

**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 – CANADIAN BRANCH**

(Motion returnable December 15, 2006)

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RELIANCE INSURANCE COMPANY – CANADIAN BRANCH**

December 8, 2006

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 in Canada of Reliance Insurance Company (“Reliance (Canada)”) for an Order:
 - a) passing the accounts of the Liquidator for the period October 1, 2005 to September 30, 2006 (the “Four Quarters”), as reflected in the financial statements of Reliance (Canada);

- b) approving the professional fees of the Liquidator and of its counsel (the “Professional Fees”) for the Four Quarters;
- c) approving and authorizing a fourth interim distribution of 15% of valid and allowed loss claims (the “Fourth Distribution”), bringing total distributions to 80% thereof, as claims are allowed.

II. OVERVIEW OF THE ESTATE

A. Policy 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;
 - b) valid claims up to the greater of \$250,000 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; and
 - c) valid claims not covered by PACICC, and claims under the Meridian program, up to \$25,000

(collectively, the “Policy Payments”).

A copy of the order appointing the Liquidator and authorizing the Policy Payments is attached as Schedule “A” (the “Appointment Order”). This Court has extended the date

for making the Policy Payments from time to time, the latest extension being to further order of the Court.

3. This Court further approved, on June 26, 2003, a first interim distribution (the “First Distribution”) to policyholders and claimants of 25% of their valid and allowed claims.
4. On September 2, 2004, this Court approved a second interim distribution (the “Second Distribution”) to policyholders and claimants of a further 25% of their valid and allowed claims, bringing the total distributions to 50%.
5. On December 21, 2005, this Court further approved a third distribution to policyholders and claimants of a further 15% of their valid and allowed claims, bringing the total distribution to 65% (the “Third Distribution”).
6. The Liquidator therefore now pays policyholders and claimants the greater of (i) the Policy Payments and (ii) the cumulative First, Second and Third Distributions.

B. Proposed Fourth Distribution

7. The Liquidator has continued to make progress in the administration of the estate since the approval of the Third Distribution. Small claims continue to be closed on an efficient basis, with the use of third party administrators where appropriate, including on programs such as Meridian, Family and Groupe PPP (described below). Further complex claims have been resolved during the Four Quarters. The collection of reinsurance from some markets continues to prove challenging, however the Liquidator continues to pursue

collection of reinsurance. The reinsurance market has generally been difficult, and collection problems are an industry-wide issue.

8. Based on the Liquidator's continuing experience with the estate, the Liquidator remains confident that all policyholders will receive full payment on all valid claims. As at September 30, 2006, the surplus on the financial statements was approximately \$78.8 million. However, there still remain uncertainties in the estate and the Liquidator is not in a position to make full payment at this time. To further alleviate hardship to policyholders whose claims are not satisfied by the Policy Payments, the Liquidator proposes to make a fourth interim distribution of 15% of valid loss claims, bringing total distributions to 80% on all claims as they are allowed.

C. The Future of the Estate

9. The Liquidator will continue the run-off of Reliance (Canada)'s business in an orderly manner, dealing with policy liabilities and collection of reinsurance on a commercially reasonable basis, seeking the approval of the Court for further interim distributions as appropriate. Given the nature of Reliance (Canada)'s business, the process can be expected to take many years. The consulting actuary retained by the Liquidator to calculate actuarial liabilities estimates that the run-off will continue to 2019, but the number of payments will begin to decline after 2007. However, based on current information and assuming no unforeseen negative developments, the Liquidator is optimistic that payment of 100% of valid loss claims will be reached by the end of 2008.

10. As previously reported, the Liquidator pursued in 2004 an intensive marketing program for the policy liabilities. This did not result in a transaction. The Liquidator has continued and will continue to monitor market conditions and use all reasonable efforts to find innovative approaches to expedite the completion of the liquidation.

III. BACKGROUND

A. General Background

11. 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” (winding-down) its existing business.
12. 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”).
13. By Orders of this Court made December 3, 2001, the insurance business of Reliance (Canada) was ordered wound-up pursuant to the provisions of the *Winding-up and Restructuring Act*, and KPMG Inc. was appointed provisional liquidator.

14. In the Appointment Order (Schedule “A” hereto), this Court appointed the U.S. Liquidator and PACICC as inspectors. By order dated January 30, 2002, this Court ordered that the Superintendent of Financial Institutions of Canada (the “Superintendent”) may attend meetings of inspectors, be included in the service list, and attend and be heard in matters before this Court.
15. The inspectors are not opposing this motion. Also, the Superintendent has advised that it takes no position on this motion.

B. Reliance (Canada)’s Insurance Business

16. Reliance (Canada) wrote a very diverse set of policies. Within the classes of liability insurance that it wrote, Reliance (Canada) specialized in providing coverage for professional liability, directors’ and officers’ liability, pollution and environmental liability and product liability. While some of Reliance (Canada)’s policies were “claims made”, meaning that claims must be reported during the term of the policy or within a defined period thereafter, a substantial portion of its policies were “occurrence” based. These occurrence based policies cover liabilities incurred during the policy period that may not become manifest for years. This business is known as “long tail” insurance. The policyholders themselves have no way of predicting what claims they may incur.
17. Reliance (Canada) also wrote policies with lengthy policy periods.

18. In addition, Reliance (Canada) acted as a reinsurer for other insurers. “Assumed Reinsurance” is treated as insurance under the *Insurance Companies Act*, and is accorded the same priority as policy loss claims under the *Winding-up and Restructuring Act*.
19. In October 2000, Reliance (Canada) voluntarily stopped writing new policies, effectively winding down its business. At the beginning of the liquidation, excluding the warranty programs, there were 16 policies still in force with all other policies having expired or been cancelled, and over 1,100 claims. In addition, Reliance (Canada) had “incurred but not reported” (“IBNR”) claims for which it may ultimately be put on notice and to which it will have to respond, primarily on the occurrence-based policies.
20. As at September 30, 2006 there were 283 open claims, and one policy remained in force. The last certificates in the Meridian program will expire July 31, 2007. (As at September 30, 2006 there were no open claims under the warranty programs.)

IV. FINANCIAL STATUS OF THE ESTATE

A. Overview

21. The First Distribution was based on the financial status of the estate at March 31, 2003. Copies of the Order of this Court dated June 26, 2003 approving and authorizing the First Distribution and of the Liquidator’s Report in support thereof (without schedules) are attached as Schedules “B” and “C” respectively.
22. The Second Distribution was based on the financial status of the estate at June 30, 2004. Copies of the Order of this Court dated September 2, 2004 approving and authorizing the

Second Distribution and of the Liquidator's Report in support with relevant schedules are attached as Schedules "D" and "E" respectively.

23. The Third Distribution was based on the financial status of the estate at September 30, 2005. Copies of the Order of this Court dated December 21, 2005 approving and authorizing the Third Distribution and of the Liquidator's Report in support with relevant schedules are attached as Schedules "F" and "G" respectively.
24. This Court has also passed and approved the accounts of the Liquidator for the periods (i) from the winding-up order to September 30, 2003, (ii) from October 1, 2003 to June 30, 2004 and from (iii) July 1, 2004 to September 30, 2005, as reflected in the Orders referenced above.
25. Attached as Schedule "H" are the unaudited financial statements for the estate as at September 30, 2006, prepared in a manner consistent with the financial statements before this Court as at September 30, 2005, and with the same system of internal controls to safeguard the accuracy and reliability of the financial reporting process.
26. In this Report, the Liquidator will generally compare the financial status of the estate at September 30, 2006 to its status at September 30, 2005.
27. As noted in previous Reports, a key characteristic of the Reliance (Canada) claims profile is its "lumpiness." That is, a significant number of its policies do not have frequent claims, but, if claims occur, they are severe. As further progress is made in dealing with the claims and more information becomes available on which to assess them, the

Liquidator adjusts the policy liabilities. In particular, where claims are resolved for amounts lower than the amounts reserved for them, the policy liabilities are reduced, and where more information becomes available to indicate a higher exposure than has been reserved, the policy liabilities are increased. Increases also have the effect of increasing the reinsurance recoverables since these claims are generally reinsured at significant levels. Such fluctuations in the level of surplus are to be expected, given the volatility of the portfolio.

28. The estate surplus has been increased from \$70 million at September 30, 2005 to \$78.8 million at September 30, 2006. This increase is largely as result of the net IBNR being reduced by \$6.5 million. An actuarial review was completed at the end of March 2006, and showed the reported losses were less than expected over the preceding year, which resulted in a lower IBNR.

B. Assets

Vested Assets

29. 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*.

30. As at the commencement of the liquidation the Vested Assets consisted of cash or investments in the amount of approximately \$171 million. The Liquidator has been making the Policy Payments (or the cumulative payments on claims, where the dividend amount is higher), and paying the costs and expenses of the liquidation. It has collected reinsurance and subrogation proceeds. As at September 30, 2006, the cash or investments total approximately \$148.9 million.

Reinsurance

31. 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”); and
 - 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*.
32. The percentage of Reliance (Canada)’s case reserves that is reinsured changes over time as the composition of the case reserves changes. As at September 30, 2005 approximately 47% of Reliance (Canada)’s gross case reserves were reinsured. Of this amount, approximately 76% was Canadian Reinsurance and 24% was International Reinsurance. As at September 30, 2006, approximately 47% of Reliance (Canada)’s gross case reserves were reinsured, approximately 71% of which was Canadian Reinsurance and

29% International Reinsurance. These percentages do not reflect estimates for uncollectible reinsurance due to credit, collection or contractual risk. Over 74.8% of the reinsurance reserves as at September 30, 2006 is with reinsurers rated “A” or higher.

33. By September 30, 2006, the Liquidator had collected approximately \$72.5 million in reinsurance since the beginning of the liquidation, with \$25 million of this since September 30, 2005. The U.S. Liquidator has collected International Reinsurance in the amount of U.S. \$159,000 on behalf of Reliance (Canada), which has not yet been forwarded to Reliance (Canada). In addition, reinsurance receivables (amounts billed to reinsurers), net of a provision for uncollectible reinsurance, were \$11.97 million at September 30, 2006, down from \$26.8 million at September 30, 2005. Reinsurance recoverables (amounts referable to (i) reported claims not yet billed and (ii) IBNR), net of a provision for uncollectible reinsurance, were \$36.9 million, down from \$44.8 million at September 30, 2005. Since September 30, 2006 the Liquidator has collected an additional sum of \$2.6 million.

Summary

34. As at September 30, 2005, the value of Reliance (Canada)’s assets was \$219.6 million, and cumulative claims and related expenses paid from the commencement of the liquidation to September 30, 2005 totalled \$94.7 million. As at September 30, 2006, the value of Reliance (Canada)’s assets was \$201.4 million. Cumulative claims and related expenses paid totalled \$112.5 million. Below is a summary breakdown for the estate as of September 30, 2006, September 30, 2005 and June 30, 2004:

	September 30, 2006 (in millions)	September 30, 2005 (in millions)	June 30, 2004 (in millions)
Cash or Investments	\$148.8	\$142.2	\$155.1
Reinsurance receivables and recoverables net of estimate for uncollectible reinsurance	\$46.9	\$71.7	\$104.1
Miscellaneous	\$5.7	5.7	\$ 6.4
Total	\$201.4	\$219.6	\$265.6
Cumulative claims and related expenses paid	\$112.5	\$94.7	\$43.3

C. Liabilities

35. The Liquidator retained a third party actuary to perform further actuarial and claims reviews since the Third Distribution. At September 30, 2005, the estimated value of the policy liabilities was \$140.7 million. As at September 30, 2006, the estimated value was \$113.6 million, determined as described below.

No Call for Claims to Date

36. 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 inefficient at this point, 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

37. There are basically three categories of loss claims:

- a) claims that are settled or otherwise resolved (the “Resolved Claims”). Since the Third Distribution, the Liquidator has resolved approximately 767 claims having a total value \$11.2 million. As at September 30, 2006:
 - (i) approximately 18,031 claims having a total value of \$115.3 million have been resolved, through settlement or otherwise, since the beginning of the liquidation;
 - (ii) of those, the Liquidator paid 754 claims in full for approximately \$9.8 million since the Third Distribution, bringing the total claims paid in full in accordance with the Court authorized Policy Payments to approximately 17,971 claims having a value of approximately \$55.5 million; and
 - (iii) the remaining 60 claims either do not qualify for PACICC coverage or exceed PACICC limits. Policy Payments (or, if greater, the cumulative distribution amount of 65%) have been made on account of these claims in

the amount of \$39.2 million but a balance of \$20.3 million remains outstanding;

- b) claims that have been reported but not yet resolved (the “Reported Claims”). As at September 30, 2006, there were approximately 283 Reported Claims outstanding, down from 379 at September 30, 2005, but outstanding gross case reserves were reduced by approximately \$10.9 million, from approximately \$51.1 million to \$40.2 million. Case reserves are adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. (As discussed earlier, this change reflects the volatility and “lumpiness” of Reliance (Canada)’s portfolio); and
- c) the provision for IBNR and for deficiencies in Reported Claims.

Non-Booked Claims

- 38. As described in previous reports, there may be claims not reported in the books of Reliance (Canada) that 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.
- 39. The U.S. Liquidator has agreed that her staff will advise the Liquidator if they identify any Non-Booked Claims, including as a result of the U.S. call for claims that expired on December 31, 2003.

40. 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). It is important to note that the U.S. Liquidator believes the open claims identified as having a possible nexus with Canada are in fact claims that, if valid, would participate in the U.S. estate.
41. If necessary to resolve the issue, the Liquidator will be seeking the directions of this Court with respect to any claim of a party who believes they have a Non-Booked Claim properly assertable against Reliance (Canada) to be brought forward, and with respect to whether the alleged Non-Booked Claim should be allowed in the Canadian estate.

Liability Claims Projection Process

42. The Liquidator has applied the same basic methodology in projecting the policy liabilities as for the Third Distribution. The Liquidator has undertaken an extensive review of the policy liabilities, including retaining the services of the consulting actuary who acted for Reliance (Canada) before it was wound up. Representatives of the U.S. Liquidator have also reviewed the largest case reserves on which there is the greatest volatility and have shared their results, which the Liquidator has taken into account in establishing the policy liabilities.

43. 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.

44. 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. In going concern situations, this may be considered appropriate.

45. The Liquidator instructed the actuaries to confirm their best estimate of the policy liabilities in accordance with accepted actuarial standards. The Liquidator then carefully reviewed the assumptions underlying the actuarial estimates, and introduced some further elements of conservatism in reaching the estimate of \$113.6 million for policy liabilities.

V. MAJOR ACTIVITIES OF THE LIQUIDATOR

A. Administration

46. On being appointed, the Liquidator considered Reliance (Canada)'s complex claims, and the seniority and reputation of its employees, and consulted with the U.S. Liquidator and PACICC. The Liquidator determined that the best interests of the estate would be served by maintaining continuity, to the extent possible, through retaining existing Reliance (Canada) staff and that this would result in cost savings. At the beginning of the liquidation there were 17 employees. As at September 30, 2006, 6 employees remained.
47. Reliance (Canada) employees perform day-to-day administration, including instructing defence counsel and outside adjusters, dealing with counsel on coverage issues, administering reinsurance collections, performing accounting and financial reporting with respect to claims and reinsurance issue functions, and liaising with PACICC and employees of the U.S. estate.
48. The Liquidator maintains responsibility for the conduct of the liquidation. The Liquidator is responsible for all strategic initiatives and major decisions and, as appropriate, is involved in supervising and augmenting, where necessary, the day-to-day activities performed by former Reliance (Canada) employees. The Liquidator performs the functions specific to the liquidation, including the development of policies and procedures for claims handling and authorities, the institution of internal controls, reporting to the Court and stakeholders, supervising and coordinating legal counsel, monitoring developments in the U.S. liquidation, and providing insureds with

information. The Liquidator reviews all claims decisions involving claims that meet criteria established in co-operation with PACICC and the U.S. Liquidator, performs the financial reporting, is actively involved in reinsurance collections, makes all investment decisions, and instructs and consults with the actuary. A further summary of the Liquidator's activities is set out below.

B. Third Party Administrators

49. Reliance (Canada) also had arrangements with third party administrators who were responsible for the administration of claims in a number of programs, the major ones including:
- a) Meridian;
 - b) Groupe PPP, a financial guarantee program underwritten in the U.S., covering automobile dealers in Quebec;
 - c) Gap Program, a financial warranty program;
 - d) Family Program, a personal lines program in British Columbia; and
 - e) Environmental Program, administered by ECS Inc. in the U.S.
50. Each of the programs is unique in respect of the volume, magnitude and complexity of its claims, and with respect to the discretion accorded the third party administrators. In each case, the Liquidator reviewed the program and the nature of the relationship between the administrator and Reliance (Canada). In assessing the continued use of the third party

administrators, the Liquidator considered their cost, the potential prejudice if the administration were disrupted and the quality of their work. As previously reported the Liquidator determined that it was appropriate to maintain the relationships, but introduced additional controls and reporting requirements, as it considered necessary, and regularly reviews the status of the administrations.

51. During the Four Quarters, it became apparent that a contracted third party for the Meridian program was not able or willing to perform its responsibilities, and the Liquidator took steps to remove the role of this party from the administration of that program. The administrator that had the operational day-to-day responsibility for the Meridian book has now assumed sole responsibility.

C. Stakeholders

PACICC

52. The Liquidator entered into a loan and services agreement with PACICC on December 3, 2001, approved by this Court in the Appointment Order.
53. PACICC approves payments in respect of claims in excess of \$25,000, to which it responds, in accordance with its Memorandum of Operations. The Liquidator regularly consults with PACICC concerning the progress of the estate.

U.S. Liquidator

54. By virtue of ss. 161(9) of the *Winding-up and Restructuring Act*, the U.S. Liquidator has an on-going interest in the administration of Reliance (Canada). Furthermore, before the liquidation, Reliance (Canada) depended on Reliance for many services, including information services and technology. In addition Reliance underwrote insurance policies which were later allocated to Reliance (Canada), entered into reinsurance treaties which also covered Reliance (Canada) liabilities and collected reinsurance proceeds on its behalf, and had ultimate decision-making power for setting Reliance (Canada)'s claims reserves and settlement.
55. Accordingly, to prevent disruption to the administration of Reliance (Canada) and in recognition of the U.S. Liquidator's financial interest in the Canadian estate, the U.S. Liquidator, the Superintendent and the Liquidator entered into the protocol dated November 28, 2001, attached as Schedule "I" (the "Protocol"), providing for cooperation with respect to use of information systems, collection of reinsurance, administration of claims, and the sale process for the policy liabilities. The Protocol remains in force and close co-operation between the two Liquidators continues. However, the Liquidator remains cognizant at all times of balancing the interests of all stakeholders.

Policyholders

56. The Liquidator has been in regular contact with policyholders, third party claimants and counsel concerning the financial status of the estate, particularly with respect to both the timing and quantum of future distributions. The Liquidator recognizes the difficulties the

liquidation poses, particularly at the time of claims settlement discussions, and has been as open and helpful as appropriate in the circumstances.

Reinsurers

57. With respect to its efforts to collect reinsurance proceeds, the Liquidator has also been in regular contact with reinsurers.
58. Through extensive efforts, including meetings with U.K. reinsurers in London, the Liquidator has made progress in reinsurance collections. This is evidenced by the increase in reinsurance collections discussed in this Report. However, the Liquidator anticipates that significant further effort will be required to maximize future reinsurance recoveries. An ongoing issue in reinsurance collections is the inter-relationship between the Canada and U.S. estates.
59. The Liquidator has continued to respond to a very significant development in the reinsurance market, namely the first importation into Canada of a “solvent scheme of arrangement” by Cavell Insurance Company Limited (“Cavell”), a U.K. reinsurer of Reliance (Canada).
60. The Liquidator has previously reported on the significance of solvent schemes of arrangement on reinsureds such as Reliance (Canada). Accordingly, as also discussed previously, the Liquidator has taken care to attempt to respond to Cavell’s scheme of arrangement appropriately, including participating in the application brought by Cavell in this Court for an order to recognize and give other relief in respect of the U.K. Court’s

proceeding. During the Four Quarters, the Liquidator participated in the appeal to the Court of Appeal of the disposition of the application, which appeal was dismissed but confirmed the several important conditions that had been imposed on the recognition of the U.K. Court's proceeding.

61. The Liquidator has continued discussions with representatives of Cavell toward a possible resolution and/or commutation of Cavell's reinsurance. The Liquidator continues to monitor the situation and consider its options in respect of the Cavell scheme in the U.K. Court, to protect the interests of the Canadian estate.

D. Summary of Activities

62. In summary, the Liquidator's major activities for the Four Quarters included:
 - a) Claims adjudication and administration – including:
 - (i) overseeing payment of defence and adjustment costs;
 - (ii) overseeing a comprehensive review of all claims including estimating range of possible outcomes;
 - (iii) engaging in extensive discussions with policyholders, claimants and their counsel concerning the estate, including its financial status; and
 - (iv) settling or otherwise resolving 767 claims having a value of \$11.2 million.
 - b) Reinsurance, including:

- (i) reconciling accounts;
 - (ii) enforcing liquidation clauses;
 - (iii) clarifying set-off issues;
 - (iv) discussions with Cavell and participating in court proceedings with respect to its scheme of arrangement;
 - (v) entering into agreements with reinsurers and the U.S. Liquidator to facilitate collection of both the Canadian and the International Reinsurance; and
 - (vi) collecting receivables, including direct communication with reinsurers, several visits with U.K. reinsurers in London, and cooperative efforts with the U.S. Liquidator;
- c) reviewing and amending as necessary the investment policy and managing investments in consultation with its investment manager;
 - d) reporting regularly to PACICC and the U.S. Liquidator;
 - e) performing extensive review of policy liabilities as at March 31, 2006;
 - f) maintaining the external website; and
 - g) continuing monitoring and auditing of the U.S. liquidation, and discussions with the U.S. Liquidator, with respect to cross-border issues and other matters that

impact the Canadian estate, including significant issues with respect to reinsurance collections.

VI. LIQUIDATOR'S ACCOUNTS AND PROFESSIONAL FEES

A. Financial Statements

63. As in the past, the Liquidator does not consider that a traditional statement of receipts and disbursements would provide a meaningful and informative reflection of the financial position of the estate. The Liquidator has therefore prepared the financial statements (unaudited), attached as Schedule "H".

64. The financial statements have been prepared in a manner consistent with the statements approved previously by this Court. The Liquidator maintains a system of internal controls to safeguard the accuracy and the reliability of the financial reporting process.

B. Professional Fees

65. The Liquidator retains professional advisors to assist in the administration of the liquidation from time to time. The Liquidator is familiar with the services provided by each of the professional advisors and has reviewed their invoices. Detailed invoices were timely received and carefully reviewed in detail by senior administrative and management level members of the Liquidator's staff. The invoices were reviewed for accuracy, adequate detailed information describing the work performed and by whom, the time spent and when it was spent, the rate and amount billed, possible duplicative

charges, reasonableness and overall compliance with the terms of retention. Clarifications and adjustments of items included in the invoices were requested where it appeared appropriate.

66. The Liquidator believes that the Professional Fees of its advisors are proper, fair and reasonable and were incurred in furtherance of the best interests of the estate of Reliance (Canada).

Goodmans LLP

67. Goodmans LLP (“Goodmans”) has acted as counsel to the Liquidator from the commencement of the liquidation and has acted or advised on all matters described in this report. The Liquidator is familiar with its services and has reviewed its invoices in detail and with the care described above.
68. At the commencement of the liquidation, Goodmans agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79%, effective October 1, 2003, reflecting the change in the Consumer Price Index over the two year period. The discount from its current market rates is approximately 20% to 30%.
69. Attached as Schedules “J”, “K” and “L”, respectively, are:
- a) a summary invoice from Goodmans to the Liquidator for the Four Quarters;

- b) a summary of the hours and average hourly rates of each of Goodmans' personnel who dedicated more than 30 hours to the estate; and
 - c) a brief description of the areas of concentration of each of Goodmans' personnel who dedicated more than 30 hours to the estate.
70. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.
71. The Liquidator is satisfied that Goodmans' fees are proper, fair and reasonable, that time was appropriately spent and that Goodmans' fees were incurred in furtherance of the best interests of the estate.

KPMG Inc.

72. The Liquidator has kept careful and detailed records of all time spent by Liquidator personnel on the estate. The Liquidator has instituted internal controls to ensure no duplicative or inappropriate charges are made. The Liquidator applied the same standard for review to its accounts as to accounts of other professionals, described above. As discussed above, the Liquidator maximized efficiency and reduced costs by retaining former Reliance (Canada) employees and third party administrators where prudent and appropriate.
73. At the commencement of the liquidation, the Liquidator agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for

one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79%, effective October 1, 2003, and an additional 2.4% effective October 1, 2004, and 3.4% effective October 1, 2005, reflecting the changes in the Consumer Price Index. The discount from current market rates is approximately 20% to 30%.

74. Attached as Schedules "M", "N" and "O", respectively, are:
 - a) an invoice from the Liquidator to the estate for the Four Quarters;
 - b) Summaries for each of the four Quarters of the hours and average hourly rates of each of the Liquidator's personnel who dedicated more than 30 hours to the estate; and
 - c) a brief description of the areas of concentration of each of such of the Liquidator's personnel.

75. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.

76. The Liquidator respectfully requests that this Court pass the accounts of the Liquidator, as reflected in the financial statements, and approve the Professional Fees.

VII. FOURTH DISTRIBUTION

A. Scheme of Distribution

77. 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, being 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. 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. Approach to Distribution

78. As with the First, Second and Third Distributions, the Liquidator has introduced further elements of conservatism, beyond those in the loss projection methodology, 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) Two major sources of uncertainty remain in the estate: reinsurance and Non-Booked Claims. To deal with these uncertainties in this distribution, the Liquidator is ascribing no value to reinsurance that has not been collected, and is building into the assumptions conservative values for the Non-Booked Claims.
79. The Liquidator is also taking into account \$2.6 million collected on reinsurance since September 30, 2006.
80. Based on the foregoing and in light of the remaining uncertainties described above, the Liquidator recommends a further distribution at this time of 15% of valid policyholder loss claims, bringing the total distributions to 80%. This distribution level is 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

81. If the Fourth 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 it received before the date of the distribution, in accordance with paragraph 12 of the Appointment Order. In effect, those Policy Payments are treated as

advances on the distribution. The Liquidator will pay the higher of the Policy Payments and the total distributions on valid policyholder claims.

82. PACICC compensated claims are deemed to be assigned to PACICC under paragraph 15 of the Appointment Order. However, the Liquidator has made the PACICC Policy Payments, which were treated as a loan to PACICC under the loan agreement dated the 3rd day of December 2001, approved by this Court in the Appointment Order. The distributions accordingly reduce the amount outstanding thereunder.

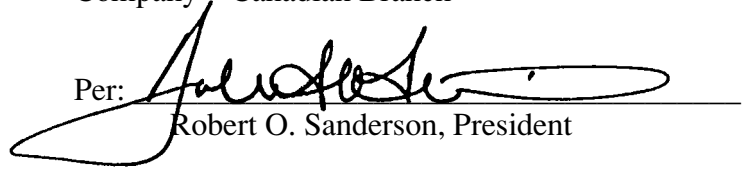
VIII. RECOMMENDATIONS

83. 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 this Court approve the Fourth Distribution of 15% on all valid and allowed loss claims, to be calculated as set out above, bringing total distributions to 80%, as claims are allowed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,

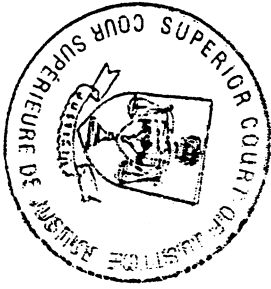
KPMG INC., the Liquidator of Reliance Insurance
Company – Canadian Branch

Per:

A handwritten signature in black ink, appearing to read "Robert O. Sanderson", is written over a horizontal line. The signature is fluid and cursive, with a large loop at the end.

Robert O. Sanderson, President

GOODMANS'SMITHG5372400.8



Schedule "A"

Court File No. 01-CL-4313

**ONTARIO
SUPERIOR COURT OF JUSTICE**

COMMERCIAL LIST

THE HONOURABLE) MONDAY THE 3RD DAY
MR. JUSTICE FARLEY) OF DECEMBER, 2001
)
)
)

**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

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.

