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**SCOTTISH RE GROUP LIMITED**  
**CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2013**

*(These consolidated financial statements are unaudited.)*

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## Table of Contents

Consolidated Balance Sheets – March 31, 2013 (unaudited) and December 31, 2012.....	2
Consolidated Statements of Operations – Three month period ended March 31, 2013 and 2012 (unaudited) .....	3
Consolidated Statements of Shareholders’ Deficit – Three month period ended March 31, 2013 and 2012 (unaudited) .....	4
Consolidated Statements of Cash Flows - Three month period ended March 31, 2013 and 2012 (unaudited) .....	5
Notes to Consolidated Financial Statements (unaudited) .....	6

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

	March 31, 2013 (Unaudited)	December 31, 2012 (Audited)
<b>Assets</b>		
Fixed-maturity investments held as trading securities, at fair value .....	\$ 1,786,121	\$ 1,733,224
Preferred stock held as trading securities, at fair value .....	1,710	2,387
Cash and cash equivalents .....	344,982	368,809
Other investments .....	29,603	19,067
Funds withheld at interest .....	476,709	482,985
Total investments <sup>1</sup> .....	2,639,125	2,606,472
Accrued interest receivable <sup>2</sup> .....	13,567	12,979
Reinsurance balances receivable .....	117,052	129,159
Deferred acquisition costs .....	159,573	162,181
Amounts recoverable from reinsurers .....	711,905	705,703
Present value of in-force business .....	23,565	24,001
Other assets .....	7,451	7,911
Total assets .....	<u>\$ 3,672,238</u>	<u>\$ 3,648,406</u>
<b>Liabilities</b>		
Reserves for future policy benefits .....	\$ 1,365,177	\$ 1,329,120
Interest-sensitive contract liabilities .....	1,084,653	1,104,413
Collateral finance facility <sup>3</sup> .....	450,000	450,000
Accounts payable and other liabilities .....	56,616	51,917
Embedded derivative liabilities, at fair value .....	22,574	26,290
Reinsurance balances payable .....	72,197	72,611
Deferred tax liabilities .....	42,303	43,129
Long-term debt, at par value .....	116,500	129,500
Total liabilities .....	<u>3,210,020</u>	<u>3,206,980</u>
<b>Mezzanine Equity</b>		
Convertible cumulative participating preferred shares, par value \$0.01; 1,000,000 shares issued and outstanding with \$600.0 million initial stated value (liquidation preference: 2013 - \$781.6 million; 2012 - \$770.7 million) .....	555,857	555,857
<b>Shareholders' Deficit</b>		
Ordinary shares, par value \$0.01; 68,383,370 shares issued and outstanding .....	684	684
Non-cumulative perpetual preferred shares, par value \$0.01: Shares issued and outstanding: 3,246,776 shares in 2013 and 2012) .....	81,169	81,169
Additional paid-in capital .....	1,218,190	1,218,190
Retained deficit .....	(1,393,682)	(1,414,474)
Total shareholders' deficit .....	<u>(93,639)</u>	<u>(114,431)</u>
Total liabilities, mezzanine equity, and total shareholders' deficit .....	<u>\$ 3,672,238</u>	<u>\$ 3,648,406</u>
<sup>1</sup> Includes total investments of consolidated variable interest entity ("VIE") .....	\$ 304,246	\$ 296,476
<sup>2</sup> Includes accrued interest receivable of consolidated VIE .....	510	488
<sup>3</sup> Reflects collateral finance facility of consolidated VIE .....	450,000	450,000

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

**SCOTTISH RE GROUP LIMITED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

(Expressed in Thousands of United States Dollars)

	<b>Three month period ended</b>	
	<b>March 31, 2013</b>	<b>March 31, 2012</b>
<b>Revenues</b>		
Premiums earned, net .....	\$ 81,763	\$ 73,242
Investment income, net .....	22,579	29,005
Net realized and unrealized gains.....	27,554	23,977
Gain on extinguishment of long-term debt.....	6,240	-
Change in fair value of embedded derivative assets and liabilities .....	3,716	2,971
Fees and other income.....	5,819	1,053
Total revenues .....	<u>147,671</u>	<u>130,248</u>
<b>Benefits and expenses</b>		
Claims, policy benefits, and changes in policyholder reserves, net.....	97,742	97,572
Interest credited to interest-sensitive contract liabilities.....	7,837	10,790
Amortization of deferred acquisition costs and other insurance expenses, net .....	10,982	10,867
Operating expenses .....	7,344	7,523
Collateral finance facilities expense.....	2,458	2,631
Interest expense.....	1,223	1,570
Total benefits and expenses.....	<u>127,586</u>	<u>130,953</u>
<b>Income (loss) before income taxes</b> .....	20,085	(705)
Income tax benefit.....	707	3,400
<b>Net income</b> .....	20,792	2,695
Gain on redemption of non-cumulative perpetual preferred shares .....	-	13,994
Net loss attributable to noncontrolling interest .....	-	439
<b>Net income attributable to Scottish Re Group Limited</b> .....	<u>\$ 20,792</u>	<u>\$ 17,128</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

