Canada) in respect of the premises so occupied or as may hereafter be negotiated by the Liquidator from time to time.

25. THIS COURT ORDERS that all persons, firms, corporations and other entities be and they are hereby enjoined from disturbing or interfering with computer software, hardware, support and data services or with utility services, including, but not limited to, the furnishing of oil, gas, heat, electricity, water, telephone service (including at present telephone numbers used by Reliance (Canada)) or any other utilities of like kind furnished to Reliance (Canada) and they are hereby enjoined from discontinuing or altering any such utilities or services to the Liquidator except upon further order of this Court, so long as the Liquidator pays the normal prices or charges for such goods and services incurred after November 8, 2001 as the same become due in accordance with usual payment terms or as may hereafter be negotiated by the Liquidator from time to time.



26. THIS COURT ORDERS that, without limiting the generality of the foregoing, and except upon further order of this Court having been obtained on at least 7 days' notice to the Liquidator:

- (a) all persons, firms, corporations and other entities be and they are hereby restrained from terminating, cancelling or otherwise withdrawing any licences, permits, approvals or consents with respect to or in connection with Reliance (Canada) as they were on November 8, 2001;
- (b) any and all proceedings or steps taken or that may be taken, wheresoever taken, by any person, firm, corporation or entity, including, without limitation, any of the policyholders or creditors of Reliance (Canada), suppliers, co-insurers, reinsurers, contracting parties, depositors, lessors, tenants, co-venturers or partners (hereinafter, in this paragraph "Claimants") against or in respect of Reliance (Canada) shall be and hereby are stayed and suspended;
- (c) the right of any Claimant to make demands for payment on or in respect of any guarantee or similar obligation or to make demand or draw down under any letters of credit, bonds or instruments of similar effect, issued by or on behalf of Reliance (Canada), to take possession of, to foreclose upon or to otherwise deal with any property, wheresoever located, of Reliance (Canada) whether held directly or indirectly, as principal or nominee, beneficially or otherwise, or to continue any actions or proceedings in respect of the foregoing, is hereby restrained;
- (d) the right of any Claimant to assert, enforce or exercise any right (including, without limitation, any right of dilution, buy-out, divestiture, forced sale, acceleration, termination, suspension, modification or cancellation or right to

revoke any qualification or registration), option or remedy available to it including a right, option or remedy arising under or in respect of any agreement (including, without limitation, any contract, debt instrument, guarantee, option, co-ownership agreement or any agreement of purchase or sale but not including any eligible financial contract, as defined in the *Winding-up and Restructuring Act*) to which Reliance (Canada) is a party, arising out of, relating to or triggered by the occurrence of any default or non-performance by Reliance (Canada) or the making or filing of these proceedings, or any allegation contained in these proceedings, is hereby restrained; and

- (e) all Claimants are restrained from exercising any extra judicial remedies against Reliance (Canada), including, without limitation, the registration or re-registration of any securities owned by Reliance (Canada) into the name of such persons, firms, corporations or entities or their nominees, the exercise of any voting rights attaching to such securities, the retention of any payments or other distributions made in respect of such securities, any right of distress, repossession, or consolidation of accounts in relation to amounts due or accruing due in respect of or arising from any indebtedness or obligation of Reliance (Canada) as of the date hereof.

27. THIS COURT ORDERS that no action lies against the Liquidator, any of its affiliates (the "Affiliates") any director, officer, agent, representative or employee of the Liquidator or of the Affiliates, any entity or person (or director, officer, agent, representative or employee of any such entity or person) acting under the direction of the Liquidator, or the Inspectors or any director, officer, agent, representative or employee thereof, for anything done or omitted to be done in good faith in the administration of the liquidation of Reliance (Canada) or in the exercise of the Liquidator's powers under this Order or otherwise.

28. THIS COURT ORDERS that no suit, action or other proceeding shall be proceeded with or commenced against the Liquidator, the Affiliates, any director, officer, agent, representative or employee of the Liquidator, or of the Affiliates, any entity or person (or director, officer agent, representative or employee of any such person) acting under the direction of the Liquidator, or the Inspectors or any director, officer, agent, representative or employee thereof, except with leave of this Court and subject to such terms as this Court may impose.

29. THIS COURT ORDERS that the Liquidator may, without the approval, sanction or intervention of this Court and without previous notice to the policyholders or creditors of Reliance (Canada) or any other person,

- (a) take control of the estate and effects of Reliance (Canada) or such part thereof as the Liquidator shall determine;
- (b) bring or defend any action, suit or prosecution or other legal proceeding, civil or criminal, in the Liquidator's own name as liquidator or in the name or on behalf of Reliance (Canada), as the case may be;
- (c) carry on the business of Reliance (Canada) so far as it is necessary or incidental to the winding-up of Reliance (Canada);
- (d) lease or mortgage or otherwise realize upon the undertaking, property and assets of Reliance (Canada) or any part or parts thereof;
- (e) sell the real and personal property, effects, intangibles and choses in action of Reliance (Canada), including all or any portion of Reliance (Canada)'s contracts and products and related assets, including, without limitation, Reliance (Canada)'s lists of policyholders and customers, by public auction or private contract, and transfer the whole thereof to any person or company, or sell them in parcels;

- (f) do all acts and execute, in the name of and on behalf of Reliance (Canada), all deeds, receipts, and other documents, and for that purpose use, when necessary, the seal of Reliance (Canada), and file any elections (tax or otherwise), objections or registrations, and file any notices, all as may be necessary or desirable in the opinion of the Liquidator for the better liquidation of Reliance (Canada);
- (g) prove, rank, claim and draw dividends in the matter of the bankruptcy, insolvency or sequestration of any contributory, for any sum due to Reliance (Canada) from the contributory, and take and receive dividends in respect of the bankruptcy, insolvency or sequestration, as a separate debt due from that contributory and rateably with the other separate creditors;
- (h) draw, accept, make and endorse any bill of exchange or promissory note in the name of and on behalf of Reliance (Canada);
- (i) give discharges of mortgages and other securities, partial discharges of mortgages and other securities, and pay property taxes and insurance premiums on mortgages and other securities taken in favour of Reliance (Canada);
- (j) pay such debts of Reliance (Canada) as may be necessary to be paid in order to properly preserve and maintain the undertaking, property and assets of Reliance (Canada) or to carry on the business of Reliance (Canada);
- (k) surrender possession of any premises occupied by Reliance (Canada) and disclaim any leases entered into by Reliance (Canada);
- (l) apply for any permits, licences, approvals or permissions as may be required by any governmental or regulatory authority;