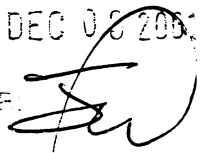
35. THIS COURT ORDERS that the Liquidator shall be at liberty to apply reasonable amounts against its remuneration, expenses and disbursements on a monthly basis and that such amounts shall constitute advances against its remuneration and expenses on, but subject to, the passing of its accounts.

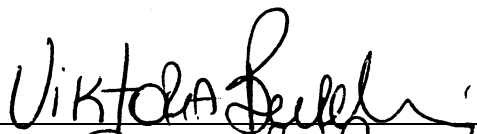
36. THIS COURT ORDERS that this Order and any other orders in these proceedings shall have full force and effect in all Provinces and Territories in Canada.

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.

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

ORDER

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Charles F. Scott LSUC# 14534N
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Solicitors for the Applicant

Schedule "B"

Court File No. 01-CL-4313



**ONTARIO SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**THE HONOURABLE
MR. JUSTICE FARLEY**

) THURSDAY, THE 26th DAY
)
) OF JUNE, 2003

**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

ORDER

THIS MOTION, brought by KPMG Inc., liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company ("Reliance (Canada)"), was heard this day at 393 University Avenue, Toronto, Ontario.

ON READING the Report of the Liquidator dated June 20, 2003, filed, the Order of this Court dated December 3, 2001 appointing the Liquidator (the "Appointment Order") and the Orders of this Court dated January 30, 2002, April 29, 2002, May 8, 2002, December 6, 2002

and March 26, 2003 (collectively the "Extension Orders"), and on hearing submissions of counsel for the Liquidator and counsel for Maritime Road Development Corporation, no one else appearing although properly served as appears from the proof of service filed:

1. **THIS COURT ORDERS** that the service of the Notice of Motion and materials herein is good and sufficient service of this motion, that the motion is properly returnable before this Court and that further service thereof upon any interested party other than those parties served be and is hereby dispensed with.

2. **THIS COURT ORDERS** that paragraphs 8, 9 and 11 of the Appointment Order, amended by the Extension Orders, are hereby further amended *nunc pro tunc* to extend the date of June 30, 2003 to December 31, 2003 or such later date as this Court may order.

3. **THIS COURT ORDERS** that the Liquidator is hereby authorized to pay a first interim distribution from the estate of Reliance (Canada) in the amount of 25% of valid and allowed policyholder loss claims, where such amount exceeds the payments authorized by paragraphs 8 and 9 of the Appointment Order.


Registrar

ENTERED AT/INSCRIT À TORONTO
ON/BOOK NO:
LE/DANS LE REGISTRE NO:

JUN 26 2003

PER/PAR:

NB

**ONTARIO SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceeding commenced at Toronto

ORDER

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Solicitors for KPMG Inc.,
Liquidator of Reliance (Canada)

**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:

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- and -

RELIANCE INSURANCE COMPANY

Respondent

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

June 20, 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
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B E T W E E N:

THE ATTORNEY GENERAL OF CANADA

Applicant

- and -

RELIANCE INSURANCE COMPANY

Respondent

June 20, 2003

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 3rd 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

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

THE HONOURABLE) THURSDAY, THE 2nd DAY
MR. JUSTICE FARLEY) OF SEPTEMBER, 2004

**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**

BETWEEN:

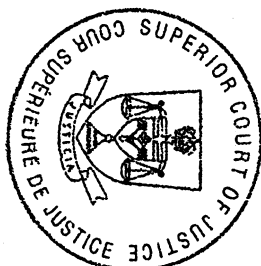
THE ATTORNEY GENERAL OF CANADA

Applicant

- and -

RELIANCE INSURANCE COMPANY

Respondent



ORDER

THIS MOTION, brought by KPMG Inc., liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company ("Reliance (Canada)"), was heard this day at 393 University Avenue, Toronto, Ontario.

ON READING the Report of the Liquidator dated August 25, 2004 (the "Report"), the Affidavit of Gale Rubenstein sworn August 25, 2004 and the Affidavit of Robert O. Sanderson sworn August 25, 2004, filed, and on hearing submissions of counsel for the

Liquidator, no one else appearing although properly served as appears from the proof of service, filed:

1. **THIS COURT ORDERS** that the service of the Notice of Motion and materials herein is good and sufficient service of this motion, that the motion is properly returnable before this Court and that further service thereof upon any interested party other than those parties served be and is hereby dispensed with.

2. **THIS COURT ORDERS** that the accounts of the Liquidator for the period October 1, 2003 to June 30, 2004, as reflected in the financial statements of Reliance (Canada) attached to the Report, be and they are hereby passed and approved as submitted.

3. **THIS COURT ORDERS** that the fees and disbursements of the Liquidator and of its counsel, Goodmans LLP, for the period October 1, 2003 to June 30, 2004 be and they are hereby approved as submitted.

4. **THIS COURT ORDERS** that the Liquidator is hereby authorized to pay up to \$25,000 on valid claims under the Meridian program, until further order of this Court.

5. **THIS COURT ORDERS** that the Liquidator is hereby authorized to pay a second interim distribution from the estate of Reliance (Canada) in the amount of 25% of valid and allowed policyholder loss claims, where, and to the extent that, such amount combined with the amount of payment by way of the first interim distribution exceeds the payments authorized by either paragraph 8 of the Order of this Court dated December 3, 2001 *inter alia* appointing the Liquidator or paragraph 4 hereinabove.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

SEP 07 2004

PER/PAR: 



DAVID EVANS
REGISTRAR

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

Proceeding commenced at Toronto

ORDER

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Liquidator of Reliance (Canada)

GOODMANS\PAQUET\TFR5046595.1

**ONTARIO
SUPERIOR COURT OF JUSTICE
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**REPORT OF KPMG INC., THE LIQUIDATOR OF
RELIANCE INSURANCE COMPANY – CANADIAN BRANCH**

August 25, 2004

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B E T W E E N:

THE ATTORNEY GENERAL OF CANADA

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- and -

RELIANCE INSURANCE COMPANY

Respondent

August 25, 2004

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) passing the accounts of the Liquidator for the period October 1, 2003 to June 30, 2004 (the "Three Quarters"), as reflected in the financial statements of Reliance (Canada);
- b) approving the professional fees of the Liquidator and of its counsel (the "Professional Fees") for the Three Quarters;

- c) authorizing the Liquidator to pay up to \$25,000 on valid claims under the Meridian program; and
- d) approving and authorizing a second interim distribution of 25% of valid and allowed loss claims (the “Second Distribution”), bringing total distributions to 50% thereof, as claims are allowed.

II. OVERVIEW OF THE ESTATE

A. Policy 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;
- 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; 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,

(collectively, the “Policy Payments”).

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

3. This Court further approved a first interim distribution (the “First Distribution”) to policyholders and claimants of 25% of their valid and allowed claims on June 26, 2003. The Liquidator therefore now pays policyholders and claimants the higher of the Policy Payments and the First Distribution.

B. Second Distribution

4. The Liquidator has made progress in the administration of the estate since the approval of the First Distribution. Small claims continue to be closed on an efficient basis, with the use of third party administrators where appropriate, including on programs such as Meridian, Family and Groupe PPP (described below). A number of large complex claims have also now been resolved. Reinsurance collections are improving, in part because outstanding issues with reinsurers that involve the U.S. estate are being resolved. However, the reinsurance market has generally been difficult, and collection problems are an industry wide issue.

5. Based on the Liquidator's continuing experience with the estate, the Liquidator remains confident that all policyholders will receive full payment on all valid claims. As at June 30, 2004, the surplus on the financial statements was \$42.9 million. However, there remain uncertainties in the estate and the Liquidator is not in a position to make full payment at this time. To further alleviate hardship to policyholders whose claims are not satisfied by the Policy Payments, the Liquidator proposes to make a second interim distribution of 25% of valid loss claims, bringing total distributions to 50% on all claims as they are allowed.

C. The Future

6. The Liquidator will continue the run-off of Reliance (Canada)'s business in an orderly manner, dealing with policy liabilities and collection of reinsurance on a commercially reasonable basis, seeking the approval of the Court for further interim distributions as appropriate. Given the nature of Reliance (Canada)'s business, the process can be expected to take many years. The consulting actuary estimates that the run-off will continue to 2018, but the number of payments will begin to decline after 2007. However, based on current information and assuming no unforeseen negative developments, the Liquidator is optimistic that payment of 100% of valid loss claims will be reached by 2007.

7. As previously reported, the Liquidator pursued an intensive marketing program for the policy liabilities last year, which did not result in a transaction. The market for the sale of policy liabilities now appears to be improving. Several parties have contacted the Liquidator to ask

very preliminary questions concerning the estate, and the possibility of acquiring the liabilities. Although the Liquidator believes that the improving reinsurance collections and the resolution of certain of the problematic claims will have a positive effect on their marketability, the Liquidator does not consider that the costs of a formal disposition program for Reliance (Canada)'s liabilities are warranted at this time. The Liquidator will continue to monitor market conditions and use all reasonable efforts to find innovative approaches to expedite the completion of the liquidation.

III. BACKGROUND

A. General Background

8. 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.

9. 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”).

10. By Orders of this Court made December 3, 2001, the insurance business of Reliance (Canada) was ordered wound-up pursuant to the provisions of the *Winding-up and Restructuring Act* and KPMG Inc. was appointed provisional liquidator.

11. In the Appointment Order, this Court appointed the U.S. Liquidator and PACICC as inspectors. By order dated January 30, 2002, this Court ordered that the Superintendent of Financial Institutions of Canada (the “Superintendent”) may attend meetings of inspectors, be included in the service list, and attend and be heard in matters before this Court.

12. The inspectors and the Superintendent are not opposing this motion.

B. Reliance (Canada)'s Insurance Business

13. Reliance (Canada) wrote a very diverse set of policies. Within the classes of liability insurance that it wrote, Reliance (Canada) specialized in providing coverage for professional liability, directors' and officers' liability, pollution and environmental liability and product liability. While some of Reliance (Canada)'s policies were "claims made", meaning that claims must be reported during the term of the policy or within a defined period thereafter, a substantial portion of its policies were "occurrence" based. These policies cover liabilities incurred during the policy period that may not become manifest for years. This business is called "longtail". The policyholders themselves have no way of predicting what claims they may incur. Reliance (Canada) also wrote policies with lengthy policy periods. In addition, Reliance (Canada) acted as a reinsurer for other insurers. "Assumed Reinsurance" is treated as insurance under the *Insurance Companies Act*, and is accorded the same priority as loss claims under the *Winding-up and Restructuring Act*.

14. In October 2000, Reliance (Canada) voluntarily stopped writing new policies, effectively winding down its business. At the beginning of the liquidation, excluding the warranty programs, there were 16 policies still in force with all other policies having expired or been cancelled, and over 1100 claims. In addition, Reliance (Canada) had "incurred but not reported" ("IBNR") claims for which it will ultimately be put on notice and to which it will have to respond, primarily on the occurrence-based policies.

15. As at June 30, 2004, two policies remained in force. The term of the second policy and the last certificates in the Meridian program will expire in 2007. There were 544 open claims, excluding the warranty programs.

IV. MERIDIAN PROGRAM

16. As discussed, the Liquidator is authorized to pay the greater of \$5,000 or the amount, if any, of PACICC's voluntary payment, the maximum of which is \$250,000.

17. PACICC does not generally respond to claims on policies in force more than 45 days after a winding-up order, but agreed to do so in the case of the Meridian program because of the potential sale of the Meridian block. It has now confirmed that it will not respond to new Meridian claims.

18. Since the winding-up order was made, there have been 13 claims that exceeded \$5,000 each, by the total amount of \$28,000. The Liquidator has no reason to believe the claims under the Meridian program will increase. The \$5,000 amount was originally chosen as likely to cover the vast majority of claims, as it has, in the event that PACICC ceased responding. Given the amounts in issue and the cost of paying multiple dividends on any amounts in excess of \$5,000, the Liquidator is of the view that the Meridian claimants should now be accorded the same treatment as other policyholders and be paid up to \$25,000 (an amount not likely to be reached in any case).

V. FINANCIAL STATUS OF THE ESTATE

19. The First Distribution was based on the financial status of the estate at March 31, 2003. Copies of the Order of this Court dated June 26, 2003 approving and authorizing the First Distribution and of the Liquidator's report in support with relevant schedules are attached as Schedules "B" and "C" respectively.

20. This Court passed and approved the accounts of the Liquidator for the period from the Winding-up Order to September 30, 2003 on December 18, 2003. Attached as Schedules "D" and "E" respectively are copies of the Order of this Court and the Liquidator's report in support with relevant schedules.

21. Attached as Schedule "F" are the unaudited financial statement for the estate as at June 30, 2004, prepared in a manner consistent with the financial statements before this Court for September 30, 2003, and with the same system of internal controls to safeguard the assets and reliability of the financial reporting process.

22. In this report, the Liquidator will generally compare the financial status of the estate at June 30, 2004 to its status at September 30, 2003, but will also make relevant comparisons to the status at the time of the First Distribution.

23. The estate surplus has been reduced from \$52.9 million at September 30, 2003 to \$42.9 million at June 30, 2004. This is, in large measure, the result of an increase in the policy liabilities. A key characteristic of the Reliance (Canada) claims profile is its “lumpiness.” A significant number of its policies do not have frequent claims, but, if claims occur, they are severe. As further progress has been made in dealing with the claims and more information becomes available on which to assess them, the Liquidator has increased the policy liabilities, reflecting increases referable to these kinds of policies. This has the effect of also increasing the reinsurance recoverables since these claims are generally reinsured at significant levels. As indicated, the net result is that the surplus has decreased. Such fluctuations in the level of surplus are to be expected, given the volatility of the portfolio.

A. Assets

Vested Assets

24. 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*.

25. 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 Policy Payments and paying the costs and expenses of the liquidation. It has collected reinsurance and subrogation proceeds. As at June 30, 2004, the cash or near cash was approximately \$155 million.

Reinsurance

26. 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”); and
- 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*.

27. The percentage of Reliance (Canada)’s case reserves that are reinsured changes over time as the composition of the case reserves changes. As at March 31, 2003 approximately 51% of Reliance (Canada)’s gross case reserves were reinsured. Of this amount, approximately 89% was Canadian Reinsurance and 11% was International Reinsurance. As at June 30, 2004, approximately 65% of Reliance (Canada)’s gross case reserves were reinsured, approximately 34% of which was Canadian Reinsurance and 66% International Reinsurance. This results from the increase in case reserves, discussed below, which brings the reserves into the excess layers, generally provided under the International Reinsurance. These percentages do not reflect estimates for uncollectible reinsurance due to credit, collection or contractual risk. Over 82% of the reinsurance is with reinsurers rated “A” or higher.

28. By June 30, 2004, the Liquidator had collected approximately \$14.7 million in reinsurance since the beginning of the liquidation, \$9.2 million since March 31, 2003. The U.S. Liquidator has collected International Reinsurance in the amount of U.S.\$4.8 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 \$27.6 million at June 30, 2004 up from \$9.2 million 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 \$76.6, up from \$61.7 million at March 31, 2003. Since June 30,

the Liquidator has collected an additional sum of \$5.1 million, reflecting the success of continuing collection efforts.

Summary

29. As at March 31, 2003, the value of Reliance (Canada)'s assets was \$242.5 million and cumulative claims and related expenses paid from the commencement of the liquidation to March 31, 2003 totalled \$22.4 million. As at June 30, 2004, the value of Reliance (Canada)'s assets was \$265.6 million. Cumulative claims and related expenses paid totalled \$43.3 million.

	June 30, 2004 (in millions)	September 30, 2003 (in millions)	March 31, 2003 (in millions)
Cash or near cash	\$155.1	\$156.3	\$161.3
Reinsurance receivables and recoverables net of estimate for uncollectible reinsurance	\$104.1	\$ 71.1	\$ 71.2
Miscellaneous	6.4	\$ 9.6	\$ 10.0
Total	<u>\$265.6</u>	<u>\$237.0</u>	<u>\$242.5</u>
Cumulative claims and related expenses	<u>\$43.3</u>	<u>\$31.5</u>	<u>\$22.4</u>

B. Liabilities

30. 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 "G".

31. The Liquidator has performed further actuarial and claims reviews but did not share those results at the time of the First Distribution because it did not wish to prejudice the sale. At September 30, 2003, the estimated value of the liabilities was \$174.4 million. As at June 30, 2004, the estimated value was \$213.7 million, determined as described below.

No Call for Claims to Date

32. 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

33. There are basically three categories of loss claims:

- a) claims that are settled or otherwise resolved (the "Resolved Claims"). Since the First Distribution, the Liquidator has resolved approximately 5,626 claims having a total value \$40.4 million. As at June 30, 2004:
 - (i) approximately 14,751 claims having a total value of \$64.8 million have been resolved, through settlement or otherwise, since the beginning of the liquidation;
 - (ii) of those, the Liquidator paid 5,598 claims in full for approximately \$9 million since the First Distribution, bringing the total claims paid in full in accordance with the court authorized Policy Payments to 14,723 claims having a value of approximately \$21.3 million; and
 - (iii) the remaining 28 claims either do not qualify for PACICC coverage or exceed PACICC limits. Policy Payments have been made on account of these claims in the amount of \$10.4 million but a balance of \$33.1 million remains outstanding;
- b) claims which have been reported but not yet resolved (the "Reported Claims"). As at June 30, 2004, there were approximately 544 Reported Claims outstanding, down from 757 at March 31, 2003 but outstanding gross case reserves almost

doubled, from approximately \$51.5 million, to \$100.2 million. Case reserves are adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. As discussed earlier, this change reflects the volatility and “lumpiness” of Reliance (Canada)’s portfolio; and

- c) the provision for IBNR and for deficiencies in Reported Claims.

Non-Booked Claims

34. As described in previous reports, there may be claims not reported in the books of Reliance (Canada) that 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.

35. No new Non-Booked Claims have been identified since the First Distribution. The U.S. Liquidator has agreed that her staff will advise the Liquidator if they identify any Non-Booked Claims, including as a result of the U.S. call for claims that expired on December 31, 2003. They are performing a preliminary adjudication of all claims filed and, as indicated, none have been identified to date. The U.S. Liquidator anticipates completing the adjudication in the next several months.

36. 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). 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.

37. 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.

Liability Claims Projection Process

38. The Liquidator has applied the same basic methodology in projecting the policy liabilities as for the First Distribution. The Liquidator has undertaken an extensive review of the policy liabilities, including retaining the services of the consulting actuary who acted for Reliance (Canada) before it was wound up. Representatives of the U.S. Liquidator have also reviewed the largest case reserves on which there is the greatest volatility and have shared their results, which the Liquidator has taken into account in establishing the policy liabilities.

39. 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.

40. 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.

41. The Liquidator instructed the actuaries to confirm their best estimate of the policy liabilities in accordance with accepted actuarial standards. The Liquidator then carefully reviewed the assumptions underlying the actuarial estimates, and introduced some further elements of conservatism in reaching the estimate of \$213.7 million for policy liabilities.

VI. MAJOR ACTIVITIES OF THE LIQUIDATOR

A. Administration

42. On being appointed, the Liquidator considered Reliance (Canada)'s complex claims, and the seniority and reputation of its employees, and consulted with the U.S. Liquidator and PACICC. The Liquidator determined that the best interests of the estate would be served by maintaining continuity, to the extent possible, through retaining existing Reliance (Canada) staff and that this would result in cost savings. At the beginning of the liquidation there were seventeen employees. As at June 30, 2004, 8 employees remained.

43. Reliance (Canada) employees perform day-to-day administration, including instructing defence counsel and outside adjusters, dealing with counsel on coverage issues, administering reinsurance collections, performing accounting and financial reporting with respect to claims and reinsurance issue functions, and liaising with PACICC and employees of the U.S. estate.

44. The Liquidator maintains responsibility for the conduct of the liquidation. The Liquidator is responsible for all strategic initiatives, and major decisions and, as appropriate, is involved in supervising and augmenting, where necessary, the day-to-day activities performed by former Reliance (Canada) employees. The Liquidator performs the functions specific to the liquidation, including the development of policies and procedures for claims handling and authorities, the institution of internal controls, reporting to court and stakeholders, supervising and coordinating legal counsel, monitoring developments in the U.S. liquidation, and providing insureds with information. The Liquidator reviews all claims decisions involving claims that meet criteria established in co-operation with PACICC and the U.S. Liquidator, performs the financial reporting, is actively involved in reinsurance collections, makes all investment

decisions, instructs and consults with the actuary. A further summary of the Liquidator's activities is set out in paragraph 53.

B. Third Party Administrators

45. Reliance (Canada) also had arrangements with third party administrators who were responsible for the administration of claims in a number of programs, the major ones including:

- a) Meridian;
- b) Groupe PPP, a financial guarantee program underwritten in the U.S., covering automobile dealers in Quebec;
- c) Gap Program, a financial warranty program;
- d) Family Program, a personal lines program in British Columbia; and
- e) Environmental Program, administered by ECS Inc. in the United States.

46. Each of the programs is unique in respect of the volume, magnitude and complexity of its claims, and with respect to the discretion accorded the third party administrators. In each case, the Liquidator reviewed the program and the nature of the relationship between the administrator and Reliance (Canada). In assessing the continued use of the third party administrators, the Liquidator considered their cost, the potential prejudice if the administration were disrupted and the quality of their work. The Liquidator determined that it was appropriate to maintain the relationships, but introduced additional controls and reporting requirements, as it considered necessary, and regularly reviews the status of the administrations.

C. Stakeholders

PACICC

47. The Liquidator entered into a loan and services agreement with PACICC on December 3, 2001, approved by this Court in the Appointment Order.

48. PACICC approves payments in respect of claims in excess of \$25,000, to which it responds, in accordance with its Memorandum of Operations. The Liquidator regularly consults with PACICC concerning the progress of the estate.

U.S. Liquidator

49. As discussed, based on the information currently available, there will be a surplus after payment of all liabilities of Reliance (Canada). This will ultimately be payable to the Reliance estate. Therefore, the U.S. Liquidator has an on-going interest in the administration of Reliance (Canada). Further, before the liquidation, Reliance (Canada) depended on Reliance for many services, including information services and technology. In addition Reliance underwrote insurance policies which were later allocated to Reliance (Canada), entered into reinsurance treaties which also covered Reliance (Canada) liabilities and collected reinsurance proceeds on its behalf, and had ultimate decision-making power for setting Reliance (Canada)'s claims reserves and settlement.

50. To prevent disruption to the administration of Reliance (Canada) and in recognition of the U.S. Liquidator's financial interest in the Canadian estate, the U.S. Liquidator, the Superintendent and the Liquidator entered into the protocol dated November 28, 2001, attached as Schedule "H" (the "Protocol"), providing for cooperation with respect to use of information systems, collection of reinsurance, administration of claims, and the sale process for the policy liabilities. The Protocol remains in force and close co-operation between the liquidators continues. However, the Liquidator remains cognizant at all times of balancing the interests of all stakeholders.

Policyholders

51. The Liquidator has been in regular contact with policyholders, third party claimants and counsel concerning the financial status of the estate, particularly with respect to both the timing and quantum of future distributions. The Liquidator recognizes the difficulties the liquidation poses, particularly at the time of claims settlement discussions, and has been as open and helpful as appropriate in the circumstances.

Reinsurers

52. The Liquidator has also been in regular contact with reinsurers, not only in respect of its collection efforts, but also to make information available and to respond to their legitimate concerns respecting primarily the inter-relationship between the Canadian and U.S. estates.

D. Summary of Activities

53. In summary, the Liquidator's major activities for the Three Quarters included:

- a) Claims adjudication and administration – including:
 - (i) overseeing payment of defense and adjustment costs;
 - (ii) overseeing a comprehensive review of all claims including estimating range of possible outcomes;
 - (iii) engaging in extensive discussions with policyholders, claimants and their counsel concerning the estate, including its financial status; and
 - (iv) settling or otherwise resolving 2,949 claims having a value of \$25.8 million.

- b) Reinsurance, including:
 - (i) reconciling accounts;
 - (ii) enforcing liquidation clause;
 - (iii) clarifying set-off issues;
 - (iv) entering into agreements with reinsurers and the U.S. Liquidator to facilitate collection of both the Canadian and the International Reinsurance; and
 - (v) collecting receivables, including direct communication with reinsurers and cooperative efforts with the U.S. Liquidator;

- c) Reviewed and amended as necessary the investment policy, managed investments, considered, and continues to consider, investment options including the retention of an investment manager;
- d) Reported regularly to PACICC and the U.S. Liquidator;
- e) Performed extensive review of policy liabilities as at March 31, 2004;
- f) Maintained external website; and
- g) Moved office to new premises at expiration of lease.

VII. LIQUIDATOR'S ACCOUNTS AND PROFESSIONAL FEES

A. Financial Statements

54. The Liquidator does not consider that a traditional statement of receipts and disbursements would provide a meaningful and informative reflection of the financial position of the estate. The Liquidator has therefore prepared unaudited financial statements, attached as Schedule "F".

55. The financial statements have been prepared in a manner consistent with the statements approved by this Court on December 18, 2003. The Liquidator maintains a system of internal controls to safeguard the assets and the reliability of the financial reporting process.

B. Professional Fees

56. The Liquidator retains professional advisors to assist in the administration of the liquidation from time to time. The Liquidator is familiar with the services provided by each of the professional advisors and has reviewed their invoices. Detailed invoices were timely received and carefully reviewed in detail by senior administrative and management level members of the Liquidator's staff. The invoices were reviewed for accuracy, adequate detailed information describing the work performed and by whom, the time spent and when it was spent, the rate and amount billed, possible duplicative charges, reasonableness and overall compliance

with the terms of retention. Clarifications and adjustments of items included in the invoices were requested where it appeared appropriate.

57. The Liquidator believes that the Professional Fees of its advisors are proper, fair and reasonable and were incurred in furtherance of the best interests of the estate of Reliance (Canada).

Goodmans LLP

58. Goodmans LLP (“Goodmans”) has acted as counsel to KPMG Inc. from the commencement of the liquidation and has acted or advised on all matters described in this report. The Liquidator is familiar with its services and has reviewed its invoices in detail and with the care described above.

59. At the commencement of the liquidation, Goodmans agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79% since the last passing, effective October 1, 2003, reflecting the change in the Consumer Price Index over the two year period. The discount from current rates is approximately 20% to 40%.

60. Attached as Schedules “I”, “J” and “K”, respectively, are:

- a) a summary invoice from Goodmans to the Liquidator for each of the Three Quarters;
- b) a summary for each of these periods of the hours and average hourly rates of each of Goodmans’ personnel who dedicated more than 30 hours to the estate; and
- c) a brief description of the areas of concentration of each of Goodmans’ personnel who dedicated more than 30 hours to the estate.

61. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.

62. The Liquidator is satisfied that Goodmans' fees are proper, fair and reasonable, that time was appropriately spent and that Goodmans' fees were incurred in furtherance of the best interests of the estate.

KPMG Inc.

63. The Liquidator has kept careful and detailed records of all time spent by Liquidator personnel on the estate. The Liquidator has instituted internal controls to ensure no duplicative or inappropriate charges are made. The Liquidator applied the same standard for review to its accounts as to accounts of other professionals, described above. As discussed above, the Liquidator maximized efficiency and reduced costs by retaining former Reliance (Canada) employees and third party administrators where prudent and appropriate.

64. At the commencement of the liquidation, the Liquidator agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79% since the last passing, effective October 1, 2003, reflecting the change in the Consumer Price Index over the two year period. The discount from current rates is approximately 15% to 40%.

65. Attached as Schedules "L", "M" and "N", respectively, are:

- a) an invoice from the Liquidator to the estate for the Three Quarters;
- b) a summary for each of these periods of the hours and average hourly rates of each of the Liquidator's personnel who dedicated more than 30 hours to the estate; and
- c) a brief description of the areas of concentration of each of the Liquidator's personnel who dedicated more than 30 hours to the estate for each of the Three Quarters.

66. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.

67. The Liquidator respectfully requests that this Court pass the accounts of the Liquidator, as reflected in the financial statements, and approve the Professional Fees.