(Expressed in Thousands of United States Dollars)

	<b>Three month period ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2013</b>	<b>2012</b>
<b>Share capital:</b>		
<b>Ordinary shares:</b>		
Beginning and end of period.....	\$ 684	\$ 684
<b>Non-cumulative perpetual preferred shares:</b>		
Beginning of period .....	81,169	120,152
Non-cumulative perpetual preferred shares redeemed.....	-	(38,873)
End of period .....	81,169	81,279
<b>Additional paid-in capital:</b>		
Beginning and end of period.....	\$ 1,218,190	\$ 1,218,190
<b>Retained deficit:</b>		
Beginning of period .....	(1,414,474)	(1,407,269)
Net income attributable to Scottish Re Group Limited.....	20,792	17,128
End of period .....	(1,393,682)	(1,390,141)
<b>Total Scottish Re Group Limited shareholders' deficit .....</b>	<b>\$ (93,639)</b>	<b>\$ (89,988)</b>
<b>Noncontrolling interest:</b>		
Beginning of period .....	-	8,859
Net loss attributable to noncontrolling interest.....	-	(439)
End of period .....	-	8,420
<b>Total shareholders' deficit .....</b>	<b>\$ (93,639)</b>	<b>\$ (81,568)</b>

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)

	<b>Three month period ended</b>	
	<b>March 31, 2013</b>	<b>March 31, 2012</b>
<b>Operating activities</b>		
Net income .....	\$ 20,792	\$ 2,695
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized and unrealized gains .....	(27,554)	(23,977)
Gain on extinguishment of long-term debt .....	(6,240)	-
Changes in value of embedded derivative assets and liabilities .....	(3,716)	(2,971)
Amortization of deferred acquisition costs .....	2,608	3,867
Amortization of present value of in-force business .....	436	548
Amortization of deferred finance facility costs .....	217	217
Depreciation of fixed assets .....	37	49
Changes in assets and liabilities:		
Funds withheld at interest .....	6,276	4,084
Other investments .....	(5,260)	-
Accrued interest receivable .....	(588)	456
Reinsurance balances receivable .....	12,107	33,760
Deferred acquisition costs .....	-	(1,160)
Other assets .....	207	270
Reserves for future policy benefits, net of amounts recoverable from reinsurers .....	29,855	18,908
Interest-sensitive contract liabilities .....	(2,889)	(1,615)
Accounts payable and other liabilities, including deferred tax liabilities .....	3,873	(4,340)
Reinsurance balances payable .....	(414)	(19,792)
Net cash used in operating activities .....	<u>29,747</u>	<u>10,999</u>
<b>Investing activities</b>		
Purchase of fixed-maturity investments .....	(103,085)	(65,183)
Proceeds from sales and maturities of fixed-maturity investments .....	77,672	121,991
Purchase of and proceeds from sales and maturities of preferred stock, net .....	794	51,797
Purchase of and proceeds from other investments, net .....	(5,276)	476
Net cash provided by investing activities .....	<u>(29,895)</u>	<u>109,081</u>
<b>Financing activities</b>		
Withdrawals from interest-sensitive contract liabilities .....	(16,919)	(13,285)
Redemption of non-cumulative perpetual preferred shares .....	-	(24,879)
Acquisition of long-term debt .....	(6,760)	-
Net cash used in financing activities .....	<u>(23,679)</u>	<u>(38,164)</u>
Net change in cash and cash equivalents .....	(23,827)	81,916
Cash and cash equivalents, beginning of period .....	368,809	282,028
Cash and cash equivalents, end of period .....	<u>\$ 344,982</u>	<u>\$ 363,944</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

#### 1. Organization, Run-Off Strategy and Business

##### *Organization*

Scottish Re Group Limited (“SRGL” and, together with SRGL’s consolidated subsidiaries and VIE, the “Company”, “we”, “our”, and “us”) is a holding company incorporated under the laws of the Cayman Islands, and our principal executive office is located in Bermuda. Through our operating subsidiaries, we are principally engaged in the reinsurance of life insurance, annuities, and annuity-type products. As of March 31, 2013, we have principal operating companies, holding companies, financing companies, and a collateral finance facility in Bermuda, the Cayman Islands, Ireland, Luxembourg, and the United States of America, as follows:

##### Bermuda

Scottish Re Life (Bermuda) Limited

##### Cayman Islands

SRGL

Scottish Annuity & Life Insurance Company (Cayman) Ltd. (“SALIC”)

##### Ireland

Scottish Re (Dublin) Limited

Orkney Re II plc (“Orkney Re II” or “VIE”)

##### Luxembourg

Scottish Financial (Luxembourg) S.á.r.l. (“SFL”)

Scottish Holdings (Luxembourg) S.á.r.l.

##### United States of America (“U.S.”)

Scottish Holdings, Inc. (“SHI”)

Scottish Re (U.S.), Inc. (“SRUS”)

Scottish Re Life Corporation (“SRLC”)

##### *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 continue to pursue a run-off strategy for our remaining business, whereby we receive premiums, pay claims, and perform key activities under our remaining reinsurance treaties.