- (m) re-direct Reliance (Canada)'s mail;
- (n) enter into any eligible financial contracts, as defined in the *Winding-up and Restructuring Act*;
- (o) take possession and control of all securities in which Reliance (Canada) has an interest (directly or indirectly) and exercise all rights that may be enjoyed by a holder of such securities including, without limitation, rights (i) that may arise by virtue of the holder being a party to a shareholder or similar agreement that may, by way of example, restrict the powers of the directors to manage or supervise the management of the business and affairs of the corporation, (ii) to receive information, (iii) to attend at and cause to be held meetings of holders of such securities, (iv) to vote such securities for the removal or election of directors and approval of significant transactions (such as the sale or disposition of all or substantially all of the assets of such company or the winding-up, liquidation, rehabilitation, bankruptcy, receivership, restructuring or amalgamation of such company), and (v) to sell or otherwise dispose of such securities;
- (p) compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts, and all claims, demands and matters in dispute in any way relating to or affecting the assets of Reliance (Canada) or the winding-up of Reliance (Canada), on the receipt of such sums, payable at such times, and generally on such terms as are agreed on by the Liquidator;
- (q) make such compromise or other arrangements with creditors or persons claiming to be creditors of Reliance (Canada) as the Liquidator deems expedient; and

- (r) do and execute all such other things as are necessary for, or incidental to the winding-up of the affairs of Reliance (Canada), including without limitation entering into agreements incurring obligations.

30. THIS COURT FURTHER ORDERS that the Liquidator may, with the approval of this Court and on such notice as the Court may direct:

- (a) arrange for the transfer or reinsurance of all or a portion of the policies of Reliance (Canada); and
- (b) cancel all or a portion of the outstanding policies of Reliance (Canada).

31. THIS COURT ORDERS that the Liquidator and any of the Liquidator's agents, officers, directors, representatives or employees shall be deemed not to be an employer or a successor employer of the employees of Reliance (Canada) within the meaning of the *Pension Benefits Act* (Ontario), *Employment Standards Act* (Ontario), the *Labour Relations Act* (Ontario) or any other Federal, Provincial or Municipal legislation governing employment or labour standards or any other statute, regulation or rule of law or equity for any purpose whatsoever and, further, that the Liquidator and any of the Liquidator's agents, directors, officers, representatives or employees shall not be and shall be deemed not to be, in possession, charge or control of the property or business or affairs of Reliance (Canada) pursuant to any Federal, Provincial or Municipal legislation, statute, regulation or rule of law or equity which imposes liability on the basis of such status including, without limitation, the *Environmental Protection Act* (Ontario), the *Canadian Environmental Protection Act*, or the *Ontario Water Resources Act*, and this shall be binding on all tribunals and administrative bodies.

32. THIS COURT ORDERS that the Liquidator may retain, employ or engage such actuaries, accountants, financial advisors, investment dealers, solicitors, attorneys, valuers or

other expert or professional persons as the Liquidator deems necessary or desirable to assist the Liquidator in fulfilling the Liquidator's duties, and all reasonable and proper expenses which the Liquidator may incur in so doing shall be costs of liquidation of Reliance (Canada).

33. THIS COURT ORDERS that the Liquidator may act on the advice or information obtained from any actuary, accountant, financial advisor, investment dealer, solicitor, attorney, valuer or other expert or professional person, and the Liquidator shall not be responsible for any loss, depreciation or damage occasioned by acting in good faith in reliance thereon.

34. THIS COURT ORDERS that the Liquidator shall be paid such remuneration as the Court Orders.

35. THIS COURT ORDERS that the Liquidator shall be at liberty to apply reasonable amounts against its remuneration, expenses and disbursements on a monthly basis and that such amounts shall constitute advances against its remuneration and expenses on, but subject to, the passing of its accounts.

36. THIS COURT ORDERS that this Order and any other orders in these proceedings shall have full force and effect in all Provinces and Territories in Canada.

37. THIS COURT SEEKS AND REQUESTS the aid and recognition of any Court or administrative body in any Province or Territory of Canada and any Canadian Federal Court or administrative body and any Federal or State Court or administrative body in the United States of America and any Court or administrative body in the United Kingdom or elsewhere to act in aid of and to be complementary to this Court in carrying out the terms of this Order.

38. THIS COURT ORDERS that the costs of this application, including the costs of the Inspectors, are to be assessed on a solicitor and his own client basis and shall be costs of liquidation of Reliance (Canada).

39. THIS COURT ORDERS that interested parties may apply to the Court for advice and directions on 7 days' notice to the Liquidator and the Inspectors, and that the Liquidator may at any time apply to this Court for advice and directions.

DEC 08 2006  
PER/PAE  
*[Handwritten signature]*

*Viktoria Seckl*  
\_\_\_\_\_  
*Registrator*



**ONTARIO SUPERIOR COURT OF JUSTICE  
-COMMERCIAL LIST**

**IN THE MATTER OF  
RELIANCE INSURANCE COMPANY**

**AND IN THE MATTER OF THE  
*INSURANCE COMPANIES ACT*, S.C. 1991, C.47, AS AMENDED**

**AND IN THE MATTER OF THE  
*WINDING-UP AND RESTRUCTURING ACT*, R.S.C. 1985, C.W-11, AS  
AMENDED**

**B E T W E E N:**

**THE ATTORNEY GENERAL OF CANADA**

Applicant

**- and -**

**RELIANCE INSURANCE COMPANY**

Respondent

**REPORT OF KPMG INC., THE LIQUIDATOR OF  
RELIANCE INSURANCE COMPANY**

**March 21, 2003**

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**ONTARIO  
SUPERIOR COURT OF JUSTICE**

**COMMERCIAL LIST**

**IN THE MATTER OF  
RELIANCE INSURANCE COMPANY  
AND IN THE MATTER OF THE  
*INSURANCE COMPANIES ACT, S.C. 1991, C.47, AS AMENDED*  
AND IN THE MATTER OF THE  
*WINDING-UP AND RESTRUCTURING ACT, R.S.C. 1985, C.W-11, AS AMENDED***

**B E T W E E N:**

**THE ATTORNEY GENERAL OF CANADA**

Applicant

- and -

**RELIANCE INSURANCE COMPANY**

Respondent

**March 21, 2003**

**I. NATURE OF THE MOTION**

1. This Report is respectfully filed in support of a motion by KPMG Inc., the liquidator (the “Liquidator”) of Reliance (Canada) (as hereinafter defined) for an Order extending the date for Policy Payments, payment of Defence Costs and Meridian Payments (all as hereinafter defined) from March 31, 2003 to June 30, 2003 or such later date as this Court may order.

**II. BACKGROUND**

2. Reliance Insurance Company (“Reliance”) is a property and casualty insurer in the United States of America, domiciled in the Commonwealth of Pennsylvania. Reliance carried on business in Canada as a “foreign company” within the meaning of the *Insurance Companies Act*

through a branch. In October, 2000, Reliance (Canada) stopped issuing new policies and began “running off” or winding down its existing business.

