
SCOTTISH RE GROUP LIMITED
CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2014

(These consolidated financial statements are unaudited.)

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

	March 31, 2014 (Unaudited)	December 31, 2013 (Audited)
Assets		
Fixed-maturity investments held as trading securities, at fair value	\$ 1,782,722	\$ 1,789,343
Preferred stock held as trading securities, at fair value	1,255	1,138
Cash and cash equivalents	266,897	247,409
Other investments	22,942	21,695
Funds withheld at interest	453,749	459,777
Total investments ¹	2,527,565	2,519,362
Accrued interest receivable ²	12,539	12,587
Reinsurance balances and risk fees receivable	107,306	128,319
Deferred acquisition costs	150,373	153,229
Amounts recoverable from reinsurers	693,534	695,163
Present value of in-force business	22,010	22,215
Other assets	6,243	6,597
Total assets	<u>\$ 3,519,570</u>	<u>\$ 3,537,472</u>
Liabilities		
Reserves for future policy benefits	\$ 1,320,423	\$ 1,332,960
Interest-sensitive contract liabilities	1,008,666	1,026,307
Collateral finance facility ³	450,000	450,000
Accounts payable and other liabilities ⁴	71,117	65,944
Embedded derivative liabilities, at fair value	15,845	18,230
Reinsurance balances payable	57,225	65,796
Deferred tax liability	27,606	37,532
Long-term debt, at par value	116,500	116,500
Total liabilities	<u>3,067,382</u>	<u>3,113,269</u>
Mezzanine Equity		
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: 2014 - \$825.1 million; 2013 - \$814.2 million)	555,857	555,857
Shareholders' Deficit		
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 issued and outstanding)	81,169	81,169
Additional paid-in capital	1,218,190	1,218,190
Retained deficit	(1,403,712)	(1,431,697)
Total shareholders' deficit	<u>(103,669)</u>	<u>(131,654)</u>
Total liabilities, mezzanine equity, and total shareholders' deficit	<u>\$ 3,519,570</u>	<u>\$ 3,537,472</u>
¹ Includes total investments of consolidated variable interest entity ("VIE")	\$ 330,781	\$ 324,101
² Includes accrued interest receivable of consolidated VIE	554	473
³ Reflects collateral finance facility of consolidated VIE	450,000	450,000
⁴ Reflects accounts payable and other liabilities of consolidated VIE	47,990	45,759

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(Expressed in Thousands of United States Dollars)

	Three month period ended	
	March 31, 2014	March 31, 2013
Revenues		
Premiums earned, net.....	\$ 88,598	\$ 81,763
Investment income, net	20,755	22,569
Net realized and unrealized gains.....	26,570	32,814
Gain on extinguishment of long-term debt.....	-	6,240
Change in fair value of embedded derivative assets and liabilities	2,385	3,716
Fees and other income.....	582	559
Total revenues	<u>138,890</u>	<u>147,661</u>
Benefits and expenses		
Claims, policy benefits, and changes in policyholder reserves, net.....	90,735	97,742
Interest credited to interest-sensitive contract liabilities.....	6,805	7,837
Other insurance expenses including amortization of deferred acquisition costs, net	13,674	12,553
Operating expenses	5,659	5,763
Collateral finance facilities expense.....	2,448	2,458
Interest expense.....	1,225	1,223
Total benefits and expenses.....	<u>120,546</u>	<u>127,576</u>
Income before income taxes	18,344	20,085
Income tax benefit.....	9,641	707
Net income	<u>\$ 27,985</u>	<u>\$ 20,792</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)

	Three month period ended	
	March 31, 2014	March 31, 2013
Share capital:		
Ordinary shares:		
Beginning and end of period.....	\$ 684	\$ 684
Non-cumulative perpetual preferred shares:		
Beginning and end of period.....	\$ 81,169	\$ 81,169
Additional paid-in capital:		
Beginning and end of period.....	\$ 1,218,190	\$ 1,218,190
Retained deficit:		
Beginning of period.....	(1,431,697)	(1,414,474)
Net income attributable to Scottish Re Group Limited.....	27,985	20,792
End of period.....	(1,403,712)	(1,393,682)
Total shareholders' deficit	\$ (103,669)	\$ (93,639)

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)