While pursuing this strategy, the Company has purchased from time-to-time and, if opportunities arise, may in the future continue to purchase, in privately-negotiated transactions, open market purchases, or by means of general solicitations, tender offers, or otherwise, 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 and recent transactions, please refer to Note 7, “Debt Obligations and Other Funding Arrangements”, and to Note 9, “Shareholders’ Deficit”. Further, the Company may continue to evaluate strategic alternatives to increase shareholder value, which transactions, individually or in the aggregate, may be material.

##### *Business*

As disclosed in SRGL’s audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012, we have written reinsurance business that is wholly or partially retained in one or more of our reinsurance subsidiaries and have classified the reinsurance as Traditional Solutions or as Financial Solutions.

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

#### 2. Basis of Presentation

Accounting Principles - Our consolidated interim financial statements are prepared in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP"). Accordingly, these consolidated interim financial statements do not include all of the information and notes required by U.S. GAAP for annual financial statements. These unaudited consolidated interim financial statements should be read in conjunction with SRGL's audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012.

Consolidation - The consolidated financial statements include the assets, liabilities, and results of operations of SRGL, its subsidiaries, and the VIE 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 intercompany transactions and balances have been eliminated in consolidation. We currently consolidate one non-recourse securitization, Orkney Re II, a special purpose VIE incorporated under the laws of Ireland.

Noncontrolling Interest - The noncontrolling interest in the prior year represented the 5% of SRLC that was not owned by the Company prior to December 21, 2012, the date when the Company acquired the remaining 5% of SRLC from the previous owner and extinguished the noncontrolling interest.

Estimates and Assumptions - The preparation of consolidated interim 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 valuations;
- accounting for derivative instruments;
- assessment of risk transfer for structured insurance and reinsurance contracts;
- estimates of premiums;
- valuation of the 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; and
- current and deferred income taxes and the determination of associated valuation allowances.

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

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**3. Investments**

Other Investments as of March 31, 2013 represented policy loans, which are carried at the outstanding loan balances, investments in debt securities, and investments accounted for under the equity method, in accordance with FASB 323 Investments – Equity Method and Joint Ventures, for which the resulting equity method carrying value is deemed to approximate fair value.

The portion of net unrealized gains for the three month period ended March 31, 2013 and 2012 that relates to trading securities, which includes fixed-maturity investments and preferred stocks, still held at the reporting date was \$27.3 million and \$17.5 million, respectively.

**4. 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 provides 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), as described in Note 5, “Fair Value Measurements” in SRGL’s audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012, which, along with Note 3, “Investments” above, also includes additional disclosures regarding our fair value measurements.

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

	<b>March 31, 2013</b>			
<b>(U.S. dollars in millions)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Investments</b>				
Government securities .....	\$ -	\$ 35.9	\$ -	\$ 35.9
Corporate securities .....	-	674.5	71.9	746.4
Municipal bonds .....	-	42.1	-	42.1
Mortgage and asset-backed securities .....	-	595.1	366.6	961.7
Fixed-maturity investments .....	-	1,347.6	438.5	1,786.1
Preferred stock .....	-	1.7	-	1.7
<b>Total assets at fair value .....</b>	<b>\$ -</b>	<b>\$ 1,349.3</b>	<b>\$ 438.5</b>	<b>\$ 1,787.8</b>
<b>Embedded derivative liabilities .....</b>	<b>-</b>	<b>-</b>	<b>(22.6)</b>	<b>(22.6)</b>
<b>Total liabilities at fair value .....</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (22.6)</b>	<b>\$ (22.6)</b>

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

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

	<b>December 31, 2012</b>			
<b>(U.S. dollars in millions)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Investments .....				
Government securities.....	\$ -	\$ 36.3	\$ -	\$ 36.3
Corporate securities.....	-	677.6	74.2	751.8
Municipal bonds.....	-	36.3	5.4	41.7
Mortgage and asset-backed securities .....	-	583.3	320.1	903.4
Fixed-maturity investments.....	-	1,333.5	399.7	1,733.2
Preferred stock .....	-	2.4	-	2.4
Total assets at fair value .....	<u>\$ -</u>	<u>\$ 1,335.9</u>	<u>\$ 399.7</u>	<u>\$ 1,735.6</u>
Embedded derivative liabilities .....	-	-	(26.3)	(26.3)
Total liabilities at fair value.....	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (26.3)</u>	<u>\$ (26.3)</u>

The following tables present additional information about our assets and liabilities 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 three month period ended March 31, 2013**