3. Reliance was ordered liquidated by Order of the Commonwealth Court of Pennsylvania dated October 3, 2001, under the Pennsylvania *Insurance Department Act of 1921*. M. Diane Koken, Commissioner of Insurance for Pennsylvania, was appointed liquidator (the “U.S. Liquidator”).

4. By Order of this Court made December 3, 2001 (the “Winding-up Order”), the insurance business of Reliance in Canada (“Reliance (Canada)”) was ordered wound-up pursuant to the provisions of the *Winding-up and Restructuring Act*. A copy of the Winding-up Order is attached as Schedule “A”.

5. By further Order of this Court made December 3, 2001 (the “Appointment Order”), KPMG Inc. was appointed provisional liquidator. A copy of the Appointment Order is attached as Schedule “B”.

6. The relevant provisions of the Appointment Order for the purposes of this motion are:

- (a) paragraph 8 provides that the Liquidator may pay all valid policyholder claims, including claims in respect of unearned premiums, to the amount of \$25,000 or the amount of the coverage limits of the Property and Casualty Compensation Insurance Corporation (“PACICC”) if any (the “Policy Payments”), until April 30, 2002 or such later date as the Court may order, subject to paragraph 9 of the Appointment Order, and that such payments are deemed to be payments made on account of claims in the liquidation;
- (b) paragraph 9 provides that the Liquidator may pay all valid claims, including claims in respect of unearned premiums, under the Meridian Warranty program and other warranty and surety programs to the amount of \$5,000 or the PACICC coverage limits, if any (the “Meridian Payments”), until January 31, 2002 or such later date as the Court may order, and that such payments are deemed to be payments made on account of claims in the liquidation;

- (c) paragraph 11 provides that the Liquidator may pay and continue to pay all reasonable legal and other costs, incurred to and including April 30, 2002 that Reliance (Canada) is obligated to pay for defending any insureds against losses under Reliance (Canada)'s policies in accordance with the applicable policy, subject to the terms and limits of such policies (the "Defence Costs"); and
- (d) paragraph 30 provides that the Liquidator may, with the approval of this Court, arrange for the transfer or reinsurance of all or a portion of the policies of Reliance (Canada) and cancel all or a portion of the outstanding policies of Reliance (Canada).

7. By Order of this Court dated January 30, 2002 the date of January 31, 2002 with respect to Meridian Payments was extended to April 30, 2002. By further Orders of this Court, the date of April 30, 2002 with respect to Policy Payments, payment of Defence Costs and Meridian Payments (collectively, the "Payments") was extended to March 31, 2003. Copies of the Orders of this Court dated January 30, 2002, April 29, 2002, May 8, 2002 and December 6, 2002 extending the dates for the Payments are attached as Schedules "C" through "F", respectively.

### **III. MERIDIAN PROGRAM**

8. Attached hereto as Schedule "G" is a copy of the Report of the Liquidator dated April 23, 2002 (the "April Report"). The April Report was filed in support of the application to extend the date for the Payments and to approve an agreement between the Liquidator and St. Paul Guarantee Insurance Company, formerly London Guarantee Insurance Company, ("St. Paul Guarantee") pursuant to which St. Paul Guarantee would assume Reliance (Canada)'s liabilities under the Meridian program (the "Meridian Program"). The April Report also discusses the Liquidator's attempts to market the liabilities under the balance of the policies (the "Policy Liabilities").

#### **Background**

9. In 1995, Reliance (Canada) entered into an arrangement with Meridian Warranty Management Inc. (an unaffiliated company), under which Reliance (Canada) issued certificates

extending repair warranty coverage on vehicles. Coverage was written in all provinces, except Quebec. There were approximately 18,000 Meridian policyholders at the beginning of the liquidation. Approximately 5,000 policies have since expired and 3,600 further policies will expire by December 31, 2003. The last policy expires in 2007.

10. The coverage under the Meridian Program was 100% reinsured by other insurers, being AXA Insurance and Lloyds Underwriters (the “Meridian Reinsurers”). This type of arrangement is known in the industry as a “fronting” arrangement, since the issuing insurer (here, Reliance (Canada)) is fully reinsured, with the objective of retaining no residual risk. Reliance (Canada) earns a percentage fee from each of the reinsurers, rather than bearing the ultimate benefit or burden of the underwriting risk. Although the Meridian Program is designed so that the ultimate underwriting risk is borne by the Meridian Reinsurers, Reliance (Canada) is the issuer of the policies and is therefore directly liable to the policyholders. This means that Reliance (Canada) bears the risk of the Meridian Reinsurers not paying and must reserve for these policies in the normal way as liabilities of Reliance (Canada). Conversely, the policyholders bear the risk of Reliance (Canada)'s insolvency. The reinsurance amounts remain an asset of Reliance (Canada).

11. After a marketing process, the Liquidator entered into an agreement with St. Paul Guarantee pursuant to which St. Paul Guarantee would assume Reliance (Canada)'s liabilities under the Meridian Program (the “Meridian Transaction”). The terms of the Meridian Transaction are detailed in the April Report. The Meridian Transaction contemplates that the consent of the Meridian Reinsurers to the transaction must be obtained before closing can take place. By Order dated May 8, 2002 (which is attached as Schedule “F” referred to above), this Court approved the Meridian Transaction. Attached as Schedule “H” is a copy of the reasons of this Court dated May 8, 2002.

12. In the April Report, the Liquidator stated that the alternatives to the Meridian Transaction are running off the policies or cancelling them. Because Reliance (Canada) fronts the Meridian Program and so bears the administrative costs but not the liabilities for claims under the policies and because the cost of calculating unearned premiums is so high, the Liquidator is of the view that the cost of cancelling the policies is likely to exceed the cost of running them off. The Liquidator is of the view that the Meridian Transaction would have materially the same

economic impact on the estate as a run-off, and therefore a more beneficial impact than cancellation of the policies.

13. The Liquidator originally anticipated that the Meridian Transaction would close by September 30, 2002. However, it did not close by that date because the Meridian Reinsurers had not provided their consent to the transaction. The Liquidator therefore sought an extension of the date to which it could make Meridian Payments while it continued its efforts to obtain necessary consents. By Order dated December 6, 2002, this Court extended the date to which the Liquidator could make Meridian Payments to March 31, 2003 or such later date as this Court may order.

