

DOCKET NO. CV-02-814173-S	:	SUPERIOR COURT
	:	
THE CONNECTICUT SURETY	:	JUDICIAL DISTRICT OF
COMPANY, CONNECTICUT SURETY	:	HARTFORD
CORPORATION, CONNECTICUT SURETY	:	
INSURANCE AGENCY, INC., FUNDS	:	
MANAGEMENT, INC., CONNECTICUT	:	
SURETY INSURANCE AGENCY OF	:	
ARIZONA, INC., BONDS II SURETY	:	
GROUP, INC. AND CONNECTICUT SURETY	:	AT HARTFORD
INSURANCE AGENCY OF NEVADA, INC.,	:	
IN LIQUIDATION	:	MAY 19, 2008

LIQUIDATOR'S SIXTH REPORT

To the Superior Court for the Judicial District of Hartford at Hartford, Connecticut, (the "Court") comes Thomas R. Sullivan, Insurance Commissioner of the State of Connecticut, in his capacity as Liquidator (the "Liquidator") of The Connecticut Surety Company, Connecticut Surety Corporation, Connecticut Surety Insurance Agency, Inc., Funds Management, Inc., Connecticut Surety Insurance Agency of Arizona, Inc., Bonds II Surety Group, Inc. and Connecticut Surety Insurance Agency of Nevada, Inc., and presents his Sixth Report pursuant to Connecticut General Statute § 38a-920, paragraph 28 of the Order of Liquidation entered by this Court on May 17, 2002, and paragraph 26 of the Order for Substantive Consolidation entered by this Court on May 29, 2003. This report provides a financial report for the period commencing April 1, 2007 and ending March 31, 2008. It also provides a report of events from April 1, 2007 through the date hereof and describes the Liquidator's plans for closing the estate.

A. Introduction.

1. The Connecticut Surety Company (“CSC”) was a Connecticut-domiciled surety company that issued commercial and contract surety and fidelity bonds. CSC’s principal offices were located at 100 Pearl Street, 16th Floor, Hartford, Connecticut. CSC was a wholly-owned subsidiary of The Connecticut Surety Corporation, a Delaware corporation (the “Holding Company”), and was part of the Connecticut Surety holding company system that included Connecticut Surety Insurance Agency, Inc. (“CSIA”), Connecticut Surety Insurance Agency of Arizona, Inc. (“CSIA-AZ”), the Connecticut Surety Insurance Agency of Nevada, Inc. (“CSIA-NV”), Bonds II Surety Group, Inc. (“Bonds II”), and Funds Management, Inc. (“FMI”) (the Holding Company, CSIA, CSIA-AZ, CSIA-NV, Bonds II and FMI are collectively referred to as the “Affiliates”). CSC was licensed to transact the business of insurance in Connecticut, 25 other states and the District of Columbia. CSC’s gross written premium for 2001 was \$2,052,486.

2. CSC and the Affiliates operated as an integrated organization, sharing office space, personnel and cash management systems. CSC issued virtually all of its bonds through its four Affiliate agencies, CSIA, CSIA-AZ, CSIA-NV and Bonds II (collectively, the “Affiliate Agencies”).

3. The Affiliate Agencies also issued and administered surety bonds on behalf of Star Insurance Company (“Star”), Redland Insurance Company (“Redland”), Acceptance Insurance Companies (“Acceptance”) and others which had licenses to write surety bonds in states where CSC lacked such licenses (collectively, with CSC, the “Sureties”). As part of underwriting bonds, CSIA (or one of the other Affiliate Agencies) would collect premium on bonds issued or

renewed in the name of the Sureties and remit the premium to the Sureties or their reinsurers less a ceding commission. In addition, in connection with the issuance and administration of surety bonds for the Sureties, CSIA obtained and held collateral security provided by the principals for the benefit of the Sureties.

B. Events Leading Up To These Proceedings.

4. As a result of a regular quarterly review of CSC's financial reports, the Connecticut Insurance Department (the "Department") became concerned about CSC's financial condition. The Department thereafter conducted on-site examinations of CSC and identified both operational and financial problems at CSC. The Department determined that CSC could not continue to operate in the manner in which it was operating, and accordingly issued an order of supervision (the "Supervision Order") for CSC on June 26, 2001.

5. Shortly after the entry of the Supervision Order, the Holding Company undertook to find a purchaser for CSC and the Affiliate Agencies. In late 2001, the Holding Company determined to enter into a transaction with Capitol Indemnity Corporation ("Capitol"), a subsidiary of Alleghany Capitol Corporation. The Holding Company, on behalf of itself, CSC and the Affiliate Agencies, entered into an asset purchase agreement (the "Asset Purchase Agreement") with Capitol. Under the terms of the Asset Purchase Agreement, Capitol purchased from the Holding Company certain tangible assets and software and an option to purchase the stock of CSC. Capitol also assumed certain lease and payroll obligations of CSC.