<b>(U.S. dollars in millions)</b>	<b>Corporate securities</b>	<b>Municipal bonds</b>	<b>Mortgage and asset-backed securities</b>	<b>Preferred stock</b>	<b>Total assets at fair value</b>	<b>Total liabilities at fair value</b>
Beginning balance at January 1, 2013.....	\$ 74.2	\$ 5.4	\$ 320.1	\$ -	\$ 399.7	\$ (26.3)
Total realized and unrealized gains (losses) included in net income.....	(0.9)	-	26.2	-	25.3	3.7
Purchases .....	0.7	-	29.6	-	30.3	-
Settlements.....	(2.1)	-	(7.1)	-	(9.2)	-
Transfers in and/or (out of) Level 3, net .....	-	(5.4)	(2.2)	-	(7.6)	-
Ending balance at March 31, 2013.....	<u>\$ 71.9</u>	<u>\$ -</u>	<u>\$ 366.6</u>	<u>\$ -</u>	<u>\$ 438.5</u>	<u>\$ (22.6)</u>

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

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

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended  
December 31, 2012**

(U.S. dollars in millions)	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Preferred stock	Total assets at fair value	Total liabilities at fair value
Beginning balance at January 1, 2012.....	\$ 84.5	\$ 5.5	\$ 335.8	\$ 50.0	\$ 475.8	\$ (33.8)
Total realized and unrealized gains included in net income.....	1.2	-	99.0	-	100.2	7.5
Purchases .....	0.1	-	88.5	-	88.6	-
Settlements.....	(21.2)	(0.1)	(200.5)	(50.0)	(271.8)	-
Transfers in and/or (out of) Level 3, net .....	9.6	-	(2.7)	-	6.9	-
Ending balance at December 31, 2012...	<u>\$ 74.2</u>	<u>\$ 5.4</u>	<u>\$ 320.1</u>	<u>\$ -</u>	<u>\$ 399.7</u>	<u>\$ (26.3)</u>

Changes in classifications impacting Level 3 financial instruments were reported in the above tables as transfers in (out) of the Level 3 category at the end of each quarterly period in which the transfers occurred. The portion of net unrealized gains for the three month period ended March 31, 2013 and 2012 that related to Level 3 trading securities still held at the reporting date was \$25.4 million and \$5.5 million, respectively.

The following table summarizes the fair values (in millions), the valuation techniques, and the significant unobservable inputs of the Level 3 fair value measurements as of March 31, 2013 for which we have been able to obtain quantitative information about the significant unobservable inputs used in those fair value measurements:

**March 31, 2013**

Assets (U.S. dollars in millions)	Fair Value	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities .....	\$ 71.7	Discounted Cash Flow	Liquidity/duration adjustment*	0.7% - 5.3%
Mortgage and asset-backed securities .....	\$ 25.3	Discounted Cash Flow	Liquidity/duration adjustment*	1.8% - 3.5%

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

4. Fair Value Measurements (continued)

December 31, 2012

Assets (U.S. dollars in millions)	Fair Value**	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities .....	\$ 74.0	Discounted Cash Flow	Liquidity/duration adjustment*	0.7% - 9.0%
Mortgage and asset-backed securities .....	\$ 25.5	Discounted Cash Flow	Liquidity/duration adjustment*	2.1% - 3.5%

\* The liquidity/duration adjustment input represents an estimated market participant composite interest spread that would be applied to the risk-free rate to discount the estimated projected cash flows for individual securities, and such liquidity/duration adjustment would reflect adjustments attributable to liquidity premiums, expected durations, credit structures, credit quality, etc., as applicable.

\*\*The December 31, 2012 comparative fair value figures in the above table have been updated to reflect the correct allocation of the fair value amounts for corporate securities and mortgage and asset-backed securities.

We have excluded from the table above Level 3 fair value measurements obtained from independent, third-party pricing sources, including prices obtained from brokers, for which we do not develop the significant inputs used to measure the fair values, and where information regarding the significant inputs is not readily available to us from the independent, third-party pricing sources or brokers.

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**5. Fair Value of Financial Instruments**

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 on a non-recurring basis, in addition to those disclosed above in Note 3, "Investments" and Note 4, "Fair Value Measurements", are described in Note 6, "Fair Value of Financial Instruments" in SRGL's audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012. The following table sets forth the fair values of our financial instruments, as of the dates indicated:

(U.S. dollars in thousands)	March 31, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Assets</b>				
Fixed-maturity investments .....	\$ 1,786,121	\$ 1,786,121	\$ 1,733,224	\$ 1,733,224
Preferred stock .....	1,710	1,710	2,387	2,387
Other investments .....	29,603	29,603	19,067	19,067
Funds withheld at interest .....	476,709	476,709	482,985	482,985
<b>Liabilities</b>				
Interest-sensitive contract liabilities .....	1,084,653	1,082,979	\$ 1,104,413	\$ 1,102,704
Collateral finance facility .....	450,000	126,335	450,000	114,638
Embedded derivative liabilities .....	22,574	22,574	26,290	26,290
Long-term debt, at par value .....	116,500	69,152	129,500	69,370

**6. Collateral Finance Facility and Securitization Structure**

***Orkney Re II***

The following table reflects the significant balances included in the accompanying Consolidated Balance Sheets that were attributable to the Orkney Re II collateral finance facility and securitization structure:

(U.S. dollars in thousands)	March 31, 2013	December 31, 2012
<b>Assets</b>		
Funds withheld at interest .....	\$ 359,233	\$ 358,856
Cash and cash equivalents .....	2,051	2,253
All other assets .....	50,508	46,226
Total assets .....	<u>\$ 411,792</u>	<u>\$ 407,335</u>
<b>Liabilities</b>		
Reserves for future policy benefits .....	\$ 137,203	\$ 133,045
Collateral finance facility .....	450,000	450,000
All other liabilities .....	40,649	37,762
Total liabilities .....	<u>\$ 627,852</u>	<u>\$ 620,807</u>

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**6. Collateral Finance Facility and Securitization Structure (continued)**

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 Orkney Re II collateral finance facility and securitization structure. The total investments of the consolidated VIE disclosed in the accompanying Consolidated Balance Sheets include the following adjustments: (i) deduction of the assets needed to satisfy future policy benefits, based on current projections, and (ii) addition of the market value of consolidated assets held in a segregated account in excess of Orkney Re II's funds withheld at interest. The reinsurance liabilities of Orkney Re II have been eliminated from the Consolidated Balance Sheets.

Historical information regarding the Orkney Re II collateral finance facility and securitization structure is discussed in Note 9, "Collateral Finance Facilities and Securitization Structures – *Orkney Re II*" in SRGL's audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012.

***Orkney Re II Event of Default, Acceleration and Foreclosure***

Orkney Re II has been unable to make scheduled interest payments on its Series A-1 Notes on all scheduled quarterly interest payment dates since May 11, 2009. As of March 31, 2013, Assured Guaranty (UK) Ltd. ("Assured") has made guarantee payments in the cumulative amount of \$13.3 million on the Series A-1 Notes. We accrue this amount of cumulative interest in Accounts Payable and Other Liabilities on the Consolidated Balance Sheets. Interest on the Series A-1 Notes on which Assured is making guarantee payments is payable quarterly at a rate equivalent to three-month LIBOR plus 0.425% for the Series A-1 Notes. As of March 31, 2013, the interest rate on the Series A-1 Notes was 0.72% (compared to 0.74% as of December 31, 2012). For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes, please refer to Note 13, "Subsequent Events - *Orkney Re II*".

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**7. Debt Obligations and Other Funding Arrangements**

Long-term debt, at par value (the “Capital and Trust Preferred Securities”), is described in Note 10, “Debt Obligations and Other Funding Arrangements” in the notes accompanying SRGL’s audited consolidated financial statements for the year ended December 31, 2012. The pertinent details regarding long-term debt, at par value are shown in the following table:

(U.S. dollars in thousands)	Capital Securities Due 2032*	Preferred Trust Securities Due 2033*	Trust Preferred Securities Due 2033*	Trust Preferred Securities Due 2034*	Trust Preferred Securities Due December 2034*
Issuer of long-term debt.....	Capital Trust*	Capital Trust II*	GPIC Trust*	Capital Trust III*	SFL Trust I*
Long-term debt outstanding.....	\$17,500	\$20,000	\$10,000	\$19,000**	\$50,000
Maturity date .....	Dec 4, 2032	Oct 29, 2033	Sept 30, 2033	June 17, 2034	Dec 15, 2034
Redeemable (in whole or in part) after ....	Dec 4, 2007	Oct 29, 2008	Sept 30, 2008	June 17, 2009	Dec 15, 2009
Interest Payable .....	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly
Interest rate: 3-month LIBOR + .....	4.00%	3.95%	3.90%	3.80%	3.50%
Interest rate as of March 31, 2013 .....	4.28%	4.23%	4.18%	4.08%	3.78%
Interest rate as of December 31, 2012 .....	4.31%	4.26%	4.21%	4.11%	3.81%
Maximum number of quarters for which interest may be deferred.....	20	20	20	20	20
Number of quarters for which interest has been deferred as of March 31, 2013.....	1	1	1	1	1

\* Defined in the notes accompanying SRGL’s audited consolidated financial statements for the year ended December 31, 2012.

\*\*SRGL owns \$13.0 million of the Trust Preferred Securities Due 2034 securities, as further explained in this Note.

***Deferral of Interest Payments on the Capital and Trust Preferred Securities***

We began deferring interest payments as of January 29, 2013 on the Capital and Trust Preferred Securities as permitted by the terms of the indentures governing the securities. As of March 31, 2013, we have accrued and deferred net payments of \$1.2 million in interest on the Capital and Trust Preferred Securities. SHI, SFL and SALIC generally are restricted in their ability to make certain dividend payments and payments in respect of obligations ranking junior or *pari passu* to the Capital and Trust Preferred Securities in any period where interest payment obligations on these securities are not current.

For discussion of relevant actions taken by our Board of Directors (the “Board”) subsequent to March 31, 2013, please refer to Note 13, “Subsequent Events – *Deferral of Interest Payments on the Capital and Trust Preferred Securities*”.