#### **Extension of the Meridian Payments**

14. As indicated, a condition of the Meridian Transaction is the consent of the Meridian Reinsurers. While the majority of the Meridian Reinsurers are Canadian registered reinsurers, their decision makers are located in London, England. The Liquidator has retained U.K. insurance counsel, Kendall Freeman (formerly D.J. Freeman), and is using the services of Reliance (Canada)'s reinsurance broker in London, AON, to assist in dealing with the Meridian Reinsurers. The Liquidator has met with the Meridian Reinsurers, has provided them with all information they have requested concerning the Meridian Transaction and has been responsive to all concerns they have raised to date. Notwithstanding these efforts, the Meridian Reinsurers have still not granted the consents. While the pace of the discussions with the Meridian Reinsurers has been very disappointing, the Liquidator is of the view that it is appropriate to continue to pursue this course of action for the time being. If the consents are not granted, the Liquidator will consider all other options, including seeking the assistance of this Court.

15. The Liquidator is recommending that this Court extend the date to which the Liquidator may make Meridian Payments to June 30, 2003. The Liquidator makes this recommendation for the following reasons:

- (a) Assuming the Meridian Transaction closes, it would be counterproductive to interrupt payments. There would be significant costs both in communicating with

the approximately 13,000 Meridian policyholders remaining to explain the interruption in the payment stream and with restarting payments after the transaction closes, which costs St. Paul Guarantee has not covenanted to pay; and

- (b) Even if the Meridian Transaction does not ultimately close, the Liquidator remains of the view that the cost of cancelling the Meridian policies is likely to exceed the cost of running them off. Therefore, it is still more beneficial to the estate to continue to make the Meridian Payments as part of a running off of the business.

16. As set out in the April Report, the Liquidator is confident, based on the information presently available to it, that the estate of Reliance (Canada) will make full payment on all valid claims. However, for the reasons discussed more fully below, the Liquidator is not yet in a position to pay all policyholders 100%. The Liquidator remains of the view that it is appropriate to continue to pay the Meridian Payments at the present level regardless of whether the Meridian Transaction closes because the administrative costs of reducing and adjusting those payments would more than offset any cost differential if the ultimate dividend rate were less than 100%.

17. The Liquidator therefore recommends that it continue to make the Meridian Payments until June 30, 2003, or such later date as this Court may order. The Liquidator will report back to this Court by June 30, 2003 with respect to the status of the Meridian Transaction.

#### **IV. REMAINING POLICY LIABILITIES**

##### **Marketing Process**

18. As also discussed in the April Report, the Liquidator undertook a process of seeking qualified insurers to assume the Policy Liabilities in exchange for the transfer of assets. The Liquidator engaged Scotia Capital Inc. and KPMG Corporate Finance Inc. as co-advisers in this process. The U.S. Liquidator has been extensively involved in the process as well.

19. In its Report of December 6, 2002 (the "December Report"), the Liquidator advised this Court that on November 21, 2002, it entered into a memorandum of understanding with respect



to a transaction that would result in the assumption by the purchaser of the Policy Liabilities at 100%. The purchaser stipulated that the terms of the memorandum, including its identity, are to be kept confidential at this time.

20. The memorandum of understanding contemplated that a number of steps would be completed by certain dates, several of which were met. One of those steps was that the parties enter into definitive agreements by February 28, 2003. To date, no definitive agreements have been finalized. The process has taken longer than the Liquidator originally anticipated given, among other things, current market conditions, and issues which result from the fact that Reliance (Canada) is a branch and not a subsidiary.

21. The Liquidator remains of the view that a transfer of the Policy Liabilities to another carrier on appropriate terms would result in a substantial benefit to the policyholders and the estate in comparison to a more traditional liquidation. The Liquidator is, therefore, not proposing to terminate discussions with the purchaser even though the issues that have arisen are difficult and the Liquidator is not, at this point, optimistic that they will be resolved.

#### **Extension of the Defence Costs and Policy Payments**

22. The Liquidator considers it appropriate and in the best interest of the estate that Policy Payments and payment of Defence Costs should continue. The payment of Defence Costs would facilitate the transaction to transfer the Policy Liabilities in that it eases any potential concerns of the purchaser with respect to the standards of claims adjudication. Payment of Defence Costs also significantly reduces immediate hardship to policyholders.

23. The Liquidator is not recommending any change to the Policy Payments. The Liquidator remains confident that, whether a transaction is consummated or not, all valid claims against Reliance (Canada) will be paid in full. However, as discussed below, there are uncertainties. The Liquidator is of the view that the present Policy Payment level balances the interests of all parties. The Liquidator is proposing that the Policy Payments continue on the same basis until June 30, 2003 or such later date as this Court may order.

24. In the December Report, the Liquidator indicated that it chose the date of March 31, 2003 for the Policy Payments and payment of Defence Costs not because it believed that the transaction to transfer the Policy Liabilities would be completed by that time, but because the Liquidator was of the view that it would be in a better position to report back to this Court on the progress of the transaction. As discussed, serious issues have arisen which throw doubt on whether a transaction can be completed. In all the circumstances, the Liquidator believes that extending the payment of Defence Costs and Policy Payments to June 30, 2003 is appropriate. The Liquidator will report back to this Court on the status of the transaction. If the transaction will not proceed, the Liquidator will make further recommendations to this Court concerning the Policy Payments and Defence Costs, including the payment of an interim dividend.

## **V. OTHER MATTERS**

25. The Liquidator is confident, based on the information presently available to it, that all valid claims against Reliance (Canada) will be paid in full. However, there are two major uncertainties, which are discussed below.

### **Non-Booked Claims**

26. One uncertainty is the potential that certain claims that were not reported in the books of Reliance (Canada) may be valid claims in its liquidation (the "Non-Booked Claims"). The Non-Booked Claims arise from policies written outside of Canada but which have some nexus with Canada, and which, arguably, should have been reported in the books of the branch and for which assets should have been deposited in Canada.

27. The Liquidator has worked co-operatively with the U.S. Liquidator to identify the Non-Booked Claims. Reliance maintains databases with historical and current policy and claim information. With directions from the Liquidator, staff of the U.S. Liquidator have searched these databases using as many query criteria as available to identify Non-Booked Claims. When the search process identifies open claims, the database details and policy files, if available, are reviewed to confirm whether the identified claims are possible Non-Booked Claims. In many cases, they are not. For example, the search may turn up a Canadian address which is not

relevant. It is important to note that the U.S. Liquidator considers the open claims identified as having a possible nexus with Canada as claims which, if valid, would participate in the U.S. estate.

28. The search has thus far identified fewer than 40 potential Non-Booked Claims. About half of these claims have only nominal reserves. In addition, one policyholder that was not identified on the search has contacted the Liquidator. Based on the information presently available, the Liquidator estimates that the total value of the Non-Booked Claims identified thus far, if all proved to be valid, is less than Cdn \$10 million. This would not impact the Liquidator's ability to pay all Reliance (Canada)'s valid claims in full. However, there is no certainty as to the magnitude of the Non-Booked Claims, since they were not originally identified as being appropriately assigned to Reliance (Canada).

