
SCOTTISH RE GROUP LIMITED
CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2010

(Issued on November 19, 2010)

(These financial statements are unaudited.)

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Summary of Results

Scottish Re Group Limited (“SRGL”, the “Company”, “we”, “our” and “us”) is a holding company incorporated under the laws of the Cayman Islands with our principal executive office in Bermuda.

For the three and nine months ended September 30, 2010, SRGL reported net income attributable to ordinary shareholders of \$82.4 million, or \$0.38 diluted income per ordinary share, and \$259.9 million, or \$1.20 diluted income per ordinary share, respectively, as compared to net income attributable to ordinary shareholders for the three and nine months ended September 30, 2009, of \$201.9 million, or \$0.92 diluted income per ordinary share, and \$2,040.3 million, or \$9.34 diluted income per ordinary share, respectively.

The net income attributable to ordinary shareholders for the three month periods ended September 30, 2010 and September 30, 2009 was primarily driven by \$89.0 million and \$191.1 million, respectively, of net realized and unrealized gains in the Company’s invested assets.

The net income attributable to ordinary shareholders for the nine months ended September 30, 2010 was primarily driven by \$255.4 million of net realized and unrealized gains in the Company’s invested assets and a \$39.4 million income tax benefit, offset by a \$15.2 million change in the value of the Company’s long-term debt carried at fair value. The income tax benefit was principally the result of a reconsideration of an uncertain tax position following a U.S. court tax ruling related to an unaffiliated third party.

The net income attributable to ordinary shareholders for the nine months ended September 30, 2009 was primarily driven by i) a \$1,150.1 million gain on the de-consolidation of a collateral finance facility; ii) a pre-tax gain of \$703.2 million from the sale of a block of life reinsurance, offset by a \$49.8 million income tax expense associated with the sale of the block of life reinsurance; iii) \$213.0 million of net realized and unrealized gains in the Company’s invested assets; and iv) a \$53.5 million gain on extinguishment of debt.

As of September 30, 2010, SRGL and Scottish Annuity & Life Insurance Company (Cayman) Ltd. (“SALIC”) had a combined \$106.4 million of unrestricted assets, compared to \$138.8 million at December 31, 2009. The unrestricted assets of SRGL and SALIC represent assets which are not held in trust accounts for the benefit of ceding companies under reinsurance agreements. These unrestricted assets were available at September 30, 2010 to meet the obligations of SRGL and SALIC. There can be no assurances that the amount of unrestricted assets held by SRGL and SALIC will not further decrease from period to period in the future or that such decrease will not be materially different from period to period in the future.

SCOTTISH RE GROUP LIMITED
CONSOLIDATED BALANCE SHEETS
(Expressed in Thousands of United States Dollars, except share data)

	September 30, 2010	December 31, 2009
	(Unaudited)	
ASSETS		
Fixed-maturity investments held as trading securities, at fair value	\$ 3,240,559	\$ 2,988,164
Preferred stock held as trading securities, at fair value	72,756	77,410
Cash and cash equivalents	312,741	390,025
Other investments	18,093	21,482
Funds withheld at interest	582,413	608,500
Total investments ¹	4,226,562	4,085,581
Accrued interest receivable ²	23,785	24,422
Reinsurance balances and risk fees receivable	123,836	161,977
Deferred acquisition costs	274,322	296,822
Amounts recoverable from reinsurers	573,986	606,347
Present value of in-force business	33,196	38,316
Other assets	25,769	67,185
Current income tax receivable	147	12,762
Deferred tax assets	3,922	3,922
Total assets	\$ 5,285,525	\$ 5,297,334
LIABILITIES		
Reserves for future policy benefits	\$ 1,457,830	\$ 1,542,639
Interest-sensitive contract liabilities	1,434,218	1,518,365
Collateral finance facilities ³	1,300,000	1,300,000
Accounts payable and other liabilities	52,046	68,921
Embedded derivative liabilities, at fair value	38,387	35,732
Reinsurance balances payable	113,144	137,597
Deferred tax liabilities	43,550	50,143
Long-term debt, at fair value	-	55,068
Long-term debt, at par value	129,500	129,500
Total liabilities	4,568,675	4,837,965
MEZZANINE EQUITY		
Convertible cumulative participating preferred shares (liquidation preference, \$748.1 million)	555,857	555,857
Commitments and contingencies (Note 15)		
EQUITY (DEFICIT)		
Scottish Re Group Limited shareholders' equity (deficit)		
Ordinary shares, par value \$0.01:		
Issued and outstanding - 68,383,370 shares in 2010 and 2009	684	684
Non-cumulative perpetual preferred shares, par value \$0.01:		
Issued: 5,000,000 shares (outstanding: 2010 - 4,806,083; 2009 - 5,000,000)	120,152	125,000
Additional paid-in capital	1,218,055	1,217,535
Retained deficit	(1,187,438)	(1,447,375)
Total Scottish Re Group Limited shareholders' equity (deficit)	151,453	(104,156)
Noncontrolling interest	9,540	7,668
Total equity (deficit)	160,993	(96,488)
Total liabilities, mezzanine equity and total equity (deficit)	\$ 5,285,525	\$ 5,297,334
¹ Includes total investments of consolidated variable interest entities ("VIEs")	\$ 1,094,370	
² Includes accrued interest receivable of consolidated VIEs	\$ 1,172	
³ Reflects collateral finance facilities of consolidated VIEs	\$ 1,300,000	

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(Expressed in Thousands of United States Dollars, except share data)

	Three months ended		Nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009 (Restated)
Revenues				
Premiums earned, net	\$ 98,177	\$ 104,417	\$ 317,869	\$ 326,283
Fee and other income.....	1,432	2,326	4,221	5,738
Investment income, net.....	41,014	43,729	129,591	135,723
Net realized and unrealized gains	88,964	191,098	255,372	212,971
Gain on de-consolidation of collateral finance facility	-	-	-	1,150,114
Change in value of long-term debt, at fair value	-	-	(15,246)	-
Gain on extinguishment of debt.....	-	-	-	53,545
Change in fair value of embedded derivative liabilities	(3,087)	11,305	(2,655)	304,925
Total revenues	<u>226,500</u>	<u>352,875</u>	<u>689,152</u>	<u>2,189,299</u>
Benefits and expenses				
Claims and other policy benefits	79,125	98,333	291,887	(129,174)
Interest credited to interest-sensitive contract liabilities	14,003	14,472	40,585	46,391
Amortization of deferred acquisition costs and other insurance expenses, net.....	28,931	18,854	65,812	95,457
Operating expenses.....	11,812	7,372	41,755	46,041
Collateral finance facilities expenses.....	10,659	8,829	26,606	31,195
Interest expense	1,399	1,165	4,021	4,840
Total benefits and expenses	<u>145,929</u>	<u>149,025</u>	<u>470,666</u>	<u>94,750</u>
Income before income taxes	80,571	203,850	218,486	2,094,549
Income tax benefit (expense).....	3,016	(1,050)	39,445	(53,001)
Consolidated income	83,587	202,800	257,931	2,041,548
Net income attributable to noncontrolling interest	(1,181)	(910)	(1,872)	(1,202)
Net income attributable to Scottish Re Group Limited	82,406	201,890	256,059	2,040,346
Gain on redemption of non-cumulative perpetual preferred shares.....	-	-	3,878	-
Net income attributable to ordinary shareholders .	<u>\$ 82,406</u>	<u>\$ 201,890</u>	<u>\$ 259,937</u>	<u>\$ 2,040,346</u>
Basic income per ordinary share	<u>\$ 1.19</u>	<u>\$ 2.91</u>	<u>\$ 3.74</u>	<u>\$ 29.41</u>
Diluted income per ordinary share	<u>\$ 0.38</u>	<u>\$ 0.92</u>	<u>\$ 1.20</u>	<u>\$ 9.34</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)
(UNAUDITED)

(Expressed in Thousands of United States dollars, except share data)

	Nine months ended	
	September 30, 2010	September 30, 2009 (Restated)
Share capital:		
Ordinary shares:		
Beginning and end of period.....	\$ 684	\$ 684
Non-cumulative perpetual preferred shares:		
Beginning of period.....	125,000	125,000
Non-cumulative perpetual preferred shares redeemed.....	(4,848)	-
End of period.....	120,152	125,000
Additional paid-in capital:		
Beginning of period.....	1,217,535	1,216,878
Option expense.....	520	481
End of period.....	1,218,055	1,217,359
Retained deficit:		
Beginning of period.....	(1,447,375)	(3,752,716)
Net income attributable to Scottish Re Group Limited.....	256,059	2,040,346
Gain on redemption of non-cumulative perpetual preferred shares.....	3,878	-
End of period.....	(1,187,438)	(1,712,370)
Total Scottish Re Group Limited shareholders' equity (deficit).....	\$ 151,453	\$ (369,327)
Noncontrolling interest:		
Beginning of period.....	7,668	6,966
Net income.....	1,872	1,202
End of period.....	9,540	8,168
Total shareholders' equity (deficit).....	\$ 160,993	\$ (361,159)

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(Expressed in Thousands of United States dollars)

	Nine months ended	
	September 30, 2010	September 30, 2009 (Restated)
Operating activities		
Consolidated income	\$ 257,931	\$ 2,041,548
Adjustments to reconcile net income to net cash used in operating activities:		
Net realized and unrealized gains	(255,372)	(212,971)
Gain on de-consolidation of collateral finance facility	-	(1,150,114)
Change in value of long-term debt, at fair value	15,246	-
Gain on extinguishment of debt	-	(53,545)
Changes in fair value of embedded derivative liabilities	2,655	(304,925)
Amortization of deferred acquisition costs	24,467	36,112
Amortization of present value of in-force business	5,120	1,193
Write-off of fixed assets associated with the sale of the Acquired Business	-	6,021
Amortization of deferred transaction costs	4,627	1,961
Depreciation of fixed assets	341	957
Option expense	520	481
Changes in assets and liabilities:		
Accrued interest receivable	637	4,592
Reinsurance balances and risk fees receivable	38,141	261,798
Deferred acquisition costs	(1,967)	22,829
Deferred tax assets and liabilities	(6,593)	49,838
Other assets	47,461	(253,951)
Current income tax receivable and payable	12,621	75
Reserves for future policy benefits, net of amounts recoverable from reinsurers	(52,448)	(2,103,251)
Funds withheld at interest	26,087	1,202,952
Interest-sensitive contract liabilities	(2,197)	(11,601)
Accounts payable and other liabilities	(14,225)	(274,825)
Embedded derivative liabilities, at fair value	(2,655)	304,925
Reinsurance balances payable	(24,453)	(130,191)
Net cash provided by (used in) operating activities	<u>75,944</u>	<u>(560,092)</u>
Investing activities		
Purchases of fixed-maturity investments	(688,251)	(590,892)
Proceeds from sales and maturities of fixed-maturity investments	607,780	890,734
Purchases of preferred stock	(1,847)	(80)
Proceeds from sales and maturities of preferred stock	11,380	10,649
Purchases of and proceeds from other investments, net	867	(54)
Net cash (used in) provided by investing activities	<u>(70,071)</u>	<u>310,357</u>
Financing activities		
Withdrawals from interest-sensitive contract liabilities	(82,187)	(161,479)
Redemption of non-cumulative perpetual preferred shares	(970)	-
Net cash used in financing activities	<u>(83,157)</u>	<u>(161,479)</u>
Net change in cash and cash equivalents	\$ (77,284)	\$ (411,214)
Cash and cash equivalents, beginning of period	390,025	824,613
Cash and cash equivalents, end of period	<u>\$ 312,741</u>	<u>\$ 413,399</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

1. Organization and Business

Organization

Scottish Re Group Limited (“SRGL”, the “Company”, “we”, “our” and “us”) is a holding company incorporated under the laws of the Cayman Islands with our principal executive office in Bermuda. Through our operating subsidiaries, we are principally engaged in the reinsurance of life insurance, annuities and annuity-type products. We have principal operating companies in Bermuda, the Cayman Islands, Ireland, and the United States.

Run Off Strategy

In 2008, we ceased writing new business and notified our existing clients that we would not be accepting any new reinsurance risks under existing reinsurance treaties, thereby placing our remaining treaties into run-off. We expect to continue to pursue a run-off strategy for the remaining business, whereby we continue to receive premiums, pay claims, and perform key activities under our remaining reinsurance treaties while maintaining solvency and meeting our obligations to third parties. No assurances can be given that we will be successful in maintaining adequate levels of capital and liquidity while executing this strategy.