	Three month period ended	
	March 31, 2014	March 31, 2013
Operating activities		
Net income	\$ 27,985	\$ 20,792
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized and unrealized gains	(26,570)	(32,814)
Gain on extinguishment of long-term debt	-	(6,240)
Changes in value of embedded derivative assets and liabilities	(2,385)	(3,716)
Amortization of deferred acquisition costs	2,856	2,608
Amortization of present value of in-force business	205	436
Amortization of deferred finance facility costs	217	217
Depreciation of fixed assets	35	37
Changes in assets and liabilities:		
Funds withheld at interest	6,028	6,276
Accrued interest receivable	48	(588)
Reinsurance balances receivable	21,013	12,107
Other assets	102	207
Reserves for future policy benefits, net of amounts recoverable from reinsurers	(10,908)	29,855
Interest-sensitive contract liabilities	(4,884)	(2,889)
Accounts payable and other liabilities, including deferred tax liabilities	(4,753)	3,873
Reinsurance balances payable	(8,571)	(414)
Net cash provided by operating activities	<u>418</u>	<u>29,747</u>
Investing activities		
Purchase of fixed-maturity investments	(53,887)	(103,085)
Proceeds from sales and maturities of fixed-maturity investments	85,683	77,672
Purchase of and proceeds from sales and maturities of preferred stock, net	-	794
Purchase of and proceeds from other investments, net	39	(5,276)
Net cash provided by (used in) investing activities	<u>31,835</u>	<u>(29,895)</u>
Financing activities		
Withdrawals from interest-sensitive contract liabilities	(12,765)	(16,919)
Acquisition of long-term debt	-	(6,760)
Net cash used in financing activities	<u>(12,765)</u>	<u>(23,679)</u>
Net change in cash and cash equivalents	19,488	(23,827)
Cash and cash equivalents, beginning of period	247,409	368,809
Cash and cash equivalents, end of period	<u>\$ 266,897</u>	<u>\$ 344,982</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

1. Organization, Business Strategy and Lines of 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, 2014, 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”)

Business 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 reinsurance business into run-off (the “Closed Block”). We continue to run-off the Closed Block, whereby we receive premiums, pay claims, and perform key activities under the related reinsurance treaties. During 2013 and early 2014, the Company began to engage with its regulators and certain ceding companies regarding the Company’s intent to accept new reinsurance risks, either through the reinsurance of existing third-party closed blocks of business or the assumption of newly originated business written by third parties (the “New Business Strategy”). There can be no assurances whether or to what extent the Company will be successful in its pursuit of the New Business Strategy or what effect such strategy will have on the Company’s reported financial results in future periods.

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.

Lines of Business

As defined and described in SRGL’s audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013, we have written reinsurance business that is wholly or partially retained in

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

1. Organization, Run-Off Strategy and Lines of Business (continued)

one or more of our reinsurance subsidiaries and have classified the reinsurance as Traditional Solutions or as Financial Solutions.

Merger of Subsidiaries

On January 14, 2013, SRUS and its wholly-owned subsidiary, Scottish Re Life Corporation (“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 would be merged with and into SRUS, with SRUS continuing as the surviving corporation (the “SRUS/SRLC Merger”). From and after the effective date of the SRUS/SRLC Merger (the “Effective Date”), SRUS, as the surviving corporation, would be responsible and liable for all of the liabilities and obligations of SRUS and SRLC existing as of the Effective Date, and all policies of insurance and contracts and agreements of reinsurance or retrocession assumed or issued by SRLC, or pursuant to which SRLC was a party will, as of the Effective Date, become policies of insurance and contracts and agreements of reinsurance or retrocession (as the case may be) of SRUS. Approval of the SRUS/SRLC Merger was received from the Insurance Commissioner of the State of Delaware on May 8, 2013 and from the Insurance Commissioner of the State of California on July 12, 2013. The Effective Date of the SRUS/SRLC Merger was July 30, 2013. The Company action level risk-based capital (“RBC”) percentage for SRUS as of December 31, 2012, after giving effect to the SRUS/SRLC Merger, would have been 373% compared to 328% without giving effect to the SRUS/SRLC Merger, thereby continuing to exceed minimum company action level RBC requirements for life and health insurance companies with the Delaware Department of Insurance. The SRUS/SRLC Merger had no effect on the Company’s consolidated financial position and results of operations.

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, 2013.

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. For further discussion on Orkney Re II, please refer to Note 6, “Collateral Finance Facility and Securitization Structure”.