29. The Liquidator will be seeking the directions of this Court with respect to giving notice to any party who believes they have a claim properly assertable against Reliance (Canada) to come forward, and will then seek directions of this Court with respect to whether the Non-Booked Claims should be allowed in the Canadian estate.

### **Reinsurance Issues**

30. Another issue that arises because Reliance (Canada) is a branch rather than a subsidiary concerns reinsurance. Some of the reinsurance relating to Reliance (Canada)'s business is included in treaties entered into by Reliance. In other cases, Reliance (Canada) entered into its own treaties with reinsurers; many of these reinsurers are also parties to treaties with Reliance, either directly or through related companies. Some of these reinsurers are asserting rights of set-off. There are also other complications that arise under the terms of the specific treaties. The Liquidator has been working co-operatively with the U.S. Liquidator to address these issues to date.

31. Based on the Liquidator's present information, this issue should not prevent the payment in full of all of Reliance (Canada)'s valid claims.

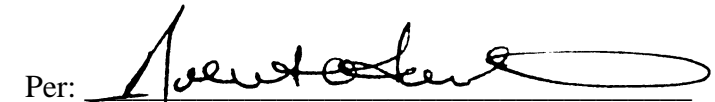
**VI. RECOMMENDATIONS**

32. The Liquidator recommends that this Court make an order extending the date for Policy Payments, payment of Defence Costs and Meridian Payments from March 31, 2003 to June 30, 2003 or such later date as this Court may order.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

**KPMG INC.**, solely in its capacity as the  
Liquidator of Reliance Insurance Company -  
Canadian Branch

Per:

  
Robert O. Sanderson, President

**LOAN AND SERVICES AGREEMENT**

**THIS AGREEMENT** dated the 3<sup>rd</sup> day of December, 2001

**B E T W E E N:**

**PROPERTY AND CASUALTY INSURANCE  
COMPENSATION CORPORATION**

(hereafter referred to as "PACICC")

**OF THE FIRST PART,**

**- and -**

**KPMG INC.**, solely in its capacity as court appointed Liquidator of the insurance business in Canada of **RELIANCE INSURANCE COMPANY** ("Reliance"), and not in its personal capacity

(hereafter referred to as the "Liquidator")

**OF THE SECOND PART.**

**WHEREAS:**

- A.** By order of the Commonwealth Court of Pennsylvania dated the 3<sup>rd</sup> day of October, 2001, the Insurance Commissioner of the Commonwealth of Pennsylvania and her successors in office was appointed Liquidator of Reliance and directed to liquidate Reliance;
- B.** By order of the Ontario Court of Justice (General Division) dated the 3<sup>rd</sup> day of December, 2001, the insurance business in Canada of Reliance was ordered wound-up pursuant to the provisions of the *Winding-up and Restructuring Act*;
- C.** By subsequent order of the Ontario Court of Justice (General Division) dated the 3<sup>rd</sup> day of December, 2001 (the "Winding-up Order"), KPMG Inc. was appointed the provisional liquidator of the insurance business in Canada of Reliance;

- D.** PACICC was established by property and casualty insurers to provide a reasonable level of compensation, through the making of voluntary payments to Policyholders and Third Party Claimants in respect of insolvent property and casualty insurers;
- E.** Reliance is a member of PACICC in satisfaction of the requirements of the relevant provincial insurance regulatory authorities;
- F.** The Liquidator and PACICC are in agreement that the interests of the claimants of Reliance would best be served by co-operation between the Liquidator and PACICC in order to facilitate the payment of claims to policyholders and the preservation of the value of the estate and to ensure the most expeditious and efficient handling of claims and processing of PACICC payments; and
- G.** To achieve these goals, the Liquidator and PACICC have agreed that the Liquidator shall make payments to Policyholders and Third Party Claimants on behalf of PACICC in accordance with the Memorandum of Operation, and that payments so made by the Liquidator on PACICC's behalf shall constitute indebtedness of PACICC to the Liquidator in accordance with the terms hereof, and they have further agreed that the Liquidator shall provide certain services to PACICC on the terms and conditions set forth herein.

**NOW THEREFORE THIS AGREEMENT WITNESSETH** that:

## **ARTICLE I**

### **DEFINITIONS AND INTERPRETATION**

#### **1.1 Memorandum of Operation**

Capitalized terms used in this Agreement and not defined in Section 1.2 below or elsewhere in this Agreement shall have the meanings attributed to such terms in the Memorandum of Operation.

#### **1.2 Definitions**

Where used in this Agreement, the following terms shall have the following meanings:

- (a) “Agreement”, “hereof”, “herein”, “hereunder” and similar expressions refer to this Agreement taken as a whole, including the Schedules attached hereto;
- (b) “Amount Outstanding” has the meaning attributed to such term in Section 2.3;
- (c) “Business Day” means any day of the year, other than a Saturday, Sunday or any other day that is a statutory holiday in Toronto, Ontario;
- (d) “Canadian Estate” means the assets and operations of Reliance under the control of the Liquidator pursuant to the orders of the Ontario Court of Justice (General Division) referred to in Recitals B and C above;
- (e) “Demand” has the meaning attributed to such term in Section 2.3;

- (f) “Eligible Amounts” are the amounts paid by the Liquidator to Policyholders or Third Party Claimants pursuant to the Winding-up Order;
- (g) “Estimated Policyholder Realization Percentage” means the Liquidator's reasonable estimate of the recovery percentage available for payments on account of Covered Claims from time to time;
- (h) “Estimated Realization Percentages” means both the Estimated Policyholder Realization Percentage and the Estimated Unearned Premium Realization Percentage;
- (i) “Estimated Unearned Premium Realization Percentage” means the Liquidator's reasonable estimate of the recovery percentage available for payments on account of claims for Unearned Premium from time to time;
- (j) “Final Realization Percentage” means the final recovery percentage determined by the Liquidator;
- (k) “Full Recovery Date” means the date on which the Liquidator publicly announces that the assets and funds in the Canadian Estate are sufficient to yield a 100% recovery (excluding interest) to claimants of Reliance on account of both Covered Claims and Unearned Premium;
- (l) “Memorandum of Operation” means the English language version of the Memorandum of Operation of PACICC, a copy of which is attached hereto as Schedule “A”;



- (m) “Prime Rate” means, for any particular day, the per annum rate of interest which the principal office of the Royal Bank of Canada in Toronto, Ontario quotes, publishes and refers to as its “prime rate” and which is its reference rate of interest for loans made in Canadian dollars to Canadian borrowers.