VIII. SECOND DISTRIBUTION

A. Scheme of Distribution

68. 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. 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. Approach to Distribution

69. As with the First Distribution, the Liquidator has introduced further elements of conservatism, beyond those in the loss projection methodology, 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) Two major sources of uncertainty remain in the estate: reinsurance and Non-Booked Claims. To deal with these uncertainties in this distribution, the Liquidator is ascribing no value to reinsurance that has not been paid, and is building into the assumptions conservative values for the Non-Booked Claims.

70. The Liquidator is also taking into account \$5.1 million collected on reinsurance since June 30, 2004.

71. Based on the foregoing and in light of the remaining uncertainties described above, the Liquidator recommends a further distribution of 25% of valid policyholder loss claims, bringing the total distributions to 50%. This distribution level is 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

72. If the Second 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 it received before the date of the distribution, in accordance with paragraph 12 of the Appointment Order. In effect, those Policy Payments are treated as advances on the distribution. The Liquidator will pay the higher of the Policy Payments and the total distributions on valid policyholder claims.


73. PACICC compensated claims are deemed to be assigned to PACICC under paragraph 15 of the Appointment Order. However, the Liquidator has made the PACICC Policy Payments, which were treated as a loan to PACICC under the loan agreement dated the 3rd day of December 2001, approved by this Court in the Appointment Order. The distributions reduce the amount outstanding thereunder.

IX. RECOMMENDATIONS

74. 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 this Court approve the Second Distribution of 25% on all valid and allowed loss claims, to be calculated as set out above, bringing total distributions to 50%, as claims are allowed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

KPMG INC., the Liquidator of Reliance Insurance
Company – Canadian Branch

Per: 
Robert O. Sanderson, President

Schedule "F"

Unaudited Financial Statements of

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

In our capacity as Liquidator, we have prepared the balance sheet of Reliance Insurance Company, Canadian Branch (in liquidation) as at June 30, 2004, September 30, 2003 and December 3, 2001, the statement of earnings and changes in surplus for the six months ended June 30, 2004, the twenty-two months ended September 30, 2003 and the statement of cash flows for the six months ended June 30, 2004 and the twenty-two months ended September 30, 2003 in our capacity as liquidator. These financial statements have not been audited or reviewed.

In view of the uncertainties surrounding a branch in liquidation, the ultimate realization on assets and liabilities will differ from the recorded amounts and the differences may be material (see notes).

Readers are cautioned that these statements may not be appropriate for their purposes.

KPMG Inc., Liquidator
Reliance Insurance Company, Canadian Branch

August 20, 2004

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Balance Sheet

As at June 30, 2004, September 30, 2003, and December 3, 2001

(Unaudited - \$000)	Jun 30, 2004	Sep 30, 2003	Dec 3, 2001
Assets			
Cash and short term investments (note 4)	\$155,078	\$156,277	\$56,165
Investments (note 4) (market value - \$0; 2003 - \$0; 2001 - \$114,392)	0	0	108,949
Receivable from other insurers/reinsurers	27,576	13,908	6,090
Receivable from income and premium taxes recoverable	0	3,070	3,446
Receivable from Reliance US (note 8)	4,848	4,181	0
Current balance due (note 8)	870	0	0
Other receivables	600	958	1,978
Reinsurers' share of provision for			
Unpaid claims	71,704	51,761	57,536
Unearned premiums	4,847	5,430	9,670
Estimate for deductibles on unpaid claims	106	1,444	2,527
	\$265,629	\$237,029	\$246,361
Liabilities and Surplus			
Policy liabilities:			
Unpaid claims (note 5)	\$171,544	\$145,815	135,088
Unearned premiums (note 6)	8,216	9,177	15,189
Allowed claims (note 9)	33,106	17,269	0
Other liabilities	841	2,158	1,917
	213,707	174,419	152,194
Payables:			
Due to Reliance US (note 8)	4,848	4,848	0
Due to other insurers/reinsurers	142	189	192
Brokers	2,916	2,924	3,389
Taxes and other creditors	1,031	1,653	1,826
Reinsurance deposits	10	10	3,494
Total	222,654	184,043	161,095
Surplus (note 10)	42,975	52,986	85,266
Contingent liabilities (note 11)			
	\$265,629	\$237,029	\$246,361

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statements of Earnings and Changes in Surplus

For the nine months ended June 30, 2004, and twenty-two months ended September 30, 2003

(Unaudited - \$000)	Oct 1, 2003 to Jun 30, 2004	Dec 3, 2001 to Sep 30, 2003
Revenue		
Gross Premiums Written	\$ (12)	\$ (508)
Less: Reinsurance Ceded	(9)	(509)
Net written premiums	(3)	1
Net premiums earned	375	1,772
Expenses:		
Claims incurred	12,539	42,317
Commissions and premium taxes	21	5,115
General expenses (note 13)	1,212	6,656
Foreign Exchange (net claims)	(656)	(62)
	13,116	54,026
Underwriting income (loss)	(12,741)	(52,254)
Investment income		
Interest on cash and short term investments	2,807	5,188
Interest on bonds	0	7,752
Investment expenses	(36)	(74)
Realized gain (loss) on disposal of investments	0	7,245
	2,771	20,111
Income (loss) before taxes	(9,970)	(32,143)
Capital taxes	41	137
Net income (loss)	(10,011)	(32,280)
Surplus beginning of period	52,986	85,266
Surplus end of period	\$42,975	\$52,986

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statement of Cash Flows

For the nine months ended June 30, 2004, and twenty-two months ended September 30, 2003

(Unaudited - \$000)	Oct 1, 2003 to Jun 30, 2004	Dec 1, 2001 to Sep 30, 2003
Operating activities		
Premiums received	\$ 1	\$ (82)
Reinsurance collected	6,163	8,601
Salvage, subrogation & deductibles received	578	2,332
Reduction in other receivables	481	697
Total sources	7,223	11,548
Gross claims paid	8,663	23,073
Claim expenses paid	3,136	8,393
Uncashed claim/expense cheques	0	(96)
Reinsurance premiums paid	(14)	(108)
General expenses		
Salaries	1,364	3,109
Office expenses	369	641
Legal/professional	138	273
Head office services	210	465
Sale of business expense	0	770
Liquidation expenses		
KPMG Inc.	818	3,121
Goodmans LLP	266	885
Foreign exchange (gain)/loss	(81)	56
Income & premium taxes (incl interest paid/rec'd)	(3,405)	(22)
Foreign exchange (gain)/loss(net claims)	(273)	(62)
Total uses	11,191	40,498
Net cash provided by (used) in operations	(3,968)	(28,950)
Investing activities		
Sale (purchase) of Bonds	0	113,225
Investment expenses	(36)	(74)
Interest received	2,895	15,812
Increase(decrease) in accrued investment income	(90)	99
Cash provided by (used in) investing activities	2,769	129,062
Increase in cash and short term investments	(1,199)	100,112
Cash and short term investments, at beginning of period	156,277	56,165
Cash and short term investments, at end of period	\$155,078	\$156,277

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY

Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

1. Nature of the business:

The Canadian Branch of Reliance Insurance Company, which was primarily engaged in the writing of commercial property and liability insurance in Canada, commenced a voluntary wind down of its operations in Canada effective August 2000. In May 2001, Reliance Insurance Company's U.S. operations ("Reliance US") were placed under an order of rehabilitation. On October 3, 2001, Reliance US was put into liquidation and declared insolvent by the Court of Pennsylvania.

On December 3, 2001, the Ontario Superior Court of Justice (the "Court"), on the application of the Attorney General of Canada, granted an order appointing KPMG Inc. as provisional liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company, including the assets in Canada of Reliance Insurance Company, together with its other assets held in Canada under the control of its chief agent ("Reliance Canada"). By further order of the same date, the Court ordered that Reliance Canada be wound up.

Since August 2000, existing insurance policies in force have been allowed to expire and Reliance Canada has neither renewed nor cancelled existing policies, nor has it written any new business. Reliance Canada continues to run off the existing policy and claims liabilities in an orderly fashion.

Pursuant to Orders of the Court the Liquidator has paid policy holders and claimants the greater of: 25% of valid and allowed loss claims pursuant to the first interim distribution approved by the Court in June 2003; or the greater of \$25, 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.

2. Basis of preparation:

The accounting policies used in the preparation of these financial statements have been selected with a view to reflecting the financial position of a company that is in liquidation.

The preparation of these financial statements requires the use of estimates and assumptions that affect the reported assets and liabilities as at the date of the financial statements and the reported amount of revenue and expenses for the reporting period. The actual results will differ from these estimates and, in view of the additional uncertainties surrounding a company in liquidation, the differences may be material. Changes in estimates are recorded in the accounting period in which they are determined.

No provision has been made for future liquidation costs. Interest income earned on the assets of Reliance Canada is likely to offset the unbooked future costs of the liquidation.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

3. Significant accounting policies:

(a) Investments and investment income:

Bonds, including accrued interest of \$3,128 at December 3, 2001, are carried at amortized cost, providing for the amortization of the discount or premium on an effective yield basis to maturity. Term deposits and treasury bills are carried at cost plus accrued interest of \$334 at June 30, 2004, \$424 at September 30, 2003, and \$325 at December 3, 2001.

Investment income is recorded as it is earned. Gains and losses arising on disposal of investments are on a settlement date basis, and are calculated on the basis of amortized cost.

(b) Premium revenue and unearned premiums:

Unearned premiums represent the amount of premiums written which are applicable to the unexpired terms of the policies in force or to the remaining terms of certificates issued as part of program business. Accordingly, premiums written are taken into income when earned. Although policies were generally issued for one year, Reliance Canada also wrote some multi-year policies and some program business with underlying certificates which are multi-year.

If the unearned premiums are not sufficient to pay expected claims and expenses, a premium deficiency is said to exist. Any changes in estimates of premium deficiencies are recorded as net premium earned in the accounting period in which they are determined.

The reinsurers' share of unearned premiums, net of a provision for doubtful amounts, is recognized as amounts recoverable at the same time and using principles consistent with the method for determining the unearned premium liability.

(c) Provision for unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate for all costs of investigating and settling claims incurred on or before the balance sheet date. The provision estimates do not take into account the time value of money, or make explicit provision for adverse deviation.

The provision includes case basis estimates, and an actuarially determined "best estimate" provision for claims incurred but not reported and for development on case basis estimates ("IBNR"). These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the accounting period in which they are determined.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

d) Reinsurance ceded:

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. To indicate the extent of the credit, collection and contractual risks related to third party reinsurance, estimates of amounts recoverable from reinsurers are recorded separately from the estimated provisions for unearned premiums and unpaid claims.

Amounts recoverable from reinsurers, net of a provision for doubtful amounts, are estimated and recognized at the same time and using principles consistent with Reliance Canada's method for establishing the related liability.

4. Short term investments and investments:

Short-term investments are readily convertible into cash and have maturities of three months or less.

Composition of investment portfolio:

	<u>Dec 03, 2001</u>	
	<u>Carrying</u>	<u>Market</u>
	<u>Value</u>	<u>Value</u>
Bonds		
Canadian Government	\$ 99,949	\$ 105,415
Canadian Corporate	<u>8,990</u>	<u>8,977</u>
	<u>\$ 108,939</u>	<u>\$ 114,392</u>

Liquidity and Interest Rate Risk:	<u>Under 1</u>	<u>1 to 5</u>	<u>6 to 10</u>
	<u>Year</u>	<u>Years</u>	<u>Years</u>
Maturity profile as at December 03, 2001			
Bonds (carrying value)	\$17,626	\$52,951	\$38,372
Effective interest rate: 8.19%			

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

5. Unpaid claims:

(a) Nature of unpaid claims:

The provision for unpaid claims and adjustment expenses (and for third party reinsurers' share thereof) are based upon estimates of the ultimate claim costs associated with claims occurring as of the balance sheet dates, including estimates for IBNR claims. These estimates are subject to variability, and the variability could be material. The variability arises because all events affecting the ultimate settlement of claims have not yet taken place and may not take place for some time. Additional factors affecting the variability include receipt of additional claim information; the continually evolving and changing regulatory and legal environment; court decisions; economic conditions; public attitudes; claims management practices; actuarial studies; the quality of the data used for projection purposes; the effect of inflationary trends on future claims handling and settlement practices; and significant changes in the severity or frequency of claims from historical trends. In addition, the longer the time required for the settlement of a group of claims, the more variable the estimates.

Reliance Canada had fronting reinsurance arrangements with other insurers and provided self-insurance facilities for selected corporate clients. Because Reliance Canada is the direct insurer under these arrangements, policyholders and claimants look to Reliance Canada for settlement of their claims; Reliance Canada obtains repayment from the insurers or corporations, either directly or from security deposits Reliance Canada maintains. The risk to Reliance Canada is a credit risk if claims exceed either the security deposits or the self-insured's ability to pay.

Reliance Canada accepted certain insurance risks that other insurance companies have underwritten ("assumed reinsurance"). Because of the necessary reliance on the ceding companies for information regarding reported claims, and the resulting reporting lag between the dates of occurrence and the time Reliance Canada is notified of the claims, the inherent uncertainties of estimating reserves is greater for assumed reinsurance than for direct insurance.

In the normal course of settling claims, Reliance Canada acquires rights to subrogate its claims against other parties and, in some cases, recover a portion of the loss from the policyholder as a deductible amount. Salvage and subrogation are deemed not to be material and, as such, are recorded as received. Deductible amounts which are recoverable on liability claims have been recognized as assets.

(b) Provision for unpaid claims:

Considerable judgement is required to evaluate claims and establish claim liabilities. The estimation of the claims provision is based on known facts and interpretation of circumstances. The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. Methods of estimation have been used which it is believed produce reasonable results given current information; however, the process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially,

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

from the best estimate made. It is also not possible to estimate the impact of the additional uncertainties surrounding a company in liquidation on the estimation process.

The changes in the unpaid claim provisions recorded in the balance sheet as at June 30, 2004, September 30, 2003, and December 3, 2001 and their impact on the claims and adjustment expenses for the fifteen months ended June 30, 2004, the twenty-two months ended September 30, 2003, are as follows:

	<u>Oct 1/03 to Jun 30/04</u>	<u>Dec 3/01 to Sep 30/03</u>
Unpaid claims at beginning of period	\$ 145,815	\$ 135,088
Recoverable from reinsurers at beginning of period	<u>51,761</u>	<u>57,536</u>
Net unpaid claims at beginning of period	<u>94,054</u>	<u>77,552</u>
Increase in estimated losses and expenses for claims occurring in prior years	12,539	42,317
Increase in outstanding deductibles	(65)	(1,090)
Paid on claims (net) occurring during current year (Gap Programs)	(577)	(1,377)
Paid on claims (net) occurring during prior years	<u>(6,111)</u>	<u>(23,348)</u>
Net reserves at end of period	99,840	94,054
Ceded reserves at end of period	<u>71,704</u>	<u>51,761</u>
Gross reserves at end of period	<u>\$ 171,544</u>	<u>\$ 145,815</u>

In order to show the progress of the liquidation from the date of winding-up and as it is not practicable in a winding-up to determine fair value with sufficient reliability, the fair value of the unpaid claims and adjustment expenses, gross and recoverable from reinsurers has been omitted.

6. Unearned premium:

The provisions for unearned premiums include actuarially determined estimates for premium deficiencies. The process for estimating any provisions for premium deficiency involves the use of estimates concerning factors such as expected claims and expenses and future payout patterns. Any provisions are necessarily subject to uncertainty.

The provision estimates do not take into account the time value of money or make explicit provision for adverse deviation.

RELIANCE INSURANCE COMPANY

Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

7. Reinsurance:

In the normal course of business, Reliance Canada sought to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. Reliance Canada is not relieved of its primary obligation to policyholders as a result of its third party reinsurance. Failure of reinsurers to honour their obligations could result in losses to Reliance Canada.

Reliance Canada makes specific provisions against reinsurance receivables and recoverables from companies who are in liquidation or run-off, with whom balances are in dispute or where the reinsurer is not settling balances due to Reliance Canada for reasons related to Reliance US. In addition, the company records a general allowance against reinsurance receivables and recoverables based upon the level of allowance already in place and management's judgement. The general allowance reflects the view that a company in liquidation or run-off has a greater collection risk than a going concern company. The establishment of the allowances for doubtful accounts involves judgement and therefore creates a degree of uncertainty as to adequacy at each reporting date.

Reliance Canada's reinsurance program includes: i) reinsurance placed by Reliance Canada directly with Canadian licensed reinsurers and ii) reinsurance entered into by Reliance US which reinsures both Reliance (Canada) policies and policies of Reliance US and other companies in the Reliance group.

8. Head office:

The liquidator for Reliance US (the "US Liquidator"), subsequent to the date of liquidation, advised Reliance Canada that Reliance US had settled underwriting commissions due to ECS Managers on behalf of Reliance Canada (the "ECS Commission Payable") prior to the respective and separate liquidations of Reliance Canada and Reliance US. The US Liquidator and the Canadian Liquidator have agreed, without prejudice, that the US Liquidator will withhold payment to the Canadian Liquidator of reinsurance collected by Reliance US on behalf of Reliance Canada on the international reinsurance treaties ("Canadian Reinsurance Proceeds") up to the amount of the ECS Commission Payable of \$4,848 or US\$3,034. The parties have also agreed that Reliance US will pay to the Reliance Canada any Canadian Reinsurance Proceeds in excess of the ECS Commission Payable.

(a) Payable to Head Office:

As at June 30, 2004, \$4,848 (2003 - \$4,848; 2001 - \$0) has been set up as an amount due to Reliance US for the ECS Commission Payable.

(b) Receivable from Reliance US:

As at June 30, 2004, on behalf of Reliance Canada, Reliance US has collected \$4,848 (2003 - \$4,181; 2001 - \$0) of Canadian Reinsurance Proceeds, which is to be held by the Reliance US pending payment of the ECS Commission Payable to Reliance US.

RELIANCE INSURANCE COMPANY

Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

(c) Receivable from Reliance US – Current Balance Due:

As at June 30, 2004, on behalf of Reliance Canada, Reliance US has collected \$870 (2003 - \$0; 2001 - \$0) of Canadian Reinsurance Proceeds which is to be forwarded by Reliance US to Reliance Canada.

(d) Protocol Agreement:

Further to a protocol agreement between the Liquidator and the US Liquidator, Reliance US provides various services to Reliance Canada, particularly in the areas of data processing, claims and reinsurance. For the 9 months ended June 30, 2004 the cost of the services was \$187 (2003 - \$505).

9. Allowed claims:

As at June 30, 2004, allowed claim balances are due on claims which have been settled and admitted by the Liquidator, in excess of the Court authorized payments of \$33,106 (2003 - \$17,269; 2001 - \$0).

10. Surplus:

As at June 30, 2004, Reliance Canada's estimated surplus is \$42,975 (2003 - \$52,986; 2001 - \$85,266). This estimate is subject to revision. In view of the uncertainties surrounding a company in liquidation, the ultimate realization of the assets and liabilities will differ from the estimated results as at June 30, 2004 and the difference may be material. Any surplus available at the wind-up of the liquidation will be paid to Reliance US.

11. Contingent liabilities:

There is the potential that certain claims that were not reported in the books of Reliance Canada may be valid claims against Reliance Canada ("Non-Booked Claims"). The Non-Booked Claims would arise from policies written outside Canada but which have some nexus with Canada and which, arguably, should have been reported in the books of Reliance Canada. 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. Should additional loss result from any new claims, such loss would be accounted for as a charge to earnings in the accounting period that the claims are verified as liabilities of Reliance Canada.

12. PACICC loan agreement:

PACICC and the Liquidator entered into a loan and services agreement, dated December 3, 2001, which 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 occurs on the Amount Outstanding at the prime rate. In the event all policyholders and creditors receive full payment on all valid claims from the assets of the estate, the

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the nine months ended June 30, 2004, twenty-two months ended September 30, 2003

(unaudited – \$000)

Liquidator will not demand repayment of the Amount Outstanding. The Amount Outstanding has not been accrued in the financial statements.

13. Supplementary expense information:

	<u>Oct 1/03 to Jun 30/04</u>			<u>Dec 3/01 to Sep 30/03</u>		
	<u>Total</u>	<u>General</u>	<u>Claims</u>	<u>Total</u>	<u>General</u>	<u>Claims</u>
Salaries	\$ 1,079	\$ 539	\$ 540	\$ 2,663	\$ 1,331	\$ 1,332
Office Expense	318	159	159	567	275	292
Legal/Professional Services	111	56	55	310	155	155
Allowance for Bad Debts	6	6	0	(108)	(108)	0
Head Office Services	187	93	94	505	262	243
Interest (Income)/Expense	(406)	(406)	0	80	80	0
Foreign Exchange (Gain)/Loss	(31)	(31)	0	(306)	(306)	0
Sale of Business Expense:						
KPMG Corporate Finance	0	0	0	227	227	0
Scotia Capital	0	0	0	214	214	0
Other	0	0	0	329	329	0
Liquidation Expenses:						
KPMG Inc.	622	622	0	3,180	3,180	0
Goodmans LLP	<u>174</u>	<u>174</u>	<u>0</u>	<u>1,017</u>	<u>1,017</u>	<u>0</u>
Total Expenses	<u>\$ 2,060</u>	<u>\$ 1,212</u>	<u>\$ 848</u>	<u>\$ 8,678</u>	<u>\$ 6,656</u>	<u>\$ 2,022</u>

The claims expenses are included in Claims incurred on the statement of earnings and changes in surplus.

14. Foreign exchange:

Further to an order from the Court, dated December 18, 2003 and amended on June 30, 2004, the Liquidator is authorized to pay claims payable in foreign currencies either:

- a) in those foreign currencies in circumstances where the Liquidator is otherwise legally entitled to do so; or
- b) in Canadian currency, converted at the Bank of Canada noon spot rate of exchange for exchanging such currencies to Canadian currency on November 8, 2001.

Further to this, in cases where the agreed claim is determined in U.S. dollars, the rate used by Reliance Canada to calculate the Canadian equivalent is \$1.5981.

RELIANCE INSURANCE COMPANY (in liquidation)

Professional Fees (including G.S.T.)

	Oct 1 to Dec 31, '03	Jan 1, '04 to Mar 31, '04	Apr 1, '04 to Jun 30, '04	Oct 1, '03 to Jun 30, '04
Core Professional				
Goodmans LLP	\$80,085	\$44,577	\$60,498	\$185,160
KPMG Inc.	221,961	202,354	258,308	682,623
	302,046	246,931	318,806	867,783
Other Professional Fees				
KPMG Inc.		27,245		27,245
Blaney McMurtry			465	465
	0	27,245	465	27,710
Actuaries				
J. S. Cheng & Partners	109,306			109,306
	109,306	0	0	109,306
TOTAL	\$411,352	\$274,176	\$319,270	\$1,004,799

January 31, 2004

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period October 1, 2003 to December 31, 2003, including the following:

Attendances with respect to claims and liabilities issues, including applications for leave to proceed, liaison and communications with adjusters, defence counsel and plaintiffs' counsel, providing advice on settlement of various claims and preparation of settlement documents, and review of various pleadings;

Attendances with respect to reinsurance issues, including collection of reinsurance proceeds, preparation of trust agreement and set-off issues;

Attendances with respect to liquidation issues, including strategy, communications with various stakeholders, preparation of motion materials and attendance at Ontario Court for passing of accounts, extension of date for policy payments, payment of defence costs and Meridian payments, and fixing the exchange rate at which claims payable in foreign currency are to be converted to Canadian currency, preparation of lease agreement re new Reliance premises, issues regarding third party administrators, liaison and meeting with PACICC, auto dealers issues under the Meridian warranty program and preparation of employment contract;

Attendances with respect to U.S. issues, including U.S. claims issues, identification of non-booked claims, liaison with U.S. Liquidator and monitoring U.S. liquidation.

GOODMANS

-2-

OUR FEE:	\$72,764.00
DISBURSEMENTS:	\$ 2,104.54
GST:	<u>\$ 5,216.58</u>
TOTAL:	<u>\$80,085.12</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5047069.1

April 30, 2004

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period January 1, 2004 to March 31, 2004, including the following:

Attendances with respect to claims and liabilities issues, including applications for leave to proceed, liaison and communications with adjusters, defence counsel and plaintiffs' counsel, review and preparation of settlement documents, review of third party action against Reliance, contingent claims issues and issues relating to Section 71 of the *Winding-Up and Restructuring Act*;

Attendances with respect to reinsurance issues, including collection of reinsurance proceeds and attendances re various agreements among reinsurers and Canadian and U.S. Liquidators;

Attendances with respect to liquidation issues including strategy, currency issues, privacy issues and documentation, third party administrator issues, distribution issues, and review of maternity leave and employee benefits issues.

OUR FEE:	\$40,821.50
DISBURSEMENTS:	\$ 846.08
GST:	<u>\$ 2,909.04</u>
TOTAL:	<u>\$44,576.62</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5047083.1

July 31, 2004

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period April 1, 2004 to June 30, 2004, including the following:

Attendances with respect to claims and liabilities issues, including applications for leave to proceed, liaison and communications with adjusters, defence counsel and plaintiffs' counsel, advising on and preparation of settlement documents, U.S. directors and officers claims, and stay issues;

Attendances with respect to reinsurance issues, including preparation of agreement with reinsurer and U.S. Liquidator to facilitate collection of reinsurance proceeds;

Attendances with respect to liquidation issues, including preparation of motion materials and attendance at Ontario Court re extension of dates for policy payments, payment of defence costs and Meridian payments and payment of claims in foreign currency, privacy issues, securities and investment issues, license and premium tax issues, and liaison with inspectors;

Attendances with respect to U.S. issues, including communications with U.S. Liquidator.

OUR FEE: \$55,796.00

DISBURSEMENTS: \$ 751.05

GST: \$ 3,950.61

TOTAL: **\$60,497.66**

GOODMANS LLP

E. & O. E.

GOODMANS\5047090.1

Schedule "J"

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF GOODMAN'S LLP PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED DECEMBER 31, 2003

Name	Rank	Area	HOURS	AVG. HRLY RATE
Rubenstein, Gale	Partner	Insolvency	67.90	\$505
Smith, Graham	Partner	Litigation	41.90	\$425
Paquette, Fanny	Sr. Clk	Insolvency	77.50	\$165
Individuals with less than 30 hours			49.20	\$185
			<u>236.50</u>	<u>\$325</u>

RELIANCE INSURANCE COMPANY
(in liquidation)

LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED MARCH 31, 2004

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	32.30	\$505
Smith, Graham	Partner	Litigation	30.70	\$425
Individuals with less than 30 hours			50.50	\$227
			<u>113.50</u>	<u>\$360</u>

RELIANCE INSURANCE COMPANY
(in liquidation)

LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED JUNE 30, 2004

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	45.90	\$505
Smith, Graham	Partner	Litigation	48.60	\$425
Individuals with less than 30 hours			47.90	\$250
			<u>142.40</u>	<u>\$392</u>

Schedule "K"

GOODMANS LLP

GENERAL LIQUIDATION RESPONSIBILITY

GALE RUBENSTEIN is a partner in the insolvency area. She oversees all legal matters and is involved in all major areas of the liquidation. Her particular areas of concentration during the Three Quarters included strategy issues, communications with various stakeholders, including certain policyholders and PACICC, and with the U.S. Liquidator. She advised with respect to claims and liabilities issues, reinsurance issues, U.S. issues, distribution issues, issues relating to the passing of accounts, auto dealers issues under the Meridian warranty program, privacy issues, currency issues, issues re extension of policy payments, payment of defence costs and Meridian payments, investment issues, and issues regarding third party administrators.

FANNY PAQUETTE is a senior law clerk in the insolvency area. She drafted basic court documents and prepared materials in connection with applications to the Ontario Court and attended to service of motion materials. She also had responsibility for internal accounting control and meeting the requirements of the Liquidator with respect to accounting and billings.

LITIGATION

GRAHAM SMITH is a partner in the litigation section. He provided litigation support and acted as liaison with adjusters, defence counsel and plaintiffs' counsel, acted on applications for leave to proceed, and provided advice and prepared settlement documentation on the settlement of various claims.