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 interim 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 embedded derivative instruments;
- assessment of risk transfer for structured insurance and reinsurance contracts;

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

2. Basis of Presentation (continued)

- 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 taxes, deferred 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.

Reclassifications - Certain prior period amounts in our consolidated interim financial statements and accompanying notes have been reclassified to conform to the current presentation. These reclassifications primarily impact amounts under the following captions reported in the Consolidated Statements of Operations:

- Investment income, net;
- Net realized and unrealized gains;
- Fees and other income;
- Other insurance expenses including amortization of deferred acquisition costs, net; and
- Operating expenses.

3. Investments

The portion of net unrealized gains for the three month periods ended March 31, 2014 and 2013 that related to trading securities, which included fixed-maturity investments and preferred stocks, still held at the reporting date was \$25.1 million and \$27.3 million, respectively.

Other investments, as of March 31, 2014 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 investments accounted for under the equity method represent executed subscription documents, signed by SALIC on March 26, 2012, 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, 2014, SALIC had invested \$13.4 million of its total commitment, which investment is included in “Other investments” on the accompanying Consolidated Balance Sheets at a carrying value of \$19.8 million. Changes in the fair value of the Cerberus Affiliated Fund are included in “Net realized and unrealized gains” on the accompanying Consolidated Statements of Operations.

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, 2013, which, along with Note 3, “Investments” above, also includes additional disclosures regarding our fair value measurements.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

4. Fair Value Measurements (continued)

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

March 31, 2014				
(U.S. dollars in millions)	Level 1	Level 2	Level 3	Total
Investments				
Government securities	\$ -	\$ 28.7	\$ -	\$ 28.7
Corporate securities	-	687.8	39.5	727.3
Municipal bonds	-	32.0	-	32.0
Mortgage and asset-backed securities	-	597.8	396.9	994.7
Fixed-maturity investments	-	1,346.3	436.4	1,782.7
Preferred stock	-	1.3	-	1.3
Total assets at fair value	<u>\$ -</u>	<u>\$ 1,347.6</u>	<u>\$ 436.4</u>	<u>\$ 1,784.0</u>
Embedded derivative liabilities	-	-	(15.8)	(15.8)
Total liabilities at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (15.8)</u>	<u>\$ (15.8)</u>

December 31, 2013				
(U.S. dollars in millions)	Level 1	Level 2	Level 3	Total
Investments				
Government securities	\$ -	\$ 32.8	\$ -	\$ 32.8
Corporate securities	-	712.0	44.0	756.0
Municipal bonds	-	37.5	-	37.5
Mortgage and asset-backed securities	-	565.4	397.7	963.1
Fixed-maturity investments	-	1,347.7	441.7	1,789.4
Preferred stock	-	1.1	-	1.1
Total assets at fair value	<u>\$ -</u>	<u>\$ 1,348.8</u>	<u>\$ 441.7</u>	<u>\$ 1,790.5</u>
Embedded derivative liabilities	-	-	(18.2)	(18.2)
Total liabilities at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (18.2)</u>	<u>\$ (18.2)</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

4. Fair Value Measurements (continued)

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

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the three month ended March 31, 2014

(U.S. dollars in millions)	Corporate securities	Mortgage and asset-backed securities	Total assets at fair value	Total liabilities at fair value
Beginning balance at January 1, 2014	\$ 44.0	\$ 397.7	\$ 441.7	\$ (18.2)
Total realized and unrealized gains (losses) included in net income	-	17.0	17.0	2.4
Purchases	-	3.0	3.0	-
Settlements	(4.5)	(5.5)	(10.0)	-
Transfers in and/or (out of) Level 3, net	-	(15.3)	(15.3)	-
Ending balance at March 31, 2014	<u>\$ 39.5</u>	<u>\$ 396.9</u>	<u>\$ 436.4</u>	<u>\$ (15.8)</u>