While pursuing our run-off strategy, we may from time to time, if opportunities arise, purchase in privately negotiated transactions, open market purchases or by means of general solicitations, tender offers or otherwise, additional amounts of our outstanding securities and other liabilities. Any such purchases will depend on a variety of factors including, but not limited, to available corporate liquidity, capital requirements and indicative pricing levels. The amounts involved in any such transactions, individually or in the aggregate, may be material. For further discussion on our outstanding securities, see Note 7, “Debt Obligations and Other Funding Arrangements”. Further, the Company continues to explore ways to increase enterprise value including consideration from time to time of transactions for the sale or disposition of our businesses or assets, which transactions individually or in the aggregate may be material.

Regulatory Considerations

We currently operate with certain regulatory constraints with respect to Scottish Re (U.S.), Inc. (“SRUS”), our primary U.S. reinsurance subsidiary. In connection with the receipt by SRUS in late 2008 of a permitted statutory accounting practice related to the reduction from liability for reinsurance ceded to an unauthorized assuming insurer (the “Permitted Practice”), SRUS consented to the issuance by the Delaware Department of Insurance (the “Department”) on January 5, 2009, of an Order of Supervision for SRUS (the “Order of Supervision”), in accordance with 18 Del. C. §5942. The Order of Supervision required, among other things, the Department’s consent to any transaction by SRUS outside the ordinary course of business and to any transaction with or any distribution or payment to its affiliates. The original Order of Supervision subsequently was amended and replaced with an Extended and Amended Order of Supervision, dated April 3, 2009 (the “Amended Order”), which amends and clarifies certain matters contained within the original Order of Supervision. See Note 12, “Regulatory and Rating Agency Matters”.

Business

We have written reinsurance business that is wholly or partially retained in one or more of our reinsurance subsidiaries. With the sale of our Wealth Management business and Life Reinsurance International Segment in 2008, and the subsequent sale of a block of individual life reinsurance business in our Life Reinsurance North America Segment (the “Acquired Business”, as more fully defined in Note 13, “Sale of a Block of Life Reinsurance North America Business”) in the first quarter of 2009, operating decisions and performance assessments of the Company are now performed without reference to any separate segments. Accordingly, we do not present information about distinct operating segments for periods after January 1, 2009.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

1. Organization and Business (continued)

We have assumed risks associated with primary life insurance, annuities, and annuity-type policies. We reinsure mortality, investment, persistency, and expense risks of life insurance and reinsurance companies based in the United States. Most of the reinsurance assumed is through automatic treaties, but we also assumed certain risks on a facultative basis. We suspended bidding for new business in 2008, and at that time, we issued notices cancelling the acceptance of new reinsurance risks for all open reinsurance treaties. The business we historically have written falls into two categories: Traditional Solutions and Financial Solutions, as detailed below.

Traditional Solutions: We reinsure the mortality risk on life insurance policies written by primary insurers. The business often is referred to as traditional life reinsurance. We wrote our Traditional Solutions business predominantly on an automatic basis. This means that we automatically reinsured all policies written by a ceding company that met the underwriting criteria specified in the treaty with the ceding company.

Financial Solutions: Financial Solutions include contracts under which we assumed the investment and persistency risks of existing, as well as newly written, blocks of business. The products reinsured include annuities and annuity-type products, cash value life insurance, and, to a lesser extent, disability products that are in a pay-out phase.

Life insurance products that we reinsure include yearly renewable term, term with multi-year guarantees, ordinary life, and variable life. Retail annuity products that we reinsure include fixed deferred annuities and variable annuities. For these products, we wrote reinsurance generally in the form of yearly renewable term, coinsurance or modified coinsurance. Under yearly renewable term, we share only in the mortality risk for which we receive a premium. In a coinsurance or modified coinsurance arrangement, we generally share proportionately in all material risks inherent in the underlying policies, including mortality, lapses and investments. Under such agreements, we agree to indemnify the primary insurer for all or a portion of the risks associated with the underlying insurance policy in exchange for a proportionate share of premiums. Coinsurance differs from modified coinsurance with respect to the ownership of the assets supporting the reserves. Under our coinsurance arrangements, ownership of these assets is transferred to us, whereas in modified coinsurance arrangements, the ceding company retains ownership of these assets, but we share in the investment income and risks associated with the assets.

2. Basis of presentation

Basis of Presentation

Accounting Principles - Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Accordingly, these consolidated interim financial statements do not include all the information and footnotes required by US GAAP for annual financial statements. These unaudited consolidated interim financial statements should be read in conjunction with both the annual consolidated financial statements and notes thereto for the year ended December 31, 2009.

Consolidation - The consolidated financial statements include the assets, liabilities, and results of operations of SRGL, its subsidiaries, and all variable interest entities for which we are the primary beneficiary, as defined in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 810-10, Consolidation – Overall ("FASB ASC 810-10"). All significant inter-company transactions and balances have been eliminated in consolidation. We consolidate two non-recourse securitizations: Orkney Holdings, LLC, a Delaware limited liability company ("Orkney I") and Orkney Re II plc, a special purpose vehicle incorporated under the laws of Ireland ("Orkney Re II"). Effective January 1, 2009, we no longer consolidate Ballantyne Re plc ("Ballantyne Re"). For further discussion of Orkney I, Orkney II and Ballantyne Re, see Note 14, "Collateral Finance Facilities". Effective October 8, 2009, we consolidated the Stingray Pass-Through Trust and the Stingray Investor Trust. For further discussion of these entities, see Note 7 "Debt Obligations and Other Funding Arrangements".

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

2. Basis of presentation (continued)

Restatement of Prior Financial Statements - During the fourth quarter of 2009, we identified an error of \$49.8 million in the tax accounting following the sale of the Acquired Business, as described in Note 13, to Hannover Re, representing deferred tax liabilities that reverse following the expiration of net operating losses in applicable jurisdictions. This error caused us to understate income tax expense for the three months ended March 31, 2009. We restated the statement of income and the earnings per share amounts for the three months ended March 31, 2009, and for the nine months ended September 30, 2009, to reflect the increase in income tax expense of \$49.8 million. The restatement of the prior financial statements as a result of the error in tax accounting increased our shareholders' deficit as of September 30, 2009 from \$319.5 million to \$369.3 million, and decreased our basic and diluted earnings per share attributable to ordinary shareholders for the nine months ended September 30, 2009 from \$30.13 per share and \$9.57 per share, respectively, to \$29.41 per share and \$9.34 per share, respectively. There was no impact to our year ended December 31, 2009 net income or shareholders' deficit because the adjustment was properly recorded in the annual consolidated financial statements.

Comprehensive Income – There are no items of other comprehensive income included in the consolidated statements of income and, therefore, net income attributable to ordinary shareholders is the same as comprehensive income attributable to ordinary shareholders.

Noncontrolling Interest in Consolidated Entity – Noncontrolling interest represents the 5% of Scottish Re Life Corporation (“SRLC”), a U.S. reinsurance subsidiary that is not owned by SRGL. The consolidated financial statements include all assets, liabilities, revenues and expenses of SRLC. In accordance with FASB ASC Topic 810, references in these consolidated financial statements to net income attributable to SRGL, net income attributable to ordinary shareholders, and shareholders' equity (deficit) attributable to SRGL do not include the noncontrolling interest, which is reported separately.

Going Concern - These consolidated interim financial statements and the annual consolidated financial statements as of December 31, 2009 have been prepared using accounting principles applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. Our ability to continue as a going concern is dependent upon our ability to successfully meet our obligations in a manner that addresses ongoing regulatory requirements and capital, liquidity, and collateral needs. There can be no assurance that any of the actions we have taken or plan to take will be successful in supplying funds in the amounts and at the times necessary to meet our liquidity requirements in future periods. These consolidated financial statements do not give effect to any adjustments to recorded amounts or to their classification which would be necessary if we were unable to continue as a going concern.

In the event that for any reason we fail to comply with the Department's Amended Order, or in the event the financial condition of SRUS was to materially deteriorate, the Department may take action to seize control of SRUS under applicable insurance law. Such a seizure would place control of all management decisions of SRUS with the Department, including with respect to controlling cash flows, settling claims and paying obligations. The primary objective of the Department would be to protect the interests of the ceding insurers (and their policyholders) with whom SRUS has contracted and would not be to protect the interests of SRGL, Scottish Annuity & Life Insurance Company (Cayman) Ltd. (“SALIC”), the shareholders, or any other stakeholders of the Company. A seizure of SRUS would have numerous consequences, and could lead to the need for SALIC and/or SRGL to seek bankruptcy protection.

Estimates, Risks and Uncertainties - The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates and assumptions used by management. Our most significant assumptions are for:

- investment valuation;
- accounting for derivative instruments;

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

2. Basis of presentation (continued)

- assessment of risk transfer for structured insurance and reinsurance contracts;
- estimates of premiums;
- valuation of present value of in-force business;
- establishment of reserves for future policy benefits;
- amortization of deferred acquisition costs;
- retrocession arrangements and amounts recoverable from reinsurers;
- interest-sensitive contract liabilities;
- long-term debt, at fair value; and
- income taxes, deferred taxes, and the determination of associated valuation allowances.

We review and revise these estimates, as appropriate. Any adjustments made to these estimates are reflected in the period in which the estimates are revised.

All tabular amounts are reported in thousands of United States dollars, except share and per share data, or as otherwise noted.

3. Recent Accounting Pronouncements

FASB ASC Topic 820, Fair Value Measurements and Disclosure

In January 2010, the FASB issued an update to require a number of additional disclosures regarding fair value measurements. Specifically, the update requires a reporting entity to disclose the amounts of significant transfers between Level 1 and Level 2 of the three tier fair value hierarchy and the reasons for these transfers, as well as the reasons for any transfers in or out of Level 3, effective for annual and interim periods beginning after December 15, 2009. The update also requires information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances, and settlements on a gross basis, effective for annual and interim periods beginning after December 15, 2010. We adopted this update in its entirety, including early adoption of the additional Level 3 information, effective January 1, 2010. The adoption of this update had no effect on our financial position or results of operations.

FASB ASC Topic 810, Consolidation

In June 2009, the FASB issued an update to FASB ASC Topic 810. This update requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or variable interests give it a controlling financial interest in a VIE. This update also requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE and is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application was prohibited. We adopted this update effective January 1, 2010. The adoption of this update resulted in additional disclosures but had no effect on our financial position or results of operations. As a result of adopting this update, we now separately disclose on the Consolidated Balance Sheet of SRGL, the assets of the consolidated VIE that can only be used to settle obligations of the VIE and the liabilities of the consolidated VIE for which creditors have no recourse on the general accounts of SRGL.

4. Investments

Trading securities are recorded at fair value, and unrealized gains and losses on trading securities are included in earnings. Interest is recorded, based upon stated coupon rates, as a component of net investment income.

The amount of net unrealized gains for the three months ended September 30, 2010 and 2009, that relates to trading securities still held at September 30, 2010 and 2009 are \$78.9 million and \$166.8 million, respectively.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

4. Investments (continued)

The amount of net unrealized gains for the nine months ended September 30, 2010 and 2009, that relates to trading securities still held at September 30, 2010 and 2009 are \$218.9 million and \$153.8 million, respectively.

5. Fair Value Measurements

FASB ASC 820 defines fair value, establishes a framework for measuring fair value based on an exit price definition, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and enhances disclosure requirements for fair value measurements. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1 – Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable.

As required by FASB ASC 820, when the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Level 1 and 2) and unobservable (Level 3).

Level 1 primarily consists of financial instruments whose value is based on quoted market prices, such as public equities and actively-traded mutual fund investments.

Level 2 includes those financial instruments that are valued by independent pricing services or valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various inputs, such as interest rate, credit spread, and foreign exchange rates for the underlying financial instruments. All significant inputs are observable or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include: certain public and private corporate fixed-maturity and equity securities; government or agency securities; certain mortgage and asset-backed securities; securities held as collateral; and segregated assets.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices or internally-developed models or methodologies that utilize significant inputs that not based on or corroborated by readily-available market information. This category primarily consists of certain less liquid fixed-maturity and equity securities where we cannot corroborate the significant valuation inputs with market observable data. Additionally, the Company's embedded derivatives, all of which are associated with reinsurance treaties, are classified in Level 3 since their values include significant unobservable inputs associated with actuarial assumptions regarding policyholder behavior.

At each reporting period, we classify all assets and liabilities in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and considers factors specific to the asset or liability.

The fair values for the majority of our fixed-maturity securities are classified as Level 2. These fair values are obtained primarily from independent pricing services which utilize Level 2 inputs. The pricing services also utilize

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

5. Fair Value Measurements (continued)

proprietary pricing models to produce estimates of fair value primarily utilizing Level 2 inputs along with certain Level 3 inputs.