August 10, 2004

Invoice

Reliance Insurance Company, in Liquidation
Suite 810, 4 King Street West
Toronto, ON M5H 1B6

GST #122363153

BILL OF COSTS

To our professional services rendered in connection with the above-noted matter for the period October 1st, 2003 to June 30th, 2004, including:

Review and approval of financial statements and related analysis for the quarters ending September 30th, 2003, December 31st, 2003, and March 31st, 2004;

Review and approval of Management Reports for the quarters ending September 30th, 2003, December 31st, 2003, and March 31st, 2004;

Review and approval of money market transactions;

Continued limited review of Reliance Canada documentation and meetings with the U.S. Liquidator to review U.S. documentation to attempt to quantify the magnitude of exposure to Canadian risk not reported on the books of Reliance Canada;

Ongoing liaison with the U.S. Liquidator including the return of surplus funds from the Canadian estate to the U.S. estate, discussions as to the status of reinsurance collections, IT systems administration, runoff models, and obtaining additional information required for the proper administration of the Canadian estate;

Receipt, review, discussion and attendance at meetings with estate legal counsel to review ongoing matters, reinsurance collections issues including set-off issues, claims settlement issues and various other estate matters as required;

Continued monitoring of the Reliance staff, including providing appropriate direction and assistance;

Meetings, discussions, review of assumptions and preparation of detailed runoff models projecting the runoff of the estate;

Discussions, receipt and review of various court motions to extend the date to which the Liquidator was authorized to make policy payments and the Meridian payments, and payments to defence costs;

Attendance at Court to hear the above noted motion;

- Continuing to deal with policyholder and claimants' telephone calls, e-mails, and correspondence requesting specific information pertaining to the liquidation or their specific claims;
- Continuing to deal with agents and brokers, especially trying to finalize the reconciliation of their accounts as at the date of liquidation;
- Performing a detailed claims review, discussion of potential outcomes with claims staff and attendance at meetings with the U.S. Liquidator's claims staff to review same;
- Attendance at meetings with actuarial consultant to perform an extensive review of policy liabilities as at March 31st, 2004;
- Receipt, review and discussion with the actuarial consultant, the results of his extensive review as performed above;
- Continued to review existing claims bordereaux in order to stratify claims as to dollar amounts, lines of business, and PACICC exposure;
- Review of new reported claims, discussions with claims adjudication staff and approving set-up of appropriate reserves;
- Continuing to liase with Reliance U.S. IT personnel to ensure the ongoing performance of the computer systems;
- Continuing to deal with numerous Meridian policyholder inquiries;
- Continued review and approval of defence and adjustment costs and authorizing payment of same;
- Continued attendance with third party administrators to ensure the continued processing and adjudication of claims under their control and ensuring that claims are adjudicated and settled according to the procedures established by the Liquidator;
- Continued monitoring and supervision of claims adjudication staff, approval of reserve changes, approval of claims settlements, approval of claims settlement costs and authorization of payment of same;
- Continued follow-up on reinsurance billings and collections;
- Continued to obtain shared reinsurance documentation from the U.S. Liquidator, particularly in respect of international and reinsurance policies;
- Continued liaison with U.S. Liquidator as to international reinsurance collections and commission expenses associated therewith;

- Supervision of build-out of new premises including all IT, data and voice requirements;
- Disposal of excess furniture and equipment;
- Overseeing move of operations to new premises;
- Providing information and analysis for the Inspectors as required;
- Preparation of appropriate accounting information and filing of appropriate non-tax statutory returns;
- Preparation of the December 31st, 2003, tax returns;
- Updating of the Reliance Canada website for the benefit of policyholders, claimants and creditors to enable them to obtain access to current information as to the status of the liquidation and their claims therein;
- Investigation of market conditions and trends, analysis of same, discussions with Inspectors and obtaining their approval for a new investment policy and implementation of same;
- Performed a detailed review of internal controls to ensure that the financial and operational controls are functioning as set forth in the Policies and Procedures;
- Overall administration of the estate and the Reliance staff consisting of approximately 8 people, dealing with day-to-day administrative issues, responding to policyholder, claimants' and creditor inquiries and attendance at all meetings, proceedings and/or court appearances as required.

Our fee:	\$624,408.90
Disbursements:	<u>13,556.41</u>
	637,965.31
GST	<u>44,657.57</u>
TOTAL	<u><u>\$682,622.88</u></u>

Schedule "M"

RELIANCE INSURANCE COMPANY
(in liquidation)

LISTING OF KPMG INC. PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED DECEMBER 31, 2003

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Sanderson, R. O.	President/Partner	Insolvency/Overall Ac	45.60	\$576
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	224.50	\$445
Burgess, J.	Manager	Insolvency/Claims	238.00	\$288
Murphy, E.	V.P./Senior Manager	Financial Report/Rein	132.70	\$445
Individuals with less than 30 hours			102.20	\$224
			<hr/>	<hr/>
			<u>743.00</u>	<u>\$372</u>

RELIANCE INSURANCE COMPANY
(in liquidation)

LISTING OF KPMG INC. PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED MARCH 31, 2004

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Sanderson, R. O.	President/Partner	Insolvency/Overall Ac	31.30	\$576
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	186.00	\$445
Burgess, J.	Manager	Insolvency/Claims	184.90	\$288
Murphy, E.	V.P./Senior Manager	Financial Report/Rein	72.00	\$445
Individuals with less than 30 hours			14.00	\$106
			<u>488.20</u>	<u>\$384</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

**LISTING OF KPMG INC. PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED JUNE 30, 2004**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Sanderson, R. O.	President/Partner	Insolvency/Overall Ac	35.80	\$576
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	192.50	\$445
Burgess, J.	Manager	Insolvency/Claims/Re	228.30	\$288
Murphy, E.	V.P./Senior Manager	Financial Report/Rein	128.70	\$445
Individuals with less than 30 hours			27.30	\$216
			<u>612.60</u>	<u>\$384</u>

KPMG INC.

(Quarter ending December 2003)

ROBERT O. SANDERSON – is President of KPMG Inc., a Chartered Accountant, Fellow of the Institute of Chartered Accountants of Ontario and a trustee in bankruptcy. He has primary responsibility for the liquidation as a whole. During this period, his particular areas of concentration were with respect to the development of the overall direction, approach and strategy for the estate, co-ordinating reporting to the supervising Court including passing of accounts, confirmation of continuance of payment of defence costs and small claims, ongoing liaison with PACICC, the U.S. Liquidator, the inspectors and major stakeholders, financial projections for the estate, responding to specific issues arising in the defence of claims and advising respective counsel as to projected outcomes.

I. GEORGE GUTFREUND – is a Vice-President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is also responsible for the development and maintenance of the website. During this period he sought, found and negotiated a lease for new premises, oversaw the move of the Reliance operations and assisted in the passing of accounts.

ELIZABETH MURPHY – is a Vice-President of KPMG Inc. and a Chartered Accountant. Ms. Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting, and overseeing the accounting department. During this period she developed the financial statement format for use in the Court passing of accounts including determining issues in adhering to Canadian GAAP. She also oversaw a review of internal controls and compliance with liquidation policies and procedures.

JANINE BURGESS – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, overseeing the Meridian and GAP programs, reviewing defence costs and contracted for and supervised the move of the Reliance operations. Janine also developed runoff models and a revised investment policy under the direction of Ms. Murphy and/or Mr. Gutfreund.

KPMG INC.

(Quarter ended March 2004)

ROBERT O. SANDERSON – is President of KPMG Inc., a Chartered Accountant, Fellow of the Institute of Chartered Accountants of Ontario and a trustee in bankruptcy. He has primary responsibility for the liquidation as a whole. During this period, his particular areas of concentration were with respect to the development of the overall direction, approach and strategy for the estate, co-ordinating reporting to the supervising Court including confirmation of continuance of payment of defence costs and small claims, ongoing liaison with PACICC, the U.S. Liquidator, the inspectors and major stakeholders, financial projections for the estate, responding to specific issues arising in the defence of claims and advising respective counsel as to projected outcomes.

I. GEORGE GUTFREUND – is a Vice-President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website. During this period the detailed claims review was completed and reviewed with the inspectors.

ELIZABETH MURPHY – is a Vice-President of KPMG Inc. and a Chartered Accountant. Ms. Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting, and overseeing the accounting department.

JANINE BURGESS – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, the detailed claims review, overseeing the Meridian and GAP programs, and reviewing defence costs. Janine also developed runoff models and a revised investment policy under the direction of Ms. Murphy and/or Mr. Gutfreund.

KPMG INC.

(Quarter ended June 2004)

ROBERT O. SANDERSON – is President of KPMG Inc., a Chartered Accountant, Fellow of the Institute of Chartered Accountants of Ontario and a trustee in bankruptcy. He has primary responsibility for the liquidation as a whole. During this period, his particular areas of concentration were with respect to the development of the overall direction, approach and strategy for the estate, co-ordinating reporting to the supervising Court including confirmation of continuance of payment of defence costs and small claims, ongoing liaison with PACICC, the U.S. Liquidator, the inspectors and major stakeholders, financial projections for the estate, responding to specific issues arising in the defence of claims and advising respective counsel as to projected outcomes.

I. GEORGE GUTFREUND – is a Vice-President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website. During this period the detailed claims review was completed and reviewed with the inspectors.

ELIZABETH MURPHY – is a Vice-President of KPMG Inc. and a Chartered Accountant. Ms. Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting, and overseeing the accounting department. During this period a full actuarial review was undertaken including additional liaison with the actuary as a result of the comprehensive claims review undertaken in part with representatives of the U.S. Liquidator. In conjunction with Ms. Burgess, she reviewed the overall investment approach and selected RBC Asset Management Inc. as the asset manager.

JANINE BURGESS – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, the detailed claims review, overseeing the Meridian and GAP programs, and reviewing defence costs. Janine also updated runoff models to reflect the results of the comprehensive claims review, staff reductions, projected runoff of claims and additional reinsurance characteristics, and a revised investment policy under the direction of Ms. Murphy and/or Mr. Gutfreund including RBC Asset Management Inc.

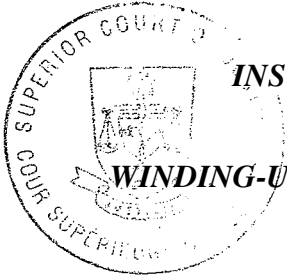
**ONTARIO
SUPERIOR COURT OF JUSTICE
- COMMERCIAL LIST**

THE HONOURABLE) WEDNESDAY, THE 21ST DAY
MR. JUSTICE FARLEY) OF DECEMBER, 2005

**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**



BETWEEN:

THE ATTORNEY GENERAL OF CANADA

Applicant

- and -

RELIANCE INSURANCE COMPANY

Respondent

ORDER

THIS MOTION, brought by KPMG Inc., liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company ("Reliance (Canada)"), was heard this day at 393 University Avenue, Toronto, Ontario.

ON READING the Report of the Liquidator dated December 14, 2005 (the "Report"), the Affidavit of Gale Rubenstein sworn December 14, 2005 and the Affidavit of I. George Gutfreund sworn December 14, 2005, filed, and on hearing submissions of counsel for

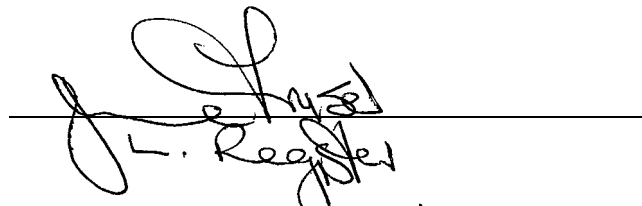
the Liquidator, and Maritime Road Development Corporation, although properly served as appears from the proof of service, filed:

1. **THIS COURT ORDERS** that the service of the Notice of Motion and materials herein is good and sufficient service of this motion, that the motion is properly returnable before this Court and that further service thereof upon any interested party other than those parties served be and is hereby dispensed with.

2. **THIS COURT ORDERS** that the accounts of the Liquidator for the period July 1, 2004 to September 30, 2005, as reflected in the financial statements of Reliance (Canada) attached to the Report, be and they are hereby passed and approved as submitted.

3. **THIS COURT ORDERS** that the fees and disbursements of the Liquidator and of its counsel, Goodmans LLP, for the period July 1, 2004 to September 30, 2005 be and they are hereby approved as submitted.

4. **THIS COURT ORDERS** that the Liquidator is hereby authorized to pay a third interim distribution from the estate of Reliance (Canada) in the amount of 15% of valid and allowed loss claims, where, and to the extent that, such amount, combined with the amount of payment by way of the first and second interim distributions, exceeds the payments authorized by paragraph 8 of the Order of this Court dated December 3, 2001 *inter alia* appointing the Liquidator.



A handwritten signature in black ink, appearing to read 'L. Regehr', is written over a horizontal line.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

DEC 2 1 2005

PER/PAR 

ONTARIO
SUPERIOR COURT OF JUSTICE
- COMMERCIAL LIST
Proceeding commenced at Toronto

ORDER

GOODMANS LLP
Barristers & Solicitors
250 Yonge Street
Suite 2400, Box 24
Toronto, Ontario
M5B 2M6

Gale Rubenstein (LSC # 17088E)
Tel: 416-597-4148
Fax: 416-979-1234

Graham Smith (LSC # 26377D)
Tel: 416-597-4161
Fax: 416-979-1234

Solicitors for KPMG Inc.,
Liquidator of Reliance (Canada)

GOODMANS\5251587.1

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

**IN THE MATTER OF
RELIANCE INSURANCE COMPANY**

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**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 – CANADIAN BRANCH**

December 14, 2005

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

**IN THE MATTER OF
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**AND IN THE MATTER OF THE
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**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

December 14, 2005

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) passing the accounts of the Liquidator for the period July 1, 2004 to September 30, 2005 (the “Five Quarters”), as reflected in the financial statements of Reliance (Canada);
 - b) approving the professional fees of the Liquidator and of its counsel (the “Professional Fees”) for the Five Quarters;

- c) approving and authorizing a third interim distribution of 15% of valid and allowed loss claims (the “Third Distribution”), bringing total distributions to 65% thereof, as claims are allowed.

II. OVERVIEW OF THE ESTATE

A. Policy 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;
- 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; and
- c) valid claims under the Meridian program up to \$25,000.

(collectively, the “Policy Payments”).

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

- 3. This Court further approved a first interim distribution (the “First Distribution”) to policyholders and claimants of 25% of their valid and allowed claims on June 26, 2003.
- 4. This Court further approved a second interim distribution (the “Second Distribution”) to policyholders and claimants of a further 25% of their valid and allowed claims, bringing the total distributions to 50% on September 2, 2004. The Liquidator therefore now pays

policyholders and claimants the higher of the Policy Payments and the First and Second Distributions.

B. Third Distribution

5. The Liquidator has made progress in the administration of the estate since the approval of the Second Distribution. Small claims continue to be closed on an efficient basis, with the use of third party administrators where appropriate, including on programs such as Meridian, Family and Groupe PPP (described below). Certain of the large complex claims have also now been resolved. Reinsurance collections are improving, in part because outstanding issues with reinsurers that involve the U.S. estate are being resolved. However, the reinsurance market has generally been difficult, and collection problems are an industry wide issue.

6. Based on the Liquidator's continuing experience with the estate, the Liquidator remains confident that all policyholders will receive full payment on all valid claims. As at September 30, 2005, the surplus on the financial statements was \$70 million. However, there remain uncertainties in the estate and the Liquidator is not in a position to make full payment at this time. To further alleviate hardship to policyholders whose claims are not satisfied by the Policy Payments, the Liquidator proposes to make a third interim distribution of 15% of valid loss claims, bringing total distributions to 65% on all claims as they are allowed.

C. The Future

7. The Liquidator will continue the run-off of Reliance (Canada)'s business in an orderly manner, dealing with policy liabilities and collection of reinsurance on a commercially reasonable basis, seeking the approval of the Court for further interim distributions as appropriate. Given the nature of Reliance (Canada)'s business, the process can be expected to take many years. The consulting actuary estimates that the run-off will continue to 2018, but the number of payments will begin to decline after 2007. However, based on current information and assuming no unforeseen negative developments, the

Liquidator is optimistic that payment of 100% of valid loss claims will be reached by 2007.

8. As previously reported, the Liquidator pursued an intensive marketing program for the policy liabilities that did not result in a transaction. The market for the sale of policy liabilities now appears to be improving. Several parties have contacted the Liquidator to ask very preliminary questions concerning the estate, and the possibility of acquiring the liabilities. Although the Liquidator believes that the improving reinsurance collections and the resolution of certain of the problematic claims will have a positive effect on their marketability, the Liquidator does not consider that the costs of a formal disposition program for Reliance (Canada)'s liabilities are warranted at this time. The Liquidator will continue to monitor market conditions and use all reasonable efforts to find innovative approaches to expedite the completion of the liquidation.

III. BACKGROUND

A. General Background

9. 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.
10. 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”).

11. By Orders of this Court made December 3, 2001, the insurance business of Reliance (Canada) was ordered wound-up pursuant to the provisions of the *Winding-up and Restructuring Act* and KPMG Inc. was appointed provisional liquidator.
12. In the Appointment Order, this Court appointed the U.S. Liquidator and PACICC as inspectors. By order dated January 30, 2002, this Court ordered that the Superintendent of Financial Institutions of Canada (the “Superintendent”) may attend meetings of inspectors, be included in the service list, and attend and be heard in matters before this Court.
13. The inspectors and the Superintendent are not opposing this motion.

B. Reliance (Canada)’s Insurance Business

14. Reliance (Canada) wrote a very diverse set of policies. Within the classes of liability insurance that it wrote, Reliance (Canada) specialized in providing coverage for professional liability, directors’ and officers’ liability, pollution and environmental liability and product liability. While some of Reliance (Canada)’s policies were “claims made”, meaning that claims must be reported during the term of the policy or within a defined period thereafter, a substantial portion of its policies were “occurrence” based. These policies cover liabilities incurred during the policy period that may not become manifest for years. This business is called “long tail”. The policyholders themselves have no way of predicting what claims they may incur. Reliance (Canada) also wrote policies with lengthy policy periods. In addition, Reliance (Canada) acted as a reinsurer for other insurers. “Assumed Reinsurance” is treated as insurance under the *Insurance Companies Act*, and is accorded the same priority as loss claims under the *Winding-up and Restructuring Act*.
15. In October 2000, Reliance (Canada) voluntarily stopped writing new policies, effectively winding down its business. At the beginning of the liquidation, excluding the warranty programs, there were 16 policies still in force with all other policies having expired or been cancelled, and over 1,100 claims. In addition, Reliance (Canada) had “incurred but

not reported” (“IBNR”) claims for which it will ultimately be put on notice and to which it will have to respond, primarily on the occurrence-based policies.

16. As at September 30, 2005, two policies remained in force. The term of the second policy and the last certificates in the Meridian program will expire in 2007. There were 379 open claims, excluding the warranty programs.

IV. FINANCIAL STATUS OF THE ESTATE

17. The First Distribution was based on the financial status of the estate at March 31, 2003. Copies of the Order of this Court dated June 26, 2003 approving and authorizing the First Distribution and of the Liquidator’s Report in support thereof (without schedules) are attached as Schedules “B” and “C” respectively.
18. The Second Distribution was based on the financial status of the estate at June 30, 2004. Copies of the Order of this Court dated September 2, 2004 approving and authorizing the Second Distribution and of the Liquidator’s Report in support with relevant schedules are attached as Schedules “D” and “E” respectively.
19. This Court passed and approved the accounts of the Liquidator for the periods from the Winding-up Order to September 30, 2003 and from October 1, 2003 to June 30, 2004.
20. Attached as Schedule “F” are the unaudited financial statements for the estate as at September 30, 2005, prepared in a manner consistent with the financial statements before this Court for June 30, 2004, and with the same system of internal controls to safeguard the assets and reliability of the financial reporting process.
21. In this Report, the Liquidator will generally compare the financial status of the estate at September 30, 2005 to its status at June 30, 2004, but will also make relevant comparisons to the status at the time of the First Distribution.

22. As noted in previous Reports, a key characteristic of the Reliance (Canada) claims profile is its “lumpiness.” That is, a significant number of its policies do not have frequent claims, but, if claims occur, they are severe. As further progress is made in dealing with the claims and more information becomes available on which to assess them, the Liquidator adjusts the policy liabilities. In particular, where claims are resolved for amounts lower than the amounts reserved for them, the policy liabilities are reduced, and where more information becomes available to indicate a higher exposure than has been reserved, the policy liabilities are increased. Increases also have the effect of increasing the reinsurance recoverables since these claims are generally reinsured at significant levels. Such fluctuations in the level of surplus are to be expected, given the volatility of the portfolio.
23. The estate surplus has been increased from \$42.9 million at June 30, 2004 to \$70 million at September 30, 2005. This increase is largely as result of the net IBNR being reduced by \$13.4 million. An actuarial review was completed at the end of March 2005, and showed the reported losses were less than expected over the preceding year, which resulted in a lower IBNR. The increase in the surplus was also partly due to a decrease in the bad debt allowance on reinsurance; this was as result of a large claim being settled for less than its original reserve.

A. Assets

Vested Assets

24. 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*.

25. As at the commencement of the liquidation the Vested Assets consisted of cash or investments in the amount of approximately \$171 million. The Liquidator has been making the Policy Payments and paying the costs and expenses of the liquidation. It has collected reinsurance and subrogation proceeds. As at September 30, 2005, the cash or investments total approximately \$142 million.

Reinsurance

26. 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”); and
 - 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*.
27. The percentage of Reliance (Canada)’s case reserves that are reinsured changes over time as the composition of the case reserves changes. As at June 30, 2004 approximately 65% of Reliance (Canada)’s gross case reserves were reinsured. Of this amount, approximately 34% was Canadian Reinsurance and 66% was International Reinsurance. As at September 30, 2005, approximately 47% of Reliance (Canada)’s gross case reserves were reinsured, approximately 76% of which was Canadian Reinsurance and 24% International Reinsurance. The change in the percentage split from June 2004 is due to the decrease in case reserves for International Reinsurance from \$43 million to \$5.7 million at September 30, 2005. The decrease is a result of several large claims, reinsured under the International Reinsurance, settling and their reserves being reduced to zero. These percentages do not reflect estimates for uncollectible reinsurance due to credit, collection or contractual risk. Over 76% of the reinsurance is with reinsurers rated “A” or higher.

28. By September 30, 2005, the Liquidator had collected approximately \$47.5 million in reinsurance since the beginning of the liquidation, with \$32.7 million of this since June 30, 2004. The U.S. Liquidator has collected International Reinsurance in the amount of U.S. \$5.1 million on behalf of Reliance (Canada), which has not yet been forwarded to Reliance (Canada). In addition, reinsurance receivables (amounts billed to reinsurers), net of a provision for uncollectible reinsurance, were \$26.8 million at September 30, 2005, down from \$27.6 million at June 30, 2004. Reinsurance recoverables (amounts referable to reported claims not yet billed and to IBNR), net of a provision for uncollectible reinsurance, were \$44.8 million, down from \$76.6 million at June 30, 2004. (Since September 30, 2005 the Liquidator has collected an additional sum of \$7.2 million, reflecting the success of continuing collection efforts.)

Summary

29. As at June 30, 2004, the value of Reliance (Canada)'s assets was \$265.6 million and cumulative claims and related expenses paid from the commencement of the liquidation to June 30, 2004 totalled \$43.3 million. As at September 30, 2005, the value of Reliance (Canada)'s assets was \$219.6 million. Cumulative claims and related expenses paid totalled \$94.7 million.

	September 30, 2005 (in millions)	June 30, 2004 (in millions)	September 30, 2003 (in millions)
Cash or Investments	\$142.2	\$155.1	\$156.3
Reinsurance receivables and recoverables net of estimate for uncollectible reinsurance	\$71.7	\$104.1	\$ 71.1
Miscellaneous	5.7	\$ 6.4	\$ 9.6
Total	\$219.6	\$265.6	\$237.0
Cumulative claims and related expenses	<u>\$94.7</u>	<u>\$43.3</u>	<u>\$31.5</u>

B. Liabilities

30. The Liquidator retained a third party actuary to perform further actuarial and claims reviews since the Second Distribution. At June 30, 2004, the estimated value of the liabilities was \$213.7 million. As at September 30, 2005, the estimated value was \$140.7 million, determined as described below.

No Call for Claims to Date

31. 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 inefficient at this point, 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

32. There are basically three categories of loss claims:
- a) claims that are settled or otherwise resolved (the "Resolved Claims"). Since the Second Distribution, the Liquidator has resolved approximately 2,510 claims having a total value \$39 million. As at September 30, 2005:
 - (i) approximately 17,263 claims having a total value of \$104 million have been resolved, through settlement or otherwise, since the beginning of the liquidation;
 - (ii) of those, the Liquidator paid 2,497 claims in full for approximately \$33 million since the Second Distribution, bringing the total claims paid in full in accordance with the Court authorized Policy Payments to 17,218 claims having a value of approximately \$54 million; and

- (iii) the remaining 45 claims either do not qualify for PACICC coverage or exceed PACICC limits. Policy Payments have been made on account of these claims in the amount of \$26 million but a balance of \$24 million remains outstanding;
- b) claims that have been reported but not yet resolved (the “Reported Claims”). As at September 30, 2005, there were approximately 379 Reported Claims outstanding, down from 544 at June 30, 2004, but outstanding gross case reserves were reduced by approximately one half, from approximately \$100.2 million to \$51.1 million. Case reserves are adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. (As discussed earlier, this change reflects the volatility and “lumpiness” of Reliance (Canada)’s portfolio); and
- c) the provision for IBNR and for deficiencies in Reported Claims.

Non-Booked Claims

- 33. As described in previous reports, there may be claims not reported in the books of Reliance (Canada) that 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.
- 34. No new Non-Booked Claims have been identified since the Second Distribution. The U.S. Liquidator has agreed that her staff will advise the Liquidator if they identify any Non-Booked Claims, including as a result of the U.S. call for claims that expired on December 31, 2003. They are performing a preliminary review of all claims filed including contingent claims, and, as indicated, none have been identified to date.
- 35. 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). It is important to note that the U.S. Liquidator believes the open claims identified as having a possible nexus with Canada are in fact claims that, if valid, would participate in the U.S. estate.

36. 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.

Liability Claims Projection Process

37. The Liquidator has applied the same basic methodology in projecting the policy liabilities as for the Second Distribution. The Liquidator has undertaken an extensive review of the policy liabilities, including retaining the services of the consulting actuary who acted for Reliance (Canada) before it was wound up. Representatives of the U.S. Liquidator have also reviewed the largest case reserves on which there is the greatest volatility and have shared their results, which the Liquidator has taken into account in establishing the policy liabilities.
38. 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.

39. 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.
40. The Liquidator instructed the actuaries to confirm their best estimate of the policy liabilities in accordance with accepted actuarial standards. The Liquidator then carefully reviewed the assumptions underlying the actuarial estimates, and introduced some further elements of conservatism in reaching the estimate of \$140.7 million for policy liabilities.

V. MAJOR ACTIVITIES OF THE LIQUIDATOR

A. Administration

41. On being appointed, the Liquidator considered Reliance (Canada)'s complex claims, and the seniority and reputation of its employees, and consulted with the U.S. Liquidator and PACICC. The Liquidator determined that the best interests of the estate would be served by maintaining continuity, to the extent possible, through retaining existing Reliance (Canada) staff and that this would result in cost savings. At the beginning of the liquidation there were 17 employees. As at September 30, 2005, 7 employees remained.
42. Reliance (Canada) employees perform day-to-day administration, including instructing defence counsel and outside adjusters, dealing with counsel on coverage issues, administering reinsurance collections, performing accounting and financial reporting with respect to claims and reinsurance issue functions, and liaising with PACICC and employees of the U.S. estate.

43. The Liquidator maintains responsibility for the conduct of the liquidation. The Liquidator is responsible for all strategic initiatives and major decisions and, as appropriate, is involved in supervising and augmenting, where necessary, the day-to-day activities performed by former Reliance (Canada) employees. The Liquidator performs the functions specific to the liquidation, including the development of policies and procedures for claims handling and authorities, the institution of internal controls, reporting to the Court and stakeholders, supervising and coordinating legal counsel, monitoring developments in the U.S. liquidation, and providing insureds with information. The Liquidator reviews all claims decisions involving claims that meet criteria established in co-operation with PACICC and the U.S. Liquidator, performs the financial reporting, is actively involved in reinsurance collections, makes all investment decisions, and instructs and consults with the actuary. A further summary of the Liquidator's activities is set out below.