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**7. Debt Obligations and Other Funding Arrangements (continued)**

***Capital and Trust Preferred Securities***

On January 31, 2013, SRGL agreed to acquire, in a private transaction, approximately \$13.0 million in aggregate liquidation amount of Trust Preferred Securities Due 2034, at a purchase price of \$520.00 per security (i.e., 52% of the \$1,000 per security liquidation amount). Consequently, in accordance with FASB ASC 405, Extinguishment of Liabilities, the Company recorded a \$6.2 million gain on the extinguishment of long-term debt in the first quarter of 2013.

**8. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares**

We accounted for the 2007 issuance of Convertible Cumulative Participating Preferred Shares (the “CCPP Shares”) to affiliates of MassMutual Capital Partners LLC and Cerberus Capital Management, L.P. (“Cerberus”, and together with MassMutual Capital Partners LLC, the “Investors”), in accordance with FASB ASC Subtopic 470-20, Debt – Debt with Conversion and Other Options (“FASB ASC 470-20”), which incorporates EITF D-98: “Classification and Measurement of Redeemable Securities”.

On December 12, 2012, our Board resolved to declare and pay dividends on our Ordinary Shares (as discussed in more detail in Note 9, “Shareholders’ Deficit – *Dividends on Ordinary Shares*”). As a result, the holders of the CCPP Shares were also entitled to receive dividends on an as-converted basis, and our Board also resolved to declare and pay dividends on the CCPP Shares, in accordance with the Certificate of Designations related to the CCPP Shares. The aggregate amount of the dividend declared was \$110.0 million, with \$75.6 million allocated to the CCPP Shares, and such dividends were paid on December 20, 2012. The payment of the dividend, which represented a portion of the accreted cumulative participating dividends on the CCPP Shares, resulted in a corresponding reduction to the liquidation preference of the CCPP Shares. As of March 31, 2013, the amount of dividends accreted pursuant to the terms of the CCPP Shares, after giving effect to the payment of the December 20, 2012 dividend, was \$181.6 million in the aggregate, or \$181.58 per share. For further discussion and additional disclosures regarding the CCPP Shares, please refer to Note 11, “Mezzanine Equity – Convertible Cumulative Participating Preferred Shares” in the notes accompanying SRGL’s audited consolidated financial statements for the year ended December 31, 2012.

**9. Shareholders’ Deficit**

***Ordinary Shares***

We are authorized to issue 590,000,000 ordinary shares (the “Ordinary Shares”) with a par value of \$0.01 per share.

The following table summarizes the activity in the Ordinary Shares during the three month period ended March 31, 2013 and the year ended December 31, 2012:

	<b>Three Month Period Ended March 31, 2013</b>	<b>Year Ended December 31, 2012</b>
<b>Ordinary shares</b>		
Beginning and end of period/year .....	<u>68,383,370</u>	<u>68,383,370</u>

**SCOTTISH RE GROUP LIMITED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**March 31, 2013**

**9. Shareholders' Deficit (continued)**

***Perpetual Preferred Shares***

We are authorized to issue 50,000,000 preferred shares with a par value of \$0.01 per share.

In 2005, we issued 5,000,000 non-cumulative Perpetual Preferred Shares (the "Perpetual Preferred Shares"). Gross proceeds were \$125 million, and related expenses were \$4.6 million.

The dividend rate on the Perpetual Preferred Shares 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. The quarterly floating rates from March 31, 2012 through March 31, 2013 ranged between 6.07% and 6.63%. 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 the Ordinary Shares and no Ordinary Shares or other junior shares may be purchased, redeemed, or otherwise acquired for consideration by SRGL.

The following table summarizes the activity in our Perpetual Preferred Shares during the three month period ended March 31, 2013 and the year ended December 31, 2012:

	<b>Three Month Period Ended March 31, 2013</b>	<b>Year Ended December 31, 2012</b>
<b>Perpetual Preferred Shares</b>		
Beginning of year.....	3,246,776	4,806,083
Perpetual Preferred Shares redeemed.....	-	(1,559,307)
End of period/year.....	3,246,776	3,246,776

On February 10, 2012, SRGL agreed to acquire, in a privately-negotiated transaction, approximately \$18.8 million in aggregate liquidation preference of its Perpetual Preferred Shares, with a liquidation preference of \$25.00 per share, at a purchase price of \$16.00 per share (the "Privately-Negotiated Transaction"). The Privately-Negotiated Transaction settled on February 13, 2012, and the related Perpetual Preferred Shares subsequently were redeemed by SRGL. Subsequent to the execution of the Privately-Negotiated Transaction, SRGL launched on February 10, 2012 a cash tender offer to purchase any and all of its then-outstanding Perpetual Preferred Shares (other than those acquired pursuant to the Privately-Negotiated Transaction) at the same per share price as the Privately-Negotiated Transaction (i.e., \$16.00 per share). The tender offer was made to all holders of such Perpetual Preferred Shares upon the terms and subject to the conditions set forth in the related Offer to Purchase, dated February 10, 2012 (the "Offer to Purchase"), and the related Letter of Transmittal, dated February 10, 2012 (together with the Offer to Purchase, the "Perpetual Preferred Share Offer").