The proprietary pricing models include matrix pricing where expected cash flows are discounted utilizing market interest rates obtained from third-party sources based on the credit quality and duration of the instrument to fair value. For securities that may not be reliably priced using internally-developed pricing models, broker quotes are obtained. These broker quotes represent an exit price, but the assumptions used to establish the fair value may not be observable, and, as a result, the fair values are classified as Level 3.

Long-term debt at fair value (i.e., outstanding Pass-Through Certificates held by third parties) has been valued using Level 2 inputs for the determination of fair value. The fair value was derived with reference to traded prices for identical liabilities.

The interest rate swap derivative has been valued using Level 2 inputs including forward interest rates derived from observable information in the market place.

The embedded derivative liabilities for funds withheld at interest include the embedded derivatives resulting from assumed modified coinsurance (“modco”) or coinsurance funds withheld in accordance with the related reinsurance arrangements. These values are based upon the difference between the fair values of the underlying assets backing the modco or coinsurance funds withheld receivable and the fair values of the underlying liabilities. The fair values of the underlying assets generally are based upon observable market data using valuation methods similar to those used for assets held directly by us. The fair values of the liabilities are determined by using market-observable swap rates as well as some unobservable inputs, such as actuarial assumptions regarding policyholder behavior. These assumptions require significant management judgment, and the resulting fair values are classified as Level 3.

The following tables set forth our assets and liabilities that are measured at fair value on a recurring basis as of the dates indicated:

	September 30, 2010			
(U.S. dollars in millions)	Total	Level 1	Level 2	Level 3
Investments				
Government securities*	\$ 94.2	\$ -	\$ 94.0	\$ 0.2
Corporate securities*	1,296.3	-	1,187.8	108.5
Municipal bonds*	59.9	-	59.9	-
Mortgage and asset-backed securities*	1,790.2	-	1,298.3	491.9
Preferred stock	72.7	-	16.3	56.4
Equity^	1.1	1.1	-	-
Total assets at fair value	\$ 3,314.4	\$ 1.1	\$ 2,656.3	\$ 657.0
Embedded derivative liabilities for Funds withheld at interest	(38.4)	-	-	(38.4)
Total liabilities at fair value.....	\$ (38.4)	\$ -	\$ -	\$ (38.4)

*Included in Fixed-maturity investments held as trading securities, at fair value in the Consolidated Balance Sheets

^ Included in Other investments in the Consolidated Balance Sheets

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

5. Fair Value Measurements (continued)

	December 31, 2009			
(U.S. dollars in millions)	Total	Level 1	Level 2	Level 3
Investments				
Government securities*	\$ 104.6	\$ -	\$ 104.4	\$ 0.2
Corporate securities*	1,166.3	-	1,033.0	133.3
Municipal bonds*	43.8	-	43.8	-
Mortgage and asset-backed securities*	1,673.5	-	1,200.7	472.8
Preferred stock	77.4	-	24.0	53.4
Equity ^	3.7	3.7	-	-
Derivatives – interest rate swap#	25.9	-	25.9	-
Total assets at fair value	<u>\$ 3,095.2</u>	<u>\$ 3.7</u>	<u>\$ 2,431.8</u>	<u>\$ 659.7</u>
Embedded derivative liabilities for Funds withheld at interest	(35.7)	-	-	(35.7)
Long-term debt, at fair value	(55.1)	-	(55.1)	-
Total liabilities at fair value	<u>\$ (90.8)</u>	<u>\$ -</u>	<u>\$ (55.1)</u>	<u>\$ (35.7)</u>
*Included in Fixed-maturity investments held as trading securities, at fair value in the Consolidated Balance Sheets				
^ Included in Other investments in the Consolidated Balance Sheets				
# Included in Other assets in the Consolidated Balance Sheets				

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

5. Fair Value Measurements (continued)

The following tables present additional information about assets measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the nine month period ended September 30, 2010

(U.S. dollars in millions)	Government securities	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Preferred stock	Embedded derivative liabilities for Funds withheld at interest	Total
Beginning balance at January 1, 2010.....	\$ 0.2	\$ 133.3	\$ -	\$ 472.8	\$ 53.4	\$ (35.7)	\$ 624.0
Total realized and unrealized gains (losses) included in net income	-	5.3	-	92.9	3.1	(2.7)	98.6
Purchases, issuances, and settlements	-	(26.2)	9.9	(51.1)	-	-	(67.4)
Transfers in and/or out of Level 3, net	-	(3.9)	(9.9)	(22.7)	(0.1)	-	(36.6)
Ending balance at September 30, 2010..	<u>\$ 0.2</u>	<u>\$ 108.5</u>	<u>\$ -</u>	<u>\$ 491.9</u>	<u>\$ 56.4</u>	<u>\$ (38.4)</u>	<u>\$ 618.6</u>

In 2010, changes in classifications impacting Level 3 financial instruments are reported as transfers in (out) of the Level 3 category as of the end of the quarter in which the transfer occurs. The portion of net unrealized gains for the three and nine months ended September 30, 2010 that relates to Level 3 trading securities still held at September 30, 2010 and 2009 were \$30.9 million and \$83.2 million, respectively.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended December 31, 2009

(U.S. dollars in millions)	Fixed-maturity investments & Preferred stock	Embedded derivative liabilities for Funds withheld at interest	Total
Beginning balance at January 1, 2009	\$ 921.6	\$ (347.5)	\$ 574.1
Transfers attributable to deconsolidation of Ballantyne Re (Note 13)	(108.6)	-	(108.6)
Total realized and unrealized gains (losses) included in net income	(16.9)	311.8	294.9
Purchases, issuances, and settlements	(43.8)	-	(43.8)
Transfers in and/or out of Level 3, net	(92.6)	-	(92.6)
Ending balance at December 31, 2009.....	<u>\$ 659.7</u>	<u>\$ (35.7)</u>	<u>\$ 624.0</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

5. Fair Value Measurements (continued)

In 2009, reclassifications impacting Level 3 financial instruments are reported as transfers in (out) of the Level 3 category as of the beginning of the quarter in which the transfer occurs.

6. Fair Value of Financial Instruments

As discussed above, the fair values of financial assets and liabilities are estimated in accordance with the framework established under FASB ASC 820. The methodology for determining the fair value of financial instruments, in addition to those disclosed in Note 5, "Fair Value Measurements" are as follows:

(i) Other investments primarily consist of policy loans and their carrying values are deemed to approximate fair value.

(ii) Funds withheld at interest represent fixed-maturity investments held by ceding companies and the fair values of the underlying instruments are consistent with the methodologies and assumptions used to determine the fair value of fixed maturities carried at fair value. Any difference between carrying value and fair value of funds withheld at interest resulting from a change in fair value of the fixed-maturity investments held by the ceding company is included as a component of the embedded derivative at fair value. We have refined our fair value estimation methodology as at September 30, 2010, and have revised the estimated fair value as at December 31, 2009 to be consistent.

(iii) Fair values for collateral finance facilities are determined with reference to underlying business models and observable market inputs. We have refined our fair value estimation methodology as at September 30, 2010, and have revised the estimated fair value as at December 31, 2009 to be consistent.

(iv) Fair values for long-term debt, at par (i.e., outstanding trust preferred securities) were determined with reference to similar quoted securities and settlements of other Company long-term debt during 2010 and 2009.

(v) Interest-sensitive contract liabilities include investment contracts. The fair value of investment contracts, which exclude significant mortality risk, is based on the cash surrender value of the liabilities as an approximation of the exit market.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

6. Fair Value of Financial Instruments (continued)

(U.S. dollars in thousands)	September 30, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets				
Fixed-maturity investments held as trading securities, at fair value	\$ 3,240,559	\$ 3,240,559	\$ 2,988,164	\$ 2,988,164
Preferred stock held as trading securities, at fair value	72,756	72,756	77,410	77,410
Other investments	18,093	18,093	21,482	21,482
Funds withheld at interest	582,413	582,413	608,500	608,500
Derivatives – interest rate swap#	-	-	25,924	25,924
Liabilities				
Collateral finance facilities	\$ 1,300,000	\$ 801,191	\$ 1,300,000	\$ 818,864
Long term debt, at fair value	-	-	55,068	55,068
Long-term debt, at par value	129,500	53,976	129,500	32,375
Investment contracts	1,434,218	1,413,700	1,518,365	1,485,554
Embedded derivative liabilities at fair value	38,387	38,387	35,732	35,732
# Included in Other assets in the Consolidated Balance Sheets				

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

7. Debt Obligations and Other Funding Arrangements

Long-term debt consists of:

(U.S. dollars in thousands)	September 30, 2010	December 31, 2009
Capital securities due 2032.....	\$ 17,500	\$ 17,500
Preferred trust securities due 2033	20,000	20,000
Trust preferred securities due 2033	10,000	10,000
Trust preferred securities due 2034	32,000	32,000
Trust preferred securities due 2034	50,000	50,000
Long-term debt, at par value.....	<u>\$ 129,500</u>	<u>\$ 129,500</u>
Outstanding Pass-Through Certificates	\$ -	\$ 55,068
Long-term debt, at fair value	<u>\$ -</u>	<u>\$ 55,068</u>

Capital Securities Due 2032

On December 4, 2002, Scottish Holdings Statutory Trust I, a Connecticut statutory business trust (“Capital Trust”) issued and sold in a private offering an aggregate of \$17.5 million Floating Rate Capital Securities (the “Capital Securities”). All of the common shares of the Capital Trust are owned by Scottish Holdings, Inc. (“SHI”), one of our wholly-owned subsidiaries.

The Capital Securities mature on December 4, 2032. They are redeemable in whole or in part at any time after December 4, 2007. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 4%. At September 30, 2010 and December 31, 2009, the interest rates were 4.29% and 4.25%, respectively. The Capital Trust may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 4, 2032. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the Debentures due December 4, 2032 (as described below).

The sole assets of the Capital Trust consist of \$18 million principal amount of Floating Rate Debentures (the “Debentures”) issued by SHI. The Debentures mature on December 4, 2032, and interest is payable quarterly at a rate equivalent to three-month LIBOR plus 4%. At September 30, 2010 and December 31, 2009, the interest rates were 4.29% and 4.25%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 4, 2032. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the Debentures at any time after December 4, 2007, and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI’s obligations under the Debentures and distributions and other payments due on the Capital Securities.

Preferred Trust Securities Due 2033

On October 29, 2003, Scottish Holdings, Inc. Statutory Trust II, a Connecticut statutory business trust (“Capital Trust II”) issued and sold in a private offering an aggregate of \$20 million Preferred Trust Securities (the “Preferred Trust Securities”). All of the common shares of Capital Trust II are owned by SHI.

The Preferred Trust Securities mature on October 29, 2033. They are redeemable in whole or in part at any time after October 29, 2008. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.95%. At September 30, 2010 and December 31, 2009, the interest rates were 4.24% and 4.20%, respectively. Prior to October 29, 2008, interest cannot exceed 12.45%. Capital Trust II may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than October 29, 2033. Any deferred payments would accrue interest quarterly on a

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

7. Debt Obligations and Other Funding Arrangements (Continued)

compounded basis if SHI defers interest on the 2033 Floating Rate Debentures due October 29, 2033 (as described below).

The sole assets of Capital Trust II consist of \$20.6 million principal amount of Floating Rate Debentures (the "2033 Floating Rate Debentures") issued by SHI. The 2033 Floating Rate Debentures mature on October 29, 2033, and interest is payable quarterly at three-month LIBOR plus 3.95%. At September 30, 2010 and December 31, 2009, the interest rates were 4.24% and 4.20%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than October 29, 2033. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the 2033 Floating Rate Debentures at any time after October 29, 2008, and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI's obligations under the 2033 Floating Rate Debentures and distributions and other payments due on the Preferred Trust Securities.

Trust Preferred Securities Due 2033

On November 14, 2003, GPIC Holdings Inc. Statutory Trust, a Delaware statutory business trust ("GPIC Trust") issued and sold in a private offering an aggregate of \$10 million Trust Preferred Securities (the "2033 Trust Preferred Securities"). All of the common shares of GPIC Trust are owned by SHI.

The 2033 Trust Preferred Securities mature on September 30, 2033. They are redeemable in whole or in part at any time after September 30, 2008. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.90%. At September 30, 2010 and December 31, 2009, the interest rates were 4.19% and 4.15%, respectively. GPIC Trust may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than September 30, 2033.

Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the Junior Subordinated Notes due September 30, 2033 (as described below).

The sole assets of GPIC Trust consist of \$10.3 million principal amount of Junior Subordinated Notes (the "Junior Subordinated Notes") issued by SHI. The Junior Subordinated Notes mature on September 30, 2033, and interest is payable quarterly at three-month LIBOR plus 3.90%. At September 30, 2010 and December 31, 2009, the interest rates were 4.19% and 4.15%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than September 30, 2033. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the Junior Subordinated Notes at any time after September 30, 2008, and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI's obligations under the Junior Subordinated Notes and distributions and other payments due on the trust preferred securities.

