SCOTTISH RE GROUP LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011

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Report of Independent Auditors

The Board of Directors and Shareholders of Scottish Re Group Limited

We have audited the accompanying consolidated balance sheets of Scottish Re Group Limited (the "Company") and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, shareholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Scottish Re Group Limited and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for the each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Charlotte, North Carolina
March 29, 2012

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

	December 31, 2011	December 31, 2010
Assets		
Fixed-maturity investments held as trading securities, at fair value	$ 1,967,689	$ 3,111,724
Preferred stock held as trading securities, at fair value	58,529	67,897
Cash and cash equivalents	282,028	417,722
Other investments	14,877	16,459
Funds withheld at interest	549,333	584,617
Total investments[1]	2,872,456	4,198,419
Accrued interest receivable[2]	16,757	22,286
Reinsurance balances and risk fees receivable	120,976	131,315
Deferred acquisition costs	173,254	269,352
Amount recoverable from reinsurers	749,034	564,869
Present value of in-force business	27,027	31,941
Other assets	8,771	22,988
Total assets	$ 3,968,275	$ 5,241,170
Liabilities		
Reserves for future policy benefits	$ 1,354,140	$ 1,477,594
Interest-sensitive contract liabilities	1,301,511	1,415,580
Collateral finance facilities[3]	450,000	1,300,000
Accounts payable and other liabilities	64,426	54,827
Embedded derivative liabilities, at fair value	33,758	32,545
Reinsurance balances payable	93,244	91,634
Deferred tax liability	45,223	44,189
Long-term debt, at par value	129,500	129,500
Total liabilities	3,471,802	4,545,869
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: 2011 - $802.8 million; 2010 - $759.3 million)	555,857	555,857
Shareholders' (Deficit) Equity		
Ordinary shares, par value $0.01:		
Issued and outstanding - 68,383,370 shares in 2011 and 2010	684	684
Non-cumulative perpetual preferred shares, par value $0.01:		
Issued: 5,000,000 shares (outstanding: 4,806,083 shares)	120,152	120,152
Additional paid-in capital	1,218,190	1,217,894
Retained deficit	(1,407,269)	(1,208,286)
Total Scottish Re Group Limited shareholders' (deficit) equity	(68,243)	130,444
Noncontrolling interest	8,859	9,000
Total shareholders' (deficit) equity	(59,384)	139,444
Total liabilities, mezzanine equity, and shareholders' (deficit) equity	$ 3,968,275	$ 5,241,170

[1] Includes total investments of consolidated variable interest entities ("VIEs")	$ 282,429	$ 1,108,193
[2] Includes accrued interest receivable of consolidated VIEs	455	1,040
[3] Reflects collateral finance facilities of consolidated VIEs	450,000	1,300,000

See Accompanying Notes to Consolidated Financial Statements

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS
(Expressed in Thousands of United States Dollars)

	Year Ended		
	December 31, 2011	**December 31, 2010**	**December 31, 2009**
Revenues			
Premiums earned, net	$ 302,920	$ 421,134	$ 451,800
Fees and other income	4,381	5,453	6,996
Investment income, net	136,223	170,454	176,923
Net realized and unrealized (losses) gains	(4,413)	242,246	242,990
Gain on de-consolidation of collateral finance facility	-	-	1,150,114
Gain on consolidation of funding agreements	-	-	253,824
Change in value of long-term debt, at fair value	-	(15,246)	(22,125)
Gain on extinguishment of debt	260,000	-	53,545
Change in value of embedded derivative assets and liabilities	(1,213)	3,187	311,787
Total revenues	697,898	827,228	2,625,854
Benefits and expenses			
Claims, policy benefits, and changes in policyholder reserves, net	314,754	394,618	(22,926)
Interest credited to interest-sensitive contract liabilities	46,911	52,346	59,959
Amortization of deferred acquisition costs and other insurance expenses, net	462,242	88,660	133,782
Operating expenses	44,388	54,581	53,781
Collateral finance facilities expense	25,303	33,061	39,410
Interest expense	6,041	5,360	6,274
Total benefits and expenses	899,639	628,626	270,280
(Loss) income before income taxes	(201,741)	198,602	2,355,574
Income tax benefit (expense)	2,617	37,941	(49,531)
Net (loss) income	(199,124)	236,543	2,306,043
Gain on redemption of non-cumulative perpetual preferred shares	-	3,878	-
Net loss (income) attributable to noncontrolling interest	141	(1,332)	(702)
Net (loss) income attributable to Scottish Re Group Limited	$ (198,983)	$ 239,089	$ 2,305,341

See Accompanying Notes to Consolidated Financial Statements

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' (DEFICIT) EQUITY
(Expressed in Thousands of United States Dollars)

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Share capital:			
Ordinary shares:			
Beginning of period	$ 684	$ 684	$ 684
Merger activity, net	-	-	-
End of period	684	684	684
Non-cumulative perpetual preferred shares:			
Beginning of period	120,152	125,000	125,000
Non-cumulative perpetual preferred shares redeemed	-	(4,848)	-
End of period	120,152	120,152	125,000
Additional paid-in capital:			
Beginning of period	1,217,894	1,217,535	1,216,878
Option expense	296	359	657
End of period	1,218,190	1,217,894	1,217,535
Retained deficit:			
Beginning of period	(1,208,286)	(1,447,375)	(3,752,716)
Net (loss) income attributable to Scottish Re Group Limited	(198,983)	239,089	2,305,341
End of period	(1,407,269)	(1,208,286)	(1,447,375)
Total Scottish Re Group Limited shareholders' (deficit) equity	$ (68,243)	$ 130,444	$ (104,156)
Noncontrolling interest:			
Beginning of period	9,000	7,668	6,966
Net (loss) income	(141)	1,332	702
End of period	8,859	9,000	7,668
Total shareholders' (deficit) equity	$ (59,384)	$ 139,444	$ (96,488)

See Accompanying Notes to Consolidated Financial Statements

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Thousands of United States Dollars)

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Operating activities			
Net (loss) income	$ (199,124)	$ 236,543	$ 2,306,043
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Net realized and unrealized losses (gains)	4,413	(242,246)	(242,990)
Gain on de-consolidation of collateral finance facility	-	-	(1,150,114)
Change in value of long-term debt, at fair value	-	15,246	22,125
Gain on consolidation of funding agreements	-	-	(253,824)
Gain on extinguishment of debt	-	-	(53,545)
Change in value of embedded derivative assets and liabilities	1,213	(3,187)	(311,787)
Amortization of deferred acquisition costs	12,349	31,141	79,848
Amortization of present value of in-force business	4,914	6,375	1,789
Write-off of fixed assets associated with the sale of the Acquired Business	-	-	6,021
Amortization of deferred finance facility costs	10,696	5,081	2,646
Depreciation of fixed assets	217	415	1,126
Option expense	296	359	657
Adjustments attributed to the Orkney I Unwind Transaction:			
Gain on extinguishment of Orkney Notes	(260,000)	-	-
Release of deferred acquisition costs	83,204	-	-
Net increase in receivables and amounts recoverable from reinsurers	(252,388)	-	-
Changes in assets and liabilities:			
Funds withheld at interest	35,284	23,883	1,140,268
Accrued interest receivable	5,529	2,136	4,665
Reinsurance balances receivable	10,339	26,812	244,592
Deferred acquisition costs	545	(3,671)	(1,906)
Other assets	7,139	60,651	(246,554)
Reserves for future policy benefits, net of amounts recoverable from reinsurers	(55,231)	(47,745)	(2,097,667)
Interest-sensitive contract liabilities	(5,760)	(2,092)	(13,813)
Accounts payable and other liabilities, including deferred tax liabilities	10,633	(14,403)	42,272
Reinsurance balances payable	1,611	(17,935)	(129,994)
Net cash (used in) provided by operating activities	(584,121)	77,363	(650,142)
Investing activities			
Purchase of fixed-maturity investments	(305,334)	(849,344)	(778,910)
Proceeds from sales and maturities of fixed-maturity investments	1,442,124	886,205	1,102,202
Purchases of preferred stock	-	(1,865)	(80)
Proceeds from sales and maturities of preferred stock	8,239	15,823	12,438
Purchase of and proceeds from other investments, net	1,581	1,353	299
Proceeds from sales of fixed assets, net	153	-	64
Net cash provided by investing activities	1,146,763	52,172	336,013
Financing activities			
Redemption of collateral finance facilities	(590,000)	-	-
Withdrawals from interest-sensitive contract liabilities	(108,336)	(100,868)	(73,845)
Extinguishment of debt	-	-	(46,614)
Redemption on non-cumulative perpetual preferred shares	-	(970)	-
Deemed capitalization of Merger Sub by Investors prior to Merger	17,647	-	-
Payment of Merger consideration by Investors on behalf of Merger Sub	(17,647)	-	-
Net cash (used in) financing activities	(698,336)	(101,838)	(120,459)
Net change in cash and cash equivalents	(135,694)	27,697	(434,588)
Cash and cash equivalents, beginning of period	417,722	390,025	824,613
Cash and cash equivalents, end of period	$ 282,028	$ 417,722	$ 390,025
Interest paid	$ -	$ 4,349	$ 1,761
Taxes paid (refunded)	$ 142	$ (12,716)	$ (3,397)

See Accompanying Notes to Consolidated Financial Statements

1. Organization and Business

Organization

Scottish Re Group Limited ("SRGL" and, together with SRGL's consolidated subsidiaries and VIEs, as applicable, 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 December 31, 2011, we have principal operating companies, holding companies, financing companies, and collateral finance facilities in Bermuda, the Cayman Islands, Ireland, Luxembourg, and the United States, as follows:

<u>Bermuda</u>
Scottish Re Life (Bermuda) Limited ("SRLB")

<u>Cayman Islands</u>
SRGL
Scottish Annuity & Life Insurance Company (Cayman) Ltd. ("SALIC")

<u>Ireland</u>
Scottish Re (Dublin) Limited ("SRD")
Orkney Re II plc ("Orkney Re II")

<u>Luxembourg</u>
Scottish Financial (Luxembourg) S.á.r.l. ("SFL")
Scottish Holdings (Luxembourg) S.á.r.l. ("SHL")

<u>United States</u>
Scottish Holdings, Inc. ("SHI")
Scottish Re (U.S.), Inc. ("SRUS")
Scottish Re Life Corporation ("SRLC")

On August 24, 2011, the Merger (as defined in Note 11, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares - *Merger Agreement*") was completed. The Merger has been treated for purposes of these consolidated financial statements as a business combination. Refer to Note 11, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares - *Merger Agreement*", for information regarding the Merger.

Run-Off Strategy

In 2008, we ceased writing new business and notified our existing clients that we would not be accepting any new reinsurance risks under existing reinsurance treaties, thereby placing our remaining treaties into run-off. We expect to continue to pursue a run-off strategy for the remaining business, whereby we continue to receive premiums, pay claims, and perform key activities under our remaining reinsurance treaties.

While pursuing our run-off 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, refer to Note 10, "Debt Obligations and Other Funding Arrangements", and to Note 12, "Shareholders' (Deficit) Equity". Refer to Note 18, "Subsequent Events – *Perpetual Preferred Shares*" for information regarding a recently-completed cash tender offer for the Perpetual Preferred Shares (as defined in Note 12, "Shareholders' (Deficit) Equity - *Perpetual Preferred Shares*"). Further, the Company is actively evaluating strategic alternatives to increase shareholder value, including consideration of

1. Organization and Business (continued)

transactions for the sale or disposition of our businesses or assets, which transactions, individually or in the aggregate, may be material. Refer to Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*", for information regarding the Orkney I Unwind Transaction (as defined therein) that we consummated on May 27, 2011.

Regulatory Considerations

We had been operating since 2009 under certain regulatory constraints with respect to SRUS, our primary United States ("U.S.") reinsurance subsidiary. In connection with the receipt by SRUS in late 2008 of approval for a permitted statutory accounting practice (the "Permitted Practice"), SRUS consented to the issuance by the Delaware Department of Insurance (the "Department") on January 5, 2009 of an Order of Supervision for SRUS, which subsequently was amended and replaced with an Extended and Amended Order of Supervision, dated April 3, 2009 (the "Amended Order").

By its terms, the Amended Order was to remain in place until such time as SRUS could make certain enumerated showings to the Department related to its financial strength and results of operations. By an order dated June 23, 2011, the Department determined that its supervision of SRUS no longer was required and formally released SRUS from the Amended Order, effective immediately. Concurrent with the release of the Amended Order, SRUS ceased utilizing the Permitted Practice.

Business

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, as detailed below.

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

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

The following table summarizes the net premiums earned by product category for the years ended December 31, 2011, 2010 and 2009.

(U.S. dollars in millions)	**Traditional Solutions**	**Financial Solutions**	**Total**
Year Ended December 31, 2011	$ 298.7	$ 4.2	$ 302.9
Year Ended December 31, 2010	$ 415.9	$ 5.2	$ 421.1
Year Ended December 31, 2009	$ 445.0	$ 6.8	$ 451.8

For further details on revenue recognition associated with the amounts shown in the table above, please refer to Note 2, "Summary of Significant Accounting Policies - *Revenue Recognition*".