6. Simultaneously with the Asset Purchase Agreement, Capitol entered into a Renewal Rights Agreement (the "Renewal Rights Agreement" and, together with the Asset Purchase

Agreement, the “Capitol Transaction”) with the Holding Company, CSC and CSIA, whereby Capitol purchased the right to renew surety bonds (the “Old Bonds”) that had previously been issued through CSIA on behalf of the Sureties. Since the Capitol Transaction, Capitol has issued hundreds of bonds (the “Replacement Bonds”) that have replaced certain of the Old Bonds. The Replacement Bonds continue to cover the identical risk of the Old Bonds being replaced.

7. The Department was aware of the negotiations leading up to the Capitol Transaction and approved of the Capitol Transaction. The Department expected that, after the closing of the Capitol Transaction, it would commence rehabilitation proceedings with respect to CSC.

8. On February 6, 2002, a consensual Order of Rehabilitation (the “Rehabilitation Order”) was entered, which placed CSC into rehabilitation proceedings pursuant to Conn. Gen. Stat. §§ 38a-903 – 38a-961, inclusive, and appointed the Insurance Commissioner of the State of Connecticut as rehabilitator (the “Rehabilitator”) of CSC.

9. Following the entry of the Rehabilitation Order, the Rehabilitator and the Department staff continued to investigate the financial condition of CSC and attempted to marshal its assets for the purpose of running off its liabilities in the ordinary course of business. During this period, the Rehabilitator became aware of claims and liabilities that had not previously been reserved or recorded in CSC’s financial statements. In addition, the Department determined that it would be unable to readily access substantial cash deposits that were being held by other state insurance regulators as a condition to CSC doing business in those states. The Department determined that it was highly uncertain whether CSC would have sufficient assets to continue to pay claims and liabilities in the ordinary course. Accordingly, the Rehabilitator determined that

it was in the best interest of CSC's policyholders, its creditors, and the estate of CSC to commence a liquidation proceeding for CSC.

10. On May 17, 2002, this Court entered an Order of Liquidation (the "Liquidation Order") with respect to CSC. The Liquidation Order provided, among other things, for the Liquidator (i) to maintain or immediately take exclusive possession and control of all property of CSC, wherever located, and to liquidate the same pursuant to the provisions of Connecticut law; and (ii) to take such actions as the nature of the case and interests of the policyholders, CSC's creditors, the stockholders of CSC, and the public may require. Pursuant to the Liquidation Order, all CSC bonds were cancelled effective June 16, 2002, if not previously cancelled. The Liquidation Order also established a bar date (the "CSC Bar Date") of November 15, 2002, by which time proofs of claim for all claims against CSC were to be filed.

C. Issues in the Wake of the Capitol Transaction.

11. It was expected that after the closing of the Capitol Transaction, Capitol would be able to administer the ongoing business of CSC and the Affiliate Agencies without further support from the Liquidator. However, two unanticipated developments required extensive involvement of the Liquidator and embroiled the Liquidator in a complex dispute with Capitol.

12. First, the shareholders and management of the Holding Company abandoned it and the Affiliates. The management and directors resigned, leaving the companies without the ability to perform even normal corporate tasks. As such, there was no one to wind up their affairs. This proved problematic for the Liquidator because the Affiliate Agencies were in control of bank accounts that contained premium held in trust for the Sureties. Because no person was

authorized to act on behalf of the Affiliate Agencies, the premiums were frozen in the Affiliate Agencies' bank accounts.

13. The Affiliate Agencies also were in possession of cash, certificates of deposit and letters of credit (the "Collateral") that had been provided as collateral security to the Sureties. The Affiliate Agencies were the authorized agents of the Sureties for purposes of administering the Collateral and the Collateral stood in the name of the Affiliate Agencies. Because no person was authorized to act on behalf of the Affiliate Agencies, Collateral could not be released to principals and could not be liquidated for the benefit of the Sureties.

14. The Holding Company had historically filed consolidated federal tax returns for the Affiliates and CSC. Without anyone to act on behalf of the Holding Company, CSC would be unable to complete the required federal tax returns.

15. Second, Capitol continued to use the Affiliate Agencies' bank accounts and CSC's licenses in its business after the closing of the Capitol Transaction. Capitol also continued collecting premium on behalf of CSC and, after Capitol established its own bank accounts, deposited that premium in those bank accounts.

16. Prior to establishing its own bank accounts, Capitol deposited premiums for new business in accounts of the Affiliate Agencies that held premiums of Sureties for prior transactions. Capitol also deposited cash collateral into accounts of the Affiliate Agencies that held Collateral for the Sureties, which had been deposited in prior transactions. Because the Affiliate Agencies

had no officers, Capitol was unable to obtain possession of the amounts deposited. In addition, the commingling of funds caused significant confusion in the Affiliate Agencies' records.

17. In connection with issuing bills for new business, Capitol also billed premiums owed to CSC. However, the bills sent on behalf of CSC indicated offsets for agent commission against premiums owed to CSC. While such offsets would be customary in ongoing insurance business, they are prohibited in liquidation cases. (Conn. Gen. Stat. § 38a-935(a)(1); Liquidation Order paragraph 23.) As a result, Capitol under-collected premiums due to CSC.

18. Capitol also renewed surety bonds in the name of CSC after the close of the Capitol Transaction and while CSC was in receivership. This practice was clearly unauthorized and prohibited by the Liquidation Order.