Trust Preferred Securities Due 2034

On May 12, 2004, Scottish Holdings, Inc. Statutory Trust III, a Connecticut statutory business trust ("Capital Trust III") issued and sold in a private offering an aggregate of \$32 million Trust Preferred Securities (the "2034 Trust Preferred Securities"). All of the common shares of Capital Trust III are owned by SHI.

The 2034 Trust Preferred Securities mature on June 17, 2034. They are redeemable in whole or in part at any time after June 17, 2009. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.80%. At September 30, 2010 and December 31, 2009, the interest rate was 4.09% and 4.05%, respectively. Prior to June 17, 2009, interest could not exceed 12.50%. Capital Trust III may defer payment of the interest for up to 20 consecutive

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

7. Debt Obligations and Other Funding Arrangements (Continued)

quarterly periods, but no later than June 17, 2034. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the 2034 Floating Rate Debentures due June 17, 2034 (as described below).

The sole assets of Capital Trust III consist of \$33 million principal amount of Floating Rate Debentures (the "2034 Floating Rate Debentures") issued by SHI. The 2034 Floating Rate Debentures mature on June 17, 2034, and interest is payable quarterly at three-month LIBOR plus 3.80%. At September 30, 2010 and December 31, 2009, the interest rate was 4.09% and 4.05%, respectively. Prior to June 17, 2009, interest could not exceed 12.50%. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than June 17, 2034. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the 2034 Floating Rate Debentures at any time after June 17, 2009, and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI's obligations under the 2034 Floating Rate Debentures and distributions and other payments due on the 2034 Trust Preferred Securities.

Trust Preferred Securities Due 2034

On December 18, 2004, SFL Statutory Trust I, a Delaware statutory business trust ("SFL Trust I") issued and sold in a private offering an aggregate of \$50 million Trust Preferred Securities (the "December 2034 Trust Preferred Securities" and, together with the 2034 Trust Preferred Securities, the 2033 Trust Preferred Securities, the Preferred Trust Securities and the Capital Securities, the "Capital and Trust Preferred Securities"). All of the common shares of SFL Trust I are owned by Scottish Financial (Luxembourg) S.a.r.l ("SFL").

The December 2034 Trust Preferred Securities mature on December 15, 2034. They are redeemable in whole or in part at any time after December 15, 2009. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.50%. At September 30, 2010 and December 31, 2009, the interest rate was 3.79% and 3.75%, respectively. Prior to December 15, 2009, interest could not exceed 12.50%. SFL Trust I may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 15, 2034. Any deferred payments would accrue interest quarterly on a compounded basis if SFL defers interest on the 2034 Floating Rate Debentures due December 15, 2034 (as described below).

The sole assets of SFL Trust I consist of \$51.5 million principal amount of Floating Rate Debentures (the "December 2034 Floating Rate Debentures") issued by SFL. The December 2034 Floating Rate Debentures mature on December 15, 2034, and interest is payable quarterly at three-month LIBOR plus 3.50%. At September 30, 2010 and December 31, 2009, the interest rate was 3.79% and 3.75%, respectively. Prior to December 15, 2009, interest could not exceed 12.50%. SFL may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 15, 2034. Any deferred payments would accrue interest quarterly on a compounded basis. SFL may redeem the December 2034 Floating Rate Debentures at any time after December 15, 2009, and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SFL's obligations under the December 2034 Floating Rate Debentures and distributions and other payments due on the December 2034 Trust Preferred Securities.

Stingray Investor Trust and Stingray Pass-Through Trust (together "Stingray")

On January 12, 2005, SALIC entered into a put agreement with the Stingray Investor Trust for an aggregate value of \$325 million, which put agreement relates to \$325 million aggregate stated amount of 5.902% Pass-Through Certificates (the "Pass-Through Certificates") issued by the Stingray Pass-Through Trust (together with the Stingray Investor Trust, "Stingray"). Under the terms of the put agreement, we acquired an irrevocable put option to issue funding agreements to the Stingray Investor Trust in return for the assets in a portfolio of 30-day commercial paper.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

7. Debt Obligations and Other Funding Arrangements (Continued)

As of April 14, 2008, this facility was fully utilized and \$325 million of funding agreements were issued to the Stingray Investor Trust.

Throughout 2009, we acquired Pass-Through Certificates in privately-negotiated purchases which represented reconsideration events under FASB ASC 810-10. We used a quantitative analysis in determining that the holder of the majority of the Pass-Through Certificates would absorb the majority of the expected gains or losses of Stingray. As a result of these acquisitions, by October 8, 2009, we had acquired Pass-Through Certificates with a stated amount of \$169.4 million. This holding represented the majority of the Pass-Through Certificates; therefore, at that time, we determined we were the primary beneficiary of Stingray, and we were able to consolidate Stingray in our consolidated financial statements. The consolidation of Stingray has been recorded in accordance with ASC 810-10, which requires us to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in Stingray at the acquisition date, measured at their fair values as of that date. We are also required to eliminate any inter-company balances and transactions. The Stingray structure included an interest rate swap (the "Interest Rate Swap") as a mechanism for charging interest to SALIC on the funding agreements at a variable interest rate and paying interest to the Pass-Through Certificate holders at a fixed rate. The Interest Rate Swap was included in Other Assets at a fair value of \$25.9 million on our Consolidated Balance Sheets as at December 31, 2009. Movements in the fair value of the Interest Rate Swap were included in net realized and unrealized income (losses) in the Consolidated Statements of Income.

On December 15, 2009, pursuant to a cash tender offer that had been launched on November 16, 2009, we acquired \$57.3 million in aggregate stated amount of Pass-Through Certificates. As a result, as of December 31, 2009, we had repurchased \$226.7 million in aggregate stated amount of the Pass-Through Certificates, leaving \$98.3 million outstanding with non-affiliated investors.

In January 2010, we acquired, in a privately-negotiated transaction, an additional \$18.1 million of aggregate stated amount of Pass-Through Certificates.

During July and August 2010, we acquired, through privately-negotiated transactions, an additional \$55.5 million and \$8 thousand, respectively, of aggregate stated amount of Pass-Through Certificates. In conjunction with the July acquisitions, we obtained consent from the sellers to proposed amendments to certain of the transaction-related documents. The proposed amendments provided for the termination of the Interest Rate Swap effective July 2, 2010. The termination of the Interest Rate Swap resulted in a swap termination payment to the Stingray Pass-Through Trust of \$39.2 million (the "Swap Termination Payment"), which amount subsequently was distributed on the July 12, 2010 payment date pro rata to all holders of record of Pass-Through Certificates as of June 30, 2010, including the July sellers. As a result of its ownership as of June 30, 2010 of \$244.8 million in aggregate stated amount of Pass-Through Certificates, SALIC received \$29.5 million of the Swap Termination Payment on the July 12, 2010 distribution date.

On August 3, 2010, pursuant to a cash tender offer that had been launched on July 7, 2010 (the "2010 Offer"), we acquired \$24.7 million in aggregate stated amount of Pass-Through Certificates. Following the 2010 Offer and the August privately-negotiated transaction, we had acquired, and, on September 2, 2010, we cancelled the entire \$325 million in aggregate stated amount of the Pass-Through Certificates. In connection with the cancellation, the corresponding \$325 million of funding agreements were surrendered by the Stingray Investor Trust, and all unamortized debt issuance costs relating to Stingray, in the amount of \$2.8 million, were written off. These were included in collateral finance facilities expenses in the Consolidated Statements of Income.

We had elected the fair value option under FASB ASC 825 in respect of the Pass-Through Certificates held by non-affiliated investors prior to the cancellation of the Pass-Through Certificates. The fair value at December 31, 2009 of the outstanding Pass-Through Certificates held by non-affiliated investors was \$55.1 million and was included in long-term debt, at fair value in our Consolidated Balance Sheets. Changes in fair value were reflected through earnings. There were no changes in fair value for the three months ended September 30, 2010 as all

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

7. Debt Obligations and Other Funding Arrangements (Continued)

purchases of the remaining Pass-Through Certificates, prior to their cancellation on September 2, 2010, were acquired at fair value amounts already reflected in the consolidated financial statements for the six months ended June 30, 2010.

Premium Asset Trust Series 2004-4

On March 12, 2004, SALIC entered into an unsecured funding agreement with the Premium Asset Trust for an aggregate of \$100 million (the "PATS"). The funding agreement had a stated maturity of March 12, 2009 (the "PATS Maturity Date"), and accrued interest at a rate of three-month LIBOR plus 0.922%, payable on a quarterly basis. The amount due under this funding agreement was included under interest-sensitive contract liabilities on the Consolidated Balance Sheets.

During the first quarter of 2009, we extinguished, primarily through negotiated repurchases, SALIC's unsecured funding agreement payment obligation in respect of the PATS. The extinguishment of the PATS securities acquired through negotiated repurchases and the settlement of the remaining funding obligation in respect of all of the PATS securities not repurchased prior to the Maturity Date were completed for a total consideration of \$46.5 million, compared to the \$100 million par value of the PATS. Consequently, in accordance with FASB ASC Topic 860, Transfers and Servicing, we recorded a gain on the extinguishment of the PATS debt of \$53.5 million in the first quarter of 2009.

Deferral of Interest Payments on Floating Rate Capital Securities and Trust Preferred Securities

We began deferring interest payments as of March 4, 2009 on our floating rate Capital and Trust Preferred Securities issued and sold through certain statutory trusts established by us. These deferrals were permitted by the terms of the indentures governing the securities and were made at the discretion of our Board to preserve liquidity. Deferral of such interest payments may continue for the duration of the permitted 20 consecutive quarterly periods. As of September 30, 2010, we have accrued and deferred payment of \$10.2 million of interest. SHI and SALIC are restricted in their ability to make dividend payments in any period where interest payment obligations on these securities are not current.

For further discussion on the accrued and deferred payment on our floating rate Capital and Trust Preferred Securities subsequent to September 30, 2010, see Note 16, "Subsequent Events".

8. Mezzanine Equity

Convertible Cumulative Participating Preferred Shares

On May 7, 2007, we completed the equity investment transaction by MassMutual Capital Partners LLC ("MassMutual Capital"), a member of the MassMutual Financial Group, and SRGL Acquisition, LDC, an affiliate of Cerberus Capital Management, L.P. ("Cerberus"), announced by us on November 27, 2006 (the "2007 New Capital Transaction"). Pursuant to the 2007 New Capital Transaction, MassMutual Capital and Cerberus invested an aggregate \$600 million in us in exchange for 1,000,000, in the aggregate, newly-issued Convertible Cumulative Participating Preferred Shares. The gross proceeds were \$600 million less \$44.1 million in closing costs, which resulted in aggregate net proceeds of \$555.9 million. Each Convertible Cumulative Participating Preferred Share has a par value of \$0.01 per share with an initial stated value and liquidation preference of \$600 per share, as adjusted for the accretion of dividends or the payment of dividends or distributions as described further below.

As of September 30, 2010, MassMutual Capital and Cerberus hold in the aggregate approximately 68.7% of our equity voting power, along with the right to designate two-thirds of the members of our Board.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

8. Mezzanine Equity (continued)

The Convertible Cumulative Participating Preferred Shares are convertible at the option of the holder, at any time, into an aggregate of 150,000,000 ordinary shares of SRGL. On the ninth anniversary of issue, the Convertible Cumulative Participating Preferred Shares automatically will convert into an aggregate of 150,000,000 ordinary shares, if not previously converted. We are not required at any time to redeem the Convertible Cumulative Participating Preferred Shares for cash, except in the event of a liquidation or upon the occurrence of a change-in-control event.

We have accounted for the Convertible Cumulative Participating Preferred Shares in accordance with FASB ASC Subtopic 470-20, Debt – Debt with Conversion and Other Options (“FASB 470-20”), which incorporates EITF D-98: “Classification and Measurement of Redeemable Securities”. Dividends on the Convertible Cumulative Participating Preferred Shares are cumulative and accrete daily on a non-compounding basis at a rate of 7.25% per annum on the stated value of \$600 million, whether or not there are profits, surplus, or other funds available for the payment of dividends. Such dividends will be made solely by increasing the liquidation preference of the Convertible Cumulative Participating Preferred Shares. As of September 30, 2010, the amount of dividends accreted pursuant to the terms of the Convertible Cumulative Participating Preferred Shares is \$148.1 million in the aggregate, or \$148 per share.

Redemption of the Convertible Cumulative Participating Preferred Shares is contingent upon a change in control. Since neither liquidation nor a change in control is currently probable, the accreted dividends have not been accrued in our consolidated financial statements.