In connection with the expiration of the Perpetual Preferred Share Offer on March 9, 2012, holders of Perpetual Preferred Shares with an aggregate liquidation preference of approximately \$20.1 million tendered their Perpetual Preferred Shares and SRGL accepted for purchase all such tendered Perpetual Preferred Shares. Payment in respect of the tendered Perpetual Preferred Shares was made on March 13, 2012, and all such shares subsequently were redeemed by SRGL.

Following the completion of the Perpetual Preferred Share Offer, SRGL agreed to acquire, in separate open-market transactions, approximately \$110.0 thousand in aggregate liquidation preference of its Perpetual Preferred Shares, at an average purchase price of \$14.93 per share.

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

#### 9. Shareholders' Deficit (continued)

As a result of the foregoing transactions, a gain on the redemption of Perpetual Preferred Shares of approximately \$14.0 million was recorded as a component of net income attributable to SRGL for the year ended December 31, 2012.

##### *Dividends on Ordinary Shares*

The Investors, as the holders of the Ordinary Shares, are entitled to receive dividends and are allowed one vote per share subject to certain restrictions in our Memorandum and Articles of Association.

On December 12, 2012, our Board resolved to declare and pay dividends on the Ordinary Shares in the amount of \$34.4 million, and such dividends were paid on December 20, 2012.

All future payments of dividends are at the discretion of our Board and will depend on such factors as the Board may deem relevant. Notwithstanding the foregoing, if dividends on the Perpetual Preferred Shares have not been declared and paid (or declared and a sum sufficient for the payment thereof set aside) for a dividend period, we generally are precluded from paying or declaring any dividend on the Ordinary Shares.

##### *Dividends on Perpetual Preferred Shares*

Although permitted in accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares to declare and pay a dividend in connection with the 2011 dividend payment dates and on the January 15, 2012, April 15, 2012, and July 15, 2012 dividend payment dates, our Board resolved not to declare and pay a dividend on such dates. 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, consecutive or not (a "Nonpayment"). Failure to declare and pay dividends on the July 15, 2009 dividend payment date marked the sixth dividend period for which dividends had not been declared and paid (i.e., a Nonpayment), as our Board was precluded from declaring and paying dividends on each of the 2009 and 2010 dividend payment dates, in accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares.

On September 24, 2012, our Board resolved to declare and pay a dividend on the Perpetual Preferred Shares, in accordance with the Certificate of Designations related to the Perpetual Preferred Shares. The amount of the dividend declared was \$1.2 million and the dividend was paid on the October 15, 2012 dividend payment date. There can be no assurances that we will make subsequent dividend payments on the Perpetual Preferred Shares, either at our Board's discretion or as a result of the application of the financial tests contained in 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 a dividend on the January 15, 2013 dividend payment date.

If and when dividends for at least four dividend periods, whether or not consecutive, following a Nonpayment have been paid in full, then the right of the holders of the Perpetual Preferred Shares to elect directors to the Company's Board shall cease. The right to elect two directors to our Board has not been exercised as of March 31, 2013.

For further discussion on the non-declaration of the Perpetual Preferred Shares dividends, please refer to Note 13, "Subsequent Events – *Non-declaration of Dividend on Perpetual Preferred Shares*".

# SCOTTISH RE GROUP LIMITED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

### 10. Income Taxes

The income tax benefit for the three month period ended March 31, 2013 and 2012 was \$0.7 million and \$3.4 million, respectively. Any net income from the operations of our Cayman Island entities are not subject to income tax. The operations of our U.S., Bermuda 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 month periods ended March 31, 2013 and 2012 were principally due to a reduction of the deferred tax liability for items reversing outside of the 15 year net operating loss (“NOL”) carryforward period in the U.S.

As of March 31, 2013, we had total unrecognized tax benefits (excluding interest and penalties) of \$3.1 million, the recognition of which would result in a \$1.5 million benefit at the effective tax rate for the applicable period. The total unrecognized tax benefits figure (excluding interest and penalties) and the resulting tax benefit recognition figure were unchanged from December 31, 2012. As of March 31, 2012, we had total unrecognized tax benefits (excluding interest and penalties) of \$109.5 million, the recognition of which would result in a \$4.2 million benefit at the effective tax rate for the applicable period. The total unrecognized tax benefits figure (excluding interest and penalties) and the resulting tax benefit recognition figure were unchanged from December 31, 2011.

Our deferred tax assets are principally supported by the reversal of deferred tax liabilities. We currently provide a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all, of our deferred tax assets will not be realized. We have maintained a full valuation allowance against any remaining deferred tax asset associated with our operations in the U.S. and Ireland, given our inability to rely on future taxable income projections and the scheduling of our current deferred tax liabilities.

As of March 31, 2013 and December 31, 2012, our deferred tax liabilities included \$42.3 million and \$43.1 million, respectively, of deferred tax liabilities that reverse after the expiration of net operating loss carryforwards in applicable jurisdictions, and, therefore, cannot support deferred tax assets.