1. Organization and Business (continued)

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

2. Summary of Significant Accounting Policies

Basis of Presentation

Accounting Principles - Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP").

Consolidation - The consolidated financial statements include the assets, liabilities, and results of operations of SRGL, its subsidiaries, and all VIEs for which we are the primary beneficiary, as defined in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 810-10, Consolidation – Overall ("FASB ASC 810-10"). All significant inter-company transactions and balances have been eliminated in consolidation. We consolidated Merger Sub, as defined in Note 11, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares - *Merger Agreement*", during the period in which the Merger was completed, as explained in Note 11. We currently consolidate one non-recourse securitization, Orkney Re II, a special purpose vehicle incorporated under the laws of Ireland. We consummated the Orkney I Unwind Transaction (as defined in Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*") on May 27, 2011, and, as a result, we no longer consolidate Orkney Holdings, LLC ("OHL") and Orkney Re, Inc. ("Orkney Re" and, together with OHL, "Orkney I"). All of the assets remaining after the completion of the Orkney I Unwind Transaction were transferred to SRUS, and OHL and Orkney Re were dissolved prior to December 31, 2011. Effective January 1, 2009, we no longer consolidate Ballantyne Re plc ("Ballantyne Re"). For further discussion of Orkney I, the Orkney I Unwind Transaction, Orkney Re II, and Ballantyne Re, refer to Note 9, "Collateral Finance Facilities and Securitization Structures". Effective October 8, 2009, we consolidated the Stingray Pass-Through Trust and the Stingray Investor Trust (together, "Stingray"). Following the acquisition of the entire $325.0 million in aggregate stated amount of the Pass-Through Certificates (as defined in Note 10, "Debt Obligations and Other Funding Arrangements - *Stingray Investor Trust and Stingray Pass-Through Trust*") on September 2, 2010, we cancelled the Pass-Through Certificates and no longer consolidate Stingray. For further discussion of Stingray, refer to Note 10, "Debt Obligations and Other Funding Arrangements - *Stingray Investor Trust and Stingray Pass-Through Trust*".

Noncontrolling Interest - The noncontrolling interest represents the 5% of SRLC that is not owned by SRGL. The consolidated financial statements include all assets, liabilities, revenues, and expenses of SRLC. In accordance with FASB ASC 810-10, references in these consolidated financial statements to net (loss) income attributable to SRGL and shareholders' (deficit) equity attributable to SRGL do not include the noncontrolling interest, which is reported separately.

Estimates and Assumptions - The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated

2. Summary of Significant Accounting Policies (continued)

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;
- deferral and amortization of deferred acquisition costs;
- retrocession arrangements and amounts recoverable from reinsurers;
- interest-sensitive contract liabilities; and
- income 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 financial statements and accompanying notes have been reclassified to conform to the current presentation.

Assessment of Risk Transfer

For both ceded and assumed reinsurance, risk transfer requirements must be met in order to obtain reinsurance status for accounting purposes, principally resulting in the recognition of cash flows under the contract as premiums and expenses. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss for the assuming entity. To assess risk transfer for certain contracts, we generally develop expected discounted cash flow analyses at contract inception to determine if the contract provides indemnification against loss or liability relating to insurance risk, in accordance with applicable accounting standards. We review all contractual features, particularly those that may limit the amount of insurance risk to which we are subject or features that delay the timely reimbursement of claims. If we determine that risk transfer requirements on a contract are not met, a contract is accounted for using the deposit method.

Revenue Recognition

Net earned premiums are recorded net of amounts retroceded and are matched with their respective benefits and expenses so as to result in the recognition of profits over the life of the contracts. The following is a summary of our revenue recognition policies:

(i) Reinsurance premiums from traditional life policies and annuity policies with life contingencies generally are recognized as premiums when due from policyholders and are reported net of amounts retroceded.

(ii) Reinsurance assumed for interest-sensitive and investment type products is accounted for under the deposit method and does not generate premiums. For this business, we recognize as fees and other income the investment income on the assets that we receive from ceding companies, net of policy charges for the cost of insurance, policy administration, and

2. Summary of Significant Accounting Policies (continued)

surrenders that have been assessed against policy account balances during the period. Fee income is recorded on an accrual basis.

(iii) Net investment income includes interest and dividend income and is net of investment management and custody fees.

Investments

Our securities as classified as "trading", and we carry our investments at fair value, as described in Note 5, "Fair Value Measurements". As a result, unrealized gains and losses on investments are included in earnings. Realized gains and losses arising from the sale of investments are determined on a specific identification method and investment transactions are recorded on the trade date. Interest income is recorded on the accrual basis, based on the securities' stated coupon rates, as a component of net investment income. Cash flows for investment transactions are classified in Investing Activities in the accompanying Consolidated Statements of Cash Flows, even though our investments are classified as trading securities, because the investment transactions are not part of our primary Operating Activities.

Cash and cash equivalents include cash and fixed deposits or short-term investments with an original maturity, when purchased, of three months or less. Cash and cash equivalents are recorded at amortized cost, which approximates fair value.

Other investments represent policy loans, which are carried at the outstanding loan balances.

Funds withheld at interest are funds held by ceding companies under modified coinsurance and funds withheld coinsurance agreements whereby the assets supporting the statutory reserves of the ceding companies are retained by the ceding companies and managed for our account, and we receive the interest income earned on the funds. The funds withheld at interest are equal to the net statutory reserve fund balances retained by the ceding company, and the amounts in the funding accounts are adjusted quarterly to equal the ceding companies' net statutory reserve balances. In the event of an insolvency of a ceding company, we would make a claim on the assets supporting the contract liabilities; however, the risk of loss is mitigated by our ability to offset the amounts owed to us by the ceding company against amounts we owe to the ceding company. Interest accrues on these assets at rates defined by the treaty terms. The underlying agreements are considered to include embedded derivative liabilities, as further discussed in this Note. We included the change in funds withheld at interest as well as the change in the fair value of embedded derivative liabilities in Operating Activities in the accompanying Consolidated Statements of Cash Flows. In addition to our modified coinsurance and funds withheld coinsurance agreements, we have entered into various reinsurance treaties that, although considered funds withheld, do not transfer significant insurance risk and are accounted for using the deposit method.

Deferred Acquisition Costs

Costs of acquiring new business, which vary with and primarily are related to the production of new business, have been deferred to the extent that such costs are deemed recoverable from future gross profits. Such deferred acquisition costs ("DAC") include commissions and allowances as well as certain costs of policy issuance and underwriting. We perform periodic tests to determine that the DAC remains recoverable, and, if financial performance significantly deteriorates to the point where a premium deficiency exists, the cumulative DAC amortization is re-estimated and adjusted by a cumulative charge to current operations.

DAC primarily is related to long-duration traditional life insurance contracts that we reinsure and is amortized in proportion to the ratio of individual period premium revenues to total anticipated premium revenues over the lives of the policies. Such anticipated premium revenues are estimated using the same assumptions used for computing reserves for future policy benefits.

2. Summary of Significant Accounting Policies (continued)

The remaining DAC that is related to interest-sensitive life and investment-type policies that we reinsure is deferred and amortized over the lives of the policies in relation to the present value of estimated gross profits from mortality and investment income, less interest credited and expense margins, without provision for adverse deviation. We update the estimated gross profits with the actual gross profits for each block of business for that reporting period. When newly-estimated gross profits change from previously-estimated gross profits, which could result from changes in the future estimates for mortality, persistency, maintenance expense, and interest, the cumulative DAC amortization is recalculated and adjusted by a cumulative charge or credit to current operations. When actual gross profits exceed those previously estimated, the DAC amortization will increase, resulting in a current period charge to earnings. The opposite result occurs when the actual gross profits are below the previously-estimated gross profits. In circumstances where calculated gross profits are negative, which can occur when asset market values are declining, we would set the actual gross profits at zero in these calculations. In addition, we periodically review the future estimated gross profit for each block of business to determine the recoverability of DAC balances based on future expectations.

The total DAC amortization expense recognized during a particular period may increase or decrease, depending upon the relative size of any amortization changes that may result from the update of actual gross profits and the re-estimation of expected future gross profits. Any significant modifications or exchanges of contracts that are considered to constitute a substantial contract change are accounted for as an extinguishment of the replaced contract, resulting in a release of any unamortized DAC. Additionally, any unearned revenue or deferred sales inducements associated with the replaced contract would also be released. Where business is terminated due to recapture or novation, the related DAC is fully charged against current operations. Refer to Note 3, "Recent Accounting Pronouncements" for information regarding FASB Accounting Standards Update No. 2010-26, Financial Services - Insurance (Topic 944) – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.

Amounts Recoverable from Reinsurers

In the ordinary course of business, our reinsurance subsidiaries cede reinsured liabilities to other reinsurance companies, which transactions are referred to as retrocessions. These agreements minimize our net loss potential arising from large risks. In the normal course of business, we seek to limit our exposure to losses on any single insured life. Our initial retention limit was set at $0.5 million per life, but, for certain blocks of business, our retention limit can be up to $3.0 million per life. Ceded reinsurance contracts, however, do not relieve us of our obligation to the direct writing companies. The cost of reinsurance related to long duration contracts is recognized over the terms of the reinsured policies on a basis consistent with the accounting for those policies, except that the cost of reinsurance related to 100% retrocessions executed with the intent to exit a block of business is recognized immediately.

Amounts recoverable from reinsurers includes the balances due from reinsurance companies for claims and policy benefits that will be recovered from reinsurers, based on contracts in-force, and are presented net of a reserve for uncollectible reinsurance that has been determined based upon a review of the financial condition of the reinsurers and other factors. The method for determining the reinsurance recoverable involves actuarial estimates as well as a determination of our ability to cede claims and policy benefits under our existing reinsurance contracts. The reserve for uncollectible reinsurance is based on an estimate of the amount of the reinsurance recoverable balance that we ultimately will be unable to recover due to reinsurer insolvency, a contractual dispute, or any other reason. At December 31, 2011 and 2010, we had a reserve for uncollectible reinsurance of $3.0 million and $1.2 million, respectively.

Present Value of In-force Business

The present value of in-force business is established upon the acquisition of a book of business and is amortized over the expected life of the business, as determined at acquisition. The amortization each year is a function of the

2. Summary of Significant Accounting Policies (continued)

ratio of annual gross profits (or revenues) to total anticipated gross profits (or total anticipated revenues) expected over the life of the business, discounted at the assumed net credit rate (4.9% for 2011, 2010, and 2009). The carrying value of the present value of in-force business is reviewed at least annually for indicators of impairment in value.

Other Assets

Other assets consist of the following:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Unamortized collateral finance facility and debt issuance costs	$ 6,065	$ 16,761
Prepaid expenses	1,922	5,023
Fixed assets	542	871
Current income tax receivable	236	189
Other	6	144
Total	$ 8,771	$ 22,988

During 2011, 2010, and 2009, we amortized collateral finance facility and debt issuance costs of $1.1 million, $2.3 million, and $2.6 million, respectively. In 2011, we wrote off unamortized debt issuance costs of $9.6 million related to the repurchase and subsequent cancellation of the Orkney Notes, which was part of the Orkney I Unwind Transaction. Both the Orkney Notes and the Orkney I Unwind Transaction are defined and explained in further detail in Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*". Following purchases of the Pass-Through Certificates during 2010, we terminated the Interest Rate Swap in 2010 and, in addition, we wrote off unamortized debt issuance costs of $2.8 million related to the cancellation of the funding agreements. The Pass-Through Certificates and the Interest Rate Swap are defined in, and the funding agreements are discussed in Note 10, "Debt Obligations and Other Funding Arrangements - *Stingray Investor Trust and Stingray Pass-Through Trust*".

Reserves for Future Policy Benefits

FASB ASC Topic 944, Financial Services – Insurance ("FASB ASC 944"), applies to the traditional life policies with continuing premiums that we reinsure. For these policies, reserves for future policy benefits are computed based upon expected mortality rates, lapse rates, investment yields, expenses, and other assumptions established at policy issue, including a margin for adverse deviation. Once these assumptions are made, they generally will not be changed over the life of the policies. We periodically review actual historical experience and future projections compared to the original assumptions used to establish reserves for future policy benefits. Further, we determine whether actual experience and future projections indicate that existing policy reserves, together with the present value of future gross premiums, are sufficient to cover the present value of future benefits, settlement, and maintenance costs, and to recover unamortized DAC and the present value of in-force business. Significant changes in experience or assumptions may require us to provide for expected losses by establishing additional net reserves.