In the event that dividends or distributions are made to ordinary shareholders, the holders of the Convertible Cumulative Participating Preferred Shares will receive a dividend or distribution equal to the dividend or distribution that such holders would have been entitled to receive had the right been exercised to convert all of the Cumulative Participating Preference Shares to ordinary shares.

To the extent that the Convertible Cumulative Participating Preferred Shares so participate on an as-converted basis in dividends paid on ordinary shares, a corresponding reduction will be made to the liquidation preference for the Convertible Cumulative Participating Preferred Shares. The Convertible Cumulative Participating Preferred Shares have a liquidation preference equal to their initial stated value, as adjusted for (x) the accretion of dividends and (y) any cash payment or payment in property of dividends or distributions. The holders of Convertible Cumulative Participating Preferred Shares may, among other things, require us to redeem the Convertible Cumulative Participating Preferred Shares upon a change-in-control event.

Upon a change-in-control event, the redemption price of the Convertible Cumulative Participating Preferred Shares is an amount equal to the greater of (i) the stated value of the outstanding Convertible Cumulative Participating Preferred Shares, plus an amount equal to the sum of all accreted dividends through the earlier of (A) the date of payment of the consideration payable upon a change-in-control event, or (B) the fifth anniversary of the issue date of the Convertible Cumulative Participating Preferred Shares, or (ii) the amount that the holder of the Convertible Cumulative Participating Preferred Shares would have been entitled to receive with respect to such change-in-control event if it had exercised its right to convert all or such portion of its Convertible Cumulative Participating Preferred Shares for ordinary shares immediately prior to the date of such change-in-control event.

The liquidation preference of the Convertible Cumulative Participating Preferred Shares (including any adjustments thereto) is not applicable once the Convertible Cumulative Participating Preferred Shares have been converted into ordinary shares, as described above.

The Convertible Cumulative Participating Preferred Shares rank, with respect to payment of dividends and distribution of assets upon voluntary or involuntary liquidation, dissolution, or winding-up (a “Liquidation Event”): (a) senior to our ordinary shares and to each other class or series of our shares established by the Board, the terms of which do not expressly provide that such class or series ranks senior to or *pari passu* with the Convertible

SCOTTISH RE GROUP LIMITED

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8. Mezzanine Equity (continued)

Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event; (b) pari passu with each class or series of our shares, the terms of which expressly provide that such class or series ranks pari passu with the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event; and (c) junior to each other class or series of our securities outstanding as of the date of the completion of the 2007 New Capital Transaction that ranks senior to our ordinary shares, and to each class or series of our shares, the terms of which expressly provide that such class or series ranks senior to the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event and all classes of our preferred shares outstanding as of the completion of the 2007 New Capital Transaction.

The Convertible Cumulative Participating Preferred Shares conversion price (\$4.00 per ordinary share) was lower than the trading value of \$4.66 of our ordinary shares on the date of issue. This discount has been accounted for as an embedded beneficial conversion feature in accordance with FASB ASC 470-20, which incorporates EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios", and EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments". Accordingly, the Company recognized a \$120.8 million embedded beneficial conversion feature, which reduced the Convertible Cumulative Participating Preferred Share issue amount shown in Mezzanine Equity and increased the amount of additional paid-in capital. Under the accounting guidance above, we had the choice to accrete the full intrinsic value of the embedded beneficial conversion feature out of retained earnings over the nine year term of the shares or immediately, due to the ability of the holders to convert at their option at any time. Given the ability of the holders to convert at any time, we elected to accrete the full intrinsic value of the embedded beneficial conversion feature on the date of issue. As we did not have any retained earnings on the date of issue, the \$120.8 million beneficial conversion feature was accreted out of additional paid-in capital into Mezzanine Equity.

Pursuant to our Securities Purchase Agreement, dated November 26, 2006 (the "Agreement"), with MassMutual Capital and Cerberus, certain representations and warranties were provided relating to our statutory accounting records. As discussed in Note 15, "Commitments and Contingencies", certain statutory accounting errors were discovered in 2006 which have resulted in an indemnification claim against us by MassMutual and Cerberus. Resolution of this claim could result in a change in the conversion formula on these securities.

9. Non-cumulative Perpetual Preferred Shares

Perpetual Preferred Shares

We are authorized to issue 50,000,000 perpetual preferred shares of par value \$0.01 each.

On June 28, 2005, we priced our offering of 5,000,000 non-cumulative Perpetual Preferred Shares (the "Perpetual Preferred Shares") and entered into a purchase agreement relating to the shares pursuant to which the underwriters of the offering agreed to purchase the shares. Gross proceeds were \$125 million and related expenses were \$4.6 million. Settlement of the net proceeds occurred on July 6, 2005.

Dividends on the Perpetual Preferred Shares are payable on a non-cumulative basis at a rate per annum of 7.25% until the dividend payment date in July 2010. Thereafter, the dividend rate may be at a fixed rate determined through remarketing of the Perpetual Preferred Shares for specific periods of varying length not less than six months or may be at a floating rate reset quarterly based on a predefined set of interest rate benchmarks. During any dividend period, unless the full dividends for the current dividend period on all outstanding Perpetual Preferred Shares have been declared or paid, no dividend may be paid or declared on our ordinary shares and no ordinary shares or other junior shares may be purchased, redeemed or otherwise acquired for consideration. Declaration of dividends on the Perpetual Preferred Shares is prohibited if we fail to meet specified capital adequacy, net income, or shareholders' equity levels. In accordance with the Certificate of Designations, dividends on the Perpetual Preferred Shares generally may be funded only to the extent they are payable out of our distributable profits, and/or

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

9. Non-cumulative Perpetual Preferred Shares (continued)

the proceeds of a new issue of shares, and/or out of the Share Premium Account (as defined in the Certificate of Designations) related to the Perpetual Preferred Shares.

The Perpetual Preferred Shares do not have a maturity date, and we are not required to redeem the shares. The Perpetual Preferred Shares were not redeemable pursuant to their terms prior to July 2010. Subsequent to July 2010, the Perpetual Preferred Shares are redeemable at our option, in whole or in part, at a redemption price equal to \$25.00 per share, plus any declared and unpaid dividends at the redemption date, without accumulation of any undeclared dividends. The Perpetual Preferred Shares are unsecured and subordinated to all indebtedness that does not by its terms rank *pari passu* or junior to the Perpetual Preferred Shares. The holders of the Perpetual Preferred Shares have no voting rights except with respect to certain fundamental changes in the terms of the Perpetual Preferred Shares and, in certain circumstances, in the case of certain dividend non-payments.

Ratings of the Perpetual Preferred Shares were withdrawn by Standard & Poor's, Moody's, Fitch Ratings and A.M. Best Company in 2009 following our notification to each of the rating agencies that we would no longer be compensating the agencies for their maintenance of such ratings. See Note 12, "Regulatory and Rating Agency Matters".

On June 23, 2010, pursuant to a cash tender offer launched on May 7, 2010, we acquired \$4.8 million in aggregate liquidation preference of Perpetual Preferred Shares, which shares were immediately redeemed by SRGL. As a result, a gain on redemption of Perpetual Preferred Shares of \$3.9 million was recorded for the three months ended June 30, 2010, as a component of net income attributable to ordinary shareholders for the purpose of calculating earnings per share.

Dividends on Perpetual Preferred Shares

On April 14, 2008, we announced that, given our current financial condition, our Board in its discretion had decided not to declare a dividend on our Perpetual Preferred Shares for the April 15, 2008 dividend payment date. In addition, we announced that pursuant to the Certificate of Designations for our Perpetual Preferred Shares our Board may be precluded from declaring and paying dividends on the October 15, 2008 dividend payment date in the event we did not meet certain financial tests under the terms of the Perpetual Preferred Shares required for us to pay such dividends, which tests subsequently were not met for such dividend payment date. On July 3, 2008, the Board determined that in light of our financial condition and in accordance with the terms of the forbearance agreements with the relevant counterparties to certain of our then outstanding collateral finance facilities, we would suspend the cash dividend for the July 15, 2008 payment date. In addition, as previously indicated our Board was precluded from declaring and paying dividends on the October 15, 2008 dividend payment date as we did not meet the relevant financial tests under the terms of the Perpetual Preferred Shares. In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, our Board was precluded from declaring and paying dividends on the January 15, 2009, April 15, 2009, July 15, 2009, October 15, 2009, January 15, 2010, April 15, 2010, and July 15, 2010 dividend payment dates and, as a result, did not declare and pay a dividend on such dates. Nonpayment of dividends on July 15, 2009 marked the sixth dividend period for which dividends had not been declared and paid. Pursuant to the terms of, and subject to the procedures set forth in, the Certificate of Designations related to the Perpetual Preferred Shares, the holders of the Perpetual Preferred Shares are entitled to elect two directors to our Board in the event dividends on the Perpetual Preferred Shares have not been declared and paid for six or more dividend periods. For further discussion on the non-declaration of Perpetual Preferred Shares dividends, see Note 16, "Subsequent Events".

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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10. Income Taxes

Income tax benefit for the three months ended September 30, 2010 was \$3.0 million. The net income of our Bermuda and Cayman entities are not subject to income tax. The net income of our U.S. and Irish entities did not generate a current tax expense, other than interest and penalties on accrued tax liabilities, due to the availability of tax losses from prior tax years. The utilization of tax losses results in a reduction in deferred tax assets and a corresponding reduction in the valuation allowance established against those deferred tax assets. The income tax benefit for the three months ended September 30, 2010, is principally due to a reduction in the valuation allowance resulting from a change in deferred tax assets not supported by deferred tax liabilities.

Income tax benefit for the nine months ended September 30, 2010 was \$39.4 million. The income tax benefit for the nine months ended September 30, 2010, is principally due to a release of \$35.9 million of accrued tax liabilities. The release was as a result of the reconsideration of our position with respect to an uncertain tax position following a U.S. tax court ruling related to an unaffiliated third party (Container Corporation v. Commissioner, 134 T.C. 5 (2010)).

At September 30, 2010, we had total unrecognized tax benefits (excluding interest and penalties) of \$115.4 million, the recognition of which would result in a \$3.7 million benefit at the effective tax rate for the applicable period. At December 31, 2009, we had total unrecognized tax benefits (excluding interest and penalties) of \$132.2 million, the recognition of which would result in a \$20.6 million benefit at the effective tax rate for the applicable period.

Our deferred tax assets are principally supported by the reversal of deferred tax liabilities. We have maintained a full valuation allowance against any remaining net deferred tax assets, given our inability to rely on future taxable income tax projections.

At September 30, 2010, our deferred tax liabilities include \$43.6 million of deferred tax liabilities that reverse after the expiration of net operating losses in applicable jurisdictions, and, therefore, cannot support deferred tax assets. At December 31, 2009, the corresponding amount of deferred tax liabilities was \$49.8 million.

We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of September 30, 2010, we remained subject to examination in the following major tax jurisdictions for the returns filed for the years indicated below:

<u>Major Tax Jurisdictions</u>	<u>Open Years</u>
U.S.	
Life Group	2006 through 2009
Non-Life Group	2006 through 2009
Ireland	2005 through 2009

11. Earnings per Ordinary Share

Basic earnings per share is computed based on the weighted average number of ordinary shares outstanding and assumes an allocation of net income to Convertible Cumulative Participating Preferred Shares for the period (or the portion of the period) that this security is outstanding. Losses are not allocated to Convertible Cumulative Participating Preferred Shares. Under the provisions of FASB ASC Topic 260, Earnings per Share ("FASB ASC 260"), formerly SFAS No. 128, basic earnings per share are computed by dividing the net income attributable to ordinary shareholders by the weighted average number of shares of our ordinary shares outstanding for the period. Diluted earnings per share is calculated based on the weighted average number of ordinary shares outstanding plus the diluted effect of potential ordinary shares in accordance with the if-converted method. In accordance with FASB ASC 260, the exercise of options and warrants or conversion of convertible securities is not assumed unless it would reduce earnings per share or increase loss per share.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

11. Earnings per Ordinary Share (continued)

The following table sets forth the computation of basic and diluted earnings per ordinary share under the two-class method and the if-converted method, respectively, as required under FASB ASC 260, which incorporates EITF No. 03-06, "Participating Securities and the Two-Class Method under FASB Statement No. 128".