19. Finally, when issuing Replacement Bonds, Capitol intended to obtain the benefit of any Collateral that had been provided in connection with the Old Bonds that were being replaced. However, Capitol did not obtain documentation from most principals authorizing the transfer of the Collateral from the Affiliate Agencies to Capitol or otherwise pledging the Collateral to secure the Replacement Bonds.

20. The Liquidator and Capitol conducted extensive negotiations concerning the foregoing matters. The Liquidator suggested that Capitol assume ownership and control of the Affiliates. Capitol declined.

21. As such, the Liquidator determined to take control of the Affiliates with appropriate authorization from the Court, undertake a reconciliation and accounting with respect to deposits

made by Capitol, obtain court authorization to transfer the Collateral to Capitol, cause Capitol to assume liability for any business written by it in the name of CSC and resolve any liability by Capitol for actions taken by it. The Liquidator was successful in achieving these goals, without the need of litigation, as described below.

D. Resolution of Capitol Disputes.

22. In order to relieve the estate of liability under bonds issued in the name of CSC after January 31, 2002, Capitol and the Liquidator agreed that the Liquidator would enter into a reinsurance agreement with Platte River Insurance Company (“Platte River”) an affiliate of Capitol. Under the reinsurance agreement, Platte River assumed the entire risk of all bonds first issued or renewed in the name of CSC after January 31, 2002. Under the agreement, the Liquidator assigned and Platte River assumed sole responsibility for the payment of all losses and loss adjustment expenses related to bonds issued by Capitol in the name of Connecticut Surety, as well as the administration and servicing of all aspects of those bonds.

23. In order to obtain control over the Affiliates with authorization from the Court, the Liquidator determined to seek an order of substantive consolidation. On April 30, 2003, the Liquidator filed a Motion for Substantive Consolidation of The Connecticut Surety Company and its Affiliates. The Court entered an Order for Substantive Consolidation on May 29, 2003 (the “Substantive Consolidation Order”).

24. The Substantive Consolidation Order authorized the Liquidator to take possession of the assets of the Holding Company and Affiliates, to pool their assets and liabilities with those of CSC as a consolidated estate (the “Consolidated Estate”), and to administer the Consolidated

Estate's assets and liabilities under the general supervision of the Court. The Substantive Consolidation Order also established a bar date (the "Affiliate Bar Date") of August 29, 2003, by which timely proofs of claim for all claims against the Affiliates were to be filed.

25. After the substantive consolidation was complete, Capitol and the Liquidator entered into extensive negotiations to resolve matters pertaining to the premiums, the Collateral, and other issues that arose following the close of the Capitol Transaction.

26. To that end, the Liquidator's staff conducted an audit of the premium trust accounts held by the Affiliate Agencies and Capitol in order to determine the amount of premium owned by each of Capitol and CSC. Capitol conducted its own audit of the accounts using PriceWaterhouseCoopers LLP. The Liquidator and Capitol also sought to reconcile ownership of the Collateral and determine what items of Collateral pertained to Replacement Bonds.

27. In order to enable the Liquidator to transfer Collateral related to Replacement Bonds, the Liquidator filed a Motion to Transfer Collateral with the Court on September 3, 2003. In the Motion, the Liquidator asserted that an interest in the Collateral securing the Replacement Bonds had been equitably assigned to Capitol. The Liquidator also asserted that the bond principals, the Sureties and Capitol all had intended that the Collateral would secure the obligations of the bond principals under the Replacement Bonds to reimburse Capitol with respect to losses under the Replacement Bonds.

28. Pursuant to an order of the Court, the Liquidator sent notice of the motion to all identifiable parties in interest, including bond principals, collateral owners, producers, the

Sureties, CSC's reinsurers, state insurance commissioners, the Internal Revenue Service and the banks at which the Affiliate Agencies held Collateral. On October 20, 2003, after a hearing, the Court entered an order (the "Collateral Transfer Order") (1) determining that an interest in the Collateral had been equitably assigned to Capitol to secure the obligations of the principals under the Replacement Bonds to reimburse Capitol with respect to losses under the Replacement Bonds; and (2) authorizing the Liquidator to transfer possession of the Collateral to Capitol and to enter into an agreement with Capitol providing for the assumption by Capitol of CSIA's obligations to administer the Collateral for the benefit of the Sureties.

29. In accordance with the Collateral Transfer Order, the Liquidator and Capitol entered into two separate collateral administration and assignment agreements – the first with Star and the second with Redland and Acceptance – effective as of November 14, 2003 (together, the "Collateral Administration and Assignment Agreements"). Under the Collateral Administration and Assignment Agreements, Star, Acceptance and Redland authorized Capitol to assume the Affiliate Agencies' obligations to administer the Collateral for the benefit of Star, Acceptance and Redland, and authorized the Liquidator to transfer possession of the Collateral provided for the benefit of Star, Acceptance and Redland to Capitol. In addition, Capitol assumed the Affiliate Agencies' rights, duties, responsibilities and obligations necessary to administer the Collateral including, without limitation, the return of Collateral to collateral owners.