During 2011, SRLC performed a review and update of the models utilized in SRLC's insurance liability valuation system. The changes to the SRLC models included the updating of in-force populations, the modification of certain existing models, and the creation of new models for certain portions of SRLC's business. These changes constituted improvements in the SRLC models based on new information or inputs, and enhancements to improve the insurance liability valuation process, and did not modify any of the actuarial assumptions. Accordingly, these changes have been accounted for as changes in accounting estimates. The foregoing model changes resulted in a

2. Summary of Significant Accounting Policies (continued)

$19.1 million positive pre-tax effect on our loss before income taxes for the year ended December 31, 2011 in the accompanying Consolidated Statements of Operations. This effect was due to the resulting reduction in SRLC's net GAAP liability, which represents the Reserves for future policy benefits less the Present value of in-force business for SRLC's business.

On certain lines of business, reserves for future policy benefits include an estimate of claims payable for incurred but not reported ("IBNR") losses. Those IBNR estimates are determined using some or all of the following: studies of actual claim lag experience, best estimates of expected incurred claims in a period, actual reported claims, and best estimates of IBNR as a percentage of current in-force.

Because of the many assumptions and estimates used in establishing reserves for future policy benefits and the long-term nature of the reinsurance contracts, the reserving process, while based on actuarial science, is inherently uncertain.

Interest-sensitive Contract Liabilities

FASB ASC 944 also applies to investment contracts, limited premium contracts, and universal life-type contracts. The liabilities for interest-sensitive contract liabilities are equal to the accumulated account values of the policies or contracts as of the valuation date. Benefit liabilities for fixed annuities during the accumulation period equal their account values; after annuitization, they equal the discounted present value of expected future payments.

Should the liabilities for future policy benefits plus the present value of expected future gross premiums be insufficient to provide for the expected future benefits and expenses, any unamortized DAC will be written off, and, thereafter, if required, a premium deficiency reserve will be established by a current period charge to earnings.

Derivatives

All derivative instruments are recognized either as assets or liabilities in the Consolidated Balance Sheets at fair value as required by FASB ASC Topic 815, Derivatives and Hedging ("FASB ASC 815"). The changes in the fair value of the Interest Rate Swap are included in net realized and unrealized gains (losses) in the Consolidated Statements of Operations.

Our embedded derivative liabilities, at fair value, are associated with funds withheld at interest, which arise on modified coinsurance and funds withheld coinsurance agreements. FASB ASC Section 815-15-55, Derivatives and Hedging – Embedded Derivatives – Implementation Guidelines and Illustrations ("FASB ASC 815-15-55"), which incorporates Derivatives Implementation Group Issue No. B36 "Embedded Derivatives: Bifurcation of a Debt Instrument that Incorporates Both Interest Rate and Credit Rate Risk Exposures that are Unrelated or Only Partially Related to the Creditworthiness of the Issuer of that Instrument", indicates that these transactions contain embedded derivatives. The embedded derivative feature in our funds withheld treaties is similar to a fixed-rate total return swap on the assets held by the ceding companies.

The sale of a block of individual life reinsurance business (the "Acquired Business"), as defined and more fully described in Note 13, "Reinsurance – *2009 Sale of a Block of Traditional Solutions Business*"), during the first quarter of 2009 resulted in the elimination of an associated embedded derivative liability of $275.5 million.

The change in the fair value of embedded derivative liabilities is reported in the Consolidated Statements of Operations under the caption "Change in value of embedded derivative assets and liabilities".

2. Summary of Significant Accounting Policies (continued)

Accounts Payable and Other Liabilities

Accounts payable and other liabilities consist of the following:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Accounts payable	$ 10,744	$ 10,272
Deferred financial guarantor fees	11,104	6,974
Uncertain income tax liabilities	9,054	12,764
Deferred interest on long-term debt	17,431	11,390
Collateral finance facility accrued interest	15,934	13,427
Current income taxes payable	159	-
Total	$ 64,426	$ 54,827

Income Taxes

Income taxes are recorded in accordance with FASB ASC Topic 740, Income Taxes (“FASB ASC 740”). For all years presented, we use the asset and liability method to record deferred income taxes. Accordingly, deferred income tax assets and liabilities are recognized that reflect the net tax effect, using enacted tax rates, of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the corresponding amounts used for income tax purposes. Such temporary differences are primarily due to the tax basis of reserves, DAC, unrealized investment losses, capital loss carry forwards, and net operating loss carry forwards. A valuation allowance is applied to deferred tax assets if it is more likely than not that all, or some portion, of the benefits related to the deferred tax assets will not be realized.

3. Recent Accounting Pronouncements

Accounting Standards Update No. 2010-26, Financial Services – Insurance (Topic 944) – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued Accounting Standards Update No. 2010-26, Financial Services - Insurance (Topic 944) – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (“ASU No. 2010-26”), which clarifies the types of costs incurred by an insurance entity that can be capitalized in the acquisition of insurance contracts. Only those costs incurred which result directly from and are essential to the successful acquisition of new or renewal insurance contracts may be capitalized. Incremental costs related to unsuccessful attempts to acquire insurance contracts must be expensed as incurred. The amendments are effective for fiscal years and interim periods beginning after December 15, 2011. Early adoption is permitted, and an entity may elect to apply the guidance prospectively or retrospectively. We will adopt the provisions of ASU 2010-26 no later than January 1, 2012; however, we do not expect the impact to be material.

Accounting Standards Update No. 2011-04, Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (“ASU No. 2011-04”). The objective of ASU No. 2011-04 is to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards (“IFRS”). The changes set forth by ASU No. 2011-04 include the

3. Recent Accounting Pronouncements (continued)

prohibition of the application of block discounts for all fair value measurement, regardless of hierarchy level, and that the "valuation premise" and "highest and best use" concepts (as defined therein) are not relevant to financial instruments. New disclosures required within ASU No. 2011-04 focus on Level 3 measurements which include quantitative information about significant unobservable inputs used for all Level 3 measurements; a qualitative discussion about the sensitivity of recurring Level 3 measurements to changes in the unobservable inputs disclosed and the interrelationship between inputs; and a description of the valuation processes. Also required to be disclosed are any transfers between Level 1 and Level 2 within the fair value hierarchy, and the hierarchy classification for items whose fair value is not recorded on the balance sheet but is disclosed in the notes. ASU No. 2011-04 is to be applied prospectively effective during interim and annual periods beginning after December 15, 2011. For non-public entities, the effective date is for annual periods beginning after December 15, 2011, and for interim and annual periods thereafter. We will adopt the provisions of ASU No. 2011-04 during 2012; however, it will have no effect on the Company's consolidated financial position and results of operations.

Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220) – Presentation of Comprehensive Income

In June 2011, the FASB issued new guidance on the presentation of comprehensive income that will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. The new guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The new guidance does not change the items that must be reported in other comprehensive income, how such items are measured or when they must be reclassified to net income. The new guidance is to be applied retrospectively, effective for fiscal years and interim periods within those years beginning after December 15, 2011. For non-public companies, this new guidance is effective for fiscal years ending after December 15, 2012 and for interim and annual periods thereafter, though early adoption is permitted. Because this guidance impacts presentation only, it will have no effect on the Company's consolidated financial position and results of operations because we have no items of comprehensive income.

4. Investments

The estimated fair values of our fixed-maturity investments and preferred stock held as trading securities at December 31, 2011 and 2010 were as follows:

(U.S. dollars in thousands)	**December 31, 2011**	**December 31, 2010**
U.S. Treasury securities and U.S. government agency obligations	$ 33,904	$ 89,248
Corporate securities	946,694	1,209,482
Municipal bonds	51,915	49,000
Mortgage and asset-backed securities	935,176	1,763,994
Fixed-maturity investments	1,967,689	3,111,724
Preferred stock	58,529	67,897
Total	$ 2,026,218	$ 3,179,621

4. Investments (continued)

The contractual maturities of the fixed-maturity investments and preferred stock held as trading securities at December 31, 2011 and 2010 were as follows (actual maturities may differ as a result of calls and prepayments):

(U.S. dollars in thousands)	Estimated Fair Value December 31, 2011	Estimated Fair Value December 31, 2010
Due in one year or less	$ 176,075	$ 216,169
Due after one year through five years	529,659	583,264
Due after five years through ten years	272,512	329,536
Due after ten years	112,796	286,658
	1,091,042	1,415,627
Mortgage and asset-backed securities	935,176	1,763,994
Total	$ 2,026,218	$ 3,179,621

The components of realized and unrealized (losses) gains and of the change in net unrealized appreciation (depreciation) on investments and other balances for the years ended December 31, 2011, 2010, and 2009 were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Realized and unrealized (losses) gains			
Fixed-maturity investments			
Gross realized gains	$ 24,114	$ 72,157	$ 118,234
Gross realized losses	(23,106)	(39,523)	(8,888)
Net unrealized (losses) gains	(8,356)	184,899	132,295
	(7,348)	217,533	241,641
Preferred stock			
Gross realized gains	759	3,129	2,687
Gross realized losses	(10)	(2,540)	(270)
Net unrealized (losses) gains	(1,883)	3,868	8,306
	(1,134)	4,457	10,723
Other			
Change in value of Interest Rate Swap	-	13,329	(6,907)
Interest Rate Swap interest income	-	6,906	3,180
Realized losses on modified coinsurance treaties	(27)	(174)	(5,628)
Other	4,096	195	(19)
	4,069	20,256	(9,374)
Net realized and unrealized (losses) gains	$ (4,413)	$ 242,246	$ 242,990

The portion of net unrealized gains and losses that relates to trading securities still held at the reporting date was $10.2 million of net losses for the year ended December 31, 2011 and $188.8 million of net gains for the year ended December 31, 2010.

4. Investments (continued)

Net investment income for the years ended December 31, 2011, 2010, and 2009 was derived from the following sources:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Fixed-maturity investments	$ 107,336	$ 134,802	$ 138,971
Preferred stock	3,519	4,284	5,250
Funds withheld at interest	27,431	32,132	34,694
Other investments	1,610	3,474	3,300
Investment expenses	(3,673)	(4,238)	(5,292)
Net investment income	$ 136,223	$ 170,454	$ 176,923

We are required to maintain assets on deposit with various U.S. regulatory authorities, in accordance with the statutory regulations of the individual jurisdictions, to support our insurance and reinsurance operations. We also have established trust funds in connection with certain transactions for the benefit of the ceding companies, which amounts include controlled assets within collateral finance facilities that we consolidate. (Refer to Note 9, “Collateral Finance Facilities and Securitization Structures”.) The assets within collateral finance facilities were held for the contractual obligations of those structures and were not available for general corporate purposes.

The estimated fair value of the components of the restricted assets at December 31, 2011 and 2010 were as follows:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Deposits with U.S. regulatory authorities	$ 17,767	$ 16,837
Trust funds	1,424,196	2,660,942
Total	$ 1,441,963	$ 2,677,779

5. Fair Value Measurements

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

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

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

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

5. Fair Value Measurements (continued)

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

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

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

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices or internally-developed models or methodologies that utilize significant inputs not based on or corroborated by readily-available market information. This category primarily consists of certain less liquid fixed-maturity securities where we cannot corroborate the significant valuation inputs with market observable data. Additionally, the Company’s embedded derivative liabilities, all of which are associated with reinsurance treaties, are classified in Level 3.

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

The fair values for the majority of our fixed-maturity investments are classified as Level 2. These fair values are obtained primarily from independent pricing services which utilize Level 2 inputs. The pricing services also utilize proprietary pricing models to produce estimates of fair value, primarily utilizing Level 2 inputs along with certain Level 3 inputs. The proprietary pricing models include matrix pricing where expected cash flows are discounted utilizing market interest rates obtained from third-party sources, based on the credit quality and duration of the instrument to fair value.

For securities that may not be reliably priced using internally-developed pricing models, broker quotes are obtained. These broker quotes represent an exit price, but the assumptions used to establish the fair value may not be observable, and, as a result, the fair values are classified as Level 3.

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

5. Fair Value Measurements (continued)

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

	December 31, 2011			
(U.S. dollars in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Investments				
Government securities	$ 33.9	$ -	$ 33.9	$ -
Corporate securities	946.7	-	862.2	84.5
Municipal bonds	51.9	-	46.4	5.5
Mortgage and asset-backed securities	935.2	-	599.4	335.8
Fixed-maturity investments	1,967.7	-	1,541.9	425.8
Preferred stock	58.5	-	8.5	50.0
Total assets at fair value	$ 2,026.2	$ -	$ 1,550.4	$ 475.8
Embedded derivative liabilities	(33.8)	-	-	(33.8)
Total liabilities at fair value	$ (33.8)	$ -	$ -	$ (33.8)

	December 31, 2010			
(U.S. dollars in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Investments				
Government securities	$ 89.2	$ -	$ 89.2	$ -
Corporate securities	1,209.5	-	1,081.0	128.5
Municipal bonds	49.0	-	49.0	-
Mortgage and asset-backed securities	1,764.0	-	1,233.8	530.2
Fixed-maturity investments	3,111.7	-	2,453.0	658.7
Preferred stock	67.9	-	11.9	56.0
Total assets at fair value	$ 3,179.6	$ -	$ 2,464.9	$ 714.7
Embedded derivative liabilities	(32.5)	-	-	(32.5)
Total liabilities at fair value	$ (32.5)	$ -	$ -	$ (32.5)

5. 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 value:

(U.S. dollars in millions)	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Preferred stock	Embedded derivative liabilities	Total
Beginning balance at January 1, 2011	$ 128.5	$ -	$ 530.2	$ 56.0	$ (32.5)	$ 682.2
Total realized and unrealized gains (losses) included in net (loss)	(2.3)	1.3	(19.2)	(1.0)	(1.3)	(22.5)
Purchases	19.6	-	7.6	-	-	27.2
Settlements	(46.6)	(0.2)	(136.6)	(5.0)	-	(188.4)
Transfers in and/or out of Level 3, net	(14.7)	4.4	(46.2)	-	-	(56.5)
Ending balance at December 31, 2011	$ 84.5	$ 5.5	$ 335.8	$ 50.0	$ (33.8)	$ 442.0

In 2011, changes in classifications impacting Level 3 financial instruments were reported as transfers in (out) of the Level 3 category as of the end of each quarterly period in which the transfer occurs.