	Three months ended		Nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009 (Restated)
(U.S. dollars in thousands, except share data)				
Basic income attributable to ordinary shareholders				
Numerator:				
Net income attributable to ordinary shareholders	\$ 82,406	\$ 201,890	\$ 259,937	\$ 2,040,346
Amounts allocable to convertible cumulative participating preferred shares	(1,188)	(2,910)	(3,747)	(29,407)
Numerator for basic income per ordinary share	<u>\$ 81,218</u>	<u>\$ 198,980</u>	<u>\$ 256,190</u>	<u>\$ 2,010,939</u>
Denominator:				
Denominator for basic income per ordinary share - weighted average number of ordinary shares	<u>68,383,370</u>	<u>68,383,370</u>	<u>68,383,370</u>	<u>68,383,370</u>
Basic income per share from continuing operations attributable to ordinary shareholders	<u>\$ 1.19</u>	<u>\$ 2.91</u>	<u>\$ 3.74</u>	<u>\$ 29.41</u>
Diluted income attributable to ordinary shareholders				
Numerator:				
Net income attributable to ordinary shareholders	<u>\$ 82,406</u>	<u>\$ 201,890</u>	<u>\$ 259,937</u>	<u>\$ 2,040,346</u>
Denominator:				
Denominator for basic income per ordinary share - weighted average number of ordinary shares	68,383,370	68,383,370	68,383,370	68,383,370
Effect of dilutive securities*	<u>150,000,000</u>	<u>150,000,000</u>	<u>150,000,000</u>	<u>150,000,000</u>
Denominator for diluted income per ordinary share	<u>218,383,370</u>	<u>218,383,370</u>	<u>218,383,370</u>	<u>218,383,370</u>
Diluted income per share from continuing operations attributable to ordinary shareholders	<u>\$ 0.38</u>	<u>\$ 0.92</u>	<u>\$ 1.20</u>	<u>\$ 9.34</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

11. Earnings per Ordinary Share (continued)

* In accordance with FASB ASC 260, exercise of options and warrants or conversion of convertible securities is not assumed if the result would be anti-dilutive, such as when a loss from continuing operations is reported, or the exercise price of the options exceeds the market price of common stock. Due to the dilutive effect on earnings per share ("EPS"), our stock options (which are convertible into 3,930,362 ordinary shares) potentially could dilute EPS in the future.

12. Regulatory and Rating Agency Matters

Order of Supervision

In connection with its receipt of the Permitted Practice described above in Note 1, SRUS consented to the issuance by the Department on January 5, 2009 of an Order of Supervision, in accordance with 18 Del. C. §5942. The Order of Supervision subsequently was extended and amended on April 3, 2009 with the issuance of the Amended Order. Pursuant to the Amended Order, SRUS generally must receive prior written consent from the Department in order to engage in any transaction outside of the ordinary course of business; make certain payments, or incur certain debts, obligations or liabilities in any transaction of \$1 million or greater (provided that this limitation does not apply to the payment of claims, premiums, and other third party reinsurance settlements, in each case of less than \$10 million per payment); engage in new business; lend any of its funds; invest any of its funds in a manner that deviates from the plan filed with the Department; commute, novate, amend or otherwise change any existing reinsurance contract or treaty; or engage in any transaction with any related party.

Rating Agencies

Our financial strength ratings and the financial strength ratings of our subsidiaries have been lowered on several occasions since 2007. Ratings at such levels also previously triggered the vesting of contractual recapture rights for certain of our reinsurance business and resulted in the increase to a maximum "stepped up" rate of certain guarantor fees related to the securitization structures used to finance the Valuation of Life Insurance Policies Model Regulation ("Regulation XXX") statutory reserve requirements associated with business ceded by SRUS to each of Orkney Re and Orkney Re II. In light of the foregoing, combined with our run-off strategy for our remaining business, among other factors, we determined that we no longer intended to utilize capital for the payment of ratings fees to maintain the financial strength and other ratings for us and our operating subsidiaries. Accordingly, we notified each of the rating agencies in June 2009 that we no longer would compensate the agencies for their maintenance of such ratings.

Following this communication, on June 4, 2009, Standard & Poor's Corporation ("S&P"), affirmed and then subsequently withdrew the "CC" counterparty credit rating of SRGL, the "C" rating of SRGL's Perpetual Preferred Shares, and the "CCC-" counterparty credit and financial strength ratings of SALIC. At the same time, S&P affirmed and then withdrew the "R" counterparty credit and financial strength ratings of SRUS, the "CCC" counterparty credit and financial strength ratings of Scottish Re Life Corporation, and the "CCC-" senior secured rating of the Pass-Through Certificates.

On June 12, 2009, A.M. Best Company Inc. ("A.M. Best") affirmed and then withdrew the financial strength ratings and issuer credit ratings of SALIC, Scottish Re Life Corporation, and Orkney Re. At the same time, A.M. Best affirmed and then withdrew our issuer credit rating and the rating of our Perpetual Preferred Shares, as well as our indicative ratings of senior unsecured debt, subordinated debt, and preferred stock. SRUS' financial strength rating of "E" (Under Regulatory Supervision) and issuer credit rating of "rs" was unchanged.

On June 22, 2009, Fitch Ratings ("Fitch") downgraded the issuer default rating of SRGL to "CC" from "CCC" and then withdrew its rating of SRGL. At the same time, Fitch affirmed and then withdrew the insurer financial strength rating of SRUS. Fitch also has withdrawn the insurer financial strength rating of SALIC and the rating of

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

12. Regulatory and Rating Agency Matters (continued)

the Pass-Through Certificates and the Perpetual Preferred Shares. As such, Fitch has withdrawn all of our ratings and no longer will provide analytical coverage of us and our affiliates.

On August 18, 2009, Moody's downgraded the insurance financial strength ratings of SALIC to "Ca" from "C" and of SRUS to "Ba3" from "Ba1", before withdrawing both ratings. At the same time, Moody's downgraded to "Ca" from "C" and then withdrew the senior secured rating of the Pass-Through Certificates and our preferred stock rating.

13. Sale of a Block of Life Reinsurance North America Business

We engaged in 2008 in a process to sell our entire Life Reinsurance North America Segment. In October 2008, the process led to exclusive negotiations with a prospective buyer; however, a satisfactory transaction for the sale of the entire Life Reinsurance North America Segment could not be reached, primarily as a result of the historic disruption in the financial markets. Thereafter, in an effort to find ways to address our capital, liquidity and collateral needs and the concerns of regulators, we pursued the sale of a specific block of individual life reinsurance in our North American business. These efforts culminated in the announcement on February 20, 2009 that we had closed the transactions contemplated by the Master Asset Purchase Agreement (the "Purchase Agreement"), by and among the Company, SHI, SRUS, Scottish Re Life (Bermuda) Limited ("SRLB") and Scottish Re (Dublin) Limited ("SRD") (collectively, the "Sellers") with Hannover Re to sell a block of individual life reinsurance business acquired in 2004 from the ING Companies, which block consisted primarily of term life reinsurance universal life with secondary guarantees, and yearly renewable term business (the "Acquired Business"), and which block was part of our Traditional Solutions business.

Pursuant to the Purchase Agreement, Hannover Re purchased the Acquired Business, which was acquired in 2004 by us from the ING Companies. The Acquired Business consists primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business. When we originally purchased the Acquired Business in 2004, the ING Companies reinsured their individual life reinsurance business to us on a 100% indemnity reinsurance basis. A large portion of such business included guaranteed level premium term life insurance that was subject to the Regulation XXX reserve requirements and universal life policies with secondary guarantees subject to the "Regulation AXXX" reserve requirements. Under our 2004 agreement with the ING Companies, the ING Companies were obligated to maintain collateral for the Regulation XXX and AXXX reserve requirements of the Acquired Business for the duration of such requirements, and financial incentives were provided to encourage us to replace this financing with alternative third party financing. The Acquired Business generally does not include business previously ceded by SRUS to Ballantyne Re, as the reinsurance transaction with this special purpose reinsurance vehicle was novated and assigned from SRUS to SLD effective October 1, 2008. However, the Acquired Business does include the business recaptured from Ballantyne Re in connection with a series of recaptures during 2008 in which SRUS recaptured business from Ballantyne Re, which business then was recaptured by SLD, which in turn ceded the recaptured business to SLDI, who ceded it to SRLB (the foregoing recaptures, collectively, the "Ballantyne Recaptures"), and the business recaptured in connection with the unwind in 2008 of our former HSBC II collateral finance facility (together with the Ballantyne Recaptures, the "ING Financings"). In connection with each of the ING Financings, SLD ceded the applicable recaptured business to SLDI, which ceded the recaptured business to SRLB. SLDI agreed to provide, or cause the provision of, one or more letters of credit in order to provide SLD with statutory financial statement credit for the excess reserves associated with the ING Financings. As partial consideration for each of the ING Financings, the Company agreed to bear the costs of the letters of credit by paying SLD a facility fee based on the face amount of such letters of credit outstanding. Upon closing the transactions contemplated by the Purchase Agreement, Hannover Re assumed the business related to the ING Financings as part of the Acquired Business, as well as the obligation to pay the existing and any future increases in the fees for the related letters of credit.

In connection with the Purchase Agreement, the ING Companies and certain of the Sellers entered into recapture agreements (and, in specific instances, novations to Hannover Re of certain existing reinsurance

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

13. Sale of a Block of Life Reinsurance North America Business (continued)

agreements) with respect to the Acquired Business, and the ING Companies and Hannover Re subsequently entered into new reinsurance agreements with respect to the Acquired Business immediately thereafter. These recapture and reinsurance transactions and the novations had an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent attributable to periods prior to January 1, 2009.

The Purchase Agreement also related to the purchase and sale of certain assets used by the Sellers in connection with their administration of the Acquired Business (the “Transferred Assets”) and the transfer of certain employees from the Sellers to Hannover Re in connection therewith. Pursuant to the Purchase Agreement, the remaining lease on SRUS’ Denver office location was assigned to Hannover Re as was a portion of SRUS’ Charlotte office location. In addition, Hannover Re entered into an administrative services agreement with SRUS pursuant to which Hannover Re administers the accepted and ceded mortality business retained by SRUS and its affiliates. Similarly, Hannover Re entered into an administrative services agreement with the ING Companies pursuant to which Hannover Re administers the Acquired Business and provides certain other administrative services to the ING Companies.

In accordance with the Purchase Agreement, payments were made as follows: (i) the Sellers made recapture payments to the ING Companies in an aggregate amount equal to \$1,325 million (adjusted for interim period earnings from January 1, 2009 to the date of closing), (ii) the ING Companies made corresponding initial premium payments to Hannover Re, and (iii) Hannover Re made a payment to the Sellers in respect of the Transferred Assets in an amount equal to \$18 million.

Following the transfer of assets with respect to the recapture payments noted above, we were released of all associated policyholder liabilities on the sale of the Acquired Business as of the effective date of January 1, 2009. The release of such liabilities resulted in a pre-tax gain of \$703.6 million, after transaction expenses and related costs. This gain was also subject to certain contingencies, which were all satisfied as of December 31, 2009. Of the \$703.6 million gain, \$642.4 million, \$59.8 million, \$1.0 million, and \$0.4 million were recognized in the first, second, third and fourth quarters of 2009, respectively. This total gain is summarized as follows:

(U.S. dollars in millions)	<u>Balance Sheet</u>	<u>Consolidated Statement of Income</u>
Transfer of investments	\$ (1,468.7)	
Release of reserve for future policy benefits	1,902.9	
Decrease in accounts payable and other liabilities.....	1.7	
Decrease in reinsurance balances and risk fees receivable	(6.3)	
Decrease in reinsurance balances payable	4.7	
Increase in other assets	18.7	
Decrease in claims and other policy benefits	\$ 453.0	\$ 453.0
Decrease in accounts payable and other liabilities.....	275.5	
Change in value of embedded derivatives.....	\$ 275.5	275.5
Release in deferred acquisition costs	(24.9)	
Acquisition costs and other insurance expenses, net.....	\$ (24.9)	(24.9)
Total pre-tax gain for the year-ended December 31, 2009		\$ 703.6

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

13. Sale of a Block of Life Reinsurance North America Business (continued)

In connection with the Purchase Agreement, the Company, Hannover Re, and the ING Companies agreed to use commercially-reasonable efforts to transfer to Hannover Re certain retrocession agreements under which we and/or the ING Companies ceded to third parties certain risks related to the Acquired Business. If a certain amount of such third party retrocessionaires did not consent to such transfers prior to April 30, 2009, we were required under the Purchase Agreement to deposit into escrow with Hannover Re by May 14, 2009, a pro-rata amount related to such retrocession agreements for which consent had not been obtained as of that date. Pursuant to the Purchase Agreement, in the event none of the retrocessionaires consented to transfer their agreements, the maximum potential escrow funding amount was \$136.3 million. In the event one or more retrocessionaire consents had not been obtained by December 31, 2009, the related escrow funds would be released to Hannover Re. As of the escrow funding requirement date of May 14, 2009, the balance was \$1.9 million. The required escrow balance subsequently was reduced to \$0 and all of the funds were released back to us by the end of 2009.