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended December 31, 2013

(U.S. dollars in millions)	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Total assets at fair value	Total liabilities at fair value
Beginning balance as of January 1, 2013.....	\$ 74.2	\$ 5.4	\$ 320.1	\$ 399.7	\$ (26.3)
Total realized and unrealized (losses) gains included in net income.....	(2.0)	-	64.1	62.1	8.1
Purchases	-	-	53.7	53.7	-
Settlements.....	(28.9)	-	(33.3)	(62.2)	-
Transfers in and/or out of Level 3, net.....	0.7	(5.4)	(6.9)	(11.6)	-
Ending balance as of December 31, 2013 ...	<u>\$ 44.0</u>	<u>\$ -</u>	<u>\$ 397.7</u>	<u>\$ 441.7</u>	<u>\$ (18.2)</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 periods ended March 31, 2014 and 2013 that related to Level 3 trading securities still held at the reporting date was \$16.9 million and \$25.4 million, respectively.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

4. Fair Value Measurements (continued)

The following tables summarize the fair values (in millions), the valuation techniques, and the significant unobservable inputs of the Level 3 fair value measurements as of March 31, 2014 and December 31, 2013, respectively, for which we have been able to obtain quantitative information about the significant unobservable inputs used in those fair value measurements:

March 31, 2014

Assets (U.S. dollars in millions)	Fair Value	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities	\$ 32.4	Discounted Cash Flow	Liquidity/duration adjustment*	0.4% - 2.9%
Mortgage and asset-backed securities	\$ 23.5	Discounted Cash Flow	Liquidity/duration adjustment*	1.6% - 1.7%

December 31, 2013

Assets (U.S. dollars in millions)	Fair Value	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities	\$ 37.0	Discounted Cash Flow	Liquidity/duration adjustment*	0.4% - 4.7%
Mortgage and asset-backed securities	\$ 23.2	Discounted Cash Flow	Liquidity/duration adjustment*	1.7% - 1.8%

* 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.

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, 2014

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 2, "Summary of Significant Accounting Policies - Investments", Note 5, "Fair Value Measurements", and Note 6, "Fair Value of Financial Instruments" in SRGL's audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013. The following table sets forth the fair values of our financial instruments, as of the dates indicated:

(U.S. dollars in thousands)	March 31, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets				
Fixed-maturity investments	\$ 1,782,722	\$ 1,782,722	\$ 1,789,343	\$ 1,789,343
Preferred stock	1,255	1,255	1,138	1,138
Other investments	22,942	22,942	21,695	21,695
Funds withheld at interest	453,749	453,749	459,777	459,777
Liabilities				
Interest-sensitive contract liabilities	1,008,666	1,007,665	\$ 1,026,307	\$ 1,025,308
Collateral finance facility	450,000	205,390	450,000	171,629
Embedded derivative liabilities	15,845	15,845	18,230	18,230
Long-term debt, at par value	116,500	83,979	116,500	81,383

6. Collateral Finance Facility and Securitization Structure

Orkney Re II

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, 2013.

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 providing support to the Company:

(U.S. dollars in thousands)	March 31, 2014	December 31, 2013
Assets		
Funds withheld at interest	\$ 364,540	\$ 366,561
Cash and cash equivalents	1,804	1,961
All other assets	54,028	41,873
Total assets	\$ 420,372	\$ 410,395

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

6. Collateral Finance Facility and Securitization Structure (continued)

(U.S. dollars in thousands)	<u>March 31, 2014</u>	<u>December 31, 2013</u>
Liabilities		
Reserves for future policy benefits	\$ 139,797	\$ 137,491
Collateral finance facility	450,000	450,000
All other liabilities	49,746	46,833
Total liabilities	<u>\$ 639,543</u>	<u>\$ 634,324</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 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 (“economic reserves”), 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.

Orkney Re II Event of Default, Acceleration and Foreclosure

Orkney Re II has been unable to make scheduled interest payments on the Series A-1 Notes and Series A-2 Notes on all scheduled quarterly interest payment dates since May 11, 2009. As of March 31, 2014, Assured Guaranty (UK) Ltd. (“Assured”) has made guarantee payments in the cumulative amount of \$16.0 million on the Series A-1 Notes which are the subject of a financial guaranty policy issued by Assured in connection with the Orkney Re II transaction. Unlike the Series A-1 Notes, the Series A-2 Notes were not guaranteed under the Orkney Re II transaction and the amount of cumulative interest on the Series A-2 Notes was \$2.4 million as of March 31, 2014. This amount of cumulative interest on the Series A-1 Notes and the Series A-2 Notes has been accrued by us in Accounts Payable and Other Liabilities in 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%. As of March 31, 2014, the interest rate on the Series A-1 Notes was 0.66% (compared to 0.66% as of December 31, 2013). Interest on the Series A-2 Notes, which are not guaranteed as part of the Orkney Re II transaction, is payable quarterly at a rate equivalent to three-month LIBOR plus 0.730%. As of March 31, 2014, the interest rate on the Series A-2 Notes was 0.96% (compared to 0.97% as of December 31, 2013). For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes and the Series A-2 Notes, please refer to Note 12, “Subsequent Events - *Orkney Re II*”.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