5. Fair Value Measurements (continued)

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended December 31, 2010

(U.S. dollars in millions)	Government securities	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Preferred stock	Embedded derivative liabilities	Total
Beginning balance at January 1, 2010	$ 0.2	$ 133.3	$ -	$ 472.8	$ 53.4	$ (35.7)	$ 624.0
Total realized and unrealized gains (losses) included in net income	(0.2)	3.8	-	117.1	2.7	3.2	126.6
Purchases		40.1	9.9	34.3	-	-	84.3
Settlements	-	(56.0)	-	(95.2)	-	-	(151.2)
Transfers in and/or out of Level 3, net	-	7.3	(9.9)	1.2	(0.1)	-	(1.5)
Ending balance at December 31, 2010	$ -	$ 128.5	$ -	$ 530.2	$ 56.0	$ (32.5)	$ 682.2

In 2010, changes in classifications impacting Level 3 financial instruments were reported as transfers in (out) of the Level 3 category as of the end of each quarterly period in which the transfer occurs. The portion of net unrealized gains and losses that relates to Level 3 trading securities still held at the reporting date was $29.7 million of net losses for the year ended December 31, 2011 and $103.9 million of net gains for the year ended December 31, 2010.

6. Fair Value of Financial Instruments

As discussed above, the fair values of financial assets and liabilities are estimated in accordance with the framework established under FASB ASC 820. The methodology for determining the fair value of financial instruments, in addition to those disclosed in Note 2, "Summary of Significant Accounting Policies - *Investments*" and Note 5, "Fair Value Measurements" are as follows:

(i) As noted above, the funds withheld at interest are equal to the net statutory reserve fund balances retained by the ceding company, and the amounts in the funding accounts consist of fixed-maturity investments held by the ceding companies. The funding accounts are adjusted quarterly to equal the ceding companies' net statutory reserve balances. The methodologies and assumptions used to determine the fair values of the underlying instruments are consistent with the fair value methodologies and assumptions we use to value our fixed-maturity investments carried at fair value. Any change in the fair value of the fixed-maturity investments held by the ceding companies is included as a component of the embedded derivative liabilities, at fair value.

(ii) Fair values for collateral finance facilities are determined with reference to underlying business models and observable market inputs, including considerations of negotiated repurchases. Refer to Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*" for information regarding the Orkney I Unwind Transaction.

6. Fair Value of Financial Instruments (continued)

(iii) Fair values for long-term debt, at par were determined with reference to similar quoted securities during 2011 and 2010.

(iv) The fair value of interest-sensitive contract liabilities, which exclude significant mortality risk, was based on the cash surrender value of the liabilities, which is deemed to approximate fair value.

	December 31, 2011		December 31, 2010	
(U.S. dollars in thousands)	**Carrying Value**	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Assets				
Fixed-maturity investments	$ 1,967,689	$ 1,967,689	$ 3,111,724	$ 3,111,724
Preferred stock	58,529	58,529	67,897	67,897
Other investments	14,877	14,877	16,459	16,459
Funds withheld at interest	549,333	549,333	584,617	584,617
Liabilities				
Interest-sensitive contract liabilities	$ 1,301,511	$ 1,291,720	$ 1,415,580	$ 1,398,365
Collateral finance facilities	450,000	40,451	1,300,000	659,713
Embedded derivative liabilities	33,758	33,758	32,545	32,545
Long-term debt, at par value	129,500	72,071	129,500	61,072

7. Deferred Acquisition Costs

The components of DAC activity for the years ended December 31, 2011 and 2010 were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010
Balance at beginning of year	$ 269,352	$ 296,822
Acquisition expenses deferred, net of novations	(545)	3,671
DAC amortization expense	(12,349)	(31,141)
Orkney I Unwind Transaction*	(83,204)	-
Balance at end of year	$ 173,254	$ 269,352

** Refer to Note 9, "Collateral Finance Facilities and Securitization Structures - Orkney I Unwind Transaction" for information regarding the Orkney I Unwind Transaction.*

The DAC amortization expense for the year ended December 31, 2010 included $9.7 million attributable to a series of ceding company recaptures that were executed during the year.

8. Present Value of In-force Business

The activity associated with the present value of in-force business for the years ended December 31, 2011 and 2010 was as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010
Balance at beginning of year	$ 31,941	$ 38,316
Interest accrued	1,565	1,878
Amortization expense	(6,479)	(8,253)
Balance at end of year	$ 27,027	$ 31,941

The amortization of the present value of in-force business for the years ended December 31, 2011 and 2010 included $3.7 million and $4.3 million, respectively, attributable to a series of ceding company recaptures that were executed during each year.

The gross amount of the present value of in-force business and the accumulated amount of amortization at December 31, 2011 and 2010 was as follows:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Gross amount of original present value of in-force business	$ 56,272	$ 56,272
Accumulated interest accrued	17,206	15,641
Accumulated amortization	(46,451)	(39,972)
Net amount of present value of in-force business	$ 27,027	$ 31,941

8. Present Value of In-force Business (continued)

Future estimated amortization of the present value of in-force business is as follows:

(U.S. dollars in thousands) Year ending December 31	
2012	$ 1,255
2013	1,323
2014	1,345
2015	1,421
2016	1,429

9. Collateral Finance Facilities and Securitization Structures

The following tables reflect the significant balances included in the Consolidated Balance Sheets that were attributable to the collateral finance facilities and securitization structures providing collateral support to the Company:

(U.S. dollars in millions)	December 31, 2011 Orkney Re II
Assets	
Funds withheld at interest	$ 362.9
Cash and cash equivalents	1.2
All other assets	41.9
Total assets	$ 406.0
Liabilities	
Reserves for future policy benefits	$ 132.3
Collateral finance facilities	450.0
All other liabilities	28.1
Total liabilities	$ 610.4

9. Collateral Finance Facilities and Securitization Structures (continued)

	December 31, 2010		
(U.S. dollars in millions)	**Orkney I**	**Orkney Re II**	**Total**
Assets			
Fixed-maturity investments	$ 1,081.7	$ -	$ 1,081.7
Funds withheld at interest	-	334.5	334.5
Cash and cash equivalents	113.5	1.5	115.0
All other assets	106.0	54.4	160.4
Total assets	$ 1,301.2	$ 390.4	$ 1,691.6
Liabilities			
Reserves for future policy benefits	$ 318.6	$ 123.9	$ 442.5
Collateral finance facilities	850.0	450.0	1,300.0
All other liabilities	19.9	19.5	39.4
Total liabilities	$ 1,188.5	$ 593.4	$ 1,781.9

The assets listed in the foregoing tables were subject to a variety of restrictions on their use, as set forth in, and governed by, the transaction documents for the applicable collateral finance facilities and securitization structures to which they relate. The total investments of consolidated VIEs disclosed on the Consolidated Balance Sheets as of December 31, 2011 and December 31, 2010, respectively, differ from the amounts shown in the above tables because the assets needed to satisfy future policy benefits, based on current projections, have been deducted in the determination of the total investments of consolidated VIEs disclosed on the Consolidated Balance Sheets. No assurances can be given that the expected reinsurance liabilities will not increase in the event of adverse mortality experience in our reinsurance agreements. Under certain circumstances, such adverse mortality experience may in future periods increase the amount of assets excluded from the total investments of the consolidated VIE(s) on the Consolidated Balance Sheets. The reinsurance liabilities of Orkney I and Orkney Re II have been eliminated from the Consolidated Balance Sheets because they represent inter-company transactions.

Orkney I

On February 11, 2005, OHL issued and sold, in a private offering, an aggregate of $850.0 million Series A Floating Rate Insured Notes due February 11, 2035 (the “Orkney Notes”). OHL was organized for the limited purpose of issuing the Orkney Notes and holding the stock of Orkney Re, originally a South Carolina special purpose financial captive insurance company prior to its 2007 redomestication to Delaware as a Delaware special purpose captive insurance company. SRUS held all of the limited liability company interest in OHL, and had contributed capital to Orkney I in the amount of $268.5 million. Proceeds from the private offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued by direct ceding companies between January 1, 2000 and December 31, 2003, and reinsured by SRUS to Orkney Re. Proceeds from the Orkney Notes were deposited into a series of accounts that collateralized the notes and the reserve obligations of SRUS.

Initially, in accordance with FASB ASC 810-10, Orkney I was considered to be a VIE, and we were considered to hold the primary beneficial interest (because all of the business assumed by Orkney Re had been ceded by us), following an analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Orkney I was consolidated in our financial statements through December 31, 2010. Following the Orkney I Unwind Transaction (see below), Orkney I was dissolved prior to December 31, 2011.

9. Collateral Finance Facilities and Securitization Structures (continued)

Orkney I Unwind Transaction

On April 15, 2011, we entered into agreements to unwind the Orkney I transaction and to recapture from Orkney Re and immediately cede to Hannover Life Reassurance Company of America ("Hannover Life Re") the defined block of level premium term life insurance policies issued by direct ceding companies between January 1, 2000 and December 31, 2003 (such defined block, the "Orkney Block", and such transactions, as further discussed below, the "Orkney I Unwind Transaction"). The Orkney I Unwind Transaction was accomplished on May 27, 2011 in part pursuant to the Settlement and Release Agreement, dated as of April 15, 2011, by and among Orkney Re, OHL, SRUS, SRGL, MBIA Insurance Corporation (the financial guarantor of the Orkney Notes) ("MBIA"), and the investment manager for the Orkney I transaction (the "Settlement Agreement"). Contemporaneous with the transactions contemplated by the Settlement Agreement, SRUS recaptured the Orkney Block from Orkney Re (the "Orkney Recapture") and immediately ceded the Orkney Block to Hannover Life Re pursuant to a coinsurance reinsurance agreement, effective January 1, 2011 (the "New Reinsurance Agreement"). SRUS is obligated pursuant to the New Reinsurance Agreement to use commercially reasonable best efforts to work with Hannover Life Re and the direct writers of the Orkney Block to obtain full novations from SRUS to Hannover Life Re of the underlying reinsurance treaties such that SRUS no longer would be a party to such reinsurance treaties.

On the date of the closing of these transactions, SRUS effectuated the Orkney Recapture and received recapture consideration from Orkney Re of $582.4 million, which recapture consideration was used to fund the ceding commission of $564.8 million due from SRUS to Hannover Life Re under the New Reinsurance Agreement. All assets thereafter remaining in the accounts at Orkney Re were transferred to OHL. OHL purchased all of the outstanding Orkney Notes pursuant to privately-negotiated purchase agreements (the "Note Purchase Agreements") for an aggregate amount of $590.0 million, which represented a discount to the $850.0 million aggregate principal amount of the Orkney Notes. Following the repurchase of the Orkney Notes, OHL immediately cancelled the Orkney Notes, and, thereafter, transferred its remaining assets to its parent, SRUS.

Approximately $700.0 million of the aggregate principal amount of the Orkney Notes purchased by OHL were held by affiliates of Cerberus Capital Management, L.P. ("Cerberus"), one of our controlling shareholders. Under the terms of the Registration Rights and Shareholders Agreement, dated May 2007 among the Company, Cerberus, MassMutual Capital Partners LLC, a member of the MassMutual Financial Group ("MassMutual Capital"), and certain other (now former) shareholders of the Company (the "Shareholders Agreement"), the Company's execution of the Note Purchase Agreement with affiliates of Cerberus required the prior approval of the independent directors of our Board. To this end, a special committee of our Board, comprised of disinterested directors, was appointed to consider, and determine whether the Company should engage in, the Orkney I Unwind Transaction. In its evaluation and approval of the Orkney I Unwind Transaction and related agreements, including the Note Purchase Agreement with Cerberus, the special committee engaged separate legal counsel and a separate financial advisor.

The closing of the Orkney I Unwind Transaction, which occurred on May 27, 2011, was subject to a number of closing conditions, including the receipt of required approvals from the Department, which were received on May 25, 2011.