This transaction resulted in a \$49.8 million income tax expense in the first quarter of 2009, due to an increase in our valuation allowance. The increased valuation allowance was because the remaining deferred tax liabilities did not support the full recoverability of our deferred tax assets, as discussed earlier in Note 2, "Basis of Presentation-Restatement of Prior Financial Statements".

14. Collateral Finance Facilities

Ballantyne Re

Ballantyne Re is a special purpose reinsurance vehicle incorporated under the laws of Ireland. In May 2006, Ballantyne Re issued, in a private offering, \$1.74 billion of debt to third party investors, \$178 million of Class C Notes and \$181.2 million in preference shares to SALIC, and \$500,000 in Class D Notes to SRGL.

Initially, in accordance with FASB ASC 810-10, Ballantyne Re was considered to be a variable interest entity, and we were considered to hold the primary beneficial interest, following a quantitative analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Ballantyne Re was consolidated in our financial statements through December 31, 2008.

Effective January 1, 2009, Ballantyne Re no longer is consolidated within the financial statements of SRGL. Pursuant to the Purchase Agreement (as defined herein) for the disposal of the Acquired Business, Hannover Re explicitly agreed to assume the mortality risk for all recaptures of business from Ballantyne Re. Our disposal of the variable interest to absorb the mortality risk recaptured from Ballantyne Re under the reinsurance agreement constituted a reconsideration event related to the consolidation of Ballantyne Re under FASB ASC 810-10, Consolidation - Overall ("FASB ASC 810-10"). We subsequently completed a primary beneficiary analysis and concluded that we were no longer the primary beneficiary of Ballantyne Re as defined within FASB ASC 810-10, and, as a result, we no longer consolidate Ballantyne Re into the consolidated financial statements of SRGL. The de-consolidation of Ballantyne Re reduced our consolidated total assets and liabilities by approximately \$885 million and \$2,035 million, respectively, resulting in a one-time non-cash de-consolidation gain of \$1,150 million, which we recognized in the first quarter of 2009. This gain had no impact on our liquidity position.

As of June 30, 2010, we had no remaining direct loss exposure related to Ballantyne Re since our interests in the Ballantyne Re Class D Notes and Preferred Shares are valued at \$0 and are classified as trading securities on the Consolidated Balance Sheets. The Class C Notes were contractually written-off during the fourth quarter of 2008.

SRUS remains liable for breaches of its representations, warranties, covenants, and other obligations that relate to periods before the assignment and novation to SLD of the reinsurance agreement with Ballantyne Re. In addition, the Company and SRUS remain responsible for certain ongoing covenants and indemnities made for the benefit of Ballantyne Re and the financial guarantors of certain of the notes issued by Ballantyne Re.

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14. Collateral Finance Facilities (continued)

Orkney I

On February 11, 2005, Orkney I issued and sold, in a private offering, an aggregate of \$850 million Series A Floating Rate Insured Notes due February 11, 2035 (the "Orkney Notes"). Orkney I was organized for the limited purpose of issuing the Orkney Notes and holding the stock of Orkney Re, Inc., originally a South Carolina special purpose financial captive insurance company, now a Delaware special purpose captive insurance company ("Orkney Re"). SRUS holds all of the limited liability company interest in Orkney I, and has contributed capital to Orkney I in the amount of \$268.5 million. Proceeds from this offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued by direct ceding companies between January 1, 2000 and December 31, 2003, and reinsured by SRUS to Orkney Re. Proceeds from the Orkney Notes have been deposited into a series of accounts that collateralize the notes and the reserve obligations of SRUS.

The holders of the Orkney Notes have no recourse against us or any of our subsidiaries, other than Orkney I. The timely payment of interest and ultimate payment of principal for the Orkney Notes are guaranteed by MBIA Insurance Corporation ("MBIA"). We are not required to provide any additional financial support to Orkney I.

Interest on the principal amount of the Orkney Notes is payable quarterly at a rate equivalent to three-month LIBOR plus 0.53%. At June 30, 2010, the interest rate was 0.96% (compared to 0.80% at December 31, 2009). Any payment of principal, including by redemption, or interest on the Orkney Notes is sourced from dividends from Orkney Re, and the balances available in a series of trust accounts generally excluding amounts on deposit in a reinsurance trust account supporting the associated reserve requirements of SRUS. Dividends may be made only after filing with the Commissioner in accordance with the terms of Orkney Re's licensing order and in accordance with applicable law. The Orkney Notes also contain a customary limitation on lien provisions and customary events of default provisions, which, if breached, could result in the accelerated maturity of the Orkney Notes. Orkney I has the option to redeem all or a portion of the Orkney Notes prior to, on, or after February 11, 2010, subject to certain call premiums.

In accordance with FASB ASC 810-10, Orkney I is considered to be a variable interest entity, and we are considered to hold the primary beneficial interest (as we cede all the business assumed by Orkney I), following an analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Orkney I is consolidated in our financial statements. The assets of Orkney I consist of fixed-maturity investments and cash and cash equivalents. Our Consolidated Statements of Income shows the investment returns of Orkney I as investment income, and the cost of the facility is reflected in collateral finance facilities expense. Funds in the securitization structure are used for the sole purpose of the securitization structure and, hence, are not available for general corporate purposes.

To the extent we experience fair value declines in our investment portfolio, we may need to recapture a pro-rata portion of the underlying business in Orkney I and find alternative collateral support for the recaptured business. No assurances can be given that we would be successful in securing such alternative collateral support.

Related Party Acquisition of Orkney Notes

We were informed by Cerberus that an affiliate of Cerberus had acquired, from one or more unaffiliated third parties, \$700 million in aggregate principal amount of the Orkney Notes in 2009. None of the Company, Orkney I, Orkney Re, or any of our other subsidiaries was a party to this purchase. No terms of the Orkney Notes or any of the underlying transaction documents were changed as a result of this purchase.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

Orkney Re/Orkney I Notices of Default

On February 9, 2009, MBIA served Orkney Re, Orkney I, and SRUS with notices of default under each of the Orkney I indenture and the insurance and indemnity agreement (the "Orkney Insurance Agreement"), alleging failure by the parties to provide certain required financial statements and improper withdrawals by the parties from Orkney I tax accounts. SRUS cured such alleged defaults within the cure periods set forth in the indenture and the Orkney Insurance Agreement.

On September 21, 2009, MBIA served Orkney Re, Orkney I, and SRUS with a notice of default under the restructuring agreement executed at the time of Orkney Re's redomestication from South Carolina to Delaware, alleging failure by the parties to provide MBIA with an actuarial review in accordance with the requirements set forth in the restructuring agreement. SRUS, Orkney I, and Orkney Re disagree with such contention. However, in the event such alleged failure to provide an actuarial review ultimately is determined to be a default, and because it was not cured within five (5) business days of the September 21, 2009 notice, then such default would constitute an event of default under the Orkney Insurance Agreement, which, in turn, would provide certain enhanced contractual rights to MBIA under the Orkney Insurance Agreement, including the right to recover from Orkney I any actual losses, costs, and expenses incurred by MBIA in connection with the event of default and the receipt of certain penalty fees. Pursuant to the terms of a letter agreement put in place between SRUS and MBIA at the time of the Orkney I transaction, SRUS would also be obligated to pay, on behalf of Orkney I, certain of the foregoing fees and expenses to the extent due from Orkney I. As of September 30, 2010, MBIA, Orkney Re, Orkney I, and SRUS are engaged in discussions and negotiations related to the actuarial review, withdrawals from the Orkney I tax accounts, and alleged defaults described above.

On February 22, 2010, MBIA served Orkney Re, Orkney I, and SRUS with notices of default under each of the Orkney I indenture and the Orkney Insurance Agreement, alleging failure by the parties to provide certain required financial statements and other documents required to be delivered under these transaction documents. SRUS subsequently caused such documents to be delivered within the applicable cure periods, and, as of the date hereof, there is no event of default resulting from such notices of default.

Orkney Re II

On December 21, 2005, Orkney Re II, whose issued ordinary shares are held by a share trustee and its nominees in trust for charitable purposes, issued, in a private offering, \$450 million of debt to external investors. The debt consisted of \$382.5 million of Series A-1 Floating Rate Guaranteed Notes (the "Series A-1 Notes"), \$42.5 million of Series A-2 Floating Rate Notes (the "Series A-2 Notes"), and \$25 million of Series B Floating Rate Notes (the "Series B Notes"), all due December 31, 2035 (collectively, the "Orkney Re II Notes"). The Orkney Re II Notes are listed on the Irish Stock Exchange. Proceeds from this offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued between January 1, 2004 and December 31, 2004 reinsured by SRUS to Orkney Re II. Proceeds from the Orkney Re II Notes have been deposited into a series of accounts that collateralize the notes and the reserve obligations of SRUS.

The holders of the Orkney Re II Notes have no recourse against us or any of our subsidiaries. Assured Guaranty (UK) Ltd. ("Assured") has guaranteed the timely payment of the scheduled interest payments and the principal on the maturity date of the Series A-1 Notes. We are not required to provide any additional financial support to Orkney Re II.

The debt issued to SALIC consisted of \$30 million of Series C Floating Rate Notes ("Series C Notes") due December 21, 2036, and \$5 million of Series B Notes. These Series C Notes accrue interest only until the Orkney Re II Notes are fully repaid. SRGL owns \$0.5 million Series D Convertible Notes due December 21, 2036, and 76,190,000 Preference Shares of \$1.00 each in capital.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

Interest on the principal amount of the Orkney Re II Notes is payable quarterly at a rate equivalent to three-month LIBOR plus 0.425% for the Series A-1 Notes, three-month LIBOR plus 0.73% for the Series A-2 Notes, and three-month LIBOR plus 3.0% for the Series B Notes. At September 30, 2010, the interest rate on the Series A-1 Notes was 0.83% (compared to 0.70% at December 31, 2009), Series A-2 Notes was 1.13% (compared to 1.00% at December 31, 2009), and Series B Notes was 3.48% (compared to 3.27% at December 31, 2009). The Orkney Re II Notes also contain customary limitations on lien provisions and customary events of default provisions, which, if breached, could result in the accelerated maturity of the Orkney Re II Notes. Orkney Re II has the option to redeem all or a portion of the Orkney Re II Notes, subject to certain call premiums and available (unencumbered) funds.

In accordance with FASB ASC 810-10, Orkney Re II is considered to be a variable interest entity, and we are considered to hold the primary beneficial interest (as we cede all the business assumed by Orkney Re II), following an analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Orkney Re II is consolidated in our financial statements. The assets of Orkney Re II consist of fixed-maturity investments and cash and cash equivalents. Our Consolidated Statements of Income shows the investment returns of Orkney Re II as investment income, and the cost of the securitization structure is reflected in collateral finance facilities expense. Funds in the securitizations are primarily used for the purpose of the securitizations and, hence, are not available for general corporate purposes.

To the extent we experience significant fair value declines in our investment portfolio, we may need to recapture a pro-rata portion of the underlying business in Orkney Re II and find alternative collateral support for the recaptured business. No assurances can be given that we would be successful in securing such alternative collateral support.

Orkney Re II Event of Default, Acceleration and Foreclosure

On the scheduled interest payment date of May 11, 2009, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. Failure to make such payments in full when due constitutes an event of default under the Orkney Re II indenture ("Orkney EOD"). Assured, in its capacity as financial guarantor of the Series A-1 Notes, made guarantee payments on the Series A-1 Notes in the amount of \$1.2 million. As a result of the Orkney EOD, Assured obtained, and will continue to have, certain enhanced contractual rights under the transaction documents and additional fees will be accrued for the guarantee coverage.

Among Assured's enhanced contractual rights are (a) the right to instruct the trustee to declare the principal of and the interest on all the Notes to be due and payable immediately and (b) the right to foreclose upon the Collateral (as defined in the related indenture). On June 1, 2009, Assured instructed the trustee to accelerate the Notes and the trustee delivered a notice of acceleration to Orkney Re II on June 18, 2009. On June 19, 2009, Assured notified Orkney Re II and the trustee that it was electing to foreclose upon the Collateral.

Following these actions, on June 26, 2009, SRUS exercised its contractual right under its agreements with Orkney Re II to withdraw all assets from the reserve credit trust established by Orkney Re II for the benefit of SRUS (which trust does not form part of the Collateral). The withdrawn assets were deposited into SRUS segregated accounts pursuant to the terms of the reinsurance agreement between SRUS and Orkney Re II (the "Orkney Re II Reinsurance Agreement"), where they are held in order to further secure Orkney Re II's obligations to SRUS under the Orkney Re II Reinsurance Agreement, including providing reserve credit to SRUS for the reinsurance liabilities that continue to be ceded to Orkney Re II and for certain other permissible uses under the Orkney Re II Reinsurance Agreement. The transfer of assets had no impact on our consolidated financial statements.