B. Third Party Administrators

44. Reliance (Canada) also had arrangements with third party administrators who were responsible for the administration of claims in a number of programs, the major ones including:

- a) Meridian;
- b) Groupe PPP, a financial guarantee program underwritten in the U.S., covering automobile dealers in Quebec;
- c) Gap Program, a financial warranty program;
- d) Family Program, a personal lines program in British Columbia; and
- e) Environmental Program, administered by ECS Inc. in the United States.

45. Each of the programs is unique in respect of the volume, magnitude and complexity of its claims, and with respect to the discretion accorded the third party administrators. In each case, the Liquidator reviewed the program and the nature of the relationship between the

administrator and Reliance (Canada). In assessing the continued use of the third party administrators, the Liquidator considered their cost, the potential prejudice if the administration were disrupted and the quality of their work. The Liquidator determined that it was appropriate to maintain the relationships, but introduced additional controls and reporting requirements, as it considered necessary, and regularly reviews the status of the administrations.

C. Stakeholders

PACICC

46. The Liquidator entered into a loan and services agreement with PACICC on December 3, 2001, approved by this Court in the Appointment Order.
47. PACICC approves payments in respect of claims in excess of \$25,000, to which it responds, in accordance with its Memorandum of Operations. The Liquidator regularly consults with PACICC concerning the progress of the estate.

U.S. Liquidator

48. As discussed, based on the information currently available, there will be a surplus after payment of all liabilities of Reliance (Canada). This will ultimately be payable to the Reliance estate. Therefore, the U.S. Liquidator has an on-going interest in the administration of Reliance (Canada). Further, before the liquidation, Reliance (Canada) depended on Reliance for many services, including information services and technology. In addition Reliance underwrote insurance policies which were later allocated to Reliance (Canada), entered into reinsurance treaties which also covered Reliance (Canada) liabilities and collected reinsurance proceeds on its behalf, and had ultimate decision-making power for setting Reliance (Canada)'s claims reserves and settlement.
49. To prevent disruption to the administration of Reliance (Canada) and in recognition of the U.S. Liquidator's financial interest in the Canadian estate, the U.S. Liquidator, the Superintendent and the Liquidator entered into the protocol dated November 28, 2001,

attached as Schedule “G” (the “Protocol”), providing for cooperation with respect to use of information systems, collection of reinsurance, administration of claims, and the sale process for the policy liabilities. The Protocol remains in force and close co-operation between the liquidators continues. However, the Liquidator remains cognizant at all times of balancing the interests of all stakeholders.

Policyholders

50. The Liquidator has been in regular contact with policyholders, third party claimants and counsel concerning the financial status of the estate, particularly with respect to both the timing and quantum of future distributions. The Liquidator recognizes the difficulties the liquidation poses, particularly at the time of claims settlement discussions, and has been as open and helpful as appropriate in the circumstances.

Reinsurers

51. The Liquidator has also been in regular contact with reinsurers, not only in respect of its collection efforts, but also to make information available and to respond to their legitimate concerns respecting primarily the inter-relationship between the Canadian and U.S. estates.
52. Through extensive efforts, including meetings with U.K. reinsurers in London, the Liquidator has made progress in reinsurance collections. This is evidenced by the increase in reinsurance collections discussed in this Report. However, significant further effort will be required, the Liquidator anticipates, to maximize future reinsurance recoveries.
53. The Liquidator has also responded to a very significant development in the reinsurance market, namely the first importation into Canada of a “solvent scheme of arrangement” by Cavell Insurance Company Limited (“Cavell”), a U.K. reinsurer of Reliance (Canada).
54. The effect of solvent schemes of arrangement on reinsureds can be very significant, particularly where the reinsurance pertains to long tail “lumpy” risks of the nature

reinsured by Cavell in the case of Reliance (Canada). Under such schemes, the reinsured is compelled to have its reinsurance contract terminated. If a termination value cannot be reached by agreement, the sole arbiter of a value is a scheme adjudicator chosen by the reinsurer.

55. Since, particularly in the case of long tail, lumpy risks, a forced termination of reinsurance at what is a speculative value can result in a serious prejudice to the reinsured where large losses in fact materialize over the long tail period, the effect on a reinsured's projections can be significant. This is magnified in the case of a reinsured in liquidation, which has no means to adjust future revenues (premiums) in such a case.
56. Accordingly, the Liquidator has taken care to attempt to respond to Cavell's scheme of arrangement appropriately, including participating in the application brought by Cavell in this Court for an order to recognize and give other relief in respect of the U.K. Court's proceeding. The Liquidator understands that the Cavell scheme is simply one of many more such schemes to come.
57. Since Cavell's recognition proceedings in this Court, Reliance (Canada) has received notice of several further class actions that may fall within the Cavell reinsurance coverage. This illustrates precisely the risk that such solvent schemes of arrangement present to a reinsured: namely significant claims that arise in a long tail period after the date for the forced termination (in the case of Cavell being December 31, 2004).
58. The Liquidator continues to closely monitor the situation and consider its options in respect of the scheme in the U.K. Court, to protect the interests of the Canadian estate.

D. Summary of Activities

59. In summary, the Liquidator's major activities for the Five Quarters included:
 - a) Claims adjudication and administration – including:
 - (i) overseeing payment of defense and adjustment costs;

- (ii) overseeing a comprehensive review of all claims including estimating range of possible outcomes;
 - (iii) engaging in extensive discussions with policyholders, claimants and their counsel concerning the estate, including its financial status; and
 - (iv) settling or otherwise resolving 2,510 claims having a value of \$39 million.
- b) Reinsurance, including:
- (i) reconciling accounts;
 - (ii) enforcing liquidation clause;
 - (iii) clarifying set-off issues;
 - (iv) discussions with Cavell and participating in court proceedings with respect to its scheme of arrangement;
 - (v) entering into agreements with reinsurers and the U.S. Liquidator to facilitate collection of both the Canadian and the International Reinsurance; and
 - (vi) collecting receivables, including direct communication with reinsurers, several visits with U.K. reinsurers in London, and cooperative efforts with the U.S. Liquidator;
- c) reviewing and amending as necessary the investment policy, managed investments, considered, and continues to consider, investment options including the retention of an investment manager;
- d) reporting regularly to PACICC and the U.S. Liquidator;
- e) performing extensive review of policy liabilities as at March 31, 2005;
- f) maintaining external website; and

- g) continuing monitoring and auditing of the U.S. liquidation, and discussions with the U.S. Liquidator, with respect to cross-border issues and other matters that impact the Canadian estate, including significant issues with respect to reinsurance collections by the U.S. Liquidator that have a Canadian nexus.

VI. LIQUIDATOR'S ACCOUNTS AND PROFESSIONAL FEES

A. Financial Statements

- 60. The Liquidator does not consider that a traditional statement of receipts and disbursements would provide a meaningful and informative reflection of the financial position of the estate. The Liquidator has therefore prepared unaudited financial statements, attached as Schedule "F".
- 61. The financial statements have been prepared in a manner consistent with the statements approved previously by this Court. The Liquidator maintains a system of internal controls to safeguard the assets and the reliability of the financial reporting process.

B. Professional Fees

- 62. The Liquidator retains professional advisors to assist in the administration of the liquidation from time to time. The Liquidator is familiar with the services provided by each of the professional advisors and has reviewed their invoices. Detailed invoices were timely received and carefully reviewed in detail by senior administrative and management level members of the Liquidator's staff. The invoices were reviewed for accuracy, adequate detailed information describing the work performed and by whom, the time spent and when it was spent, the rate and amount billed, possible duplicative charges, reasonableness and overall compliance with the terms of retention. Clarifications and adjustments of items included in the invoices were requested where it appeared appropriate.

63. The Liquidator believes that the Professional Fees of its advisors are proper, fair and reasonable and were incurred in furtherance of the best interests of the estate of Reliance (Canada).

Goodmans LLP

64. Goodmans LLP (“Goodmans”) has acted as counsel to KPMG Inc. from the commencement of the liquidation and has acted or advised on all matters described in this report. The Liquidator is familiar with its services and has reviewed its invoices in detail and with the care described above.

65. At the commencement of the liquidation, Goodmans agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79%, effective October 1, 2003, reflecting the change in the Consumer Price Index over the two year period. The discount from its current market rates is approximately 20% to 30%.

66. Attached as Schedules “H”, “I” and “J”, respectively, are:

- a) a summary invoice from Goodmans to the Liquidator for each of the Five Quarters;
- b) a summary for each of these periods of the hours and average hourly rates of each of Goodmans’ personnel who dedicated more than 30 hours to the estate; and
- c) a brief description of the areas of concentration of each of Goodmans’ personnel who dedicated more than 30 hours to the estate.

67. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.

68. The Liquidator is satisfied that Goodmans' fees are proper, fair and reasonable, that time was appropriately spent and that Goodmans' fees were incurred in furtherance of the best interests of the estate.

KPMG Inc.

69. The Liquidator has kept careful and detailed records of all time spent by Liquidator personnel on the estate. The Liquidator has instituted internal controls to ensure no duplicative or inappropriate charges are made. The Liquidator applied the same standard for review to its accounts as to accounts of other professionals, described above. As discussed above, the Liquidator maximized efficiency and reduced costs by retaining former Reliance (Canada) employees and third party administrators where prudent and appropriate.

70. At the commencement of the liquidation, the Liquidator agreed to a discount from its then current market rates of approximately 15% to 20%, with rates not to be increased for one year. In fact, rates were not increased for the first two years of the liquidation, but were raised by 4.79%, effective October 1, 2003, and an additional 2.4% since the last passing, effective October 1, 2004, reflecting the changes in the Consumer Price Index. The discount from current market rates is approximately 20% to 45%.

71. Attached as Schedules "K", "L" and "M", respectively, are:

- a) an invoice from the Liquidator to the estate for the Five Quarters;
- b) a summary for each of these periods of the hours and average hourly rates of each of the Liquidator's personnel who dedicated more than 30 hours to the estate; and
- c) a brief description of the areas of concentration of each of the Liquidator's personnel who dedicated more than 30 hours to the estate for each of the Three Quarters.

72. Detailed supporting records, including time sheets, are available should this Court wish them produced. An affidavit attesting to the accuracy of the fees and disbursements is also being filed.
73. The Liquidator respectfully requests that this Court pass the accounts of the Liquidator, as reflected in the financial statements, and approve the Professional Fees.

VII. THIRD DISTRIBUTION

A. Scheme of Distribution

74. 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, being 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. 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. Approach to Distribution

75. As with the First and Second Distributions, the Liquidator has introduced further elements of conservatism, beyond those in the loss projection methodology, 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) Two major sources of uncertainty remain in the estate: reinsurance and Non-Booked Claims. To deal with these uncertainties in this distribution, the Liquidator is ascribing no value to reinsurance that has not been paid, and is building into the assumptions conservative values for the Non-Booked Claims.
76. The Liquidator is also taking into account \$7.2 million collected on reinsurance since September 30, 2005.
77. Based on the foregoing and in light of the remaining uncertainties described above, the Liquidator recommends a further distribution of 15% of valid policyholder loss claims, bringing the total distributions to 65%. This distribution level is 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

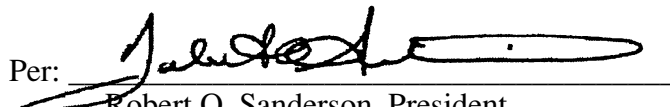
78. If the Third Distribution is approved by the Court, each claimant's dividend will be calculated by deducting from the amount to which it would otherwise be entitled any Policy Payments it received before the date of the distribution, in accordance with paragraph 12 of the Appointment Order. In effect, those Policy Payments are treated as advances on the distribution. The Liquidator will pay the higher of the Policy Payments and the total distributions on valid policyholder claims.
79. PACICC compensated claims are deemed to be assigned to PACICC under paragraph 15 of the Appointment Order. However, the Liquidator has made the PACICC Policy Payments, which were treated as a loan to PACICC under the loan agreement dated the 3rd day of December 2001, approved by this Court in the Appointment Order. The distributions reduce the amount outstanding thereunder.

VIII. RECOMMENDATIONS

80. 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 this Court approve the Third Distribution of 15% on all valid and allowed loss claims, to be calculated as set out above, bringing total distributions to 65%, as claims are allowed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

KPMG INC., the Liquidator of Reliance Insurance
Company – Canadian Branch

Per: 
Robert O. Sanderson, President

Schedule "F"

Unaudited Financial Statements of

RELIANCE INSURANCE COMPANY

Canadian Branch (in liquidation)

In our capacity as Liquidator, we have prepared the Balance Sheet of Reliance Insurance Company, Canadian Branch (in liquidation) as at September 30, 2005, June 30, 2004, September 30, 2003 and December 31, 2001, the Statement of Earnings and Changes in Surplus for the fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003, and the Statement of Cash Flows for the fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003 in our capacity as liquidator. These financial statements have not been audited or reviewed.

In view of the uncertainties surrounding a branch in liquidation, the ultimate realization of the assets and liabilities will differ from the recorded amounts and the differences may be material (see notes).

Readers are cautioned that these statements may not be appropriate for their purposes.

KPMG Inc., Liquidator.
Reliance Insurance Company, Canadian Branch

December 13, 2005

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Balance Sheet

As at September 30, 2005, June 30, 2004, September 30, 2003 and December 3, 2001

(\$000)

(Unaudited - see cover page)	September 30, 2005	June 30, 2004	September 30, 2003	December 3, 2001
Assets				
Cash and short term investments (note 4)	\$ 916	\$ 155,078	\$ 156,277	\$ 56,165
Investments (note 4)	141,308	-	-	108,949
(market value: Sept 30, 2005 - \$140,919; 2004 - \$0; 2003 - \$0; 2001 - \$114,392)				
Receivable from other insurers/reinsurers	26,863	27,576	13,908	6,090
Income and premium taxes recoverable	-	-	3,070	3,446
Receivable from Reliance US (note 8)	4,848	4,848	4,181	-
Receivable from Reliance US - current balance due (note 8)	222	870	-	-
Other receivables	621	600	958	1,978
Reinsurers' share of provision for				
Unpaid claims	42,172	71,704	51,761	57,536
Unearned premiums	2,564	4,847	5,430	9,670
Estimate for deductibles on unpaid claims	78	106	1,444	2,527
Total assets	\$ 219,592	\$ 265,629	\$ 237,029	\$ 246,361
Liabilities and Surplus				
Policy liabilities:				
Unpaid claims (note 5)	\$ 111,980	\$ 171,544	\$ 145,815	\$ 135,088
Unearned premiums (note 6)	3,989	8,216	9,177	15,189
Allowed claims (note 9)	24,163	33,106	17,269	-
Other liabilities	567	841	2,158	1,917
	140,699	213,707	174,419	152,194
Payables:				
Due to Reliance US (note 8)	4,848	4,848	4,848	-
Due to other insurers/reinsurers	260	142	189	192
Brokers	2,656	2,916	2,924	3,389
Taxes and other creditors	1,034	1,031	1,653	1,826
Reinsurance deposits	10	10	10	3,494
Total liabilities	149,507	222,654	184,043	161,095
Surplus (note 10)	70,085	42,975	52,986	85,266
Contingent liabilities (note 11)				
Total liabilities and surplus	\$ 219,592	\$ 265,629	\$ 237,029	\$ 246,361

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statements of Earnings and Changes in Surplus

For the fifteen months ended September 30, 2005, nine months ended June 30, 2004,
and twenty-two months ended September 30, 2003
(\$000)

(Unaudited - see cover page)	July 1, 2004 to September 30, 2005	October 1, 2003 to June 30, 2004	December 3, 2001 to September 30, 2003
Revenue			
Gross premiums written	\$ (8)	\$ (12)	\$ (508)
Less: reinsurance ceded	323	(9)	(509)
Net written premiums	(331)	(3)	1
Net premiums earned	1,613	375	1,772
Expenses			
Claims incurred	(19,974)	12,539	42,317
Commissions and premium taxes	49	21	5,115
General expenses (note 13)	2,789	1,212	6,656
Foreign exchange (net claims)	(3,466)	(656)	(62)
	(20,602)	13,116	54,026
Investment income			
Interest on cash and short term investments	1,991	2,807	5,188
Interest on investments	3,031	-	7,752
Investment expenses	(123)	(36)	(74)
Realized gain (loss) on disposal of investments	-	-	7,245
	4,899	2,771	20,111
Income (loss) before capital taxes	27,114	(9,970)	(32,143)
Capital taxes	4	41	137
Net income (loss)	27,110	(10,011)	(32,280)
Surplus beginning of period	42,975	52,986	85,266
Surplus end of period	\$ 70,085	\$ 42,975	\$ 52,986

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Note)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statement of Cash Flows

For the fifteen months ended September 30, 2005, nine months ended June 30, 2004,
and twenty-two months ended September 30, 2003
(\$000)

(Unaudited - see cover page)	July 1, 2004 to September 30, 2005	October 1, 2003 to June 30, 2004	December 3, 2001 to September 30, 2003
Operating activities			
Premiums received	\$ (17)	\$ 1	\$ (82)
Reinsurance collected	32,692	6,163	8,601
Salvage, subrogation & deductibles received	1,545	578	2,332
Reduction in other receivables	31	481	697
Total sources	34,251	7,223	11,548
Gross claims paid	48,056	8,663	23,073
Claim expenses paid	3,406	3,136	8,393
Uncashed claim/expense cheques		-	(96)
Reinsurance premiums paid	23	(14)	(108)
General expenses			
Salaries	943	1,364	3,109
Office expenses	351	369	641
Legal/professional	306	138	273
Head office services	244	210	465
Sale of business expense	-	-	770
Liquidation expenses			
KPMG Inc.	1,013	818	3,121
Goodmans LLP	497	266	885
Foreign exchange (gain)/loss	624	(81)	56
Income & premium taxes (incl interest paid/rec'd)	(13)	(3,405)	(22)
Foreign exchange (gain)/loss(net claims)	(3,425)	(273)	(62)
Total uses	52,025	11,191	40,498
Net cash provided by (used) in operating activities	(17,774)	(3,968)	(28,950)
Investing activities			
Sale (purchase) of Investments	(141,308)	-	113,225
Investment expenses	(95)	(36)	(74)
Interest received	5,349	2,895	15,812
Investment income	(334)	(90)	99
Cash provided by (used in) investing activities	(136,388)	2,769	129,062
Increase in cash and short term investments	(154,162)	(1,199)	100,112
Cash and short term investments, at beginning of period	155,078	156,277	56,165
Cash and short term investments, at end of period	\$ 916	\$ 155,078	\$ 156,277
Cash consists of:			
Cash	\$ 916	\$ 2,856	\$ 420
Short term investments (note 4)	-	152,222	155,857
	\$ 916	\$ 155,078	\$ 156,277

The accompanying notes are an integral part of the financial statements

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

1. Nature of the business:

The Canadian Branch of Reliance Insurance Company, which was primarily engaged in the writing of commercial property and liability insurance in Canada, commenced a voluntary wind down of its operations in Canada effective August 2000. In May 2001, Reliance Insurance Company's U.S. operations ("Reliance US") were placed under an order of rehabilitation. On October 3, 2001, Reliance US was put into liquidation and declared insolvent by the Court of Pennsylvania.

On December 3, 2001, the Ontario Superior Court of Justice (the "Court"), on the application of the Attorney General of Canada, granted an order appointing KPMG Inc. as provisional liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company, including the assets in Canada of Reliance Insurance Company, together with its other assets held in Canada under the control of its chief agent ("Reliance Canada"). By further order of the same date, the Court ordered that Reliance Canada be wound up.

Since August 2000, existing insurance policies in force have been allowed to expire and Reliance Canada has neither renewed nor cancelled existing policies, nor has it written any new business. Reliance Canada continues to run off the existing policy and claims liabilities in an orderly fashion.

Pursuant to Orders of the Court the Liquidator has paid policy holders and claimants the greater of: 50% of valid and allowed loss claims pursuant to the first interim distribution approved by the Court in August 2004; or the greater of \$25, 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.

2. Basis of preparation:

The accounting policies used in the preparation of these financial statements have been selected with a view to reflecting the financial position of an insurance company that is in liquidation.

The preparation of these financial statements requires the use of estimates and assumptions that affect the reported assets and liabilities as at the date of the financial statements and the reported amount of revenue and expenses for the reporting period. The actual results will differ from these estimates and, in view of the additional uncertainties surrounding a company in liquidation, the differences may be material. Changes in estimates are recorded in the accounting period in which they are determined.

No provision has been made for future liquidation costs. Interest income earned on the assets of Reliance Canada is likely to offset the unbooked future costs of the liquidation.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

3. Significant accounting policies:

(a) Investments and investment income:

RBC funds are carried at net invested proceeds with all of the income distributions and interest received being reinvested back into the funds. When the carrying amount is greater than the fair value, the carrying amount of these financial instruments is not reduced to fair value as such market rate variations are considered temporary in nature. Term deposits and treasury bills are carried at cost plus accrued interest of \$334 at June 30, 2004, \$424 at September 30, 2003 and \$325 at December 3, 2001. Bonds, including accrued interest of \$3,128 at December 3, 2001, are carried at amortized cost, providing for the amortization of the discount or premium on an effective yield basis to maturity.

Investment income is recorded as it is earned. Gains and losses arising on disposal of investments are on a settlement date basis, and are calculated on the basis of amortized cost.

(b) Premium revenue and unearned premiums:

Unearned premiums represent the amount of premiums written which are applicable to the unexpired terms of the policies in force or to the remaining terms of certificates issued as part of program business. Accordingly, premiums written are taken into income when earned. Although policies were generally issued for one year, Reliance Canada also wrote some multi-year policies and some program business with underlying certificates, which are multi-year.

If the unearned premiums are not sufficient to pay expected claims and expenses, a premium deficiency is said to exist. Any changes in estimates of premium deficiencies are recorded as net premium earned in the period in which they are determined.

The reinsurers' share of unearned premiums, net of a provision for doubtful amounts, is recognized as amounts recoverable at the same time using principles consistent with the method for determining the unearned premium liability.

(c) Provision for unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate for all costs of investigating and settling claims incurred on or before the balance sheet date. The provision estimates do not take into account the time value of money, or make explicit provision for adverse deviation.

The provision includes case basis estimates, and an actuarially determined "best estimate" provision for claims incurred but not reported and for development on case basis estimates ("IBNR"). These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the period in which they are determined.

(d) Reinsurance ceded:

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. To indicate the extent of the credit, collection and contractual risks related to third party reinsurance, estimates of amounts recoverable from reinsurers are recorded separately from the estimated provisions for unearned premiums and unpaid claims.

Amounts recoverable from reinsurers, net of a provision for doubtful amounts, are estimated and recognized at the same time and using principles consistent with Reliance Canada's method for establishing the related liability.

4. Short term investments and investments:

Short-term investments are readily convertible into cash and have maturities of less than 12 months or less. The carrying value of the short-term investments approximates their market value.

Composition of the cash and short term investments:

	September 30, 2005	June 30, 2004	September 30, 2003	December 3, 2001
Cash	\$ 916	\$ 2,856	\$ 420	\$ 1,263
Short term investments	-	152,222	155,857	54,902
Total	\$ 916	\$ 155,078	\$ 156,277	\$ 56,165

Composition of investment portfolio:

	September 30, 2005		December 3, 2001	
	Book Value	Market Value	Book Value	Market Value
RBC Canadian Money Market	\$ 61,506	\$ 61,506	\$ -	\$ -
RBC Short Term Income	71,007	70,618	-	-
RBC US Money Market	8,795	8,795	-	-
Bonds - Canadian Government	-	-	99,959	105,415
Bonds - Canadian Corporate	-	-	8,990	8,977
Total Investments	\$141,308	\$140,919	\$108,949	\$114,392

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

Liquidity and interest rate risk:

Maturity profile as at December 03, 2001			
Bonds (carrying value)	\$17,626	\$52,951	\$38,372
Effective interest rate: 8.19%			

5. Unpaid claims:

(a) Nature of unpaid claims:

The provision for unpaid claims and adjustment expenses (and for third party reinsurers' share thereof) are based upon estimates of the ultimate claim costs associated with claims occurring as of the balance sheet dates, including estimates for IBNR claims. These estimates are subject to variability, and the variability could be material. The variability arises because all events affecting the ultimate settlement of claims have not yet taken place and may not take place for some time. Additional factors affecting the variability include receipt of additional claim information; the continually evolving and changing regulatory and legal environment, court decisions, economic conditions, public attitudes, claims management practices, actuarial studies, the quality of the data used for projection purposes, the effect of inflationary trends on future claims handling and settlement practices, and significant changes in the severity or frequency of claims from historical trends. In addition, the longer the time required for the settlement of a group of claims, the more variable the estimates.

Reliance Canada had fronting reinsurance arrangements with other insurers and provided self-insurance facilities for selected corporate clients. Because Reliance Canada is the direct insurer under these arrangements, policyholders and claimants look to Reliance Canada for settlement of their claims; Reliance Canada obtains repayment from the insurers or corporations, either directly or from security deposits Reliance Canada maintains. The risk to Reliance Canada is credit risk if claims exceed either the security deposits or the self-insured's ability to pay.

Reliance Canada accepted certain insurance risks that other insurance companies have underwritten ("assumed reinsurance"). Because of the necessary reliance on the ceding companies for information regarding reported claims, and the resulting reporting lag between the dates of occurrence and the time Reliance Canada is notified of the claims, the inherent uncertainties of estimating reserves is greater for assumed reinsurance than for direct insurance.

In the normal course of settling claims, Reliance Canada acquires rights to subrogate its claims against other parties and, in some cases, recover a portion of the loss from the policyholder as a deductible amount. Salvage and subrogation are deemed not to be material and, as such, are recorded as received. Deductible amounts, which are recoverable on liability claims, have been recognized as assets.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

(b) Provision for unpaid claims:

Considerable judgement is required to evaluate claims and establish claim liabilities. The estimation of the claims provision is based on known facts and interpretation of circumstances. The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. Methods of estimation have been used which it is believed produce reasonable results given current information; however, the process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimate made. It is also not possible to estimate the impact of the additional uncertainties surrounding a company in liquidation on the estimation process.

The changes in the unpaid claim provisions recorded in the balance sheet as at September 30, 2005, June 30, 2004, and September 30, 2003 and their impact on the claims and adjustment expenses for the fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003, are as follows:

	<u>July 1, 2004 to September 30, 2005</u>	<u>October 1, 2003 to June 30, 2004</u>	<u>December 3, 2001 to September 30, 2003</u>
Unpaid claims at beginning of period	\$ 171,544	\$ 145,815	\$ 135,088
Recoverable from reinsurers at beginning of period	<u>71,704</u>	<u>51,761</u>	<u>57,536</u>
Net unpaid claims at beginning of period	<u>99,840</u>	<u>94,054</u>	<u>77,552</u>
Increase(decrease) in estimated losses and expenses for claims occurring in prior years	(19,974)	12,539	42,317
Increase(decrease) in outstanding deductibles	(30)	(65)	(1,090)
Paid on claims (net) occurring during current year			
(Gap Programs)	(278)	(577)	(1,377)
Paid on claims (net) occurring during prior years	<u>(9,750)</u>	<u>(6,111)</u>	<u>(23,348)</u>
Net reserves at end of period	69,808	99,840	94,054
Ceded reserves at end of period	<u>42,172</u>	<u>71,704</u>	<u>51,761</u>
Gross reserves at end of period	<u>\$ 111,980</u>	<u>\$ 171,544</u>	<u>\$ 145,815</u>

In order to show the progress of the liquidation from the date of winding-up and as it is not practicable in a winding-up to determine fair value with sufficient reliability, the fair value of the unpaid claims and adjustment expenses, gross and recoverable from reinsurers has been omitted.

6. Unearned premium:

The provisions for unearned premiums include actuarially determined estimates for premium deficiencies. The process for estimating any provisions for premium deficiency involves the use of estimates concerning factors such as expected claims and expenses and future payout patterns. Any provisions are necessarily subject to uncertainty.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

The provision estimates do not take into account the time value of money or make explicit provision for adverse deviation.

7. Reinsurance:

In the normal course of business, Reliance Canada sought to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. Reliance Canada is not relieved of its primary obligation to policyholders as a result of its third party reinsurance. Failure of reinsurers to honour their obligations could result in losses to Reliance Canada.