30. Pursuant to the Collateral Administration and Assignment Agreements, on November 25, 2003, the Liquidator transferred to Capitol via wire transfer \$1,280,488.82 in cash Collateral provided for the benefit of Star, \$1,033,169.44 in cash Collateral provided for the benefit of

Acceptance and Redland, and \$1,675,277.19 in cash Collateral provided to secure the Replacement Bonds. The Liquidator also delivered to Capitol possession of all letters of credit, certificates of deposit and other Collateral posted for the benefit of Star, Acceptance and Redland.

31. The Liquidator and Capitol undertook to settle a wide range of matters outstanding between the parties, including the commingling of CSC and Capitol premiums. After months of negotiation, Capitol (and its affiliates) and the Liquidator entered into the Mutual Release Agreement dated as of November 14, 2003 pursuant to which the parties settled all pending disputes.

32. Subsequently, Capitol paid the Liquidator all remaining amounts owing under the Renewal Rights Agreement and paid the Liquidator the amount of return premium owed under the Platte River reinsurance agreement. The Liquidator has delivered to Capitol the remaining bond collateral that relates to bonds renewed by Capitol.

E. Administration of the Consolidated Estate.

Personnel and Facilities.

33. Following the close of the Capitol Transaction, the Liquidator operated the Consolidated Estate from the Hartford, Connecticut premises where CSC (and then Capitol) historically operated. By the terms of the Capitol Transaction, Capitol has continued to provide the Liquidator and the Department staff with office space throughout the proceeding.

34. Substantially all employees of CSC and the Affiliates were terminated as of the closing of the Capitol Transaction, and the remaining employees were terminated during the Rehabilitation. As such, the Liquidator retained, and continues to retain, consultants and professionals to assist in the Liquidation as needed. In addition, the law firm of Bingham McCutchen LLP continues to provide legal services to the Liquidator and the Consolidated Estate.

35. The Liquidator entered into a claims management agreement with Forcon International Nevada, Ltd. and Forcon International - N.E., LLC (collectively, "Forcon") under which Forcon managed commercial and contract bond claims arising out of or relating to bonds issued by CSC, and provided recovery services relating to those bonds. Forcon was assigned 287 proofs of claim for losses under bonds. Of these 287 proofs of claim, 3 proofs of claim were withdrawn by the respective claimants. Forcon made recommendations to the Liquidator with respect to all of the 284 remaining proofs of claim.

36. The Liquidator has retained The Warren Group as a tax consultant to the Liquidator. The Warren Group specializes in tax and accounting matters for insurance companies in receivership. Previously, the Warren Group produced and filed Federal tax returns for the years 2001 through 2006. The Liquidator plans to prepare and file state tax returns or obtain appropriate waivers in the future. During the Report Period, the Warren Group produced and filed Federal tax returns for the year 2007, and also produced income statements for each of CSC and its Affiliates so that they can file appropriate returns or obtain appropriate waivers from state taxing authorities.

Reinsurance.

37. CSC maintained reinsurance on its outstanding bond exposure. Prior to June 1, 2000, CSC had only excess of loss reinsurance. Commencing June 1, 2000, CSC entered into a quota share reinsurance agreement (the "Quota Share Agreement") under which it was reinsured for one hundred percent of all losses on bonds written and renewed thereafter.

38. The Liquidator has notified the reinsurers of all proofs of claim filed in the liquidation which may give rise to claims covered by their reinsurance, and notified them in connection with motions to the Court for allowance of claims.

39. The Liquidator produced a report of premiums and claims for the quota share reinsurers as of June 2004. Due to extremely poor record keeping by CSC and the Affiliates, the Liquidator had to reconstruct significant portions of CSC's books and records to prepare this report. In addition, because the Quota Share Agreement covers Star and Acceptance as well as CSC, the Liquidator obtained information from them in order to determine the sliding scale ceding commissions.

40. On November 8, 2004, the Liquidator's staff met with the quota share reinsurers to discuss the report. Thereafter, the Liquidator responded to various inquiries from the quota share reinsurers. As a result of further claims activity and the filing of new claims, the Liquidator has revised the report with respect to the quota share reinsurance several times.

41. As part of the process of preparing the quota share reinsurance report, the Liquidator undertook to determine amounts of premium that had been collected on behalf of Star which had

not been remitted. The Liquidator ultimately reached a global settlement with Star pursuant to which the Liquidator paid to Star the amounts that had been collected. The settlement has now been approved by the Court and the payment has been made.

42. During the Report Period, the Liquidator prepared and delivered to the reinsurers updated analyses of liability under the Quota Share Agreement. The Liquidator has now reconciled all obligations under the Quota Share Agreement and has entered into settlement agreements with each of the reinsurers. Pursuant to those settlement agreements, the Liquidator has allowed certain claims by the reinsurers, but has preserved Connecticut Surety's rights to submit and be paid further amounts under the Quota Share Agreement in the unlikely event that there are additional bond claims in the future.

Proofs of Claim.

43. On or about May 24, 2002, the Liquidator sent notice of the CSC Bar Date and the CSC claims process, along with a proof of claim form, to all persons or entities known or reasonably expected to have claims against, or an interest in, CSC. In addition, notice of the CSC Bar Date and the CSC claims process appeared in The Hartford Courant on May 24, 2002, and on the Department's website. Proof of claim forms also were available through the Department's website.