### **1.3 Interpretation**

Unless the context otherwise requires:

- (a) where the word “including” or “includes” is used in this Agreement it means including (or includes), without limitation;
- (b) words importing the singular number or masculine gender only shall include the plural number or the feminine gender, and vice-versa;
- (c) all references to “Articles”, “Sections” and “Schedules” are references to Articles or Sections of, and Schedules to and forming part of this Agreement;
- (d) all references herein to an act, statute or regulation shall, unless otherwise stated, be deemed to be a reference to that act, statute or regulation as supplemented, amended, revised, substituted for or renumbered from time to time;
- (e) the division of this Agreement into Articles, Sections, paragraphs and other subdivisions and the insertion of headings are for convenience of reference only and shall not affect the construction or interpretation of this Agreement;
- (f) all references to this Agreement to “Dollars” or “\$” are to lawful money of Canada unless otherwise indicated;

- (g) all references in this Agreement to time are to the time in effect in Toronto, Ontario on the applicable date; and
- (h) where in this Agreement a term is defined, a derivative of that term shall have a corresponding meaning.

#### **1.4 Governing Law**

This Agreement shall be governed by and interpreted in accordance with the laws of the Province of Ontario and the laws of Canada applicable therein and shall be treated as an Ontario contract. The parties irrevocably attorn to the non-exclusive jurisdiction of the courts of the Province of Ontario.

#### **1.5 Invalidity**

Any provision of this Agreement, which is prohibited or unenforceable shall be ineffective only to the extent of that prohibition or unenforceability, without invalidating the remaining provisions of this Agreement.

#### **1.6 Time**

Time is of the essence of this Agreement.

#### **1.7 Date For Any Action**

If any action, including any payment, is required or allowed to be taken or made under this Agreement by any of the parties on or by a date that is not a Business Day, that action may be taken on the next Business Day. In the case of payments, that extension of time shall be included in computing any applicable interest.

## **1.8 Conflict**

If there is any conflict between the provisions of this Agreement and any document or agreement delivered in accordance with this Agreement, the provisions of this Agreement shall govern.

## **ARTICLE II**

### **COMPENSATION PAYMENTS AND LOAN ARRANGEMENTS**

#### **2.1 Determination of Validity and Amount of Covered Claims and Unearned Premiums**

The Liquidator will have sole authority and responsibility to determine the validity and amount of all Claims in the Canadian Estate, including all Covered Claims and Unearned Premiums, provided that the Liquidator shall not determine the validity and amount of any Covered Claim in excess of twenty-five thousand dollars (\$25,000.00), or any Claim for Unearned Premiums, without first consulting, and obtaining the approval of, PACICC. In accordance with paragraph 4 of the Memorandum of Operation, the amount determined by the Liquidator in accordance with the foregoing in respect of a Covered Claim shall be deemed to be the “Amount of the Covered Claim” and the amount determined by the Liquidator in accordance with the foregoing in respect of Unearned Premium shall be deemed to be the “Amount of the Unearned Premium”, and for so long as the payment procedures prescribed for this Agreement are in effect, PACICC will not dispute the Liquidator’s determination of the validity and dollar amount of Covered Claims or Unearned Premium or attempt to verify same pursuant to Section 5 of the Memorandum of Operation.

## **2.2 Estimated Realization Percentage**

The Liquidator will have sole authority to establish the Estimated Realization Percentages and will give PACICC seven (7) days notice before any change. It is acknowledged that each of the Estimated Realization Percentages as of the date hereof is one-hundred percent (100%). It is further acknowledged that if the Estimated Policyholder Realization Percentage is less than 100%, the Estimated Unearned Premium Realization Percentage shall be 0%.

## **2.3 Payments**

Once the Liquidator has determined the Amount of a Covered Claim pursuant to Section 2.1, the Liquidator may make, on behalf of PACICC to the extent the Estimated Policyholder Realization Percentage is less than 100%, a payment or payments (including on an interim basis) to a Policyholder in respect of that Covered Claim in an aggregate amount equal to the lesser of (i) the amount of the Covered Claim, and (ii) the Ceiling Amount. Similarly, once the Amount of the Unearned Premium has been determined pursuant to Section 2.1, the Liquidator may make a payment to a Policyholder in respect thereof on behalf of PACICC to the extent the Estimated Unearned Premium Realization Percentage is less than 100% in an amount equal to the lesser of (i) seventy percent (70%) of the Amount of Unearned Premium and (ii) the Unearned Premium Limit. Notwithstanding the foregoing:

- (a) where the Liquidator is of the view that all or any portion of a Compensation Payment should be made to one or more Third Party Claimants instead of to the Policyholder, the Liquidator may refuse to make a Compensation Payment to the Policyholder on behalf of PACICC and may pay all or a portion of the

Compensation Payment on behalf of PACICC to one or more Third Party Claimants;

- (b) the Liquidator shall not make any payment hereunder on behalf of PACICC to any Person whom the Liquidator believes in good faith would likely be designated an Ineligible Person by PACICC's board of directors without first consulting with PACICC and obtaining its approval (provided that the Liquidator shall have no liability for Compensation Payments made by it in good faith to a Person whom it subsequently learns has been designated as an Ineligible Person by PACICC's board of directors); and
- (c) the Liquidator will not be required to make hardship payments on behalf of PACICC pursuant to paragraph 30 of the Memorandum of Operation unless the Liquidator is satisfied that the making of such payment is in the overall best interest of the Canadian Estate.

## **2.4 Loan**

The difference between all Eligible Amounts and the amount which is the result of multiplying Eligible Amounts by the Estimated Policyholder Realization Percentage or the Estimated Unearned Premium Realization Percentage (as the case may be) shall be deemed to have been loaned by the Liquidator to PACICC and paid by the Liquidator to Policyholders or Third Party Claimants on behalf of PACICC, and the aggregate of such amounts outstanding from time to time is referred to herein as the "Amount Outstanding". The Amount Outstanding shall include any amount which would have been advanced on behalf of PACICC if the respective Estimated Realization Percentage had been the Final Realization Percentage on a Covered Claim or

Unearned Premium from the date of each payment on a Covered Claim or Unearned Premium. From and after the date hereof, interest shall accrue on the Amount Outstanding from time to time at a rate per annum equal to the Prime Rate until such time as the Amount Outstanding has been repaid in full. Interest will be calculated and will compound semi-annually. The Liquidator may at any time, by written notice to PACICC, demand repayment of the Amount Outstanding and all interest accrued thereon (a "Demand") whereupon the obligation of the Liquidator to make further payments to Policyholders and Third Party Claimants on behalf of PACICC hereunder will immediately terminate and PACICC will be required to repay to the Liquidator within the ninety (90) days of the issuance of the Demand, without any right of set-off or deduction whatsoever (except as expressly contemplated by Section 4.1), the principal amount of the Amount Outstanding and all interest accrued hereunder, without presentment, demand, protest or further notice of any kind, all of which are hereby expressly waived by PACICC.