Reliance Canada makes specific provisions against reinsurance receivables and recoverables from companies who are in liquidation or run-off, with whom balances are in dispute or where the reinsurer is not settling balances due to Reliance Canada for reasons related to Reliance US. In addition, the Reliance Canada records a general allowance against reinsurance receivables and recoverables based upon the level of allowance already in place and management's judgement. The general allowance reflects the view that a company in liquidation or run-off has a greater collection risk than a going concern company. The establishment of the allowances for doubtful accounts involves judgement and therefore creates a degree of uncertainty as to adequacy at each reporting date.

Reliance Canada's reinsurance program includes: i) reinsurance placed by Reliance Canada directly with Canadian licensed reinsurers and ii) reinsurance entered into by Reliance US which reinsures both Reliance (Canada) policies and policies of Reliance US and other companies in the Reliance group.

8. Head office:

(a) Payable to Head Office:

As at September 30, 2005, \$4,848 has been set up as an amount due to Reliance US for underwriting commissions paid to ECS Managers (the "ECS Commission Payable"); at June 30, 2004 the payable to head office was \$4,848; at September 30, 2003 \$4,848; and at December 3, 2001 the payable was nil. The liquidator for Reliance US (the "US Liquidator"), subsequent to the date of liquidation, advised Reliance Canada that the Reliance US had settled the ECS Commission Payable with ECS Managers on behalf of Reliance Canada prior to the respective and separate liquidations of Reliance Canada and Reliance US. The US Liquidator has taken the position that it wishes to withhold payment to the Canadian Liquidator of reinsurance collected by Reliance US on behalf of Reliance Canada on the international reinsurance treaties ("Canadian Reinsurance Proceeds") up to the amount of the ECS Commission Payable of \$4,848 or US\$3,034. The Canadian Liquidator disputes that the US Liquidator is entitled to do this; however, the parties have agreed that, without prejudice, Reliance US will pay to Reliance Canada any Canadian Reinsurance Proceeds in excess of the ECS Commission Payable. The US Liquidator and the Canadian Liquidator have agreed to fix the Canadian dollar balance due to Reliance US for the ECS Commission Payable using the exchange rate of 1.5981 (see note 14).

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

(b) Receivable from Reliance US:

As at September 30, 2005, on behalf of Reliance Canada, Reliance US has collected \$4,848; at June 30, 2004 \$4,848; at September 30, 2003 \$4,181; and at December 3, 2001 nil of Canadian Reinsurance Proceeds, which is to be held by the Reliance US pending payment of the ECS Commission Payable. While Reliance Canada has generally billed the reinsurance in Canadian dollars, Reliance US has generally collected the Canadian Reinsurance Proceeds in US dollars. The US dollar amount due from the Reliance US to Reliance Canada has been fixed at a rate of 1.5981 (see note 14). The resulting foreign exchange gain was booked through the income statement in June 2004.

(c) Receivable from Reliance US – Current Balance Due:

As at September 30, 2005, on behalf of Reliance Canada, Reliance US has collected \$222; at June 30, 2004 \$870; at September 30, 2003 nil; and at December 3, 2001 nil of Canadian reinsurance proceeds, which have yet to be forwarded by Reliance US to Reliance Canada. While Reliance Canada has generally billed the reinsurance in Canadian dollars, Reliance US has generally collected the reinsurance in US dollars. Reliance Canada will recognize a foreign exchange gain or loss on this balance upon receipt of funds from the Reliance US.

(d) Protocol Agreement:

Further to a protocol agreement between the Liquidator and the US Liquidator, Reliance US provides various services to Reliance Canada, particularly in the areas of data processing, claims and reinsurance. For the fifteen months ended September 30, 2005 the cost of the services was \$262; October 1, 2003 to June 30, 2004 \$187; December 3, 2001 to September 30, 2003 \$505.

9. Allowed claims:

As at September 30, 2005, allowed claim balances are due on claims which have been settled and admitted by the Liquidator, in excess of the Court authorized payments of \$24,163; at June 30, 2004 \$33,106; September 30, 2003 \$17,269; and at December 3, 2001 nil.

10. Surplus:

As at September 30, 2005, Reliance Canada's estimated surplus is \$70,085; at June 30, 2004 \$42,975; at September 30, 2003 \$52,986; and at December 3, 2001 \$85,266. This estimate is subject to revision. In view of the uncertainties surrounding a company in liquidation, the ultimate realization of the assets and liabilities will differ from the estimated results as at September 30, 2005 and the difference may be material. Any surplus available at the wind-up of the liquidation will be paid to Reliance US.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

11. Contingent liabilities:

There is the potential that certain claims that were not reported in the books of Reliance Canada may be valid claims against Reliance Canada ("Non-Booked Claims"). The Non-Booked Claims would arise from policies written outside Canada but which have some nexus with Canada and which, arguably, should have been reported in the books of Reliance Canada. 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. Should additional loss result from any new claims, such loss would be accounted for as a charge to earnings in the accounting period that the claims are verified as liabilities of Reliance Canada.

12. PACICC loan agreement:

PACICC and the Liquidator entered into a loan and services agreement, dated December 3, 2001, which 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 occurs on the Amount Outstanding at the prime rate. In the event all policyholders and creditors receive full payment on all valid claims from the assets of the Reliance Canada, the Liquidator will not demand repayment of the Amount Outstanding. The Amount Outstanding has not been accrued in the financial statements.

13. Supplementary expense information:

	<u>July 1, 2004 to September 30, 2005</u>			<u>October 1, 2003 to June 30, 2004</u>		
	<u>Total</u>	<u>General</u>	<u>Claims</u>	<u>Total</u>	<u>General</u>	<u>Claims</u>
Salaries	\$ 945	\$ 473	\$ 472	\$ 1,079	\$ 539	\$ 540
Office expense	342	171	171	318	159	159
Legal/professional services	311	155	156	111	56	55
Allowance for bad debts	(3)	(3)	0	6	6	0
Head office services	262	130	132	187	93	94
Interest (income)/expense	27	27	0	(406)	(406)	0
Foreign exchange (gain)/loss	482	482	0	(31)	(31)	0
Sale of business expense:						
Other	0	0	0	0	0	0
Liquidation expenses:						
KPMG Inc.	869	869	0	622	622	0
Goodmans LLP	<u>485</u>	<u>485</u>	<u>0</u>	<u>174</u>	<u>174</u>	<u>0</u>
Total expenses	<u>\$ 3,720</u>	<u>\$ 2,789</u>	<u>\$ 931</u>	<u>\$ 2,060</u>	<u>\$ 1,212</u>	<u>\$ 848</u>

The claims expenses are included in Claims incurred on the statement of earnings and changes in surplus.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the fifteen months ended September 30, 2005, and nine months ended June 30, 2004, and twenty-two months ended September 30, 2002

(unaudited – \$000)

14. Foreign exchange:

Further to an order from the Court, dated December 18, 2003 and amended on June 30, 2004, the Liquidator is authorized to pay claims payable in foreign currencies either:

- a) in those foreign currencies in circumstances where the Liquidator is otherwise legally entitled to do so; or
- b) in Canadian currency, converted at the Bank of Canada noon spot rate of exchange for exchanging such currencies to Canadian currency on November 8, 2001.

Further to this, in cases where the agreed claim is determined in U.S. dollars, the rate used by Reliance Canada to calculate the Canadian equivalent is \$1.5981.

**RELIANCE INSURANCE COMPANY
(in liquidation)**

Professional Fees (including G.S.T.)

	Jul 1, 04 to Sep 30, 04	Oct 1, 04 to Dec 31, 04	Jan 1, 05 to Mar 31, 05	Apr 1, 05 to Jun 30, 05	Jul 1, 05 to Sep 30, 05	Jul 1, 04 to Sep 30, 05
Core Professional						
Goodmans LLP	\$142,386	\$78,807	\$120,552	\$86,397	\$44,253	\$472,395
KPMG Inc.	169,108	206,592	211,607	148,804	73,458	809,570
	311,494	285,399	332,159	235,201	117,711	1,281,965
Other Professional Fees						
Kendall Freeman			117,814	82,144	14,637	214,595
Blaney McMurtry						
Allen & Overy				4,597		4,597
	0	0	117,814	86,741	14,637	219,192
Actuaries						
J. S. Cheng & Partners	86,707					86,707
	86,707	0	0	0	0	86,707
TOTAL	\$398,201	\$285,399	\$449,973	\$321,941	\$132,348	\$1,587,864

October 1, 2004

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period July 1, 2004 to September 30, 2004, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims, U.S. directors and officers claims, liaison and communications with adjusters, defence and plaintiffs' counsel, policyholders and claimants;

Attendances with respect to reinsurance issues; and

Attendances with respect to liquidation issues, including preparation of motion materials and attendance at Ontario Court re passing of accounts, approval of the professional fees of the Liquidator and of its counsel and authorizing a second interim distribution, issues re payment of post-liquidation interest, liaison with inspectors, and entering into arrangements with Royal Bank of Canada for investment of assets.

OUR FEE:	\$130,663.50
DISBURSEMENTS:	\$ 2,407.58
GST:	<u>\$ 9,314.99</u>
TOTAL:	<u>\$142,386.07</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5235632.1

January 1, 2005

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period October 1, 2004 to December 31, 2004, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims and preparation of settlement documents, liaison and communications with adjusters, defence and plaintiffs' counsel, U.S. directors and officers claims and applications for leave to proceed;

Attendances with respect to reinsurance issues;

Attendances with respect to liquidation issues, including employee issues, preparation of motion materials and attendance at Ontario Court re approval of arrangements entered into with Royal Bank of Canada; and

Attendances with respect to U.S. issues, including establishment of a protocol between the Canadian and U.S. estates with respect to claims.

GOODMANS

-2-

OUR FEE:	\$72,524.00
DISBURSEMENTS:	\$ 1,142.07
GST:	<u>\$ 5,141.23</u>
TOTAL:	<u>\$78,807.30</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5235661.1

April 1, 2005

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period January 1, 2005 to March 31, 2005, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims and preparation of settlement documents, liaison and communications with adjusters, defence and plaintiffs' counsel, U.S. directors and officers claims and applications for leave to proceed;

Attendances with respect to reinsurance issues, including proposed scheme of arrangement by foreign reinsurer including determination of financial interest of Reliance Canada, review of treaties and scheme materials, preparation for and attendance at motion at Ontario Court and research with respect to enforcement of foreign insolvency orders;

Attendances with respect to general liquidation issues, including set-off issues; and

Attendances with respect to U.S. issues, including U.S. non-booked claims.

GOODMANS

-2-

OUR FEE:	\$110,687.00
DISBURSEMENTS:	\$ 1,995.43
GST:	<u>\$ 7,869.77</u>
TOTAL:	<u>\$120,552.20</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5235674.1

July 1, 2005

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period April 1, 2005 to June 30, 2005, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims and preparation of settlement documents, liaison and communications with adjusters, defence and plaintiffs' counsel, U.S. directors and officers claims and applications for leave to proceed;

Attendances with respect to reinsurance issues, including preparation of motion materials and attendances at Ontario Court with respect to scheme of arrangement by foreign reinsurer; and

Attendances with respect to U.S. issues, including U.S. non-booked claims.

OUR FEE:	\$78,031.50
DISBURSEMENTS:	\$ 2,729.54
GST:	<u>\$ 5,635.51</u>
TOTAL:	<u>\$86,396.55</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5235681.1

GOODMANS

-2-

OUR FEE:	\$110,687.00
DISBURSEMENTS:	\$ 1,995.43
GST:	<u>\$ 7,869.77</u>
TOTAL:	<u>\$120,552.20</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5235674.1

October 1, 2005

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period July 1, 2005 to September 30, 2005, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims and preparation of settlement documents, liaison and communications with adjusters, defence and plaintiffs' counsel, U.S. directors and officers claims and applications for leave to proceed;

Attendances with respect to reinsurance issues, including appeal and preparation of factum; and

Attendances with respect to U.S. issues, including cross-border issues and U.S. non-booked claims.

OUR FEE:	\$40,851.00
DISBURSEMENTS:	\$ 507.11
GST:	<u>\$ 2,895.08</u>
TOTAL:	<u>\$44,253.19</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5236768.1

Schedule "I"

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED SEPTEMBER 30, 2004**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	72.6	\$505
Wiener, Kenneth	Partner	Corp./Comm.	98.1	\$460
Smith, Graham	Partner	Litigation	57.9	\$425
Bell, Scott	Associate	Research	46.0	\$245
Paquette, Fanny	Law Clerk	Insolvency	36.4	\$165
Individuals with less than 30 hours			<u>46.2</u>	<u>\$150</u>
			<u>357.2</u>	<u>\$365</u>

GOODMANS\5236797.1

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED DECEMBER 31, 2004**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	32.4	\$505
Wiener, Kenneth	Partner	Corp./Comm.	35.1	\$460
Smith, Graham	Partner	Litigation	68.4	\$425
Individuals with less than 30 hours			<u>59.5</u>	<u>\$185</u>
			<u>195.4</u>	<u>\$370</u>

GOODMANS\5236816.1

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED MARCH 31, 2005**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	190.1	\$505
Smith, Graham	Partner	Litigation	49.9	\$425
Individuals with less than 30 hours			<u>36.3</u>	<u>\$130</u>
			<u>276.3</u>	<u>\$400</u>

GOODMANS\5236821.1

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED JUNE 30, 2005**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Smith, Graham	Partner	Litigation	94.3	\$425
Individuals with less than 30 hours			<u>15.6</u>	<u>\$ 50</u>
			<u>109.9</u>	<u>\$370</u>

GOODMANS\5236823.1

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED SEPTEMBER 30, 2005**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Smith, Graham	Partner	Litigation	163.8	\$425
Individuals with less than 30 hours			<u>27.5</u>	<u>\$305</u>
			<u>191.3</u>	<u>\$410</u>

GOODMANS\5236827.1

GOODMANS LLP

GENERAL LIQUIDATION RESPONSIBILITY

GALE RUBENSTEIN is a partner in the insolvency area. She oversees all legal matters and is involved in all major areas of the liquidation. Her particular areas of concentration during the Five Quarters included strategy issues, communications with various stakeholders and with the U.S. Liquidator. She advised with respect to claims and liabilities issues, reinsurance issues, U.S. protocol and non-booked claims, distribution issues, issues relating to the passing of accounts, post-liquidation interest issues, investment issues, and issues regarding third party administrators.

FANNY PAQUETTE is a senior law clerk in the insolvency area. She drafted basic court documents and prepared materials in connection with applications to the Ontario Court and attended to service of motion materials. She also had responsibility for internal accounting control and meeting the requirements of the Liquidator with respect to accounting and billings.

LITIGATION

GRAHAM SMITH is a partner in the litigation section. He provided litigation support and acted as liaison with adjusters, defence counsel and plaintiffs' counsel, acted on applications for leave to proceed, provided advice and prepared settlement documentation on the settlement of various claims, and dealt with the proposed scheme of arrangement by a foreign reinsurer, including attendances at Ontario Court motions and appeal.

CORPORATE/COMMERCIAL

KEN WIENER is a partner in the corporate/commercial area. He reviewed and prepared agreements and had responsibility for the arrangements entered into with Royal Bank of Canada with respect to the investment of assets.

RESEARCH

SCOTT BELL is an associate in the research section. He provided research with respect to the issue of payment of post-liquidation interest.

December 5, 2005

Reliance Insurance Company, in Liquidation
Suite 810, 4 King St W
Toronto ON M5H 1B6

GST #122363153

BILL OF COSTS

To our professional services rendered in connection with the above-noted matter for the period July 1, 2004 to September 30, 2005:

- Review and approval of financial statements and related analysis for the quarters ending June 30th, 2004, September 30th, 2004, December 31st, 2004, March 31st, 2005 and June 30th, 2005;
- Review and approval of Management Reports for the quarters ending June 30th, September 30th and December 31st, 2004 and March 31st and June 30th, 2005;
- Review and approval of money market transactions;
- Continued limited review of Reliance Canada documentation and meetings with the U.S. Liquidator to review U.S. documentation to attempt to quantify the magnitude of exposure to Canadian risk not reported on the books of Reliance Canada;
- Ongoing liaison with the U.S. Liquidator, including the return of surplus funds from the Canadian estate to the U.S. estate, discussions as to the status of reinsurance collections, IT systems administration, runoff models, and obtaining additional information required for the proper administration of the Canadian estate;
- Receipt, review, discussion and attendance at meetings with estate legal counsel to review ongoing matters, reinsurance collections issues including setoff issues, claims settlement issues and various other estate matters as required;
- Continued monitoring of the Reliance staff, including providing appropriate direction and assistance;
- Meetings, discussions, review of assumptions and preparation of detailed runoff models projecting the runoff of the estate;
- Continuing to deal with policyholder and claimants' telephone calls, e-mails and correspondence requesting specific information pertaining to the liquidator or their specific claims;
- Continuing to deal with agents and brokers, especially trying to finalize the reconciliation of their accounts as at the date of liquidation;
- Performing a detailed claims review, discussion of potential outcomes with claims staff and attendance at meetings with the U.S. Liquidator's claims staff to review same;

- Attendance at meetings with actuarial consultant to perform an extensive review of policy liabilities as at March 31, 2005
- Receipt, review and discussion with the actuarial consultant, the results of his extensive review as performed above;
- Continued to review existing claims bordereaux in order to stratify claims as to dollar amounts, lines of business and PACICC exposure;
- Review of new reported claims, discussions with claims adjudication staff and approving set up of appropriate reserves;
- Continuing to liaise with Reliance U.S. IT personnel to ensure the ongoing performance of the computer systems;
- Overseeing the upgrade of the computer hardware, software and connections to the U.S. IT systems;
- Continuing to deal with numerous Meridian policyholder inquiries;
- Continued review and approval of defense and adjustment costs and authorizing payment of same;
- Continued attendance with third party administrators to ensure the continued processing and adjudication of claims under their control and ensuring that claims are adjudicated and settled according to the procedures established by the Liquidator;
- Continued monitoring and supervision of claims adjudication staff, approval of reserve changes, approval of claims settlements, approval of claims settlement costs and authorization of payment of same;
- Continued follow-up on reinsurance billings and collections;
- Preparation for and attendance at meetings with reinsurers in the London market to agree amounts due and ensure collection of same;
- Responding to requests of reinsurers to perform claims audits, development of and execution of confidentiality agreements, obtaining requested claim files from storage and responding to their queries;
- Continued to obtain shared reinsurance documentation from the U.S. Liquidator, particularly in respect of international and reinsurance policies;
- Continued liaison with U.S. Liquidator as to international reinsurance collections and commission expenses associated therewith;
- Providing information and analysis for the Inspectors as required;
- Preparation of appropriate accounting information and filing of appropriate non-tax statutory returns;
- Preparation of the December 31st, 2004 tax returns;
- Receipt and review of the Cavell Scheme of Arrangement under the U.K. Companies Act;

- Attendance at numerous meetings in person or by conference call with representatives of Cavell, their Canadian counsel, representatives of Canadian insurance companies and or their legal counsel and representatives of OSFI to review the terms of the scheme, the effects on Canadian policyholders and to try to negotiate changes;
- Filing of proofs of claim in the Cavell scheme, instructing U.K. counsel and attendance at meetings of creditors;
- Attendance at Cavell court appearances and filing of appropriate materials as required;
- Updating of the Reliance Canada website for the benefit of policyholders, claimants and creditors to enable them to obtain access to current information as to the status of the liquidation and their claims therein;
- Performed a detailed review of internal controls to ensure that the financial and operational controls are functioning as set forth in the Policies and Procedures;
- Overall administration of the estate and the Reliance staff consisting of approximately seven people, dealing with day-to-day administrative issues, responding to policyholder, claimants and creditor inquiries and attendance at all meetings, proceedings and/or Court appearances as required.

Our fee	\$ 724,564.10
Disbursements	<u>32,043.19</u>
	756,607.29
GST	<u>52,962.51</u>
Total	<u><u>\$ 809,569.80</u></u>

Schedule "L"

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED SEPTEMBER 30, 2004

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	140.50	\$445
Burgess, J.	Manager	Insolvency/Claims/Reinsurance	118.90	\$288
Murphy, E.	V.P./Senior Manager	Financial Report/Reinsurance	65.10	\$445
Individuals with less than 30 hours			100.20	\$309
			<u>424.70</u>	<u>\$369</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED DECEMBER 31, 2004

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	194.50	\$456
Burgess/Bradley, J.	Manager	Insolvency/Claims/Reinsurance	88.10	\$295
Murphy, E.	Associate Partner	Financial Report/Reinsurance	115.80	\$495
Individuals with less than 30 hours			26.50	\$448
			<u>424.90</u>	<u>\$433</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED MARCH 31, 2005

Name	Rank	Area	HOURS	AVG. HRLY RATE
Sanderson, R. O.	President/Partner	Insolvency/Overall Admin./Strategy	40.80	\$590
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	194.50	\$456
Bradley, J.	Manager	Insolvency/Claims/Reinsurance	36.00	\$295
Murphy, E.	Associate Partner	Financial Report/Reinsurance	114.80	\$495
Individuals with less than 30 hours			30.70	\$320
			<hr/>	<hr/>
			<u>416.80</u>	<u>\$456</u>

RELIANCE INSURANCE COMPANY**(in liquidation)****LISTING OF KPMG INC. PERSONNEL
HOURS AND AVERAGE HOURLY RATE
THREE MONTH PERIOD ENDED JUNE 30, 2005**

Name	Rank	Area	HOURS	AVG. HRLY RATE
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	119.00	\$456
Bradley, J.	Manager	Insolvency/Claims/Reinsurance	32.90	\$295
Murphy, E.	Associate Partner	Financial Report/Reinsurance	54.90	\$495
Manktelow, B	Senior Manager	Financial Report/Reinsurance	39.30	\$380
Mehra, S	Technician	Financial Report/Reinsurance	46.00	\$120
Individuals with less than 30 hours			48.90	\$440
			<hr/>	<hr/>
			<u>341.00</u>	<u>\$390</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED SEPTEMBER 30, 2005

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	62.00	\$456
Murphy, E.	Associate Partner	Financial Report/Reinsurance	49.00	\$495
Individuals with less than 30 hours			25.80	\$319
			<u>136.80</u>	<u>\$444</u>

KPMG Inc.

(Quarter ending September 2004)

I GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is also responsible for the development and maintenance of the website. During this period, he assisted in the passing of accounts.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. During this period she oversaw a review of internal controls and compliance with liquidation policies and procedures.

JANINE BURGESS – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, overseeing the Meridian and GAP programs and reviewing defense costs. Janine also developed runoff models under the direction of Ms Murphy and/or Mr. Gutfreund and assisted in the passing of accounts and distribution of dividends declared.

KPMG Inc.

(Quarter ending December 2004)

I GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is also responsible for the development and maintenance of the website.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. During this period Ms Murphy met with several reinsurers in the London market to agree balances due to Reliance Canada and to pursue collections of same.

JANINE BRADLEY – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, overseeing the Meridian and GAP programs, reviewing defense costs and contracted for the supervised the move of the Reliance operations.

KPMG Inc.

(Quarter ending March 2005)

ROBERT O. SANDERSON – is President of KPMG Inc., a Chartered Accountant, Fellow of the Institute of Chartered Accountants of Ontario and a trustee in bankruptcy. He has primary responsibility for the liquidation as a whole. During this period, his particular areas of concentration were with respect to the development of the overall direction, approach and strategy for the estate, coordinating reporting to the supervising Court including confirmation of continuance of payment of defense costs and small claims, ongoing liaison with PACICC, the U.S. Liquidator, the inspectors and major stakeholders, financial projections for the state, responding to specific issues arising in the defense of claims and advising respective counsel as to projected outcomes. During this period, Mr. Sanderson oversaw the negotiation with Cavell.

I. GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed, trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website. During this period, the detailed claims review was completed and reviewed with the inspectors and Mr. Gutfreund was involved in the Cavell negotiations and analyses.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. Ms Murphy met with several reinsurers to pursue collections and assisted with the analysis of the Cavell scheme.

JANINE BRADLEY – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, the detailed claims review, overseeing the Meridian and GAP programs and reviewing defense costs.

KPMG Inc.
(Quarter ending June 2005)

I. GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website. During this period, Mr. Gutfreund continued to be involved in the Cavell scheme negotiations and was involved in the settlement of a large complex claim.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is responsible for financial reporting and overseeing the accounting department. During this period, a full actuarial review was undertaken including additional liaison with the actuary as a result of the comprehensive claims review undertaken in part with representatives of the U.S. Liquidator. Ms Murphy also met with reinsurers in the London market to further pursue collections.

JANINE BRADLEY – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, the detailed claims review, overseeing the Meridian and GAP programs and reviewing defense costs. She also updated runoff models to reflect the results of the comprehensive claims review, staff reductions, projected runoff of claims and additional reinsurance characteristics under the direction of Ms Murphy and/or Mr. Gutfreund.

BLAIR MANKTELOW – is a Senior Manager in the Financial Institutions and Real Estate assurance practice. He is an accredited actuary and assisted in determination of the differences in Canadian versus U.K. actuarial GAAP. Mr. Manktelow also oversaw the actuarial valuation of Reliance Canada's claim in the Cavell scheme.

SIMMI MEHRA – is a Technician in the Financial Institutions and Real Estate tax practice and assisted in the preparation of the December 31, 2004 corporate tax returns.

KPMG Inc.

(Quarter ending September 2005)

I. GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administration of the liquidation, including oversight of all financial and internal controls, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department.

Schedule "H"

Unaudited Financial Statements of

RELIANCE INSURANCE COMPANY

Canadian Branch (in liquidation)

In our capacity as Liquidator, we have prepared the Balance Sheet of Reliance Insurance Company, Canadian Branch (in liquidation) as at September 30, 2006, September 30, 2005, June 30, 2004, September 30, 2003 and December 3, 2001, the Statement of Earnings and Changes in Surplus for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003, and the Statement of Cash Flows for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003 in our capacity as liquidator. These financial statements have not been audited or reviewed.

In view of the uncertainties surrounding a branch in liquidation, the ultimate realization of the assets and liabilities will differ from the recorded amounts and the differences may be material (see notes).

Readers are cautioned that these statements may not be appropriate for their purposes.