44. On or about June 3, 2003, the Liquidator sent notice of the Affiliate Bar Date, along with a proof of claim form, to all persons or entities known or reasonably expected to have claims against, or an interest in, the Affiliates. In addition, notice of the Affiliate Bar Date appeared in

The Hartford Courant on June 13, 2003, and on the Department's website. Proof of claim forms also were available through the Department's website.

45. As of May 10, 2008, 1,244 claims had been asserted in proofs of claim (the "Proofs of Claim") filed with the Liquidator. The Proofs of Claim are comprised of various classes of claims, as defined by Conn. Gen. Stat. § 38a-944 as follows:

46. Claims for Loss Under a CSC Bond (the "Bond Loss Claims"). 389 Bond Loss Claims have been filed with the Liquidator. 366 Bond Loss Claims were filed in the aggregate stated amount of \$6,965,399.63. 23 Bond Loss Claims were filed in an unstated amount. The aggregate bond penalty on Bond Loss Claims filed in an unstated amount is \$402,700. To date, the Liquidator has obtained orders from the Court allowing 195 Bond Loss Claims in the aggregate amount of \$1,814,526.32 and there are no pending motions for the allowance of Bond Loss Claims. The Liquidator has also obtained orders from the Court disallowing 190 Bond Loss Claims totaling \$3,253,540.35, and there is pending a motion for the disallowance of 1 Bond Loss Claim totaling \$310.19. Additionally, 3 proofs of claim were withdrawn by the respective claimants and, accordingly, disallowed by order from this Court. Upon the disposition of the foregoing motion, all Bond Loss Claims will have been allowed or disallowed by the Court.

47. Claims for Unearned Premium (the "Unearned Premium Claims"). 746 Unearned Premium Claims were filed with the Liquidator. 465 Unearned Premium Claims were filed in the aggregate stated amount of \$234,285.13. 281 Unearned Premium Claims were filed in an unstated amount. To date, the Liquidator has obtained orders from the Court allowing 611

Unearned Premium Claims in the total amount of \$149,727.31. The Liquidator has also obtained orders from the Court disallowing 134 Unearned Premium Claims totaling \$148,087.50. Additionally, 1 Proof of Claim was abandoned by the respective claimant. All Unearned Premium Claims have been allowed or disallowed by the Court.

48. Of the Unearned Premium Claims filed, the Liquidator determined that 82 Unearned Premium Claims were covered by the Platte River reinsurance agreement. Based on the Liquidator's calculations, \$14,856.94 of unearned premium was due on those claims. The Liquidator agreed to allow these unearned premium claims and obtained from Platte River reimbursement of that amount.

49. The Liquidator delivered 70 Proofs of Claim in the aggregate stated amount of \$259,871.69, of which 56 were Unearned Premium Claims, filed in the aggregate stated amount of \$7,459.14 and 14 were Bond Claims, filed in the aggregate stated amount of \$252,412.55. The guaranty funds have paid 44 claims totaling \$82,002.63, of which \$76,950.83 were paid Bond Claims, \$4,547.52 were paid Unearned Premium Claims, and \$504.28 were paid return premium claims. The guaranty funds have disallowed the remainder because the claimants were ineligible for guaranty fund coverage. The Liquidator has allowed the claims of 19 of those claimants and disallowed 7. All Unearned Premium Claims referred to guaranty funds have been allowed or disallowed by the Court.

50. Guaranty Fund Claims. 12 proofs of claim were filed by various guaranty funds with the Liquidator. All such claims were filed in an unstated amount. The Liquidator has now resolved the claims of all guaranty funds. Claims for loss reimbursement have been allowed on behalf of

New York in the amount of \$39,285.54 and Arkansas in the amount of \$42,717.09. This Court has allowed claims for reimbursement of expenses of New York in the amount of \$30,000 and Arkansas in the amount of \$10,312.18. All other guaranty fund claims have been disallowed on the basis that such guaranty funds did not adjust or pay any claims on behalf of Connecticut Surety.

51. General Creditor Claims (the "General Creditor Claims"). 62 General Creditor Claims were filed with the Liquidator. Of these, 52 General Creditor Claims were filed in the aggregate stated amount of \$33,895,714.36, including one claim which was filed in the amount of \$28,555,000.

52. The Liquidator has now resolved all of the General Creditor Claims. Of the claims filed, the Liquidator has allowed 34 in the aggregate amount of \$4,862,476.62 and disallowed 28 in the aggregate amount of \$1,800,464.95. The Liquidator settled one claim which had been filed in the amount of \$28,555,000 in consideration of a payment of \$90,000 (which is approximately equivalent to an allowed class 6 claim of \$900,000). Motions are pending for the approval of the allowance of certain of these claims. It is expected that a distribution will be made to the holders of class 6 claims. The amount of such distribution is uncertain at present, but is expected to be in the range of 10 to 15%.