On the scheduled interest payment dates of August 11, 2009, November 12, 2009, February 11, 2010, May 11, 2010 and August 11, 2010, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. Assured made guarantee payments on the Series A-1 Notes in the amount of \$1.4 million, \$0.9 million, \$0.7 million, \$0.6 million and \$0.8 million, respectively.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes, see Note 16, “Subsequent Events”.

Consolidated collateral finance facilities and securitization structures

The following table reflects the significant balances attributable to the collateral finance facilities and securitization structures providing collateral support to us as of September 30, 2010:

(U.S. dollars in millions)	<u>Orkney I</u>	<u>Orkney Re II</u>	<u>Total</u>
Assets			
Fixed-maturity investments	\$ 1,143.5	\$ -	\$ 1,143.5
Funds withheld at interest	-	325.0	325.0
Cash and cash equivalents	49.9	1.6	51.5
All other assets	104.3	59.2	163.5
Total assets	<u>\$ 1,297.7</u>	<u>\$ 385.8</u>	<u>\$ 1,683.5</u>
Liabilities			
Reserves for future policy benefits	\$ 316.7	\$ 126.5	\$ 443.2
Collateral finance facilities.....	850.0	450.0	1,300.0
All other liabilities	20.4	17.4	37.8
Total liabilities	<u>\$ 1,187.1</u>	<u>\$ 593.9</u>	<u>\$ 1,781.0</u>

The assets listed in the foregoing table are subject to a variety of restrictions on their use, as set forth in, and governed by, the transaction documents for the applicable collateral finance facilities and securitization structures to which they relate. In addition, of the amounts set forth in total assets above, \$357.9 million and \$102.5 million, for Orkney I and Orkney Re II, respectively, have been excluded from the total investments of consolidated VIE amount on the Consolidated Balance Sheet of SRGL as at September 30, 2010. Such excluded amounts represent the assets projected to support the expected reinsurance liabilities of \$316.7 million and \$126.5 million, associated with business ceded to Orkney I and Orkney Re II, respectively. No assurances can be given that the expected reinsurance liabilities will not increase in the event of adverse mortality experience in our reinsurance agreements. Under certain circumstances, such adverse mortality experience may in future periods increase the amount of assets excluded from the total investments of consolidated VIE on the Consolidated Balance Sheet of SRGL. These reinsurance liabilities of Orkney I and Orkney Re II are eliminated from the Consolidated Balance Sheet of SRGL because they represent inter-company transactions.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

The following table reflects the significant balances attributable to the collateral finance facilities and securitization structures providing collateral support to us as of December 31, 2009:

(U.S. dollars in millions)	Orkney I	Orkney Re II	Total
Assets			
Fixed-maturity investments	\$ 1,001.1	\$ -	\$ 1,001.1
Funds withheld at interest	-	303.1	303.1
Cash and cash equivalents	113.1	1.9	115.0
All other assets	106.4	60.1	166.5
Total assets	<u>\$ 1,220.6</u>	<u>\$ 365.1</u>	<u>\$ 1,585.7</u>
Liabilities			
Reserves for future policy benefits	\$ 313.0	\$ 118.0	\$ 431.0
Collateral finance facilities.....	850.0	450.0	1,300.0
All other liabilities	33.9	10.8	44.7
Total liabilities	<u>\$ 1,196.9</u>	<u>\$ 578.8</u>	<u>\$ 1,775.7</u>

The following tables reflect the significant income statement amounts attributable to the collateral finance facilities and securitization structures providing collateral support to us for the three and nine months ended September 30, 2010:

Three months ended September 30, 2010

(U.S. dollars in millions)	Orkney I	Orkney Re II	Total
Revenues			
Premiums earned, net	\$ 21.6	\$ 9.2	\$ 30.8
Investment income, net	5.7	3.6	9.3
Net realized and unrealized gains (losses)	25.4	(0.7)	24.7
Net embedded derivative adjustments.....	-	8.8	8.8
Total revenues	<u>\$ 52.7</u>	<u>\$ 20.9</u>	<u>\$ 73.6</u>
Expenses			
Claims and other policy benefits	\$ 21.2	\$ 8.3	\$ 29.5
Amortization of deferred acquisition costs and other insurance expenses, net	4.6	1.9	6.5
Operating expenses	-	0.1	0.1
Collateral finance facilities expenses ..	4.0	2.4	6.4
Total benefits and expenses.....	<u>\$ 29.8</u>	<u>\$ 12.7</u>	<u>\$ 42.5</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

Nine months ended September 30, 2010

(U.S. dollars in millions)	Orkney I	Orkney Re II	Total
Revenues			
Premiums earned, net	\$ 64.6	\$ 37.9	\$ 102.5
Investment income, net	17.6	13.6	31.2
Net realized and unrealized gains (losses)	72.6	(0.9)	71.7
Net embedded derivative adjustments.....	-	17.1	17.1
Total revenues	<u>\$ 154.8</u>	<u>\$ 67.7</u>	<u>\$ 222.5</u>
Expenses			
Claims and other policy benefits	\$ 56.3	\$ 29.4	\$ 85.7
Amortization of deferred acquisition costs and other insurance expenses, net	13.6	8.4	22.0
Operating expenses	0.2	0.3	0.5
Collateral finance facilities expenses ..	11.4	6.9	18.3
Total benefits and expenses.....	<u>\$ 81.5</u>	<u>\$ 45.0</u>	<u>\$ 126.5</u>

The following tables reflect the significant income statement amounts attributable to the collateral finance facilities and securitization structures providing collateral support to us for the three and nine months ended September 30, 2009:

Three months ended September 30, 2009

(U.S. dollars in millions)	Orkney I	Orkney Re II	Total
Revenues			
Premiums earned, net	\$ 24.0	\$ 10.9	\$ 34.9
Investment income, net	4.7	2.8	7.5
Net realized and unrealized gains (losses)	54.6	(2.3)	52.3
Total revenues	<u>\$ 83.3</u>	<u>\$ 11.4</u>	<u>\$ 94.7</u>
Expenses			
Claims and other policy benefits	\$ 22.4	\$ 6.9	\$ 29.3
Amortization of deferred acquisition costs and other insurance expenses, net	5.7	2.1	7.8
Operating expenses	-	-	-
Collateral finance facilities expenses ..	4.6	2.7	7.3
Total benefits and expenses.....	<u>\$ 32.7</u>	<u>\$ 11.7</u>	<u>\$ 44.4</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

14. Collateral Finance Facilities (continued)

Nine months ended September 30, 2009

(U.S. dollars in millions)	Orkney I	Orkney Re II	Total
Revenues			
Premiums earned, net	\$ 68.3	\$ 41.2	\$ 109.5
Investment income, net	17.4	8.4	25.8
Net realized and unrealized gains (losses)	51.0	(30.3)	20.7
Total revenues	<u>\$ 136.7</u>	<u>\$ 19.3</u>	<u>\$ 156.0</u>
Expenses			
Claims and other policy benefits	\$ 60.4	\$ 25.1	\$ 85.5
Amortization of deferred acquisition costs and other insurance expenses, net	15.3	8.9	24.2
Operating expenses	0.2	0.3	0.5
Collateral finance facilities expenses ..	16.6	9.5	26.1
Total benefits and expenses	<u>\$ 92.5</u>	<u>\$ 43.8</u>	<u>\$ 136.3</u>

15. Commitments and Contingencies

Indemnification

In connection with an examination of the statutory financial statements of certain of our operating insurance subsidiaries, and, specifically, the purchase accounting entries made in connection with the 2004 acquisition of the ING business, we determined that certain intercompany receivables and intercompany claims were not reflected in the statutory financial statements of SRUS and SRD in accordance with applicable statutory accounting practices. Management determined that, as a result of these errors, the statutory surplus for SRD was overstated on a cumulative basis at year-end 2004, 2005 and 2006, resulting in a restated statutory surplus at year-end 2006 of approximately \$285 million, after giving effect to these corrections.

In addition, management determined that the statutory surplus for SRUS was understated on a cumulative basis at year-end 2005 and 2006, resulting in a restated statutory surplus at year-end 2006 of approximately \$344 million, after giving effect to these corrections.

The restated statutory surplus of each of SRUS and SRD met the applicable minimum statutory surplus requirements at December 31, 2006. None of these corrections impacted our historical consolidated financial statements under U.S. GAAP.

Pursuant to the Agreement with MassMutual Capital and Cerberus, we made certain representations and warranties regarding the statutory financial statements of each of our insurance subsidiaries, including SRD and SRUS, for the years ended 2003, 2004, and 2005 and, with respect to SRUS but not SRD, the first three quarters of 2006, including that these statements were prepared in conformity with applicable statutory accounting practices and fairly present, in accordance with such practices and in all material respects, the statutory financial condition of the relevant insurance subsidiary at the respective dates. In light of our discovery of the corrections described above, we notified MassMutual Capital and Cerberus, as required by the terms of the Agreement, of the misstatement of reported statutory surplus in SRD at year-end 2004 and year-end 2005 resulting in a cumulative overstatement for the two year period at year-end 2005 of approximately \$70 million on an after-tax basis, and the understatement of

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

15. Commitments and Contingencies (continued)

statutory surplus in SRUS for the year ended December 31, 2005 of approximately \$14.5 million on an after-tax basis. On November 16, 2007, MassMutual Capital and Cerberus responded by notifying us of their concern that the corrections described above may constitute breaches of certain of the representations and warranties made by us in the Agreement. Under the Agreement, in the event of a claim for losses resulting from a diminution in value, such losses would be determined by an independent investment banking firm of national reputation, agreed upon by us and MassMutual Capital and Cerberus, based on changes in the valuation of SRGL using the assumptions and models used by MassMutual Capital and Cerberus at the time of their decision to invest in us. Furthermore, should any claim for indemnification be made by MassMutual Capital and Cerberus, the Agreement provides that any decision regarding defending or settling such claim will be taken by a committee of independent directors of our Board of Directors. In their November 16, 2007 correspondence, MassMutual Capital and Cerberus requested that we convene a committee of independent directors. No action has since been taken by us or MassMutual Capital and Cerberus in respect of this claim. At this time, we do not know what the amount of any indemnifiable losses would be, if any, or what potential defenses or other limitations on indemnification may be available to us under those circumstances. The Agreement provides that any indemnification claim would be satisfied by adjusting the conversion amount at which the Convertible Cumulative Participating Preferred Shares issued to MassMutual Capital and Cerberus are convertible into our Ordinary Shares.

16. Subsequent Events

The subsequent events disclosed in these notes to the consolidated financial statements have been evaluated by management up to and including the publication of the financial statements on November 19, 2010.

Orkney Re

Subsequent to September 30, 2010, Orkney Re changed its intent to hold its investments for a period of time sufficient to recover the statutory accounting amortized cost basis of its investments. This change in intent caused Orkney Re to record other-than temporary impairments (“OTTIs”) of approximately \$115 million, which represented the difference between the amortized cost bases and the fair values of Orkney Re’s investments. Orkney Re recorded the OTTIs as realized losses in its statutory accounting basis financial statements for the nine months ended September 30, 2010, but this change in intent and the resulting statutory basis losses did not affect our financial statements or the results of our operations because the investments were classified as held for trading and were already carried at fair value in our consolidated financial statements. The statutory losses reduced Orkney Re’s statutory surplus from \$992 million to \$877 million and reduced its company action level Risk Based Capital ratio by approximately 10%, to 2,076%.

Orkney Re II

On the scheduled interest payment date of November 11, 2010, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. As a result, Assured made guarantee payments on the Series A-1 Notes in the amount of \$0.8 million.

Deferral of Interest Payments on Floating Rate Capital Securities and Trust Preferred Securities

Subsequent to September 30, 2010, we have accrued and deferred payment of an additional \$0.2 million of interest on our floating rate capital securities and trust preferred securities. As of November 19, 2010, we have accrued and deferred payment on a total of \$10.4 million of interest.

Non-declaration of Perpetual Preferred Shares Dividends

In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, our Board was precluded from declaring and paying dividends on the October 15, 2010 dividend payment date. As discussed in

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2010

16. Subsequent Events (continued)

Note 9, “Non-cumulative Perpetual Preferred Shares”, the holders of the Perpetual Preferred Shares continue to be entitled, pursuant to the terms of and subject to the procedures set forth in the Certificate of Designations for the Perpetual Preferred Shares, to elect two directors to our Board as a result of dividends on the Perpetual Preferred Shares having not been declared and paid for six or more dividend periods. This right has not been validly exercised to date.