KPMG Inc., Liquidator.
Reliance Insurance Company, Canadian Branch

December 6, 2006

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Balance Sheet

As at September 30, 2006, September 30, 2005, June 30, 2004, September 30, 2003 and December 3, 2001
(\$000)

(Unaudited - see cover page)	September 30, 2006	September 30, 2005	June 30, 2004	September 30, 2003	December 3, 2001
Assets					
Cash and short term investments (note 4)	\$ 1,101	\$ 916	\$ 155,078	\$ 156,277	\$ 56,165
Investments (note 4) (market value: Sept 30, 2006 - \$148,049; 2005 - \$140,919 2004 - \$0; 2003 - \$0; 2001 - \$114,392)	147,761	141,308	-	-	108,949
Receivable from other insurers/reinsurers	11,965	26,863	27,576	13,908	6,090
Income and premium taxes recoverable		-	-	3,070	3,446
Receivable from Reliance US (note 8)	4,848	4,848	4,848	4,181	-
Receivable from Reliance US - current balance due (note 8)	159	222	870	-	-
Other receivables	361	621	600	958	1,978
Reinsurers' share of provision for					
Unpaid claims	34,928	42,172	71,704	51,761	57,536
Unearned premiums	306	2,564	4,847	5,430	9,670
Estimate for deductibles on unpaid claims	-	78	106	1,444	2,527
Total assets	\$ 201,429	\$ 219,592	\$ 265,629	\$ 237,029	\$ 246,361
Liabilities and Surplus					
Policy liabilities:					
Unpaid claims (note 5)	\$ 92,190	\$ 111,980	\$ 171,544	\$ 145,815	\$ 135,088
Unearned premiums (note 6)	421	3,989	8,216	9,177	15,189
Allowed claims (note 9)	20,340	24,163	33,106	17,269	-
Other liabilities	605	567	841	2,158	1,917
	113,556	140,699	213,707	174,419	152,194
Payables:					
Due to Reliance US (note 8)	4,848	4,848	4,848	4,848	-
Due to other insurers/reinsurers	576	260	142	189	192
Brokers	2,573	2,656	2,916	2,924	3,389
Taxes and other creditors	1,096	1,034	1,031	1,653	1,826
Reinsurance deposits	10	10	10	10	3,494
Total liabilities	122,659	149,507	222,654	184,043	161,095
Surplus (note 10)	78,770	70,085	42,975	52,986	85,266
Contingent liabilities (note 11)					
Total liabilities and surplus	\$ 201,429	\$ 219,592	\$ 265,629	\$ 237,029	\$ 246,361

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Page)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statements of Earnings and Changes in Surplus

For the twelve months ended September 30, 2006, fifteen months ended September 30, 2005,
nine months ended June 30, 2004, and twenty-two months ended September 30, 2003
(\$000)

(Unaudited - see cover page)	October 1, 2005 to September 30, 2006	July 1, 2004 to September 30, 2005	October 1, 2003 to June 30, 2004	December 3, 2001 to September 30, 2003
Revenue				
Gross premiums written	\$ (5)	\$ (8)	\$ (12)	\$ (508)
Less: reinsurance ceded	938	323	(9)	(509)
Net written premiums	(943)	(331)	(3)	1
Net premiums earned	366	1,613	375	1,772
Expenses				
Claims incurred	(8,722)	(19,974)	12,539	42,317
Commissions and premium taxes	20	49	21	5,115
General expenses (note 13)	2,022	2,789	1,212	6,656
Foreign exchange (net claims)	2,806	(3,466)	(656)	(62)
	(3,874)	(20,602)	13,116	54,026
Investment income				
Interest on cash and short term investments	80	1,991	2,807	5,188
Write-down of investments (note 4)	(1,658)			
Interest on investments	6,219	3,031	-	7,752
Investment expenses	(187)	(123)	(36)	(74)
Realized gain (loss) on disposal of investments	-	-	-	7,245
	4,454	4,899	2,771	20,111
Income (loss) before capital taxes	8,694	27,114	(9,970)	(32,143)
Capital taxes	9	4	41	137
Net income (loss)	8,685	27,110	(10,011)	(32,280)
Surplus beginning of period	70,085	42,975	52,986	85,266
Surplus end of period	\$ 78,770	\$ 70,085	\$ 42,975	\$ 52,986

The accompanying notes are an integral part of the financial statements

(Unaudited - See Cover Note)

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Statement of Cash Flows

For the twelve months ended September 30, 2006, fifteen months ended September 30, 2005,

nine months ended June 30, 2004, and twenty-two months ended September 30, 2003

(\$000)

(Unaudited - see cover page)	October 1, 2005 to September 30, 2006	July 1, 2004 to September 30, 2005	October 1, 2003 to June 30, 2004	December 3, 2001 to September 30, 2003
Operating activities				
Premiums received	\$ -	\$ (17)	\$ 1	\$ (82)
Reinsurance collected	25,090	32,692	6,163	8,601
Salvage, subrogation & deductibles received	355	1,545	578	2,332
Reduction in other receivables	42	31	481	697
Total sources	25,487	34,251	7,223	11,548
Gross claims paid	15,146	48,056	8,663	23,073
Claim expenses paid	2,661	3,406	3,136	8,393
Uncashed claim/expense cheques	0		-	(96)
Reinsurance premiums paid	41	23	(14)	(108)
General expenses	0			
Salaries	748	943	1,364	3,109
Office expenses	228	351	369	641
Legal/professional	135	306	138	273
Head office services	172	244	210	465
Sale of business expense	0	-	-	770
Liquidation expenses	0			
KPMG Inc.	339	1,013	818	3,121
Goodmans LLP	182	497	266	885
Foreign exchange (gain)/loss	845	624	(81)	56
Income & premium taxes (incl interest paid/rec'd)	6	(13)	(3,405)	(22)
Foreign exchange (gain)/loss(net claims)	2,806	(3,425)	(273)	(62)
Total uses	23,309	52,025	11,191	40,498
Net cash provided by (used) in operating activities	2,178	(17,774)	(3,968)	(28,950)
Investing activities				
Sale (purchase) of Investments	(8,111)	(141,308)	-	113,225
Investment expenses	(178)	(95)	(36)	(74)
Interest received	6,296	5,349	2,895	15,812
Investment income	0	(334)	(90)	99
Cash provided by (used in) investing activities	(1,993)	(136,388)	2,769	129,062
Increase in cash and short term investments	185	(154,162)	(1,199)	100,112
Cash and short term investments, at beginning of period	916	155,078	156,277	56,165
Cash and short term investments, at end of period	\$ 1,101	\$ 916	\$ 155,078	\$ 156,277
Cash consists of:				
Cash	\$ 1,101	\$ 916	\$ 2,856	\$ 420
Short term investments (note 4)	-	-	152,222	155,857
	\$ 1,101	\$ 916	\$ 155,078	\$ 156,277

The accompanying notes are an integral part of the financial statements

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

1. Nature of the business:

The Canadian Branch of Reliance Insurance Company, which was primarily engaged in the writing of commercial property and liability insurance in Canada, commenced a voluntary wind down of its operations in Canada effective August 2000. In May 2001, Reliance Insurance Company's U.S. operations ("Reliance US") were placed under an order of rehabilitation. On October 3, 2001, Reliance US was put into liquidation and declared insolvent by the Court of Pennsylvania.

On December 3, 2001, the Ontario Superior Court of Justice (the "Court"), on the application of the Attorney General of Canada, granted an order appointing KPMG Inc. as provisional liquidator (the "Liquidator") of the insurance business in Canada of Reliance Insurance Company, including the assets in Canada of Reliance Insurance Company, together with its other assets held in Canada under the control of its chief agent ("Reliance Canada"). By further order of the same date, the Court ordered that Reliance Canada be wound up.

Since August 2000, existing insurance policies in force have been allowed to expire and Reliance Canada has neither renewed nor cancelled existing policies, nor has it written any new business. Reliance Canada continues to run off the existing policy and claims liabilities in an orderly fashion.

Pursuant to Orders of the Court the Liquidator has paid policy holders and claimants the greater of: 65% of valid and allowed loss claims pursuant to the first interim distribution approved by the Court in December 2005; or the greater of \$25, 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.

2. Basis of preparation:

The accounting policies used in the preparation of these financial statements have been selected with a view to reflecting the financial position of an insurance company that is in liquidation.

The preparation of these financial statements requires the use of estimates and assumptions that affect the reported assets and liabilities as at the date of the financial statements and the reported amount of revenue and expenses for the reporting period. The actual results will differ from these estimates and, in view of the additional uncertainties surrounding a company in liquidation, the differences may be material. Changes in estimates are recorded in the accounting period in which they are determined.

No provision has been made for future liquidation costs. Interest income earned on the assets of Reliance Canada is likely to offset the unbooked future costs of the liquidation.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

3. Significant accounting policies:

(a) Investments and investment income:

RBC funds are carried at net invested proceeds with all of the income distributions and interest received being reinvested back into the funds. When the carrying amount is greater than the fair value and the market rate variation is considered temporary in nature, the carrying amount of these financial instruments is not reduced to fair value. Where the carrying amount is greater than the fair value, and after considering such factors as the length of time the carrying value has exceeded the fair value and the significance of the difference in the values, and if the market rate valuation is considered to be other than temporary in nature, the investment will be written down to fair value.

Term deposits and treasury bills are carried at cost plus accrued interest of \$334 at June 30, 2004, \$424 at September 30, 2003 and \$325 at December 3, 2001. Bonds, including accrued interest of \$3,128 at December 3, 2001 are carried at amortized cost, providing for the amortization of the discount or premium on an effective yield basis to maturity.

Investment income is recorded as it is earned. Gains and losses arising on disposal of investments are on a settlement date basis, and are calculated on the basis of amortized cost.

(b) Premium revenue and unearned premiums:

Unearned premiums represent the amount of premiums written which are applicable to the unexpired terms of the policies in force or to the remaining terms of certificates issued as part of program business. Accordingly, premiums written are taken into income when earned. Although policies were generally issued for one year, Reliance Canada also wrote some multi-year policies and some program business with underlying certificates, which are multi-year.

If the unearned premiums are not sufficient to pay expected claims and expenses, a premium deficiency is said to exist. Any changes in estimates of premium deficiencies are recorded as net premium earned in the period in which they are determined.

The reinsurers' share of unearned premiums, net of a provision for doubtful amounts, is recognized as amounts recoverable at the same time using principles consistent with the method for determining the unearned premium liability.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

(c) Provision for unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate for all costs of investigating and settling claims incurred on or before the balance sheet date. The provision estimates do not take into account the time value of money, or make explicit provision for adverse deviation.

The provision includes case basis estimates, and an actuarially determined “best estimate” provision for claims incurred but not reported and for development on case basis estimates (“IBNR”). These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the period in which they are determined.

(d) Reinsurance ceded:

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. To indicate the extent of the credit, collection and contractual risks related to third party reinsurance, estimates of amounts recoverable from reinsurers are recorded separately from the estimated provisions for unearned premiums and unpaid claims.

Amounts recoverable from reinsurers, net of a provision for doubtful amounts, are estimated and recognized at the same time and using principles consistent with Reliance Canada’s method for establishing the related liability.

4. Short term investments and investments:

Short-term investments are readily convertible into cash and have maturities of less than 12 months. The carrying value of the short-term investments approximates their market value.

Composition of the cash and short term investments:

	September 30, 2006	September 30, 2005	June 30, 2004	September 30, 2003	December 3, 2001
Cash	\$ 1,101	\$ 916	\$ 2,856	\$ 420	\$ 1,263
Short term investments	-	-	152,222	155,857	54,902
Total	\$ 1,101	\$ 916	\$ 155,078	\$ 156,277	\$ 56,165

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

Composition of investment portfolio:

	September 30, 2006		September 30, 2005		December 3, 2001	
	Book Value	Market Value	Book Value	Market Value	Book Value	Market Value
RBC Cdn Money Market fund	\$ 53,243	\$ 53,243	\$ 61,506	\$ 61,506	\$ -	\$ -
RBC Short Term Income fund	77,845	78,173	71,007	70,618	-	-
RBC US Money Market fund	16,673	16,673	8,795	8,795	-	-
Bonds - Canadian Government	-	-	-	-	99,959	105,415
Bonds - Canadian Corporate	-	-	-	-	8,990	8,977
Total investments	<u>\$ 147,761</u>	<u>\$ 148,089</u>	<u>\$ 141,308</u>	<u>\$ 140,919</u>	<u>\$ 108,949</u>	<u>\$ 114,392</u>

The carrying value of the Short Term Income Fund was written down to fair value as at March 31, 2006. The amount of the adjustment was \$1,658.

5. Unpaid claims:

(a) Nature of unpaid claims:

The provision for unpaid claims and adjustment expenses (and for third party reinsurers' share thereof) are based upon estimates of the ultimate claim costs associated with claims occurring as of the balance sheet dates, including estimates for IBNR claims. These estimates are subject to variability, and the variability could be material. The variability arises because all events affecting the ultimate settlement of claims have not yet taken place and may not take place for some time. Additional factors affecting the variability include receipt of additional claim information, the continually evolving and changing regulatory and legal environment, court decisions, economic conditions, public attitudes, claims management practices, actuarial studies, the quality of the data used for projection purposes, the effect of inflationary trends on future claims handling and settlement practices, and significant changes in the severity or frequency of claims from historical trends. In addition, the longer the time required for the settlement of a group of claims, the more variable the estimates.

Reliance Canada had fronting reinsurance arrangements with other insurers and provided self-insurance facilities for selected corporate clients. Because Reliance Canada is the direct insurer under these arrangements, policyholders and claimants look to Reliance Canada for settlement of their claims; Reliance Canada obtains repayment from the insurers or corporations, either directly or from security deposits Reliance Canada maintains. The risk to Reliance Canada is credit risk if claims exceed either the security deposits or the self-insured's ability to pay.

Reliance Canada accepted certain insurance risks that other insurance companies have underwritten ("assumed reinsurance"). Because of the necessary reliance on the ceding companies for information regarding reported claims, and the resulting reporting lag between the dates of occurrence and the time Reliance Canada is notified of the claims, the

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

inherent uncertainties of estimating reserves is greater for assumed reinsurance than for direct insurance.

In the normal course of settling claims, Reliance Canada acquires rights to subrogate its claims against other parties and, in some cases, recover a portion of the loss from the policyholder as a deductible amount. Salvage and subrogation are deemed not to be material and, as such, are recorded as received. Deductible amounts, which are recoverable on liability claims, have been recognized as assets.

(b) Provision for unpaid claims:

Considerable judgement is required to evaluate claims and establish claim liabilities. The estimation of the claims provision is based on known facts and interpretation of circumstances. The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. Methods of estimation have been used which it is believed produce reasonable results given current information; however, the process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimate made. It is also not possible to estimate the impact of the additional uncertainties surrounding a company in liquidation on the estimation process.

The changes in the unpaid claim provisions recorded in the balance sheet as at September 30, 2006, September 30, 2005, June 30, 2004, and September 30, 2003 and their impact on the claims and adjustment expenses for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004, and twenty-two months ended September 30, 2003, are as follows:

	<u>October 1, 2005 to September 30, 2006</u>	<u>July 1, 2004 to September 30, 2005</u>	<u>October 1, 2003 to June 30, 2004</u>	<u>December 3, 2001 to September 30, 2003</u>
Unpaid claims at beginning of period	\$ 111,980	\$ 171,544	\$ 145,815	\$ 135,088
Recoverable from reinsurers at beginning of period	<u>42,172</u>	<u>71,704</u>	<u>51,761</u>	<u>57,536</u>
Net unpaid claims at beginning of period	<u>69,808</u>	<u>99,840</u>	<u>94,054</u>	<u>77,552</u>
Increase(decrease) in estimated losses and expenses for claims occurring in prior years	(8,722)	(19,974)		42,317
Increase(decrease) in outstanding deductibles	(60)	(30)	(65)	(1,090)
Paid on claims (net) occurring during current year (Gap Programs)	(171)	(278)	(577)	(1,377)
Paid on claims (net) occurring during prior years	<u>(3,593)</u>	<u>(9,750)</u>	<u>(6,111)</u>	<u>(23,348)</u>
Net reserves at end of period	57,262	69,808	99,840	94,054
Ceded reserves at end of period	<u>34,928</u>	<u>42,172</u>	<u>71,704</u>	<u>51,761</u>
Gross reserves at end of period	<u>\$ 92,190</u>	<u>\$ 111,980</u>	<u>\$ 171,544</u>	<u>\$ 145,815</u>

In order to show the progress of the liquidation from the date of winding-up and, as it is not practicable in a winding-up situation to determine fair value with sufficient reliability, the fair value of the unpaid claims and adjustment expenses, gross and recoverable from reinsurers has been omitted.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

6. Unearned premium:

The provisions for unearned premiums include actuarially determined estimates for premium deficiencies. The process for estimating any provisions for premium deficiency involves the use of estimates concerning factors such as expected claims and expenses and future payout patterns. Any provisions are necessarily subject to uncertainty.

The provision estimates do not take into account the time value of money or make explicit provision for adverse deviation.

7. Reinsurance:

In the normal course of business, Reliance Canada sought to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. Reliance Canada is not relieved of its primary obligation to policyholders as a result of its third party reinsurance. Failure of reinsurers to honour their obligations could result in losses to Reliance Canada.

Reliance Canada makes specific provisions against reinsurance receivables and recoverables from companies who are in liquidation or run-off, with whom balances are in dispute or where the reinsurer is not settling balances due to Reliance Canada for reasons related to Reliance US. In addition, the Reliance Canada records a general allowance against reinsurance receivables and recoverables based upon the level of allowance already in place and management's judgement. The general allowance reflects the view that a company in liquidation or run-off has a greater collection risk than a going concern company. The establishment of the allowances for doubtful accounts involves judgement and therefore creates a degree of uncertainty as to adequacy at each reporting date.

Reliance Canada's reinsurance program includes: i) reinsurance placed by Reliance Canada directly with Canadian licensed reinsurers and ii) reinsurance entered into by Reliance US which reinsures both Reliance (Canada) policies and policies of Reliance US and other companies in the Reliance group.

8. Head office:

(a) Payable to Head Office:

As at September 30, 2006, \$4,848 has been set up as an amount due to Reliance US for underwriting commissions paid to ECS Managers (the "ECS Commission Payable"); at September 30, 2005 the payable to head office was \$4,848; at June 30, 2004 \$4,848; at September 30, 2003 \$4,848 and at December 3, 2001 the payable was nil. The liquidator for Reliance US (the "US Liquidator"), subsequent to the date of liquidation, advised Reliance Canada that Reliance US had settled the ECS Commission Payable with ECS Managers on behalf of Reliance Canada prior to the respective and separate liquidations of Reliance Canada and Reliance US. The US Liquidator has taken the position that it wishes

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

to withhold payment to the Canadian Liquidator of reinsurance collected by Reliance US on behalf of Reliance Canada on the international reinsurance treaties (“Canadian Reinsurance Proceeds”) up to the amount of the ECS Commission Payable of \$4,848 or US\$3,034. The Canadian Liquidator disputes that the US Liquidator is entitled to do this; however, the parties have agreed that, without prejudice, Reliance US will pay to Reliance Canada any Canadian Reinsurance Proceeds in excess of the ECS Commission Payable. The US Liquidator and the Canadian Liquidator have agreed to fix the Canadian dollar balance due to Reliance US for the ECS Commission Payable using the exchange rate of 1.5981 (see note 14).

(b) Receivable from Reliance US:

As at September 30, 2006, on behalf of Reliance Canada, Reliance US has collected \$4,848; at September 30, 2005 \$4,848; at June 30, 2004 \$4,848; at September 30, 2003 \$4,181; and at December 3, 2001 nil of Canadian Reinsurance Proceeds, which is to be held by the Reliance US pending payment of the ECS Commission Payable. While Reliance Canada has generally billed the reinsurance in Canadian dollars, Reliance US has generally collected the Canadian Reinsurance Proceeds in US dollars. The US dollar amount due from the Reliance US to Reliance Canada has been fixed at a rate of 1.5981 (see note 14). The resulting foreign exchange gain was booked through the income statement in June 2004.

(c) Receivable from Reliance US – Current Balance Due:

As at September 30, 2006, on behalf of Reliance Canada, Reliance US has collected \$159; at September 30, 2005 \$222; at June 30, 2004 \$870; at September 30, 2003 nil; and at December 3, 2001 nil of Canadian reinsurance proceeds, which have yet to be forwarded by Reliance US to Reliance Canada. While Reliance Canada has generally billed the reinsurance in Canadian dollars, Reliance US has generally collected the reinsurance in US dollars. Reliance Canada will recognize a foreign exchange gain or loss on this balance upon receipt of funds from the Reliance US.

(d) Protocol Agreement:

Further to a protocol agreement between the Liquidator and the US Liquidator, Reliance US provides various services to Reliance Canada, particularly in the areas of data processing, claims and reinsurance. For the twelve months ended September 30, 2006 the cost of the services was \$175; July 1, 2004 to September 30, 2005 \$262; October 1, 2003 to June 30, 2004 \$187; and December 3, 2001 to September 30, 2003 \$505.

9. Allowed claims:

As at September 30, 2006, allowed claim balances are due on claims which have been settled and admitted by the Liquidator, in excess of the Court authorized payments of \$20,340; at September 30, 2005 \$24,163; at June 30, 2004 \$33,106; September 30, 2003 \$17,269; and December 3, 2001 nil.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

10. Surplus:

As at September 30, 2006, Reliance Canada's estimated surplus was \$78,770; at September 30, 2005 \$70,085; at June 30, 2004 \$42,975; at September 30, 2003 \$52,986; and at December 3, 2001 \$85,266. This estimate is subject to revision. In view of the uncertainties surrounding a company in liquidation, the ultimate realization of the assets and liabilities will differ from the estimated results as at September 30, 2006 and the difference may be material. Any surplus available at the wind-up of the liquidation will be paid to Reliance US.

11. Contingent liabilities:

There is the potential that certain claims that were not reported in the books of Reliance Canada may be valid claims against Reliance Canada ("Non-Booked Claims"). The Non-Booked Claims would arise from policies written outside Canada but which have some nexus with Canada and which, arguably, should have been reported in the books of Reliance Canada. 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. Should additional loss result from any new claims, such loss would be accounted for as a charge to earnings in the accounting period that the claims are verified as liabilities of Reliance Canada.

12. PACICC loan agreement:

PACICC and the Liquidator entered into a loan and services agreement, dated December 3, 2001, which 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 occurs on the Amount Outstanding at the prime rate. In the event all policyholders and creditors receive full payment on all valid claims from the assets of Reliance Canada, the Liquidator will not demand repayment of the Amount Outstanding. The Amount Outstanding has not been accrued in the financial statements.

RELIANCE INSURANCE COMPANY
Canadian Branch (in liquidation)

Notes to Financial Statements for the twelve months ended September 30, 2006, fifteen months ended September 30, 2005, nine months ended June 30, 2004 and twenty-two months ended September 30, 2003

(unaudited – \$000)

13. Supplementary expense information:

	<u>October 1, 2005 to September 30, 2006</u>			<u>July 1, 2004 to September 30, 2005</u>		
	<u>Total</u>	<u>General</u>	<u>Claims</u>	<u>Total</u>	<u>General</u>	<u>Claims</u>
Salaries	\$ 664	\$ 289	\$ 375	\$ 945	\$ 473	\$ 472
Office expense	247	122	125	342	171	171
Legal/professional services	135	67	68	311	155	156
Allowance for bad debts	(1)	(1)	0	(3)	(3)	0
Head office services	175	88	87	262	130	132
Interest (income)/expense	14	14	0	27	27	0
Foreign exchange (gain)/loss	764	764	0	482	482	0
Sale of business expense:						
Other	0	0	0	0	0	0
Liquidation expenses:						
KPMG Inc.	478	478	0	869	869	0
Goodmans LLP	<u>201</u>	<u>201</u>	<u>0</u>	<u>485</u>	<u>485</u>	<u>0</u>
 Total expenses	 <u>\$ 2,677</u>	 <u>\$ 2,022</u>	 <u>\$ 655</u>	 <u>\$ 3,720</u>	 <u>\$ 2,789</u>	 <u>\$ 931</u>

The claims expenses are included in Claims incurred on the statement of earnings and changes in surplus.

14. Foreign exchange:

Further to an order from the Court, dated December 18, 2003 and amended on June 30, 2004, the Liquidator is authorized to pay claims payable in foreign currencies either:

- a) in those foreign currencies in circumstances where the Liquidator is otherwise legally entitled to do so; or
- b) in Canadian currency, converted at the Bank of Canada noon spot rate of exchange for exchanging such currencies to Canadian currency on November 8, 2001.

Further to this, in cases where the agreed claim is determined in U.S. dollars, the rate used by Reliance Canada to calculate the Canadian equivalent is \$1.5981.

**RELIANCE INSURANCE COMPANY
(in liquidation)**

Summary of Professional Fees (including G.S.T.)

	Oct 1, '05 to Dec 31, '05	Jan 1, '06 to Mar 31, '06	Apr 1, '06 to Jun 30, '06	Jul 1, '06 to Sep 30, '06	Oct 1, '05 to Sep 30, '06
Core Professional					
Goodmans LLP	\$54,114	\$52,632	\$33,326	\$61,948	\$202,020
KPMG Inc.	141,148	113,277	70,732	152,307	477,464
	195,262	165,909	104,059	214,255	679,484
Other Professional Fees					
Kendall Freeman	31,692	20,100	2,271	4,207	58,270
Actuaries					
J. S. Cheng & Partners	86,593				86,593
TOTAL	\$313,547	\$186,009	\$106,330	\$218,462	\$824,347

November 28, 2001

Schedule "I"

M. Diane Koken
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in her capacity as Liquidator of
Reliance Insurance Company

Dear Commissioner:

RE: Reliance Insurance Company ("Reliance")

By order (the "U.S. Order") of the Commonwealth Court of Pennsylvania (the "U.S. Court") made the 3rd day of October, 2001, the Insurance Commissioner of the Commonwealth of Pennsylvania (the "U.S. Liquidator") has been appointed Liquidator of Reliance.

The Superintendent of Financial Institutions (the "Superintendent") has designated KPMG Inc. as one of his representatives in connection with his taking control of the assets of Reliance in Canada, 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 (collectively, the "Canadian Insurance Business"). At the Superintendent's request, the Attorney General of Canada has applied to the Ontario Superior Court of Justice (the "Canadian Court") for an order (the "Canadian Winding-up Order") winding-up the Canadian Insurance Business under the *Winding-up and Restructuring Act*. He is recommending that KPMG Inc. be appointed as liquidator of the Canadian Insurance Business (the "Canadian Liquidator"), in a further order (the "Canadian Appointment Order"). The Canadian Winding-up Order and the Canadian Appointment Order will be referred to collectively as the "Canadian Order".

References in this agreement to "Reliance (Canada)", in the context of the period prior to the issuance of the Canadian Order, mean the Canadian Insurance Business and, in the context of the period following the issuance of the Canadian Order, mean the estate and effects under the control of the Canadian Liquidator pursuant to the Canadian Order. References in this agreement to "Reliance (U.S.)", in the context of the period prior to the issuance of the U.S.

Order, mean the U.S. operations of Reliance and, in the context of the period following the issuance of the U.S. Order, mean the legal estate under the control of the U.S. Liquidator pursuant to the U.S. Order and, for greater certainty, exclude Reliance (Canada).

The parties are in agreement that it is in the best interests of Reliance (U.S.) and Reliance (Canada) and their respective stakeholders that they agree to co-operate with one another with respect to certain matters as set out below.

1. **APPOINTMENT AS INSPECTOR**

The Canadian Liquidator will consent to the appointment by the Canadian Court of the U.S. Liquidator as an inspector in the liquidation of Reliance (Canada) under the *Winding-up and Restructuring Act*. The Canadian Liquidator will convene regular meetings of inspectors.

2. **INFORMATION**

The U.S. Liquidator will receive the financial information with respect to the operations of Reliance (Canada) which, prior to the issuance of the U.S. Order, Reliance (U.S.) typically received from Reliance (Canada). The Canadian Liquidator will further provide information concerning material developments in the Canadian estate and such other information as the U.S. Liquidator may reasonably request.

3. **DETERMINATION OF RELIANCE (CANADA) POLICYHOLDERS**

The U.S. Liquidator and the Canadian Liquidator agree to co-operate with one another in order to avoid and eliminate duplicate claims within Reliance (U.S.) and Reliance (Canada). To that end, the U.S. Liquidator and the Canadian Liquidator will consult with one another when there is a need to determine whether an individual or entity is the holder of a policy which ought properly to be considered a liability of Reliance (Canada).

4. **SERVICES**

Prior to the issuance of the U.S. Order, Reliance (U.S.) provided various services to Reliance (Canada), particularly in the areas of data processing, claims and reinsurance. The U.S.

Liquidator agrees to ensure that these services continue to be provided with the same scope and at the same level of quality both before and after issuance of the Canadian Order.

Fees for such services will be negotiated in good faith based on the actual costs incurred by the U.S. Liquidator in providing the services and a reasonable mark-up thereon for associated overhead. These services include but are not limited to:

- (a) **Data Processing.** The U.S. Liquidator will cause the employees and independent third party contractors of Reliance (U.S.) to provide to Reliance (Canada) data processing services of the same nature and scope and at the same level of quality as had been provided prior to the date hereof. Without limiting the generality of the foregoing, the U.S. Liquidator will cause the employees of Reliance (U.S.) to:
 - (i) provide the data processing services currently being provided (it being agreed by the parties that they will agree upon a definitive schedule of such services within 30 days of the date hereof);
 - (ii) provide such further data processing services as may be necessary from time to time to enable the Canadian Liquidator to meet its obligations as a liquidator and an officer of the court and as it is reasonably feasible for the U.S. Liquidator to provide;
 - (iii) carry out and implement, within a commercially reasonable timeframe, such programming and processing changes as necessary to reflect the change of Reliance (Canada)'s status and as appropriate for better management of data and operations as the Canadian Liquidator may from time to time reasonably request; and
 - (iv) develop, in conjunction with the Canadian Liquidator, a plan for the migration of Reliance (Canada)'s data to a new third party processor or a new platform. In connection with such migration, the U.S. Liquidator will use reasonable efforts to assist the Canadian Liquidator in obtaining, at the lowest possible cost, licenses and sub-licenses of the software currently

being used to provide the services described above to be granted to the Canadian Liquidator or its designee.