## **2.5 Ability to Repay**

To ensure that PACICC is able to repay the Amount Outstanding to the Liquidator, PACICC hereby covenants and agrees that the aggregate of:

- (a) the amount currently available for use by PACICC in its Compensation Fund; and
- (b) the total draws which PACICC is permitted to levy from its Contributing Members pursuant to section 20(1) of its Memorandum of Operation for the remainder of the calendar year,

will at all times exceed Cdn.\$50,000,000. PACICC further covenants and agrees it will undertake no commitments and incur no obligations which would impair its abilities to meet its obligations hereunder. PACICC shall provide evidence satisfactory to the Liquidator of its compliance

herewith at the Liquidator's request, failing which the Liquidator may terminate this agreement forthwith on written notice to PACICC.

**ARTICLE III**  
**ADDITIONAL SERVICES**

**3.1 Services**

In addition to making Compensation Payments on behalf of PACICC pursuant to Article II, the Liquidator shall provide such services as PACICC may reasonably require including, without limitation:

- (a) liaising with Policyholders and Third Party Claimants, including answering their questions during regular business hours regarding PACICC's role with respect to their particular claims or relating to any documents contemplated by Section 2.2(b) above;
- (b) calculating the amount of the Compensation Payment to be made to each Policyholder or Third Party Claimant, and keeping appropriate records for PACICC as to how such amounts were calculated;
- (c) sending, notices, brochures, pamphlets, booklets or other items to Policyholders and Third Party Claimants, which PACICC shall provide, as and when PACICC may reasonably request; and
- (d) advising PACICC of any claim which the Liquidator believes, acting reasonably and in good faith, may involve an Ineligible Person, or might reasonably be

considered to be a hardship case contemplated by paragraph 30 of the Memorandum of Operation.

### **3.2 Fees and Expenses**

For its services hereunder, PACICC will pay the Liquidator its reasonable fees calculated on the same basis as the fees charged the estate for any incremental costs, plus goods and services tax. In addition, PACICC will pay the Liquidator's reasonable out-of-pocket expenses in connection with the provision of services hereunder within thirty (30) days of the receipt of proper invoices therefor.

### **3.3 Indemnities**

PACICC agrees to indemnify the Liquidator against any and all losses, liabilities, costs, claims, actions or demands (collectively "Indemnified Claims") which the Liquidator may incur or which may be made against the Liquidator as a result of, or in connection with the Liquidator's services and activities hereunder, other than any Indemnified Claims which arise as a result of the Liquidator's negligence or wilful misconduct.

The Liquidator agrees to indemnify PACICC against any and all Indemnified Claims which PACICC may incur or which may be made against PACICC which arise as a result of the Liquidator's negligence or wilful misconduct in the carrying out of the Liquidator's activities and the provision of the Liquidator's services hereunder.



### **3.4 Standard of Care**

In providing its services hereunder, the Liquidator will act diligently, honestly and in good faith and will exercise that degree of care that a prudent professional would exercise in similar circumstances.

### **3.5 Voluntary Nature of Payments**

The Liquidator acknowledges that the compensation arrangements administered by PACICC are voluntary and will conduct itself and carry out its obligations and duties hereunder accordingly.

### **3.6 Representations and Warranties of PACICC**

PACICC hereby represents and warrants that its obligations hereunder are legal, valid and binding obligations, enforceable in accordance with the terms hereof.

## **ARTICLE IV**

### **TERM AND TERMINATION**

#### **4.1 Term**

This Agreement will commence on the date hereof and continue until the earlier of:

- (a) the Full Recovery Date;
- (b) the issuance of a Demand; and
- (c) termination pursuant to Section 2.5 above or Section 4.2 below.

No termination of this Agreement will prejudice or impair the Liquidator's right to demand repayment of the Amount Outstanding and all interest accrued thereon. The amount of interest payable to PACICC hereunder will be adjusted by the parties forthwith after the Final Realization Percentage is determined.

#### **4.2 Termination**

Either party may terminate this Agreement by giving thirty (30) days written notice of termination to the other party.

### **ARTICLE V GENERAL PROVISIONS**

#### **5.1 Public Disclosure**

The parties shall consult with each other before making any public disclosure or announcement of the subject matter of this Agreement. Any such disclosure or announcement will be mutually satisfactory to the parties, acting reasonably. The foregoing shall not, however, apply if a party is advised by its counsel that certain disclosures or announcements, which the other party after reasonable notice will not consent to, are required to be made by applicable laws, rules or policies of regulatory authorities having jurisdiction.

#### **5.2 Notices**

All notices and other communications required or permitted to be provided under this Agreement shall be in writing and deemed to have been properly given or delivered when delivered personally or sent by telecopy addressed as follows:

- (a) If to the Liquidator: KPMG Inc.

Commerce Court West, Suite 3300  
Toronto, Ontario  
M5L 1B2  
Attention: Robert O. Sanderson

Facsimile: (416) 777-3683

with a copy to:

Goodmans LLP

250 Yonge Street, Suite 2400  
Toronto, Ontario  
M5B 2M6  
Attention: Gale Rubenstein

Facsimile: (416) 979-1234

(b) If to PACICC:

Property and Casualty Insurance Compensation Corporation

20 Richmond St. East, Suite 210  
Toronto, Ontario  
M5C 2R9  
Attention: Alex Kennedy

Facsimile: (416) 364-5889

with a copy to:

Torys

Suite 3000, Maritime Life Tower  
79 Wellington Street West  
Box 270, TD Centre  
Toronto, Ontario  
M5K 1N2  
Attention: Peter B. Birkness

Facsimile: (416) 865-7380

Any notice that is delivered shall be deemed to have been received on the Business Day that it is delivered, or if it is delivered on a day that is not a Business Day, the immediately

following Business Day. Any notice sent by telecopy shall be deemed to have been received at the beginning of the next Business Day following the day of transmission. Either party may change its address for service by notice served on the other party in accordance with the provisions of this Section 5.2.

### **5.3 Assignment**

This Agreement, and the parties' rights and obligations under this Agreement, are not assignable in whole or in part without the prior written consent of the other party, which consent may be withheld in the discretion of the party. Notwithstanding the foregoing, in the event of the appointment of a person replacing KPMG Inc. as liquidator of the Canadian Estate, such party shall automatically and without further formality succeed to the rights and obligations of the Liquidator hereunder.

### **5.4 Enurement**

This Agreement shall enure to the benefit of, and be binding on the parties and their respective successors and permitted assigns.

### **5.5 Waiver**

No waiver by a party of any breach of any of the covenants, conditions and provisos contained in this Agreement shall be effective or binding on that party unless that waiver is expressed in writing.

### **5.6 Amendments**

No amendments to this Agreement shall be effective unless in writing and executed by each of the parties.

**5.7 Counterparts**

This Agreement may be executed in counterparts, and if executed in that manner, shall have the same effect as if the parties had executed the same document.