7. Debt Obligations and Other Funding Arrangements

Long-term debt, at par value (collectively, the “Capital and Trust Preferred Securities”), is individually defined and 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, 2013. 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, 2014	4.23%	4.18%	4.13%	4.03%	3.73%
Interest rate as of December 31, 2013	4.25%	4.20%	4.15%	4.05%	3.75%
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, 2014	5	5	5	5	5

* Defined in the notes accompanying SRGL’s audited consolidated financial statements for the year ended December 31, 2013.

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

Capital and Trust Preferred Securities

On January 31, 2013, SRGL agreed to acquire, in a privately-negotiated transaction, approximately \$13.0 million in aggregate liquidation amount of Trust Preferred Securities Due 2034, with a liquidation preference of \$1,000 per security, at a purchase price of \$520.00 per security. In accordance with FASB ASC 405, Extinguishment of Liabilities, the Company recorded a \$6.2 million gain on the extinguishment of debt in the Consolidated Statements of Operations in the first quarter of 2013.

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, 2014, we have accrued and deferred net payments of \$6.4 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.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

7. Debt Obligations and Other Funding Arrangements (continued)

For further discussion on the accrued and deferred payment on our Capital and Trust Preferred Securities subsequent to March 31, 2014, please refer to Note 12, “Subsequent Events – *Deferral of Interest Payments on the Capital and Trust Preferred Securities*”.

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”.

As of March 31, 2014, the net amount of dividends accreted pursuant to the terms of the CCPP Shares was \$225.1 million in the aggregate, or \$225.08 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, 2013.

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, 2014 and the year ended December 31, 2013:

	Three Month Period Ended March 31, 2014	Year Ended December 31, 2013
Ordinary shares		
Beginning and end of period/year	68,383,370	68,383,370

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 for March 31, 2014 and 2013 were 7.00% and 6.51%, respectively. 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,

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

9. Shareholders' Deficit (continued)

redeemed, or otherwise acquired for consideration by SRGL. Please refer below to “*Dividends on Perpetual Preferred Shares*” in the Note below for additional information.

The following table summarizes the activity in our Perpetual Preferred Shares during the three month period ended March 31, 2014 and the year ended December 31, 2013:

	Three Month Period Ended March 31, 2014	Year Ended December 31, 2013
Perpetual Preferred Shares		
Beginning and end of period/year	3,246,776	3,246,776

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.

All future payments of dividends are at the discretion of our Board of Directors (the “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

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 in connection with each of the 2013 dividend payment 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); however, the right of the holders of the Perpetual Preferred Shares to elect two directors to our Board has not been exercised as of March 31, 2014. If and when dividends for at least four dividend periods, whether or not consecutive, following a Nonpayment have been paid in full, this right will cease.

There can be no assurances when or whether, as a result of the application of the financial tests contained in the terms of the Perpetual Preferred Shares, our Board will be permitted to make subsequent dividend payments on the Perpetual Preferred Shares or, if permitted, when or whether our Board will choose in its discretion to make any such dividend payments on the Perpetual Preferred Shares.

For further discussion on the non-declaration of the Perpetual Preferred Shares dividends, please refer to Note 12, “*Subsequent Events – Non-declaration of Dividend on Perpetual Preferred Shares*”.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

10. Income Taxes

The income tax benefit for the three month periods ended March 31, 2014 and 2013 was \$9.6 million and \$0.7 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 potential interest and penalties on accrued tax liabilities for unrecognized tax benefits, due to the operating performance and 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, 2014 and 2013 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, 2014, 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 unchanged from March 31, 2014 and December 31, 2013.

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, 2014 and December 31, 2013, our deferred tax liabilities included \$27.6 million and \$37.5 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, 2014, 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	2010 through 2013
Non-Life Group	2010 through 2013
Ireland	2009 through 2013

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, 2013.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

11. Commitments and Contingencies

Ballantyne Re plc

Ballantyne Re plc (“Ballantyne Re”), which was previously a consolidated VIE of the Company, 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, \$178.0 million of Class C Notes to SALIC, \$181.2 million in preference shares to SALIC, and \$500,000 in Class D Notes to SRGL.