Following the consummation of the Orkney I Unwind Transaction, SRGL recorded a consolidated net loss of approximately $153.3 million. Due to the New Reinsurance Agreement with Hannover Life Re being effective January 1, 2011, the reinsurance activity associated with the Orkney Block for the period from January 1, 2011 through March 31, 2011 and the negotiated interest on the ceding commission that was paid to Hannover Life Re for the period from January 1, 2011 through May 27, 2011 were settled with Hannover Life Re following the consummation of the Orkney I Unwind Transaction. The Orkney I Unwind Transaction reduced our consolidated total assets and liabilities by approximately $1,007.2 million and $853.9 million, respectively, and resulted in a consolidated U.S. GAAP loss of $153.3 million. The following tables illustrate the impact of the Orkney I Unwind transaction on SRGL's Consolidated Balance Sheets and Consolidated Statements of Operations:

9. Collateral Finance Facilities and Securitization Structures (continued)

Impact of the Orkney I Unwind Transaction
Condensed Consolidated Balance Sheet

(U.S. dollars in thousands)	December 31, 2011
Assets	
Total investments	$ (1,175,334)
Deferred acquisition costs	(83,204)
Receivables and amounts recoverable from reinsurers	252,388
Other assets	(1,002)
Total assets	$ (1,007,152)
Liabilities	
Collateral finance facilities	$ (850,000)
Other liabilities	(3,860)
Total liabilities	$ (853,860)
Shareholders' (Deficit)	(153,292)
Total liabilities, and shareholders' (deficit)	$ (1,007,152)

Impact of the Orkney I Unwind Transaction
Condensed Statement of Operations

(U.S. dollars in thousands)	Year Ended December 31, 2011
Revenues	
Gain on extinguishment of debt	$ 260,000
Total revenues	$ 260,000
Benefits, expenses, and taxes	
Amortization of deferred acquisition costs and other insurance expenses, net	$ 411,374
Collateral finance facilities expense	10,227
Operating expenses	280
Income tax benefit	(8,589)
Total benefits, expenses, and taxes	$ 413,292
Net loss attributable to Scottish Re Group Limited	$ (153,292)

The Orkney I Unwind Transaction was recorded in accordance with the Company's accounting policy to recognize, as a net loss in current period income, the full cost of reinsurance on 100% retrocessions executed with the intent to exit that block of business. The Company viewed the Orkney I Unwind Transaction as a sale of the Orkney Block and is contractually obligated to utilize commercially reasonable efforts to facilitate the novation of the underlying business from SRUS to Hannover Life Re.

9. Collateral Finance Facilities and Securitization Structures (continued)

Orkney Re II

On December 21, 2005, Orkney Re II, whose issued ordinary shares are held by a share trustee and its nominees in trust for charitable purposes, issued, in a private offering, $450.0 million of debt primarily to external investors. The debt consisted of $382.5 million of Series A-1 Floating Rate Guaranteed Notes (the "Series A-1 Notes"), $42.5 million of Series A-2 Floating Rate Notes (the "Series A-2 Notes"), and $25.0 million of Series B Floating Rate Notes (the "Series B Notes"), all due December 31, 2035 (collectively, the "Orkney Re II Notes"). In addition to $5.0 million of the Series B Notes, Orkney Re II also issued to SALIC $30.0 million of Series C Floating Rate Notes ("Series C Notes") due December 21, 2036. The Series C Notes accrue interest only until the Orkney Re II Notes are fully repaid. SRGL owns $0.5 million of Orkney Re II Series D Convertible Notes due December 21, 2036, and 76,190,000 Preference Shares of Orkney Re II of $1.00 each in capital. The Orkney Re II Notes are listed on the Irish Stock Exchange. Proceeds from this private offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued between January 1, 2004 and December 31, 2004, and reinsured by SRUS to Orkney Re II. Proceeds from the Orkney Re II Notes have been deposited into a series of accounts that collateralize the notes and the reserve obligations of SRUS.

Orkney Re II Event of Default, Acceleration and Foreclosure

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

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

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

On all scheduled quarterly interest payment dates since May 11, 2009, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. As of December 31, 2011, Assured made guarantee payments on the Series A-1 Notes in the cumulative amount of $7.9 million over the duration of the scheduled interest payment dates. This amount of cumulative interest is accrued for by us in Accounts Payable and Other Liabilities on the Consolidated Balance Sheets. Interest on the principal amount of the Orkney Re II Notes that Assured is making guarantee payments of is payable quarterly at a rate equivalent to three-month LIBOR plus 0.425% for the Series A-1 Notes. As of December 31, 2011, the interest rate on the Series A-1 Notes was 0.87% (compared to 0.71% as of December 31, 2010. For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes, refer to Note 18, "Subsequent Events – *Orkney Re II*".

9. Collateral Finance Facilities and Securitization Structures (continued)

Ballantyne Re

Ballantyne Re is a special purpose reinsurance vehicle incorporated under the laws of Ireland. In May 2006, Ballantyne Re issued, in a private offering, $1.74 billion of debt to third party investors, $178.0 million of Class C Notes and $181.2 million in preference shares to SALIC, and $500,000 in Class D Notes to SRGL.

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

Effective January 1, 2009, because of an agreement with Hannover Life Re and its affiliate Hannover Life Reassurance (Ireland) Limited ("Hannover (Ireland)" and, together with Hannover Life Re, "Hannover Re") (refer to Note 13, "Reinsurance - *2009 Sale of a Block of Tradition Solutions Business*" for further information), Ballantyne Re is no longer consolidated within the financial statements of SRGL. The de-consolidation of Ballantyne Re reduced our consolidated total assets and liabilities by approximately $885.0 million and $2,035.1 million, respectively, resulting in a one-time non-cash de-consolidation gain of $1,150.1 million, which we recognized in the first quarter of 2009. This gain had no impact on our liquidity position.

As of December 31, 2011, we had no remaining direct loss exposure related to Ballantyne Re since our interests in the Ballantyne Re Class D Notes and Preferred Shares are valued at $0 and are classified as trading securities on the Consolidated Balance Sheets. The Class C Notes were contractually written-off during the fourth quarter of 2008.

SRUS remains liable for 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 ("SLD") of the reinsurance agreement with Ballantyne Re. In addition, the Company and SRUS remain responsible for certain ongoing covenants and indemnities made for the benefit of Ballantyne Re and the financial guarantors of certain of the notes issued by Ballantyne Re.

10. Debt Obligations and Other Funding Arrangements

Long-term debt, at par value (the "Capital and Trust Preferred Securities", as defined below), consisted of:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Capital Securities Due 2032*	$ 17,500	$ 17,500
Preferred Trust Securities Due 2033*	20,000	20,000
Trust Preferred Securities Due 2033*	10,000	10,000
Trust Preferred Securities Due 2034*	32,000	32,000
Trust Preferred Securities Due December 2034*	50,000	50,000
Long-term debt, at par value	$ 129,500	$ 129,500

**Defined below.*

10. Debt Obligations and Other Funding Arrangements (continued)

(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 (as defined below)	Capital Trust*	Capital Trust II*	GPIC Trust*	Capital Trust III*	SFL Trust I*
Long-term debt outstanding	$17,500	$20,000	$10,000	$32,000	$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 at December 31, 2011	4.58%	4.53%	4.48%	4.38%	4.08%
Interest rate at December 31, 2010	4.30%	4.25%	4.20%	4.10%	3.80%
Maximum number of quarters for which interest may be deferred	20	20	20	20	20
Number of quarters for which interest was deferred as of December 31, 2011	12	12	12	12	12

**Defined below.*

Capital Securities Due 2032

On December 4, 2002, Scottish Holdings Statutory Trust I, a Connecticut statutory business trust ("Capital Trust"), issued and sold in a private offering an aggregate of $17.5 million Floating Rate Capital Securities (the "Capital Securities Due 2032"). All of the common shares of the Capital Trust are owned by SHI, one of our wholly-owned subsidiaries. The sole assets of the Capital Trust consist of $18.0 million principal amount of Floating Rate Debentures (the "Debentures") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2011) as the Capital Securities Due 2032.

Preferred Trust Securities Due 2033

On October 29, 2003, Scottish Holdings, Inc. Statutory Trust II, a Connecticut statutory business trust ("Capital Trust II"), issued and sold in a private offering an aggregate of $20.0 million Preferred Trust Securities (the "Preferred Trust Securities Due 2033"). All of the common shares of Capital Trust II are owned by SHI. The sole assets of Capital Trust II consist of $20.6 million principal amount of Floating Rate Debentures (the "2033 Floating Rate Debentures") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2011) as the Preferred Trust Securities Due 2033.

Trust Preferred Securities Due 2033

On November 14, 2003, GPIC Holdings Inc. Statutory Trust, a Delaware statutory business trust ("GPIC Trust") issued and sold in a private offering an aggregate of $10.0 million Trust Preferred Securities (the "Trust

10. Debt Obligations and Other Funding Arrangements (continued)

Preferred Securities Due 2033”). All of the common shares of GPIC Trust are owned by SHI. The sole assets of GPIC Trust consist of $10.3 million principal amount of Junior Subordinated Notes (the “Junior Subordinated Notes”) issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2011) as the Trust Preferred Securities Due 2033.

Trust Preferred Securities Due 2034

On May 12, 2004, Scottish Holdings, Inc. Statutory Trust III, a Connecticut statutory business trust (“Capital Trust III”) issued and sold in a private offering an aggregate of $32.0 million Trust Preferred Securities (the “Trust Preferred Securities Due 2034”). All of the common shares of Capital Trust III are owned by SHI. The sole assets of Capital Trust III consist of $33.0 million principal amount of Floating Rate Debentures (the “2034 Floating Rate Debentures”) issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2011) as the Trust Preferred Securities Due 2034.

Trust Preferred Securities Due December 2034

On December 18, 2004, SFL Statutory Trust I, a Delaware statutory business trust (“SFL Trust I”) issued and sold in a private offering an aggregate of $50.0 million Trust Preferred Securities (the “Trust Preferred Securities Due December 2034” and, together with the Trust Preferred Securities Due 2034, the Trust Preferred Securities Due 2033, the Preferred Trust Securities Due 2033 and the Capital Securities Due 2032, the “Capital and Trust Preferred Securities”). All of the common shares of SFL Trust I are owned by SFL. The sole assets of SFL Trust I consist of $51.5 million principal amount of Floating Rate Debentures (the “December 2034 Floating Rate Debentures”) issued by SFL, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2011) as the Trust Preferred Securities Due December 2034.

SALIC has guaranteed SHI’s and SFL’s obligations under the Debentures, the 2033 Floating Rate Debentures, the Junior Subordinated Notes, the 2034 Floating Rate Debentures, and the December 2034 Floating Rate Debentures and distributions and other payments due on the Capital and Trust Preferred Securities.

For all the securities listed above, any deferred payments would accrue interest quarterly on a compounded basis.

Deferral of Interest Payments on the Capital and Trust Preferred Securities

In order to preserve liquidity, we began deferring interest payments as of March 4, 2009 on the Capital and Trust Preferred Securities. These deferrals were permitted by the terms of the indentures governing the securities and were made at the discretion of our Board of Directors (the “Board”) to preserve liquidity. As of December 31, 2011, we have accrued and deferred payment of $17.4 million of interest on such securities. SHI, SFL, and SALIC are restricted in their ability to make dividend payments in any period where interest payment obligations on these securities are not current.

For further discussion on the accrued and deferred payment on our Capital and Trust Preferred Securities subsequent to December 31, 2011, see Note 18, “Subsequent Events - *Deferral of Interest Payments on the Capital and Trust Preferred Securities*”.

10. Debt Obligations and Other Funding Arrangements (continued)

Stingray Investor Trust and Stingray Pass-Through Trust

On January 12, 2005, SALIC entered into a put agreement with the Stingray Investor Trust for an aggregate value of $325.0 million, which put agreement relates to $325.0 million aggregate stated amount of 5.902% Pass-Through Certificates (the "Pass-Through Certificates") issued by the Stingray Pass-Through Trust (together with the Stingray Investor Trust, "Stingray"). Under the terms of the put agreement, we acquired an irrevocable put option to issue funding agreements to the Stingray Investor Trust in return for the assets in a portfolio of 30-day commercial paper.

This facility was fully utilized, as of April 14, 2008, and $325.0 million of funding agreements were issued to the Stingray Investor Trust.

The Stingray structure included an interest rate swap (the "Interest Rate Swap") as a mechanism for charging interest to SALIC on the funding agreements at a variable interest rate and paying interest to the Pass-Through Certificate holders at a fixed rate. Movements in the fair value of the Interest Rate Swap were included in net realized and unrealized income (losses) in the Consolidated Statements of Operations.

During 2009, we acquired Pass-Through Certificates in privately-negotiated purchases which represented reconsideration events under FASB ASC 810-10. We used a quantitative analysis in determining that the holder of the majority of the Pass-Through Certificates would absorb the majority of the expected gains or losses of Stingray. As a result of these acquisitions, by October 8, 2009, we had acquired Pass-Through Certificates with a stated amount of $169.4 million. This holding represented the majority of the Pass-Through Certificates; therefore, at that time, we determined we were the primary beneficiary of Stingray, and we were required to consolidate Stingray in our consolidated financial statements. The consolidation of Stingray was recorded in accordance with ASC 810-10, which required us to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in Stingray at the acquisition date, measured at their fair values as of that date. We were also required to eliminate any inter-company balances and transactions. The total assets and liabilities of Stingray at initial consolidation were $32.8 million and $52.1 million, respectively. As a result of the initial consolidation of Stingray, we recognized a gain of $248.9 million in the fourth quarter of 2009 as follows.