**5.8 No Personal Liability**

KPMG Inc. is executing this Agreement solely in its capacity as liquidator of the Canadian Estate and shall have no personal liability under or by virtue of this Agreement, whether in tort, contract or under any other legal or equitable theory, except as a result of its gross negligence or wilful misconduct. PACICC's recourse under or by virtue of this Agreement shall be limited to the assets of the Canadian Estate.

**IN WITNESS WHEREOF** the parties have duly executed this Agreement as of the date and year first written above.

**KPMG INC. solely in its capacity as  
Liquidator of the insurance business in  
Canada of Reliance Insurance Company, and  
not in its personal capacity**

Per:

---

**PROPERTY AND CASUALTY  
INSURANCE COMPENSATION  
CORPORATION**

Per:

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## SCHEDULE "D"

*The following memorandum was prepared by Reliance Insurance Company, KPMG Inc., Scotia Capital Inc. and KPMG Corporate Finance Inc. based on publicly available information. The information contained herein is not guaranteed as to accuracy or completeness. This memorandum is for information purposes only and does not constitute an offer to sell or a solicitation to buy the securities referred to herein.*

### **RELIANCE INSURANCE COMPANY (Canada Branch)**

#### **OVERVIEW**

Reliance Insurance Company ("Reliance") is a federally registered property and casualty insurance company headquartered in Philadelphia, Pennsylvania, United States. Reliance's Canadian branch ("Reliance Canada" or the "Branch") operates from a head office located in Toronto, Ontario, Canada. Major lines of business included property, casualty, professional liability, directors & officers, group and association programs. Reliance Canada has been in run-off since September 2000.

As an alternative to the orderly run-off of Reliance Canada, one of the options being considered is an assumption reinsurance transaction for the net insurance liabilities in consideration for cash. Scotia Capital and KPMG Corporate Finance Inc. (the "Co-Advisors") have been engaged to assist in identifying interested parties and arranging an assumption reinsurance transaction.

The key attractions of this opportunity are:

- a large block of seasoned long-tail claims - the business has been in run-off since September 2000;
- portfolio backed in part by reinsurance from highly rated reinsurers - over 80% of the reinsurance cover is with "A" rated reinsurers;
- skilled and highly experienced claims staff – collectively over 177 years of experience;
- potential expense savings by combining with an existing portfolio; and
- opportunity to manage claims and investment portfolio to maximize returns.

Excluded from this transaction is a small block of insurance liabilities and associated reinsurance and other recoverables relating to the vehicle warranty business administered by Meridian Management Inc.

#### **DESCRIPTION OF BUSINESS**

Prior to the commencement of the run-off in September 2000, Reliance Canada historically wrote mainly commercial business including property, general liability and professional liability, and was licensed to transact business in all Canadian provinces and territories.

The Branch largely operated, and continues to operate, independently of Reliance in the United States although it shares certain services, including information technology and selected reinsurance activities. The Branch currently employs 16 people. Claims are handled in Canada by 5 claims examiners with a total of 177 years of cumulative claims experience. The Company's claims staff possesses unique qualifications for dealing with the book of business and may be available for transfer with the book of business.



## INSURANCE LIABILITIES (CON'T)

⇒ At June 30, 2001, the breakdown of net unpaid claims of \$71.9 million was as follows (in \$000):

Business Line	Number Claims	Case Reserve	IBNR	Total Reserve	% of Total
Liability					
General	445	\$13,507	\$23,478	\$36,985	51.4%
E&O	162	\$753	\$4,275	\$5,028	7.0%
D&O	34	\$1,953	\$4,313	\$6,266	8.7%
Malpractice	142	\$6,962	\$846	\$7,808	10.9%
Pollution	80	\$1,759	\$1,946	\$3,705	5.2%
Other	8	\$21	\$0	\$21	0.0%
Commercial Property	261	\$3,110	\$1,139	\$4,249	5.9%
Commercial Automobile	57	\$3,013	\$2,956	\$5,969	8.3%
Other	24	\$805	\$1,076	\$1,881	2.6%
	<u>1,213</u>	<u>\$31,883</u>	<u>\$40,029</u>	<u>\$71,912</u>	<u>100.0%</u>

Province or Territory	Case Reserve	IBNR	Total Reserve	% of Total
Ontario	\$19,879	\$25,235	\$45,114	62.7%
Québec:	\$4,742	\$5,728	\$10,470	14.6%
Alberta	\$3,125	\$4,096	\$7,221	10.0%
British Columbia	\$2,469	\$2,992	\$5,461	7.6%
All others	\$1,669	\$1,977	\$3,646	5.1%
	<u>\$31,884</u>	<u>\$40,028</u>	<u>\$71,912</u>	<u>100.0%</u>



## REINSURANCE

- ⇒ At June 30, 2001, the amounts recoverable from reinsurers (excluding amounts recoverable related to the Meridian block of business) were as follows (in \$000):

Reinsurer Rating <sup>(1)</sup>	Unpaid Claims and Adjustment Expenses	Unearned premiums	Total	% of Total
A++	\$26,383	\$33	\$26,416	43.4%
A+	\$8,812	\$190	\$9,002	14.8%
A	\$6,829	\$208	\$7,037	11.6%
A-	\$8,290	\$13	\$8,303	13.6%
B++	\$1	\$0	\$1	0.0%
B+	\$2,738	\$6	\$2,744	4.5%
Not rated and other	\$7,176	\$155	\$7,331	12.1%
	<u>\$60,229</u>	<u>\$605</u>	<u>\$60,834</u>	<u>100.0%</u>

Notes:

(1) Ratings as determined by A.M. Best Co.

- ⇒ The top 5 reinsurers account for 41.3% of the total amounts recoverable.
- ⇒ The top 10 reinsurers account for 58.4% of the total amounts recoverable.

## CONTACT INFORMATION

Please feel to contact the Co-Advisors in regards to this opportunity at the numbers listed below:

***Scotia Capital Inc***

Paul Hodgson (416) 945-4032  
 Vikas Sharma (416) 945-4282  
 Richard Smith (416) 863-7401

***KPMG Corporate Finance Inc.***

Christian Plumer (416) 777-8995  
 Derek Sutherland (416) 777-3177

**ONTARIO SUPERIOR COURT OF  
JUSTICE  
COMMERCIAL LIST**  
Proceeding commenced at TORONTO

**NOTICE OF MOTION**

**GOODMANS LLP**  
**Barristers & Solicitors**  
**250 Yonge Street, Suite 2400**  
**Toronto, Ontario M5B 2M6**  
Gale Rubenstein (LSUC# 17088E)  
Tel: 416-597-4148  
Fax: 416-979-1234  
Solicitors for KPMG Inc.,  
Liquidator of Reliance (Canada)  
Our File No. 01.6699  
G26\4486202.1