53. Claims of State and Local Governments. 17 claims were filed by state and local governments for premium, corporate and other taxes. Of those, 15 claims were filed in the aggregate stated amount of \$40,700.88. Two claims were filed in an unstated amount. To date, the Liquidator has determined to recommend to the Court to deny 4 such claims, which were

filed in the aggregate stated amount of \$6,825.55, on the basis that they were either exact duplicates of other claims of state and local governments or were filed after the Bar Date. Reserves on state and local government claims currently are estimated at \$29,022.58. It is not expected that a distribution will be made on these claims.

54. Subordinated Surplus Notes (the "Notes"). Three proofs of claim filed with the Liquidator included claims with respect to Notes issued by CSC. The Notes underlying those claims are in the aggregate face amount of \$4,211,667. Accrued interest on the Notes through the date of the Liquidation Order totals \$542,309.29. Reserves on the Notes currently are estimated at \$4,753,976.29. The Notes are class 8 claims. It is not expected that a distribution will be made on these claims.

55. Miscellaneous Claims. The Liquidator received 16 miscellaneous unclassified claims, consisting of one claim for a banking fee for securities on deposit, which was paid by the Consolidated Estate; 7 claims for return of collateral, which were satisfied; and one claim classified as a Class 8 Claim, which was allowed by the Court, but will not be paid due to insufficient funds to satisfy all claimants.

F. Collection of Deposits Held by Other States.

56. At the commencement of the liquidation proceeding, the most significant assets of the estate were deposits that CSC made, in the form of bonds or money market funds, with the insurance departments of Alaska, Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Massachusetts, Nevada, Oregon and South Carolina as a condition to do business and operate in

those states (the “Deposits”). The Deposits are intended, in most states, to secure the obligations of CSC to residents of those states and, accordingly, are available to pay Class 3 claims.

57. In accordance with Conn. Gen. Stat. § 38a-923(a)(6), which authorizes a liquidator to collect assets belonging to an estate, the Liquidator has pursued and collected each of the Deposits.

G. Distribution of Assets to Class 3 Claimants.

58. On or about December 23, 2005, the Liquidator made an interim partial distribution of assets to certain Class 3 claimants holding Allowed Claims (the “Interim Distribution”), pursuant to an order of the Court dated November 9, 2005 (the “Interim Class 3 Distribution Order”).

59. Pursuant to the Interim Class 3 Distribution Order, on or about December 23, 2005, the Liquidator paid \$522,039.50 representing a partial interim distribution of the Class 3 Allowed Claims to those claimants residing in Alaska, California, Florida, Iowa, Louisiana, Maryland, Missouri, Nebraska, New Jersey, New Mexico, Ohio, Oklahoma, Pennsylvania, Texas, Utah, Vermont, Washington and Quebec, Canada, and a full distribution of the Class 3 Allowed Claims of those claimants in Arizona, Connecticut, Oregon and South Carolina.

60. In accordance with Conn. Gen. Stat. § 38a-946, the Liquidator sought authorization from the Court to make a final distribution to all Claimants holding Class 3 claims that had been allowed by a final order of the Court (the “Allowed Claims”). By order dated October 26, 2006 (the “Final Class 3 Distribution Order”), the Court authorized the Liquidator to pay one-hundred percent (100%) of the amount of the allowed Class 3 claims held by Claimants (except for claimants that resided in states where the insurance department failed to return a deposit).

61. Pursuant to the Final Class 3 Distribution Order, on or about December 15, 2006, the Liquidator paid \$737,506.75 to those claimants residing in Alaska, California, Florida, Iowa, Louisiana, Maryland, Missouri, Nebraska, New Jersey, New Mexico, Ohio, Oklahoma, Pennsylvania, Texas, Utah, Vermont, Washington, and Quebec, Canada, representing the unpaid balance of their Class 3 Allowed Claims. In addition, the Liquidator paid \$17,884.19 to claimants residing in Arizona, Connecticut, Oregon and South Carolina whose claims were allowed after the Interim Distribution Date, and to those claimants residing in Massachusetts following release by Massachusetts of its deposit.

62. On or about April 18, 2007 also pursuant to the Final Class 3 Distribution Order, the Liquidator paid an additional \$239,016.61 to claimants holding allowed Class 3 Claims in the States of Arkansas and Nevada, following the release of the deposits held by those States. The Liquidator is preparing to distribute \$10,692.67 to 4 claimants holding allowed Class 3 Claims in Georgia following the release by Georgia of its deposit, and \$4,269.68 to claimants whose claims have recently been allowed.

H. Financial Statements.

63. The attached financial statements were compiled by the Liquidator's staff on the basis of the bank records, proofs of claim and records of CSC and the Affiliates. Due to deficiencies in the records of CSC and the Affiliates, the financial statements represent only the Liquidator's best estimate of certain liabilities of the estate.

Assets.

64. Short-term investments of \$2,194,451 include funds held at Bank of America and in the Short Term Investment Fund managed by the Treasurer of the State of Connecticut.

65. Funds held for others total approximately \$78,973.14. It consists of funds held by the Liquidator as collateral for bond obligations.

66. Recoverables from reinsurers is stated in the amount of \$1,450,233. This is the amount of claims owing under the Quota Share Agreement. It is subject to offsets for premiums owed of a greater amount which is included in the Amounts Due to Reinsurers and Insurers. The reconciliation of these amounts and their mutual offset has been accomplished in settlements with the reinsurers that were implemented after the date of this financial report and therefore are not included in the report.