(U.S. dollars in thousands)	
Elimination of investment in Stingray Pass-Through Trust	$ (56,747)
Recognition of Interest Rate Swap at fair value	32,831
Recognition of outstanding Pass-Through Certificates at fair value	(52,128)
Elimination of liability to Stingray Investor Trust	325,000
Gain on initial consolidation of Stingray	$ 248,956

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

We had elected the fair value option under FASB ASC 825 in respect of the Pass-Through Certificates held by non-affiliated investors prior to the cancellation of the Pass-Through Certificates. The fair value at December 31, 2009 of the outstanding Pass-Through Certificates held by non-affiliated investors was $55.1 million and was included in long-term debt, at fair value in our Consolidated Balance Sheets. Changes in fair value were reflected in change in value of long-term debt, at fair value, in the Consolidated Statements of Operations.

10. Debt Obligations and Other Funding Arrangements (continued)

In January 2010, we acquired, in a privately-negotiated transaction, an additional $18.1 million of aggregate stated amount of Pass-Through Certificates. During July and August 2010, we acquired, through privately-negotiated transactions, an additional $55.5 million and $8.0 thousand, respectively, of aggregate stated amount of Pass-Through Certificates. In conjunction with the July acquisitions, we obtained consent from the sellers to proposed amendments to certain of the transaction-related documents. The proposed amendments provided for the termination of the Interest Rate Swap effective July 2, 2010. The termination of the Interest Rate Swap resulted in a swap termination payment to the Stingray Pass-Through Trust of $39.2 million (the "Swap Termination Payment"), which amount subsequently was distributed on the July 12, 2010 payment date pro rata to all holders of record of Pass-Through Certificates as of June 30, 2010, including the July sellers. As a result of its ownership as of June 30, 2010 of $244.8 million in aggregate stated amount of Pass-Through Certificates, SALIC received $29.5 million of the Swap Termination Payment on the July 12, 2010 distribution date.

Pursuant to a cash tender offer launched on July 7, 2010, we acquired another $24.7 million in aggregate stated amount of Pass-Through Certificates. On September 2, 2010, we cancelled the entire $325.0 million in aggregate stated amount of the Pass-Through Certificates. In connection with the cancellation, the corresponding $325.0 million of funding agreements were surrendered by the Stingray Investor Trust, and all unamortized debt issuance costs relating to Stingray, in the amount of $2.8 million, were written off. These were included in collateral finance facilities expenses in the Consolidated Statements of Operations.

Premium Asset Trust Series 2004-4

On March 12, 2004, SALIC entered into an unsecured funding agreement with the Premium Asset Trust for an aggregate of $100.0 million (the "PATS"). The funding agreement had a stated maturity of March 12, 2009 (the "PATS Maturity Date") and accrued interest at a rate of three-month LIBOR plus 0.922%, payable on a quarterly basis. The amount due under this funding agreement was included under interest-sensitive contract liabilities in our Consolidated Balance Sheets.

During the first quarter of 2009, we extinguished, primarily through negotiated repurchases, SALIC's unsecured funding agreement payment obligation in respect of the PATS. The extinguishment of PATS securities acquired through negotiated repurchases and the settlement of the remaining funding obligation in respect of all PATS securities not repurchased prior to the PATS Maturity Date were completed for a total consideration of $46.5 million compared to the $100.0 million par value of the PATS. Consequently, in accordance with FASB ASC Topic 860, Transfers and Servicing, we recorded a gain on the extinguishment of the PATS debt of $53.5 million in the first quarter of 2009.

Credit Facilities

On November 30, 2006, SALIC and Scottish Re Limited entered into a one year, $5.0 million letter of credit facility with a single bank on a fully-secured basis. This facility was amended on October 31, 2007, to a term of two years and to a limit of $15.0 million. On October 31, 2009, this facility was automatically renewed and remains in place until cancelled by either us or the bank. Outstanding letters of credit for SALIC at December 31, 2011 and 2010 were $75.0 thousand.

11. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares

On May 7, 2007, we completed the equity investment transaction by MassMutual Capital and SRGL Acquisition, LDC, an affiliate of Cerberus, announced by us on November 27, 2006 (the "2007 New Capital Transaction"). Pursuant to the 2007 New Capital Transaction, MassMutual Capital and Cerberus (together, the "Investors") invested an aggregate $600.0 million in the Company in exchange for 1,000,000, in the aggregate, newly-issued Convertible Cumulative Participating Preferred Shares. The gross proceeds were $600.0 million less $44.1 million in closing costs, which resulted in aggregate net proceeds of $555.9 million. Each Convertible Cumulative Participating Preferred Share has a par value of $0.01 per share with an initial stated value and liquidation preference of $600 per share, as adjusted for the accretion of dividends or the payment of dividends or distributions as described further below.

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

We have accounted for the Convertible Cumulative Participating Preferred Shares in accordance with FASB ASC Subtopic 470-20, Debt – Debt with Conversion and Other Options ("FASB ASC 470-20"). Dividends on the Convertible Cumulative Participating Preferred Shares are cumulative and accrete daily on a non-compounding basis at a rate of 7.25% per annum on the stated value of $600.0 million, whether or not there are profits, surplus, or other funds available for the payment of dividends. Such dividends will be made solely by increasing the liquidation preference of the Convertible Cumulative Participating Preferred Shares. As of December 31, 2011, the amount of dividends accreted pursuant to the terms of the Convertible Cumulative Participating Preferred Shares was $202.8 million in the aggregate, or $202.76 per share.

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

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

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

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

11. Mezzanine Equity - Convertible Cumulative Participating Preferred Shares (continued)

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

The Convertible Cumulative Participating Preferred Shares rank, with respect to payment of dividends and distribution of assets upon voluntary or involuntary liquidation, dissolution, or winding-up (a "Liquidation Event"): (a) senior to our ordinary shares and to each other class or series of our shares established by the Board, the terms of which do not expressly provide that such class or series ranks senior to or pari passu with the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event; (b) pari passu with each class or series of our shares, the terms of which expressly provide that such class or series ranks pari passu with the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event; and (c) junior to each other class or series of our securities outstanding as of the date of the completion of the 2007 New Capital Transaction that ranks senior to our ordinary shares, and to each class or series of our shares, the terms of which expressly provide that such class or series ranks senior to the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event and all classes of our preferred shares outstanding as of the completion of the 2007 New Capital Transaction.

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

In connection with a closing of the Merger (as defined below in Mezzanine Equity – Convertible Cumulative Participating Preferred Shares – *Merger Agreement)*, the Investors were required to release their indemnification claim against SRGL arising from alleged breaches of representations and warranties made by SRGL in the Securities Purchase Agreement dated as of November 26, 2006. Refer to Note 15, "Commitments and Contingencies - *Indemnification*".

Merger Agreement

On April 15, 2011, we entered into an agreement and plan of merger (the "Merger Agreement") with affiliates of our controlling shareholders, the Investors, pursuant to which an affiliate of the Investors ("Merger Sub") would be merged into SRGL and SRGL would continue as the surviving entity. Under the Merger Agreement, all ordinary shares would be converted into the right to receive $0.30 per share, which represented a premium of $0.14 (or 87.5%) over the average trading price of the ordinary shares for the three months preceding April 15, 2011 (collectively, the "Merger"), provided that any ordinary shares held by shareholders that properly exercised dissenter rights (the "Dissenting Shareholders") under the Companies Law (2010 Revised) of the Cayman Islands (the "Companies Law") would be valued in accordance with the procedures set forth under the Companies Law. The Merger consideration to all such ordinary shares held by non-Dissenting Shareholders was funded solely by the Investors, on behalf of Merger Sub. Following the effectiveness of the Merger, all of the outstanding ordinary shares of SRGL would be owned by affiliates of the Investors. The Convertible Cumulative Participating Preferred Shares and the Perpetual Preferred Shares were unaffected by the Merger and remain outstanding. Under the terms of the Shareholders Agreement, any agreement for the Company to merge with the Investors or an affiliate of the Investors required the prior approval of a majority of disinterested directors of our Board. To this end, a special committee of the Board, comprised of disinterested directors, was appointed to consider, and determine whether to recommend to the full Board that the Company should engage in, the Merger Agreement. In its evaluation and approval of the Merger and related agreements, the special committee engaged separate legal counsel and a separate financial advisor.

11. Mezzanine Equity - Convertible Cumulative Participating Preferred Shares (continued)

The Merger Agreement permitted SRGL to solicit, receive, evaluate, and enter into negotiations with respect to alternative proposals for a 45 day “go-shop” period beginning April 15, 2011. The special committee, with the assistance of its independent advisors, solicited during this period alternative proposals for the acquisition of the ordinary shares. The Merger Agreement also provided the Investors with a customary right to match a superior proposal. This process did not result in a superior proposal.

Completion of the Merger was subject to, among other conditions, approval by a majority of the ordinary shares held by parties unaffiliated with the Investors or the Company attending and voting at the shareholders meeting (whether in person or by proxy). SRGL prepared and delivered to shareholders on May 11, 2011, in connection with the extraordinary general meeting of shareholders held on June 8, 2011, an Information Statement (which Information Statement subsequently was posted to the Company’s website) containing detailed information regarding the Merger. The Merger was approved at such meeting by the Company’s shareholders, including by a majority of the ordinary shares held by parties not affiliated with the Investors or the Company (attending and voting at the shareholders meeting whether in person or by proxy).

The Merger Agreement imposed certain conditions to the obligations of the respective parties to close the Merger. Among these conditions was the receipt of required governmental consents and approvals, all of which were received. Additionally, it was a condition to the obligation of the Investors and Merger Sub to effect the Merger that ordinary shareholders holding no more than 10% of the issued and outstanding ordinary shares (excluding, generally, any ordinary shares owned by the Investors, the Company, or their respective affiliates (“Owned Shares”)) have exercised dissenters’ rights under the Companies Law. In connection with the procedures set forth in the Information Statement and Section 238 of the Companies Law, the Company received notices to exercise such dissenter’s rights from the Dissenting Shareholders holding in excess of 10% of the outstanding ordinary shares (excluding Owned Shares). The Investors and Merger Sub subsequently waived this condition, and, on August 24, 2011, the Merger was completed. Upon the closing and effectiveness of the Merger on August 24, 2011, all existing ordinary shares of the Company were cancelled and all shareholders (other than Dissenting Shareholders and the holders of any Owned Shares) were eligible to receive Merger consideration of $0.30 per ordinary share. With the completion of the Merger, all outstanding voting shares of the Company are now owned by the Investors. The deemed capitalization of Merger Sub by the Investors prior to the Merger and the subsequent payment of the Merger consideration by the Investors on behalf of the Merger Sub, effective on August 24, 2011, totaled approximately $17.7 million, and had no net impact on the Company’s consolidated financial statements. Following the closing and effectiveness of the Merger, the Company continued to have certain obligations under Section 238 of the Companies Law which could have included participating in court proceedings in the Cayman Islands to determine the fair value of the Dissenting Shareholders’ ordinary shares. In connection with the requirements of Section 238 of the Companies Law, the Company engaged in negotiations with each of the Dissenting Shareholders in respect of the consideration to be paid for their ordinary shares and reached resolution with each such Dissenting Shareholder. Other than with respect to the reimbursement of a minimal amount of costs and expenses that were paid by the Company, all amounts paid to the Dissenting Shareholders in respect of their ordinary shares were funded by the Investors.

12. Shareholders' (Deficit) Equity

Ordinary Shares

We are authorized to issue 590,000,000 ordinary shares of par value $0.01 each.

The following table summarizes the activity in our ordinary shares during the years ended December 31, 2011, 2010, and 2009:

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Ordinary shares			
Beginning of year	68,383,370	68,383,370	68,383,370
Ordinary Shares cancelled in connection with the Merger*	(68,383,370)	-	-
Ordinary Shares into which shares of Merger Sub were converted in connection with the Merger*	68,383,370	-	-
End of year	68,383,370	68,383,370	68,383,370

***** *Refer to Note 11, "Mezzanine Equity - Convertible Cumulative Participating Preferred Shares - Merger Agreement", for information regarding the Merger.*

Perpetual Preferred Shares

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

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 following table summarizes the activity in our non-cumulative Perpetual Preferred Shares during the years ended December 31, 2011, 2010, and 2009:

	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Non-cumulative Perpetual Preferred Shares			
Beginning of year	4,806,083	5,000,000	5,000,000
Non-cumulative Perpetual Preferred Shares redeemed	-	(193,917)	-
End of year	4,806,083	4,806,083	5,000,000

Dividends on the Perpetual Preferred Shares are payable on a non-cumulative basis at a rate per annum of 7.25% until the dividend payment date in July 2010. Thereafter, the dividend rate may be at a fixed rate determined through remarketing of the Perpetual Preferred Shares for specific periods of varying length not less than six months or may be at a floating rate reset quarterly based on a predefined set of interest rate benchmarks. The quarterly floating rates from September 30, 2010 through December 31, 2011 ranged between 6.41% and 8.04%. During any dividend period, unless the full dividends for the current dividend period on all outstanding Perpetual Preferred Shares have been declared or paid, no dividend may be paid or declared on our ordinary shares and no ordinary shares or other junior shares may be purchased, redeemed, or otherwise acquired for consideration. For further discussion on the Perpetual Preferred Shares, see Note 18, "Subsequent Events - *Perpetual Preferred Shares*".