We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of March 31, 2013, 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 insurance (“U.S. Life Group”) .....	2010 through 2012
Non-Life Group .....	2009 through 2012
Ireland .....	2008 through 2012

Our U.S. subsidiaries are subject to U.S. federal, state, and local corporate income taxes and other taxes applicable to U.S. corporations. Upon distribution of current or accumulated earnings and profits in the form of dividends or otherwise from our U.S. subsidiaries to us, we would be subject to U.S. withholding taxes at a 30% rate.

Net U.S. operating losses are being carried forward from closed years and could be examined by the Internal Revenue Service (“IRS”) when utilized in an open year in the future. Additionally, to the extent that a NOL has been carried back to an otherwise closed year, that earlier year could be subject to examination as long as the loss year remains open.

Further information regarding recent IRS activity is discussed in Note 14, “Income Taxes”, in SRGL’s consolidated financial statements and accompanying notes thereto for the year ended December 31, 2012.

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

#### 11. Commitments and Contingencies

##### *Ballantyne Re plc*

The Company remains liable for certain ongoing covenants and indemnities, as well as the accuracy and performance of certain representations, warranties, and other obligations to or for the benefit of Security Life of Denver Insurance Company, Ballantyne Re plc (“Ballantyne Re”), and the financial guarantors of certain of the notes issued by Ballantyne Re, as applicable.

The structure and historical information for Ballantyne Re are described in Note 9, “Collateral Finance Facilities and Securitization Structures – *Ballantyne Re*”, accompanying SRGL’s audited consolidated financial statements for the year ended December 31, 2012.

##### *Indemnification of Our Directors, Officers, Employees, and Agents*

We indemnify our directors, officers, employees, and agents against any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, by reason of the fact that they are our director, officer, employee, or agent, as provided in our articles of association. As of March 31, 2013, there is no current action, suit, or proceeding, whether civil, criminal, administrative, or investigative, against any of our directors, officers, employees, and agents.

Since this indemnity generally is not subject to limitation with respect to duration or amount, we do not believe it is possible to determine the maximum potential amount due under this indemnity in the future.

#### 12. Related Party Transactions

##### *Investment in Cerberus Affiliated Fund*

On March 26, 2012, SALIC executed subscription documents pursuant to which SALIC committed to make an investment of up to an aggregate \$30.0 million in an investment fund affiliated with and controlled, directly or indirectly, by Cerberus (the “Cerberus Affiliated Fund”). As of March 31, 2013, SALIC had invested \$19.1 million of its total commitment, which investment is included in Other Investments on the accompanying Consolidated Balance Sheets at a carrying value of \$26.3 million.

For further discussion on the Cerberus Affiliated Fund, please refer to Note 13, “Subsequent Events – *Investment in Cerberus Affiliated Fund*”.

#### 13. Subsequent Events

The subsequent events disclosed in these notes to the consolidated financial statements have been evaluated by Company management up to and including the filing of these consolidated financial statements on, May 14, 2013.

##### *Non-declaration of Dividends on 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 a dividend on the April 15, 2013 dividend payment date.

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2013

#### 13. Subsequent Events (continued)

##### *Deferral of Interest Payments on the Capital and Trust Preferred Securities*

Subsequent to March 31, 2013, we have accrued and deferred payment of an additional \$0.2 million of interest on our Capital and Trust Preferred Securities (as outlined in Note 7, “Debt Obligations and Other Funding Arrangements”). These deferrals are permitted by terms of the indentures governing the Capital and Trust Preferred Securities and have been made at the discretion of our Board. As of May 14, 2013, we had accrued and deferred a net payment on a total of \$1.4 million of interest on our Capital and Trust Preferred Securities.

##### *Orkney Re II*

Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes on the May 11, 2013 scheduled interest payment date. As a result, Assured made guarantee payments on the Series A-1 Notes for such scheduled interest payment date in the amount of \$0.7 million.

##### *Plan of Merger of Subsidiaries*

On January 14, 2013, SRUS and its wholly-owned subsidiary, SRLC, entered into an Agreement and Plan of Merger. Upon the terms and subject to the conditions therein, including receipt of all required approvals, and in accordance with the provisions of Section 253 of the Delaware General Corporation Law and Section 4930 of the Delaware Insurance Code, SRLC will be merged with and into SRUS, with SRUS continuing as the surviving corporation (the “SRUS/SRLC Merger”). On May 8, 2013, SRUS and SRLC received the Final Order and Decision of the Insurance Commissioner of the State of Delaware, approving the SRUS/SRLC Merger. The SRUS/SRLC Merger is expected to become effective prior to June 30, 2013; however, there can be no assurance that the conditions to effectiveness, including obtaining the approval of the Insurance Commissioner of the State of California, will be satisfied by such time, if at all. The SRUS/SRLC Merger will have no effect on the Company’s consolidated financial position and results of operations.

##### *Investment in Cerberus Affiliated Fund*

On May 9, 2013, the Cerberus Affiliated Fund returned to SALIC \$4.0 million of its capital commitment investment. Because this return of investment is recallable in the future, the amount will be added back to SALIC’s remaining commitment to the Cerberus Affiliated Fund. As of May 14, 2013, SALIC had invested \$15.1 million of its total commitment of \$30.0 million.