Liabilities.

67. Class 2 administrative expenses of the Guaranty Funds have been determined to be \$40,312.18.

68. Class 3 consists of Bond Loss Claims, Unearned Premium Claims and Guaranty Fund claims (other than class 2 claims) for which the Liquidator had reserved \$130,026.86 as of March 31, 2008.

69. Class 6 general creditor claims and reinsurer claims are expected to be allowed at \$4,862,476.62.

70. Class 7 state and local government claims are \$34,010. This amount is the Liquidator's best estimate of the class 7 claims based on the claims filed with the Liquidator and the Liquidator's review of the accounting and tax records of CSC.

71. Class 8 claims based on subordinated surplus notes issued by CSC are estimated to be \$4,753,976. This amount is the Liquidator's best estimate of the class 8 claims filed with the Liquidator and the Liquidator's calculation of interest accrued on those notes through May 17, 2002.

72. Funds held for others include collateral pledged by third parties for various bonds.

Statement Of Receipts And Disbursements.

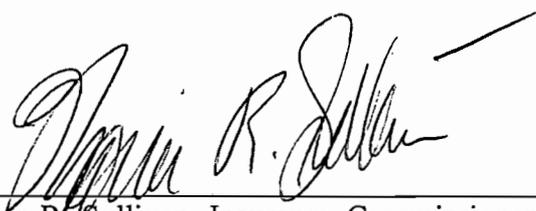
73. During the Report Period, the Consolidated Estate paid \$282,535.05 to Bingham McCutchen in legal fees and expenses and \$2,119.00 to other law firms in connection with claim disputes and salvage litigation. In addition, \$60,339.62 was paid to other consultants in connection with the preparation of tax returns.

CONCLUSION

During the sixth year of this liquidation proceeding, the Liquidator has nearly completed winding up the affairs of CSC. The principal tasks pursued by the Liquidator during this period were the payment of the Final Class 3 Distribution, collection of Deposits, the disposition of claims and the preparation of materials in order to comply with state and federal tax laws. At this point, all Bond Loss Claims, Guaranty Fund Claims, Unearned Premium Claims and General

Creditor Claims have been determined, including one pending court approval. It is expected that final distributions will be made in the third quarter of 2008 and that the case will be closed shortly thereafter.

Respectfully submitted this 19th day of May, 2008.

A handwritten signature in black ink, appearing to read "Thomas R. Sullivan", with a long horizontal stroke extending to the right.

Thomas R. Sullivan, Insurance Commissioner of the State of Connecticut, as Liquidator of The Connecticut Surety Company, Connecticut Surety Corporation, Connecticut Surety Insurance Agency, Inc., Funds Management, Inc., Connecticut Surety Insurance Agency of Arizona, Inc., Bonds II Surety Group, Inc. and Connecticut Surety Insurance Agency of Nevada, Inc.

THE CONNECTICUT SURETY COMPANY et al., IN LIQUIDATION
BALANCE SHEET
As of 3/31/08

CSC - Date Placed in Rehabilitation: February 6, 2002
 CSC - Date Placed in Liquidation: May 17, 2002
 Consolidated Group - Date Placed in Liquidation: May 29, 2003