12. Shareholders' (Deficit) Equity (continued)

Dividends on Ordinary Shares

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 July 28, 2006, our Board suspended the dividend on the ordinary shares. All future payments of dividends are at the discretion of our Board and will depend on our income, capital requirements, insurance regulatory conditions, operating conditions, and such other 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 the current dividend period, we generally are precluded from paying or declaring any dividend on the Ordinary Shares. Refer to Note 11, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares - *Merger Agreement*", for information regarding the ordinary shares following the completion of the Merger.

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 dividends on each of the 2009 and 2010 dividend payment dates and, as a result, did not declare and pay a dividend on such dates. Although permitted under the terms of the Perpetual Preferred Shares to declare and pay a dividend in connection with the 2011 dividend payment dates, the Board resolved not to declare and pay a dividend on each such dividend payment date. 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. Nonpayment of dividends on July 15, 2009 marked the sixth dividend period for which dividends had not been declared and paid. This right to elect two directors to our Board has not been exercised as of December 31, 2011. For further discussion on the non-declaration of Perpetual Preferred Shares dividends, refer to Note 18, "Subsequent Events - *Non-declaration of Dividends on Perpetual Preferred Shares*".

13. Reinsurance

Premiums Earned, Net

The components of the net premiums earned were as follows for the years ended:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010	December 31, 2009
Premiums assumed	$ 647,871	$ 714,916	$ 763,190
Premiums ceded	(344,951)	(293,782)	(311,390)
Premiums earned, net	$ 302,920	$ 421,134	$ 451,800

Reinsurance agreements may provide for recapture rights on the part of the ceding company. Recapture rights permit the ceding company to reassume all or a portion of the risk formerly ceded to the reinsurer after an agreed-upon period of time or, in some cases, due to changes in the financial condition or ratings of the reinsurer. The recapture of business previously ceded to the Company does not affect premiums assumed prior to the recapture of such business, but would reduce premiums in subsequent periods.

13. Reinsurance (continued)

Claims, Policy Benefits and Changes in Policyholder Reserves, Net

The components of the claims, policy benefits and changes in policyholder reserves, net were as follows for the years ended:

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010	December 31, 2009
Claims, policy benefits and changes in policyholder reserves assumed	$ 656,628	$ 617,723	$ 267,240
Claims, policy benefits and changes in policyholder reserves ceded	(341,874)	(223,105)	(290,166)
Claims, policy benefits and changes in policyholder reserves, net	$ 314,754	$ 394,618	$ (22,926)

At December 31, 2011 and 2010, there were no reinsurance ceded receivables associated with a single reinsurer in excess of 1% of total assets.

2009 Sale of a Block of Traditional Solutions Business

We announced on February 20, 2009 that we had closed the transactions contemplated by the Master Asset Purchase Agreement (the "Purchase Agreement"), by and among the Company, SHI, SRUS, SRLB and SRD (collectively, the "Sellers") with Hannover Re to sell a block of individual life reinsurance business acquired in 2004 from SLD and Security Life of Denver International Limited ("SLDI" and, together with SLD, the "ING Companies"), which block consisted primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business (the "Acquired Business"), and which block was part of our Traditional Solutions business.

The Acquired Business generally did not include business previously ceded by SRUS to Ballantyne Re, as the reinsurance transaction with this special purpose reinsurance vehicle was novated and assigned from SRUS to SLD effective October 1, 2008. However, the Acquired Business did include certain business recaptured in 2008 from Ballantyne Re to SRUS, then recaptured from SRUS to SLD, and ultimately ceded by SLD through its affiliate, SLDI, to SRLB, as well as the business recaptured in connection with the unwind in 2008 of our former HSBC II collateral finance facility.

In connection with the Purchase Agreement, the ING Companies and certain of the Sellers entered into recapture agreements (and, in specific instances, novations to Hannover Re of certain existing reinsurance agreements) with respect to the Acquired Business, and the ING Companies and Hannover Re subsequently entered into new reinsurance agreements with respect to the Acquired Business immediately thereafter. These recapture and reinsurance transactions and the novations had an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent such liabilities were attributable to periods prior to January 1, 2009, but we were released from all associated policy holder liabilities attributable to periods subsequent to December 31, 2008.

The Purchase Agreement also related to the purchase and sale of certain assets used by the Sellers in connection with the administration of the Acquired Business and the transfer of certain employees from the Sellers to Hannover Re. Pursuant to the Purchase Agreement, the remaining lease on SRUS' Denver office location was assigned to Hannover Re as was a portion of SRUS' Charlotte office location. In addition, Hannover Life Re entered into an administrative services agreement with SRUS pursuant to which Hannover Life Re administers the accepted and ceded mortality business retained by SRUS and its affiliates.

13. Reinsurance (continued)

The release of liabilities associated with the transaction resulted in a pre-tax gain of $703.6 million, after transaction expenses and related costs. This gain was also subject to certain contingencies, which were all satisfied during 2009. This total gain is summarized as follows:

(U.S. dollars in millions)	**Balance Sheet**	**Consolidated Statement of Operations**
Transfer of investments	$ (1,468.7)	
Release of reserve for future policy benefits	1,902.9	
Decrease in accounts payable and other liabilities	1.7	
Decrease in reinsurance balances and risk fees receivable	(6.3)	
Decrease in reinsurance balances payable	4.7	
Increase in other assets	18.7	
Decrease in claims and other policy benefits	$ 453.0	$ 453.0
Change in value of embedded derivative liabilities	$ 275.5	275.5
Amortization of deferred acquisition costs and other insurance expenses, net	$ (24.9)	(24.9)
Total pre-tax gain in 2009		$ 703.6

This transaction resulted in a $49.8 million income tax expense due to an increase in our valuation allowance. The increased valuation allowance was because the remaining deferred tax liabilities did not support the full recoverability of our deferred tax assets.

14. Income Taxes

For the years ended December 31, 2011, 2010, and 2009, we had income tax expense (benefit) from operations, as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Current tax expense (benefit):			
U.S.	$ -	$ -	$ (8,088)
Non-U.S.	178	(33,590)	-
Total current tax expense (benefit)	178	(33,590)	(8,088)
Deferred tax (benefit) expense:			
U.S.	1,035	(5,892)	49,838
Non-U.S.	(3,830)	1,541	7,781
Total deferred tax (benefit) expense	(2,795)	(4,351)	57,619
Total tax (benefit) expense	$ (2,617)	$ (37,941)	$ 49,531

The deferred tax expense for the year ended December 31, 2011 for the U.S. companies listed above was primarily caused by an increase of approximately $10.8 million in our deferred tax liabilities associated with the SRLC model change (as explained in Note 2, "Summary of Significant Accounting Policies - *Reserves for Future Policy Benefits*"), offset by an approximately $8.6 million deferred tax benefit associated with the Orkney I Unwind Transaction (as discussed in Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*"). The deferred tax benefit for the year ended December 31, 2011 for the non-U.S. entities listed above was primarily caused by the release of a potential withholding tax liability due to the formation of a new Luxembourg subsidiary, SHL, and the related transfer of an intercompany surplus note (issued by SRUS) from SALIC to SHL.

The weighted average expected tax (benefit) expense has been calculated using the pre-tax accounting income (loss) in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. Reconciliation of the difference between the (benefit) expense for income taxes and the expected tax (benefit) expense at the weighted average tax rate for the years ended December 31, 2011, 2010, and 2009 is provided below:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
Pre-tax (loss) income	$ (201,741)	$ 198,602	$ 2,355,574
Expected tax (benefit) expense at weighted average rate	(62,701)	53,516	196,629
Change in valuation allowance	60,832	(55,271)	(147,580)
Uncertain tax positions	(2,446)	(37,484)	8,558
Other and state taxes	1,698	1,298	(8,076)
Total tax (benefit) expense	$ (2,617)	$ (37,941)	$ 49,531

14. Income Taxes (continued)

We are not subject to income taxation other than as stated above. There can be no assurance that there will not be changes in applicable tax laws, regulations or treaties, which might require us to change the way we operate or become subject to taxes. At December 31, 2011 and 2010, we had tax operating loss carry forwards in our U.S. and Irish entities, as presented in the table below.

(U.S. dollars in thousands)	U.S. Life & Non-Life Groups	Irish Operating Company	Irish Special Purpose Vehicles	Total
Operating loss carry forwards available at December 31, 2010	$ 720,060	$ 524,841	$ 306,271	$ 1,551,172
Operating losses accrued during 2011	132,401	19,706	10,732	162,839
Operating loss carry forwards available at December 31, 2011	$ 852,461	$ 544,547	$ 317,003	$ 1,714,011
Deferred tax asset for operating losses, before valuation allowance, at December 31, 2011	$ 291,285	$ 68,068	$ 79,251	$ 438,604

The operating loss carry forwards in our U.S. entities will expire, if not utilized, in years 2021 through 2031, while the operating loss carry forwards in our Irish entities benefit from an unlimited carry forward period. The net operating loss carry forwards generated prior to 2011 resulted primarily from the current operations of SRUS, SRLC, SHI, SRD, Orkney Re, and Orkney Re II. The net operating loss carry forward generated in the current year resulted primarily from the current operations of SRUS, SRLC, SHI, SRD, Orkney Re II, and the Orkney I Unwind Transaction. Refer to Note 9, "Collateral Finance Facilities and Securitization Structures – *Orkney I Unwind Transaction*" for information regarding the Orkney I Unwind Transaction.

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. Significant components of our deferred tax assets and liabilities as of December 31, 2011 and 2010 were as follows:

14. Income Taxes (continued)

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Deferred tax asset		
Net operating losses (net of FASB ASC 740-10 and section 382*)	$ 438,604	$ 388,360
Unrealized depreciation on investments	5,822	50,821
Intangible assets	2,408	3,340
Capital loss carryforwards	55,287	22,372
Collateral finance facilities costs	-	649
Surplus note accrual	709	13,923
Embedded derivative liabilities	9,668	10,970
Foreign affiliate accruals	6,230	5,611
Other	3,364	1,377
Total deferred tax asset	522,092	497,423
Deferred tax liability		
Deferred acquisition costs	(24,316)	(53,578)
Reserves for future policy benefits	(143,547)	(136,888)
Present value of in-force business	(9,189)	(10,860)
Deferred market discount	(7,483)	(12,783)
Other	(2,226)	(159)
Total deferred tax liability	(186,761)	(214,268)
Net deferred tax asset before valuation allowance	335,331	283,155
Valuation allowance	(380,552)	(327,316)
Net deferred tax liability	$ (45,221)	$ (44,161)

* *Described below*

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 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. Our valuation allowance increased by approximately $53.2 million during the year ended December 31, 2011, to $380.5 million.

Section 382 Event

The investments made by the Investors on May 7, 2007 (as discussed in Note 11, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares") qualified as a change in ownership under Section 382 of the Internal Revenue Code. Section 382 operates to limit the future deduction of net operating losses that were in existence as of the change in ownership. Because we had previously established a valuation allowance against these net operating losses, there was not a significant tax expense associated with Section 382 limitations.

FASB ASC Subtopic 740-10, Income Taxes – Overall (formerly FIN 48)

In 2011, the statute of limitations expired for the 2006 Irish income tax year, which resulted in a reduction of our unrecognized tax benefits in the amount of $2.4 million. The 2007 tax year remains open for the U.S. life insurance ("U.S. Life Group") due to the statute extension that SRUS signed as part of the Internal Revenue Service ("IRS") examination described below. At December 31, 2011, 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 tax benefit at the effective tax rate. At December 31, 2010, we had total unrecognized tax benefits (excluding interest and penalties) of $111.3 million, the recognition of which would result in a $3.5 million tax benefit at the effective tax rate.

14. Income Taxes (continued)

As a result of a 2010 U.S. tax court ruling relating to an unaffiliated third party (Container Corporation v. Commissioner, 134 T.C. 5 (2010)), we reconsidered our position in respect of an uncertain tax position and evaluated the implications of the ruling in accordance with FASB ASC 740-10. As a result of the tax court ruling, we released a tax liability of $35.9 million (inclusive of interest and penalties) in the first quarter of 2010.