Notwithstanding the foregoing, if it is not reasonably feasible for the U.S. Liquidator to provide the services contemplated in this paragraph on a commercially reasonable basis at a commercially reasonable cost, the parties will negotiate in good faith commercially reasonable alternative arrangements.

Services described in this paragraph (a) will be provided by the U.S. Liquidator until at least December 31, 2004, and the Canadian Liquidator will avail himself of such services until such date, provided that:

- i. the Canadian Liquidator may terminate such services upon 30 days prior written notice at any time after December 31, 2003 if the Canadian Liquidator can demonstrate to the reasonable satisfaction of the U.S. Liquidator that it is in the financial best interests of Reliance (Canada) to have such services performed by another service provider;
- ii. the Canadian Liquidator may terminate such services if the Canadian Insurance Business is transferred as contemplated by paragraph 5;
- iii. the Canadian Liquidator may terminate such services if the U.S. Liquidator breaches a provision of this paragraph 4(a) in a material respect and fails to remedy such breach within 30 days written notice thereof, provided that the Canadian Liquidator may not terminate under this clause (iii) by reason of a failure of the U.S. Liquidator to perform her obligations hereunder which is attributable to an event of *force majeure*; and
- iv. the Canadian Liquidator may terminate such services if the U.S. Liquidator is prevented from performing such services by reason

of a force *majeure condition* or event which continues for 90 days or more.

After December 31, 2004, either party will be entitled to terminate the services provided for in this paragraph (a) without cause upon 150 days prior written notice to the other.

(b) **Claims.**

To date there has been an operational policy in effect whereunder any claim (on an occurrence basis) under a Reliance (Canada) policy in excess of U.S. \$500,000.00 (on a gross basis), has been forwarded to Reliance's U.S. head office for authorization, prior to an adjustment to the claims reserve or the establishment of a claim amount. The Canadian Liquidator, (or, if applicable, Reliance (Canada)'s employees) will seek the advice of the U.S. Liquidator with respect to such claims, and at the same time will advise the U.S. Liquidator of any proposed course of action with respect to such claim. Within ten (10) days of receipt in writing of such proposed course of action (or such shorter period as required in the circumstances), the U.S. Liquidator will provide her comments thereon in writing to the Canadian Liquidator. If the Canadian Liquidator and U.S. Liquidator disagree on a proposed course of action, each will advise the other of why it does not agree, and what alternate course of action it would propose. If the U.S. Liquidator proposes an alternate course of action, the Canadian Liquidator will either implement such proposed alternate course of action or, if it determines to proceed with a different course of action, will advise the U.S. Liquidator in writing as to its reasons for doing so (but may nonetheless proceed with such different course of action.)

The Canadian Liquidator will seek, and the U.S. Liquidator will provide, its advice on the law firms who should be chosen by the Canadian Liquidator for the defence of claims brought in the U.S. under Reliance (Canada) policies. Where the U.S. Liquidator is required to defend a claim brought in Canada under a

Reliance (U.S.) policy she will seek, and the Canadian Liquidator will provide, its advice on the law firms who should be chosen for the defence of the claim.

The services described in this paragraph (b) will be provided until the Canadian Insurance Business is transferred as contemplated in Section 5.

- (c) **Reinsurance.** A large portion of the reinsurance ceded in respect of Reliance (Canada) business was ceded under reinsurance treaties or arrangements also covering business of Reliance (U.S.), and was administered by Reliance (U.S.). The U.S. Liquidator will cause the employees of Reliance (U.S.) to continue to administer such reinsurance in a reasonable and competent manner, to collect amounts owing from reinsurers thereunder in respect of Reliance (Canada) business promptly in accordance with the terms of the applicable reinsurance documents and to promptly remit same to the Canadian Liquidator without set-off other than for amounts actually set-off by a reinsurer referable to claims in respect of Reliance (Canada). In the event a reinsurer asserts a set-off or otherwise attempts to reduce payments otherwise due from such reinsurer or a insurer becomes insolvent the U.S. Liquidator and the Canadian Liquidator will work together in good faith to maximize recoveries from such reinsurer.

The Canadian Liquidator will cause Reliance (Canada) to provide such information as is necessary to bill the reinsurers. To the extent practicable, the frequency of billings to reinsurers will be accelerated. Any such amounts collected and received by the U.S. Liquidator shall be received by the U.S. Liquidator in trust for the Canadian Liquidator and, pending prompt remittance to the Canadian Liquidator, shall be held by the U.S. Liquidator in trust for the Canadian Liquidator. There shall be no obligation on the U.S. Liquidator to hold such amounts in a segregated account. The U.S. Liquidator will provide a detailed accounting to support each remittance of proceeds. On request, the U.S. Liquidator will provide the Canadian Liquidator with such other records and accounting support so that the Canadian Liquidator can confirm that all appropriate billings have been made and remittances paid.

Subject to the final sentence of the penultimate paragraph of Section 5, the services described in this paragraph (c) will be provided until the Canadian Insurance Business is transferred as contemplated in Section 5.

5. TRANSFER OF BUSINESS

The U.S. Liquidator and the Canadian Liquidator agree that it is in the best interests of the stakeholders of both Reliance (U.S.) and Reliance (Canada) that forthwith after the issuance of the Canadian Order the Canadian Liquidator attempt to transfer the Reliance (Canada) business to one or more other carriers, most likely through one or more assumption reinsurance transactions. To this end, the Canadian Liquidator intends to engage one or more financial advisors and to initiate a bid solicitation process. The Canadian Liquidator will consult with the U.S. Liquidator regarding its choice of financial advisor(s) and acknowledges that the U.S. Liquidator has advised she considers Scotia McLeod Inc. acceptable. The Canadian Liquidator will seek the U.S. Liquidator's comments on a list of intended recipients of bid solicitation materials. The U.S. Liquidator will also be afforded the opportunity to review and comment upon all bid solicitation materials, and the U.S. Liquidator will provide such comments and information as are, in the opinion of the U.S. Liquidator, acting reasonably, necessary to afford prospective bidders true and fair disclosure in such materials. The U.S. Liquidator will assist the Canadian Liquidator in establishing a data room which provides true and fair disclosure.

During the bid solicitation process, the Canadian Liquidator will convene regular progress meetings with its financial advisor(s) and will afford the U.S. Liquidator the opportunity to participate in such meetings, either in person or via conference call. The Canadian Liquidator will instruct its financial advisor(s) to copy the U.S. Liquidator on all written communications to the Canadian Liquidator regarding the bid solicitation process.

Once bids have been received, representatives of the U.S. Liquidator may review and provide their comments on the relative merits of the bids received. The Canadian Liquidator will also afford the U.S. Liquidator the opportunity to review and comment on all transactional documentation prior to execution,

The U.S. Liquidator will, if requested by the Canadian Liquidator, enter into an agreement with any transferee of all or a substantial portion of the business of Reliance (Canada) whereunder the

U.S. Liquidator agrees to provide to such transferee, for a period not exceeding twelve months, the data processing services referred to above for the fees being charged to the Canadian Liquidator. In addition, the U.S. Liquidator will co-operate with the Canadian Liquidator in attempting to effect a novation of all reinsurance treaties currently covering both the business of Reliance (Canada) and Reliance (U.S.), such that the Reliance (Canada) business now covered thereby is covered under separate and distinct reinsurance treaties between the transferee and the reinsurers. If such a novation is not effected, it may be necessary for the U.S. Liquidator to provide certain of the services described in paragraph 4(c) to the transferee on such terms as are agreed. The U.S. Liquidator will provide such further support and services to a transferee as may be reasonably required, on such terms as are agreed.

It is acknowledged that the Canadian Liquidator will likely follow a shorter and simpler process with respect to the transfer of the Meridian block of business which would not involve the engagement of financial advisors or the formal solicitation of competitive bids, but will nonetheless keep the U.S. Liquidator apprised of all material steps in the transfer process.

6. COMMUNICATIONS

It is acknowledged that provision of the services outlined in Section 4 above will require regular interaction and communication between the employees of Reliance (U.S.) and Reliance (Canada) on the same basis as same have been conducted in the past, and the U.S. Liquidator and the Canadian Liquidator agree to continue to facilitate such communications and interactions. However, all other communications between the U.S. Liquidator and the Canadian Liquidator, whether pertaining to the subject matter of this letter agreement or otherwise, will be conducted only through their "Designated Representatives". Each of the U.S. Liquidator and the Canadian Liquidator will appoint three (3) Designated Representatives. The U.S. Liquidator's initial Designated Representatives will be Arthur Mullin, David Brietling and Robert Haberle. The Canadian Liquidator's initial Designated Representatives will be Robert O. Sanderson, Edward G. Bossence and 1. George Gutfreund. Each party may change one or more of their Designated Representatives upon forty-eight (48) hours prior written notice to the other. The U.S. Liquidator agrees to keep the Canadian Liquidator advised of significant developments in the liquidation of Reliance (U.S.) which might reasonably be expected to have a material impact upon the U.S. Liquidator's ability to perform its obligations hereunder.

7. **CONFIDENTIALITY**

The U.S. Liquidator acknowledges that the data processed by Reliance (U.S.) on behalf of Reliance (Canada) and other information provided by the Canadian Liquidator to the U.S. Liquidator hereunder includes information which is either non-public, confidential or proprietary in nature (the “Confidential Information”). The U.S. Liquidator further acknowledges that the Confidential Information is the proprietary information of Reliance (Canada). The U. S. Liquidator agrees not to use the Confidential Information for any purpose other than the performance of its services as contemplated herein, and not to transfer or disclose any portion of such data to any third party, other than upon the express direction of the Canadian Liquidator, provided that:

- a. Confidential Information may be disclosed to (i) the U.S. Liquidator’s counsel, advisors, experts, consultants, directors, officers, employees, agents (including employees and officers of its agents), (ii) any guaranty or compensation fund or association that has a reasonable need to know the Confidential Information and who has signed a confidentiality agreement containing confidentiality obligations substantially the same as those provided herein and (iii) qualified persons recording testimony involving such documents or information (e.g. court reporters) and necessary stenographic and clerical assistants thereof, and
- b. to the extent that the U.S. Liquidator may be compelled by legal or regulatory requirements to disclose any of Confidential Information to a third party, she may disclose the Confidential Information if she has used all reasonable efforts to obtain, and shall have afforded the Canadian Liquidator the opportunity to obtain, an appropriate protective order or other satisfactory assurance of confidential treatment for the information compelled to be disclosed.

This agreement shall not apply to those portions of the Confidential Information which (i) are, or prior to the time of disclosure or utilization, have become, generally available to the public other than as a result of disclosure by the U.S. Liquidator; (ii) have been made or, prior to the time of disclosure or utilization, have become, available to the U.S. Liquidator on a non-confidential basis from a source other than the Canadian Liquidator

provided that such source is not known to the U.S. Liquidator to be bound by a confidentiality agreement with the Canadian Liquidator or otherwise prohibited from transmitting the Confidential Information by a contractual, legal or fiduciary obligation; or (iii) was known to the U.S. Liquidator on a non-confidential basis prior to its disclosure to her by the Canadian Liquidator.

8. **CANADIAN ORDER**

It is acknowledged that the Attorney General of Canada has sought the issuance of the Canadian Order, the Canadian Appointment Order being substantially in the form previously provided to the U.S. Liquidator, now returnable before the Canadian Court on December 3, 2001, in accordance with the order of the Canadian Court dated November 13, 2001. The Attorney-General has advised that he will seek confirmation from the Canadian Court in the Canadian Winding-up Order that no finding of insolvency has been made by the Canadian Court. The U.S. Liquidator agrees to withdraw its opposition to the Canadian Order. The provisions of this Section 8 and Sections 4, 6, 7, 9 and 10 will take effect immediately upon execution of this agreement, and references in such paragraphs to the Canadian Liquidator shall be deemed to include the Superintendent during the period prior to the issuance of the Canadian Order. The remaining provisions will take effect immediately upon the obtaining of a Canadian Order which does not contain terms which are materially inconsistent with this agreement.

9. **GOOD FAITH CO-OPERATION**

The parties acknowledge that they cannot address in this agreement all issues which might arise between them in the course of the liquidation of Reliance (U.S.) and Reliance (Canada). They agree to discuss and resolve all such issues in good faith, and to do, or cause to be done, all such further acts and things as may be reasonably necessary or desirable to give full effect to this agreement.

10. **JURISDICTION**

This agreement and any disputes or disagreements between the parties under this agreement shall be governed by the laws of the Province of Ontario and the laws of Canada applicable therein. For the purposes of resolution of any disputes or disagreements between the parties that may

arise from or in connection with this agreement, and except as otherwise expressly provided herein, each party hereby irrevocably subjects itself to the jurisdiction of the courts of the Province of Ontario. The U.S. Liquidator agrees not to bring proceedings in any court other than the courts of the Province of Ontario.

11. **ENUREMENT**

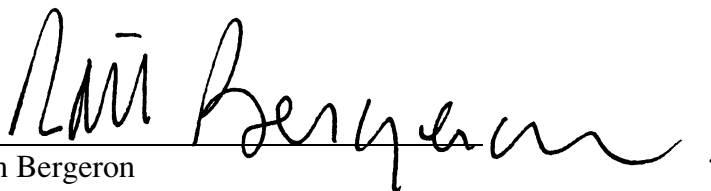
This agreement shall enure to the benefit of and be binding upon any successors to the parties hereto in their respective capacities as U.S. Liquidator and Canadian Liquidator.

Please sign in the space provided below to indicate your agreement with the foregoing.

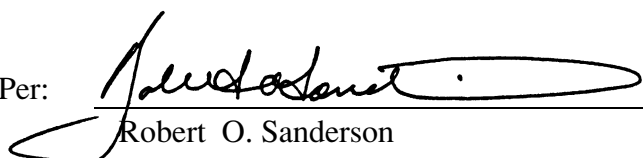
Yours very truly,

SUPERINTENDENT OF FINANCIAL INSTITUTIONS

prior to the issuance of the Canadian Order

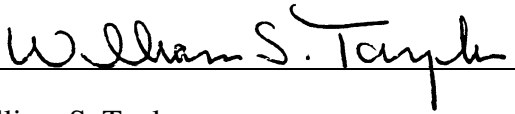
Per: 
Ron Bergeron
Senior Director

KPMG INC. solely in its capacity as Liquidator
of the Canadian Branch of Reliance Insurance Company
(and not in its personal capacity) after the issuance of the
Canadian Order

Per: 
Robert O. Sanderson
President, KPMG Inc.

ACCEPTED AND AGREED this 27 day of November, 2001.

**M. DIANE KOKEN, INSURANCE COMMISSIONER
OF THE COMMONWEALTH OF PENNSYLVANIA,**
solely in her capacity as Liquidator of Reliance Insurance Company,
and not in her personal capacity

A handwritten signature in cursive script that reads "William S. Taylor". The signature is written in black ink and is positioned above a horizontal line.

William S. Taylor
Deputy Insurance Commissioner of the
Commonwealth of Pennsylvania, solely
in his capacity as Liquidator Designee
Reliance Insurance Company (In Liquidation)

G23\GORMLEYD\2497616.8

October 1, 2006

KPMG Inc.
Suite 3300, Commerce Court West
Stn. Commerce Court
Toronto, Ontario
M5L 1B2

Attention: Robert O. Sanderson

OUR FILE NO. KPMG/016699

Re: Reliance Insurance Company, in Liquidation ("Reliance")

TO OUR PROFESSIONAL SERVICES RENDERED in connection with the above-noted matter for the period October 1, 2005 to September 30, 2006, including the following:

Attendances with respect to claims and liabilities issues, including settlement of claims, preparation of settlement documents, liaison and communications with adjusters, defence and plaintiffs' counsel, and applications for leave to proceed;

Attendances with respect to reinsurance issues, including preparation and attendance on appeal with respect to recognition of a U.K. solvent scheme of arrangement by Cavell Insurance Company ("Cavell") and conditions of recognition, communications with Cavell representatives, analysis of potential valuation of the claim, communications and co-ordination with U.K. counsel for the Liquidator and monitoring status of U.K. solvent scheme proceeding, reinsurance collections, commutations and settlement negotiations;

Attendances with respect to U.S. issues, including cross-border issues, protocol between Canadian and U.S. estates, set-off issues and non-booked claims;

Attendances with respect to liquidation issues, including preparation of motion materials and attendance at Ontario Court re passing of accounts, approval of the professional fees of the Liquidator and of its counsel and authorizing a third interim distribution, analysis of issues re post-liquidation interest, liaison with inspectors, amendment of PACICC loan and services agreement, confidentiality and due diligence issues and issues re third party administration of claims.

OUR FEE:	\$184,933.00
DISBURSEMENTS:	\$ 4,498.01
GST:	<u>\$ 12,589.89</u>
TOTAL:	<u>\$202,020.90</u>

GOODMANS LLP

E. & O. E.

GOODMANS\5376310.1

Schedule "K"

**RELIANCE INSURANCE COMPANY
(in liquidation)**

**LISTING OF GOODMAN'S LLP PERSONNEL
HOURS AND AVERAGE HOURLY RATE
TWELVE MONTH PERIOD ENDED SEPTEMBER 30, 2006**

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Rubenstein, Gale	Partner	Insolvency	50.3	\$505
Smith, Graham	Partner	Litigation	312.1	\$425
Paquette, Fanny	Law Clerk	Insolvency	52.8	\$165
Individuals with less than 30 hours			<u>80.6</u>	<u>\$226</u>
			<u>495.8</u>	<u>\$373</u>

GOODMANS\5374734.1

GOODMANS LLP

GENERAL LIQUIDATION RESPONSIBILITY

GALE RUBENSTEIN is a partner in the insolvency area. She oversees all legal matters and is involved in all major areas of the liquidation. Her particular areas of concentration included strategy issues, communications with various stakeholders and with the U.S. Liquidator. She advised with respect to claims and liabilities issues, reinsurance issues, U.S. protocol, cross-border issues, non-booked claims, distribution issues, issues relating to the passing of accounts, post-liquidation interest issues and issues regarding third party administration of claims.

FANNY PAQUETTE is a senior law clerk in the insolvency area. She drafted basic court documents and prepared materials in connection with applications to the Ontario Court and attended to service of motion materials. She also had responsibility for internal accounting control and meeting the requirements of the Liquidator with respect to accounting and billings.

LITIGATION

GRAHAM SMITH is a partner in the litigation section. He provided litigation support and acted as liaison with adjusters, defence counsel and plaintiffs' counsel, acted on applications for leave to proceed, provided advice and prepared settlement documentation on the settlement of various claims, prepared materials and appeared on an appeal with respect to recognition of a U.K. solvent scheme of arrangement, dealt with set-off issues and non-booked claims, prepared an analysis re post-liquidation interest, prepared materials and attended at the Ontario Court on the motion for the passing of accounts, approval of professional fees and third interim distribution, and prepared an agreement re third party administration of claims.

December 5, 2006

Reliance Insurance Company, in Liquidation
Suite 810, 4 King St W
Toronto ON M5H 1B6

GST #122363153

BILL OF COSTS

To our professional services rendered in connection with the above-noted matter for the period October 1, 2005 to September 30, 2006:

- Review and approval of financial statements and related analysis for the quarters ending December 31st, 2005, March 31st, 2006, June 30th, 2006 and September 30th, 2006;
- Review and approval of Management Reports for the quarters ending December 31st, 2005 and March 31st and June 30th and September 30th, 2006;
- Review and approval of money market transactions;
- Continued limited review of Reliance Canada documentation and meetings with the U.S. Liquidator to review U.S. documentation to attempt to quantify the magnitude of exposure to Canadian risk not reported on the books of Reliance Canada;
- Receipt, review, discussion and attendance at meetings with estate legal counsel to review ongoing matters, reinsurance collections issues including setoff issues, claims settlement issues and various other estate matters as required;
- Ongoing liaison with the U.S. Liquidator, including the return of surplus funds from the Canadian estate to the U.S. estate, discussions as to the status of reinsurance collections, IT systems administration, runoff models, and obtaining additional information required for the proper administration of the Canadian estate;
- Continued monitoring of the Reliance staff, including providing appropriate direction and assistance;
- Meetings, discussions, review of assumptions and preparation of detailed runoff models projecting the runoff of the estate;
- Continuing to deal with agents and brokers, especially trying to finalize the reconciliation of their accounts as at the date of liquidation;
- Performing a detailed claims review, discussion of potential outcomes with claims staff and attendance at meetings with the U.S. Liquidator's claims staff to review same;
- Attendance at meetings with actuarial consultant to perform an extensive review of policy liabilities as at March 31, 2006;

- Continuing to deal with policyholder and claimants' telephone calls, e-mails and correspondence requesting specific information pertaining to the liquidation or their specific claims;
- Receipt, review and discussion with the actuarial consultant, the results of his extensive review as performed above;
- Continued to review existing claims bordereaux in order to stratify claims as to dollar amounts, lines of business and PACICC exposure;
- Continuing to liaise with Reliance U.S. IT personnel to ensure the ongoing performance of the computer systems;
- Continuing to deal with numerous Meridian policyholder inquiries and replacement of the contract administrator;
- Continued review and approval of defense and adjustment costs and authorizing payment of same;
- Continued attendance with third party administrators to ensure the continued processing and adjudication of claims under their control and ensuring that claims are adjudicated and settled according to the procedures established by the Liquidator;
- Continued monitoring and supervision of claims adjudication staff, approval of reserve changes, approval of claims settlements, approval of claims settlement costs and authorization of payment of same;
- Review of new reported claims, discussions with claims adjudication staff and approving set up of appropriate reserves;
- Continued follow-up on reinsurance billings and collections;
- Preparation for and attendance at meetings with reinsurers in the London market to agree amounts due and ensure collection of same;
- Responding to requests of reinsurers to perform claims audits, development of and execution of confidentiality agreements, obtaining requested claim files from storage and responding to their queries;
- Continued to obtain shared reinsurance documentation from the U.S. Liquidator, particularly in respect of international and reinsurance policies;
- Providing information and analysis for the Inspectors as required;
- Preparation of appropriate accounting information and filing of appropriate non-tax statutory returns;
- Preparation of the December 31st, 2005 tax returns;
- Attendance at numerous meetings in person or by conference call with representatives of Cavell and/or their Canadian counsel, to review the terms of the scheme, and to try to negotiate a settlement of the Reliance claims;

- Instructing our U.K. Cavell counsel and attendance at meetings with them;
- Participation in Appeal to the Court of Appeal in the Cavell matter and filing of appropriate materials as required;
- Continued liaison with U.S. Liquidator as to international reinsurance collections and commission expenses associated therewith;
- Updating of the Reliance Canada website for the benefit of policyholders, claimants and creditors to enable them to obtain access to current information as to the status of the liquidation and their claims therein;
- Performed a detailed review of internal controls to ensure that the financial and operational controls are functioning as set forth in the Policies and Procedures;
- Overall administration of the estate and the Reliance staff consisting of approximately seven people, dealing with day-to-day administrative issues, responding to policyholder, claimants and creditor inquiries and attendance at all meetings, proceedings and/or Court appearances as required.

Our fee	\$ 405,695.40
Disbursements	<u>43,498.00</u>
	449,193.40
GST	<u>28,270.76</u>
Total	<u>\$ 477,464.16</u>

Schedule "N"

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED DECEMBER 31, 2005

<u>Name</u>	<u>Rank</u>	<u>Area</u>	<u>HOURS</u>	<u>AVG. HRLY RATE</u>
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	91.50	\$472
Murphy, E.	Associate Partner	Financial Report/Reinsurance	70.90	\$512
Bradley, J.	Manager	Insolvency/Claims/Reinsurance	76.50	\$305
Li, K	Technician		35.20	\$136
Individuals with less than 30 hours			57.40	\$301
			<u>331.50</u>	<u>\$377</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED MARCH 31, 2006

Name	Rank	Area	HOURS	AVG. HRLY RATE
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	89.00	\$472
Murphy, E.	Associate Partner	Financial Report/Reinsurance	36.40	\$512
Bradley, J.	Manager	Insolvency/Claims/Reinsurance	52.10	\$305
Individuals with less than 30 hours			40.70	\$430
			<hr/>	<hr/>
			<u>218.20</u>	<u>\$431</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED JUNE 30, 2006

Name	Rank	Area	HOURS	AVG. HRLY RATE
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	39.50	\$472
Murphy, E.	Associate Partner	Financial Report/Reinsurance	44.80	\$512
Individuals with less than 30 hours			64.90	\$347
			<hr/>	<hr/>
			<u>149.20</u>	<u>\$430</u>

RELIANCE INSURANCE COMPANY

(in liquidation)

LISTING OF KPMG INC. PERSONNEL

HOURS AND AVERAGE HOURLY RATE

THREE MONTH PERIOD ENDED SEPTEMBER 30, 2006

Name	Rank	Area	HOURS	AVG. HRLY RATE
Gutfreund, G.	V.P./Senior Manager	Insolvency/Claims	34.50	\$472
Murphy, E.	Associate Partner	Financial Report/Reinsurance	110.20	\$512
Bradley, J.	Manager	Insolvency/Claims/Reinsurance	83.50	\$305
Individuals with less than 30 hours			75.80	\$323
			<hr/>	<hr/>
			<u>304.00</u>	<u>\$404</u>

Schedule "O"

KPMG Inc.

(Quarter ending December 2005)

I GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administrative matters in the liquidation, including oversight of claims, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is also responsible for the development and maintenance of the website. During this period he assisted in the passing of accounts.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator, and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. During this period Ms Murphy met with several reinsurers in the London market to agree balances due to Reliance Canada and to pursue collections of same. She was also involved in discussions with a third party for the potential assumption of the branch operations.

JANINE BRADLEY – is a Manager in the corporate restructuring group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, overseeing the Meridian and GAP programs, reviewing defense costs and assisted in the passing of accounts and distribution of dividends declared. She also assists Ms Murphy in the areas of financial oversight and reinsurance.

K. LI – is a Technician in the Transaction Advisory Services Group who assisted Ms Murphy with the assembly of information for a data room in anticipation of the potential assumptions of the branch operations.

KPMG Inc.

(Quarter ending March 2006)

I. GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administrative matters in the liquidation, including oversight of claims, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website. During this period, the detailed claims review was completed and for review with the inspectors and Mr. Gutfreund was involved in meetings and collection of reinsurance in the London market.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. Ms Murphy met with several reinsurers to pursue collections and continued to assist with the analysis of the Cavell scheme.

JANINE BRADLEY – is a Manager in the corporate restructuring group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, the detailed claims review, overseeing the Meridian and GAP programs and reviewing defense costs.

KPMG Inc.
(Quarter ending June 2006)

I. GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administrative matters in the liquidation, including oversight of claims, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is responsible for the maintenance of the website.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator, and determination of actuarial liabilities. She is responsible for financial reporting and overseeing the accounting department. During this period, a full actuarial review was undertaken including additional liaison with the actuary as a result of the comprehensive claims review undertaken in part with representatives of the U.S. Liquidator. Ms Murphy also met with reinsurers in the London market to further pursue collections.

KPMG Inc.

(Quarter ending September 2006)

I GEORGE GUTFREUND – is a Vice President of KPMG Inc. and a Chartered Accountant, a Certified Insurance Receiver and licensed trustee in bankruptcy. He is responsible for the general administrative matters in the liquidation, including oversight of claims, human resources and office management. Mr. Gutfreund oversees the claims adjudication staff, liaises with PACICC concerning claims matters, participates as required in the formulation of the appropriate strategy, reviews and approves all significant reserve adjustments and is also responsible for the development and maintenance of the website.

ELIZABETH MURPHY – is a Vice President of KPMG Inc. and a Chartered Accountant. Ms Murphy has general responsibility for all reinsurance matters, management of the investment portfolio, communications with PACICC and the U.S. Liquidator and determination of actuarial liabilities. She is also responsible for financial reporting and overseeing the accounting department. During this period she oversaw a review of internal controls and compliance with liquidation policies and procedures.

JANINE BRADLEY – is a Manager in the corporate recovery group. She assists Mr. Gutfreund with the claims adjudication process, analysis and stratification of claims, overseeing the Meridian and GAP programs and reviewing defense costs.

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

MOTION RECORD
(Returnable December 15, 2006)

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Solicitors for KPMG Inc.,
Liquidator of Reliance (Canada)

Our File No. 01.6699

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