As of March 31, 2014, 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. The Class C Notes were fully written-off in 2008 under the contractual terms of the Ballantyne Re indenture.

SRUS remains liable for the accuracy and performance, as applicable, of its representations, warranties, covenants, and other obligations that relate to periods before the assignment and novation to Security Life of Denver Insurance Company 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.

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

Davis v. Scottish Re Group Limited, et al.

The Company and SRUS (together, “Scottish Re”) learned that a lawsuit was filed on or about November 20, 2013, in New York state court against Scottish Re, our shareholders and certain of their affiliates, and various former and current directors of Scottish Re (collectively, the “Defendant Parties”). The plaintiff, a holder of our Perpetual Preferred Shares and a former holder of our Ordinary Shares (please refer to Note 9, “Shareholders’ Deficit” for information regarding our Ordinary Shares and our Perpetual Preferred Shares), alleges, among other things, claims against the Defendant Parties for breach of contract, breach of fiduciary duty, tortious interference, and derivative claims. The complaint seeks an unspecified amount of damages, as well as other forms of relief, and largely centers around the Orkney I Unwind Transaction, including the 2009 acquisition by affiliates of Cerberus of Orkney Notes (as disclosed in Note 9, “Collateral Finance Facilities and Securitization Structures – *Orkney I Unwind Transaction*” and Note 17, “Related Party Transactions – *Cerberus*” in SRGL’s consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013), the completion of the Merger on August 24, 2011 (as disclosed in Note 11, “Mezzanine Equity – Convertible Cumulative Participating Preferred Shares – *Merger Agreement*” in SRGL’s consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013), the redemption by SRGL of Perpetual Preferred Shares acquired pursuant to tender offers in 2010 and 2012 (as disclosed in Note 12, “Shareholders Deficit – *Perpetual Preferred Shares*” in SRGL’s consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013), and a purported distribution policy affecting the Perpetual Preferred Shares (also as disclosed in Note 12, “Shareholders Deficit – *Dividends on Perpetual Preferred Shares*” in SRGL’s consolidated financial statements and accompanying notes thereto for the year ended December 31, 2013).

On February 21, 2014, Motions to Dismiss were filed with the court on behalf of the Defendant Parties pursuant to a briefing schedule previously agreed with the court and the plaintiff.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

March 31, 2014

11. Commitments and Contingencies (continued)

We believe the plaintiff's allegations to be without merit and are vigorously defending our interest in the action. Accordingly, it is not possible to estimate any loss in respect of the plaintiff's claims.

For further discussion regarding the Davis v. Scottish Re Group Limited, et al. litigation, please refer to Note 12, "Subsequent Events – Davis vs. Scottish Re Group Limited, et al."

12. 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 15, 2014.

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, 2014 dividend payment date.

Deferral of Interest Payments on the Capital and Trust Preferred Securities

Subsequent to March 31, 2014, 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 15, 2014, we had accrued and deferred a net payment on a total of \$6.6 million of interest on our Capital and Trust Preferred Securities.

Orkney Re II

On the scheduled interest payment date of May 11, 2014, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes and the Series A-2 Notes. As a result, Assured, subject to the financial guaranty policy issued by Assured, as discussed in Note 6, "Collateral Finance Facility and Securitization Structure", made guarantee payments on the Series A-1 Notes in the amount of \$0.6 million. The interest amount for the Series A-2 Notes, which were not guaranteed under the Orkney Re II transaction, was \$0.1 million. We have accrued the interest on both the Series A-1 Notes and the Series A-2 Notes.

Davis v. Scottish Re Group Limited, et al.

As previously discussed in Note 11, "Commitments and Contingencies – Davis vs. Scottish Re Group Limited, et al.", on February 21, 2014, Motions to Dismiss were filed with the court on behalf of the Defendant Parties pursuant to a briefing schedule previously agreed with the court and the plaintiff. Pursuant to that schedule, the plaintiff submitted on May 7, 2014 its opposition to the Motions to Dismiss. The Defendant Parties have until June 23, 2014 to submit replies in further support of their Motions to Dismiss.