	CSC As of 5/28/03	Consolidated As of 5/29/03	Consolidated As of 3/31/04	Consolidated As of 3/31/05	Consolidated As of 3/31/06	Consolidated As of 3/31/07	Consolidated As of 3/31/08
ASSETS							
Cash	156,926.36	2,086,989.93	992,263.97	1,036,852.50	181,725.97	727,456.83	142,629.52
Short-Term Investments	875,762.62	1,569,486.07	2,473,159.34	1,712,705.19	2,938,763.74	1,864,381.59	2,194,451.13
Total Cash & Short Term Investments	1,032,688.98	3,656,476.00	3,465,423.31	2,749,557.69	3,120,489.71	2,591,838.42	2,337,080.65
Bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Advances to Guaranty Associations	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Recoverable from Reinsurers	1,280,599.10	1,280,599.10	1,416,234.46	1,801,310.17	1,815,074.00	1,450,233.00	1,450,233.00
Salvage and Subrogation Recoverables	53,000.00	53,000.00	0.00	0.00	0.00	0.00	0.00
Premiums/Agents Balances in Course of Collection	207,681.43	0.00	0.00	0.00	0.00	0.00	0.00
Receivable from Affiliates	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Accrued Investment Income	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other Assets:							
Fees Receivable from Capitol Indemnity	18,179.00	18,179.00	18,179.00	18,179.00	0.00	0.00	0.00
Funds Held by Reinsurers	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Furniture & Office Equipment	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Data Processing Equipment	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Unrestricted Assets	2,592,148.51	5,008,254.10	4,899,836.77	4,569,046.86	4,935,563.71	4,042,071.42	3,787,313.65
Restricted Assets:							
Securities on Deposit Held as Bonds	1,776,099.50	1,776,099.50	1,471,802.50	1,418,287.50	0.00	0.00	0.00
Securities on Deposit Held as Cash or MMF's	237,364.79	237,364.79	237,586.76	938,057.44	939,104.83	40,901.00	42,527.89
Funds Held for Others	953,234.20	4,096,996.08	351,017.95	351,989.37	331,017.95	303,017.95	78,973.14
Total Restricted Assets	2,966,698.49	6,110,460.37	2,060,407.21	2,708,334.31	1,270,122.78	343,918.95	121,501.03
Total Assets	5,558,847.00	11,118,714.47	6,960,243.98	7,277,381.17	6,205,686.49	4,385,990.37	3,908,814.68
LIABILITIES							
Claims:							
Secured Claims:							
Class 1 Claims:	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Class 2 Claims:	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	90,000.00
Class 3 Claims:	3,361,431.05	3,361,431.05	3,749,356.36	3,567,792.28	2,937,457.98	398,888.19	130,026.86
Class 4 Claims:	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Class 5 Claims:	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Class 6 Claims:	5,328,841.91	5,328,841.91	10,287,126.55	10,294,513.44	10,294,513.44	10,294,513.44	4,862,476.62
Class 7 Claims:	20,089.69	20,089.69	23,459.24	29,708.13	29,022.58	29,022.58	34,010.33
Class 8 Claims:	4,753,976.29	4,753,976.29	4,753,976.29	4,753,976.29	4,753,976.29	4,753,976.29	4,753,976.29
Class 9 Claims:	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Claims Received	13,514,338.94	13,514,338.94	18,863,918.44	18,695,990.14	18,064,970.27	15,526,400.50	9,910,802.28
Other Liabilities Not Included Above:							
Amounts Due to Reinsurers & Insurers	207,681.43	1,521,739.35	1,523,398.49	2,653,952.80	2,853,342.00	3,199,100.00	3,199,100.00
Funds Held for Others	953,234.20	4,096,996.08	351,017.95	351,989.37	331,017.95	303,017.95	78,973.14
Total Other Liabilities	1,160,915.63	5,618,735.43	1,874,416.44	3,005,942.17	3,184,359.95	3,502,117.95	3,278,073.14
Total Liabilities	14,675,254.57	19,133,074.37	20,738,334.88	21,701,932.31	21,249,330.22	19,028,518.45	13,188,875.42
Excess (Deficiency) of Assets Over Liabilities	(9,116,407.57)	(8,014,359.90)	(13,778,090.90)	(14,424,551.14)	(15,043,643.73)	(14,642,528.08)	(9,280,060.74)
Total Liabilities and Equity	5,558,847.00	11,118,714.47	6,960,243.98	7,277,381.17	6,205,686.49	4,385,990.37	3,908,814.68

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THE CONNECTICUT SURETY COMPANY et al., IN LIQUIDATION
STATEMENT OF RECEIPTS AND DISBURSEMENTS
For the Period of 4/1/07 - 3/31/08

CSC - Date Placed In Rehabilitation: February 6, 2002

CSC - Date Placed In Liquidation: May 17, 2002

Consolidated Group - Date Placed In Liquidation: May 29, 2003

Period
4/1/07 - 3/31/08

Cumulative
5/29/03 - 3/31/08

RECEIPTS

Marshaling of Estate Assets:		
Premium Receipts	0.00	11,612.38
Proceeds from Sales:		
Sale of Company Assets to Capitol Transamerica Corporation	0.00	0.00
Reinsurance Recoveries	0.00	189,485.90
Advances from Reinsurers	0.00	212,500.00
Agents Balances	0.00	0.00
Collection of Affiliate Receivables	0.00	0.00
Salvage and Subrogation Recoveries	5,000.00	112,548.10
Recovery of Taxes Previously Paid	0.00	0.00
Expense Reimbursements	0.00	5,064.33
Miscellaneous Income	0.00	112,121.13
Receipts Before Investment Activities	5,000.00	643,331.84
Interest and Dividend Receipts	108,801.58	603,637.87
Proceeds from Sales and Maturities of:		
Short Term Investments Deposits	0.00	900,000.00
Bonds	0.00	1,460,495.00
Receipts from Investment Activities	108,801.58	2,964,132.87
Total Cash Receipts	113,801.58	3,607,464.71

DISBURSEMENTS AND DISTRIBUTIONS

Class 3 Creditor Payments	243,154.26	1,925,485.73
LAE Payments	0.00	24,428.22
Legal Fees	284,654.05	2,066,528.81
Consulting Fees	60,339.62	787,943.60
Salaries	0.00	0.00
Employee Benefits	0.00	0.00
Taxes	0.00	0.00
Operating Expenses	2,829.34	21,200.04
Release of Bond Collateral	0.00	48,000.00
Reinsurance Payments	0.00	324,385.32
Disbursements	590,977.27	5,197,971.72
Early Access Distributions:	0.00	0.00
Disbursements & Distributions Before Investment Activities	590,977.27	5,197,971.72
Investment Expenses	0.00	0.00
Disbursements for Investment Activities	0.00	0.00
Total Cash Disbursements & Distributions	590,977.27	5,197,971.72
Net Increase (Decrease) in Cash	(477,175.69)	(1,590,507.01)

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