The following is a roll-forward of our FASB ASC 740-10 unrecognized tax benefits for the years ended December 31, 2011 and 2010:

(U.S. dollars in thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010
Total unrecognized tax benefits at beginning of year	$ 111,266	$ 132,247
Gross amount of decreases for prior year's tax position	-	(17,887)
Gross amount of increases for current year's tax position	689	828
Reductions due to lapse of statutes of limitation	(2,446)	(3,922)
Total unrecognized tax benefits at end of year	109,509	111,266
Tax benefit of unrecognized tax benefits if recognized at the effective tax rate	$ 4,168	$ 3,522

Interest and penalties (not included in the "unrecognized tax benefits" above) are a component of the position for income taxes.

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010	December 31, 2009
Total interest & penalties in the Consolidated Balance Sheets at beginning of year	$ 2,946	$ 19,442	$ 16,640
Total interest and penalties in the Consolidated Statements of Operations	1,184	(16,496)	2,802
Total interest & penalties in the Consolidated Balance Sheets at end of year	$ 4,130	$ 2,946	$ 19,442

We are unable to determine with any certainty whether it is reasonably possible that significant changes in the gross balance of unrecognized tax benefits may occur in the next twelve months.

We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of December 31, 2011, we remained subject to examination in the following major tax jurisdictions for the years indicated in the table below:

Major Tax Jurisdictions	Open Years
U.S.	
Life Group	2007 through 2011
Non-Life Group	2008 through 2011
Ireland	2007 through 2011

Net operating losses are being carried forward from closed years and could be examined by the IRS when utilized in an open year in the future. Additionally, to the extent that a net operating loss has been carried back to an

14. Income Taxes (continued)

otherwise closed year, that earlier year could be subject to examination as long as the loss year remains open.

On March 30, 2011, SRUS was notified that the IRS would perform an examination of our consolidated U.S. Life Group tax returns for 2004, 2007, 2008, and 2009. As of December 31, 2011, this examination was still in progress, but we believe the examination will be concluded with no cash tax liability or any impact to the Company's Consolidated Statements of Operations. When the IRS completes their examination, our case will be submitted for review and approval to the Joint Committee on Taxation (the "Joint Committee"); however, final approval could take up to twelve months from the date of submission to the Joint Committee. For further discussion on the IRS examination, please refer to Note 18, "Subsequent Events - *Internal Revenue Service Examination*".

15. Commitments and Contingencies

Indemnification

In connection with an examination of the statutory financial statements of certain of our operating insurance subsidiaries, and, specifically, the purchase accounting entries made in connection with the 2004 acquisition of the ING business, we determined in 2007 that certain intercompany receivables and intercompany claims were not reflected in the statutory financial statements of SRUS and SRD in accordance with applicable statutory accounting practices. The effect of the associated corrections resulted in a restated statutory surplus at year-end 2006 for each of SRUS and SRD.

Although the restated statutory surplus of each of SRUS and SRD met the applicable minimum statutory surplus requirements at December 31, 2006, and none of these corrections impacted our historical consolidated financial statements under U.S. GAAP, we were obligated under the terms of the Purchase Agreement with the Investors to notify the Investors in November 2007 of the cumulative overstatement of reported statutory surplus in SRD and the cumulative understatement of statutory surplus in SRUS. The Investors responded by notifying us of their concern that such corrections may constitute breaches of certain of the representations and warranties made by us in the Purchase Agreement. Under the Purchase Agreement, in the event of a claim for losses resulting from a diminution in value, such losses generally would be determined by an independent investment banking firm based on changes in the valuation of SRGL using the assumptions and models used by the Investors at the time of their decision to invest in us, and any such indemnification claim would be satisfied by adjusting the conversion amount at which the Convertible Cumulative Participating Preferred Shares issued to the Investors would be convertible into our ordinary shares. Following communications from the Investors in 2007, no further action was taken by us or the Investors in respect of this claim. We were not able to predict what the amount of any indemnifiable losses would have been, if any, or what potential defenses or other limitations on indemnification would have been available to us under those circumstances. In connection with the closing of the Merger (described in more detail in Note 11, "Mezzanine Equity - Convertible Cumulative Participating Preferred Shares – *Merger Agreement*"), the Investors were required to release their indemnification claim against SRGL arising from such alleged breaches of representations and warranties. The Investors waived in connection with the Merger Agreement any claim to indemnification in respect of this matter.

Lease Commitments

We lease office space in certain countries in which we conduct business under operating leases that expire at various dates through 2016. Total rent expense with respect to these operating leases for the years ended December 31, 2011, 2010, and 2009 was approximately $0.7 million, $1.2 million, and $1.4 million, respectively. The operating lease for our former Denver office was sold as part of the sale of the Acquired Business to Hannover Re in 2009. Refer to Note 13, "Reinsurance – *2009 Sale of a Block of Traditional Solutions Business*" for information regarding the sale of the Acquired Business to Hannover Re in 2009. At December 31, 2011, we held operating leases for our offices in Charlotte, North Carolina, U.S.; Dublin, Ireland; and Hamilton, Bermuda.

15. Commitments and Contingencies (continued)

Future minimum lease payments under the leases are expected to be:

(U.S. dollars in thousands) Year ending December 31,	Gross Lease Payments	Sublease Rentals	Net Lease Payments
2012	$ 1,657	$ (1,269)	$ 388
2013	1,265	(700)	565
2014	1,294	(603)	691
2015	1,333	(621)	712
2016	1,372	(639)	733
Total future lease commitments	$ 6,921	$ (3,832)	$ 3,089

Concentrations of Credit Risk

The creditworthiness of a counterparty is evaluated by us, taking into account credit ratings assigned by rating agencies and other factors. The credit approval process involves an assessment of factors including, among others, counterparty, country, and industry credit exposure limits. Collateral may be required, at our discretion, on certain transactions, based on our evaluation of the creditworthiness of the counterparty.

The areas where significant concentrations of credit risk may exist include amounts recoverable from reinsurers and reinsurance balances receivable (collectively "reinsurance assets"), investments, and cash and cash equivalent balances. A credit exposure exists with respect to reinsurance assets as they may become uncollectible. We manage our credit risk in our reinsurance relationships by transacting with reinsurers that we consider financially sound, and if necessary, we may hold collateral in the form of funds, trust accounts, and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis.

Revenues from transactions with a single external customer did not amount to 10% or more of our revenues.

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.

16. Statutory Requirements and Dividend Restrictions

Our insurance and reinsurance subsidiaries are subject to insurance laws and regulations in the jurisdictions in which they operate, which include Bermuda, the Cayman Islands, Ireland, and the U.S. Certain of these regulations include restrictions that limit the amount of dividends or other distributions, such as loans or cash advances, available to shareholders of the insurance and reinsurance subsidiaries without prior approval of the insurance regulatory authorities. The difference between financial statements prepared for insurance regulatory authorities and statements prepared in accordance with U.S. GAAP vary by jurisdiction; however, the primary difference is that financial statements prepared for some of the insurance regulatory authorities do not reflect DAC, limit the amount of deferred income tax net assets, limit or disallow certain intangible assets, have different investment measurement methodologies, establish reserves for invested assets, and calculate benefit reserves by a defined formulaic process, among other differences from U.S. GAAP.

16. Statutory Requirements and Dividend Restrictions (continued)

Statutory Requirements for Non-U.S. Subsidiaries

Our Bermuda insurance company, SRLB, is required to maintain a minimum capital of $0.25 million as of December 31, 2011, and, under The Insurance Law of the Cayman Islands, SALIC must maintain a minimum net capital worth of $0.24 million. There were no statutory restrictions on the payment of dividends from retained earnings by any of the Bermuda or Cayman subsidiaries as the minimum statutory capital and surplus requirements are satisfied by the share capital and additional paid-in capital of each of the subsidiaries.

SRD is required by the Central Bank of Ireland (the "Central Bank") to maintain a minimum level of paid up share capital. The Central Bank has put certain restrictions in place on the ability of SRD to make dividend payments from profits available for distribution within the meaning of the Companies (Amendment) Act, 1983. On July 15, 2006, Statutory Instrument 380 ("SI 380") of 2006 transposed into Irish law European Union Council Directive 2005/68/EC, which establishes a regulatory regime for reinsurance organizations and defines minimum requirements for certain liabilities, assets backing these liabilities, and surplus. At December 31, 2011 and 2010, SRD had a solvency margin of 195% and 191%, respectively. These percentages were based on the available capital versus the Minimum Guaranteed Fund, which is required to be held under Schedule 2 of SI 380.

SALIC is a party to a net worth maintenance agreement with SRD, pursuant to which SALIC effectively guarantees SRD's regulatory solvency.

Statutory Requirements for U.S. Subsidiaries

Our Delaware-domiciled reinsurance subsidiaries file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by the Department, including the Department's adherence to National Association of Insurance Commissioners (the "NAIC") risk-based capital ("RBC") requirements for life and health insurance companies (the "Delaware Basis"). The Department recognizes only statutory accounting practices prescribed or permitted by the Department for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under Delaware Insurance Law. The NAIC's Accounting Practices and Procedures Manual ("AP&P Manual") has been adopted as a component of prescribed accounting practices by the Department.

As of December 31, 2011 and 2010, SRUS and SRLC exceeded all minimum RBC requirements on a Delaware Basis. The maximum amount of dividends that can be paid by SRUS and SRLC without prior approval of the Delaware Insurance Commissioner (the "Commissioner") is limited to the greater of the net gain from operations for the preceding year or 10% of statutory surplus as of the preceding year-end, not exceeding earned surplus. The applicable statutory provisions only permit an insurer to pay a shareholder dividend from unassigned surplus. Unassigned surplus for SRUS and SRLC at December 31, 2011 and 2010 was negative. Accordingly, SRUS and SRLC cannot pay dividends in 2012 without the prior approval of the Commissioner.

Prior to completion of the Orkney I Unwind Transaction, Orkney Re was another one of our Delaware-domiciled reinsurance companies. Refer to Note 9, "Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*", for information regarding the New Reinsurance Agreement with Hannover Life Re effective January 1, 2011 and the dissolution of Orkney Re.

The following table presents, for each of our U.S. reinsurance subsidiaries, the statutory capital and surplus as of December 31, 2011 and 2010, and the statutory net income (loss) for the years ended December 31, 2011, 2010, and 2009, as reflected in each company's most recent statutory financial statement filings with the Department.

16. Statutory Requirements and Dividend Restrictions (continued)

	Statutory Capital & Surplus		Statutory Net Income (Loss)		
(U.S. dollars in thousands)	**2011**	**2010**	**2011**	**2010**	**2009**
SRUS	$ 328,626	$ 292,318	$ (199,667)	$ 49,397	$ 119,134
SRLC	$ 44,460	$ 68,483	$ (22,334)	$ (7,396)	$ (4,102)
Orkney Re*	$ -	$ 874,706	$ -	$ 22,194	$ 14,116

** With the Department's approval, in connection with the Orkney I Unwind Transaction, Orkney Re did not make a statutory financial statement filing for the year ended December 31, 2011.*

The company action level RBC percentage at December 31, 2011 for SRUS and SRLC was 527% and 219%, respectively, as filed with the Department. The company action level RBC percentage at December 31, 2010 for SRUS, SRLC, and Orkney Re was 466%, 292%, and 2,078%, respectively, as filed with the Department. The 2011 U.S. statutory filings are subject to audit and, consequently, may be subject to adjustments.

SRUS

SRUS historically obtained credit for reinsurance on its statutory financial statements for reinsurance ceded to each of Orkney Re and certain of its non-U.S. affiliated reinsurers (each a "Subject Reinsurer" and, collectively, "Subject Reinsurers") to the extent of the fair market value of eligible securities held in the qualifying reserve credit trust account established by each of the respective Subject Reinsurers, for the exclusive benefit of SRUS, pursuant to and in accordance with Delaware Insurance Regulation §1003 (Credit for Reinsurance) (each such eligible security meeting the requirements of subsection 9.1.2 thereof, an "Eligible Security", and each such trust account, a "Trust Account").

In connection with the filing of its statutory financial statement for the period ended September 30, 2008, SRUS requested and received approval for a Permitted Practice from the Department. Specifically, under the Permitted Practice, SRUS received permission to take as a reduction from liability the reinsurance ceded by SRUS to each Subject Reinsurer in an amount up to, but not greater than, the specific obligations under the reinsurance agreements with such Subject Reinsurer that the respective Trust Account was established to secure, provided that:

1. The original book value of all Eligible Securities on deposit in the applicable Trust Account (such book value to be determined at the time such securities were deposited to such Trust Account) was, when combined with any cash on deposit therein, not less than the specific obligations related to such Trust Account; and

2. The current fair market value of cash and Eligible Securities held in the applicable Trust Account was not less than the specific obligations related to such Trust Account calculated using the Commissioners Standard Ordinary mortality basis (2001 CSO); and

3. The appointed actuary opined that sufficient experience exists to demonstrate that such 2001 CSO mortality basis provided reasonable margin relative to experience.

In the event any one or more of the foregoing conditions (each a "Condition") was not met, the reduction from liability for reinsurance ceded by SRUS to any applicable Subject Reinsurer would be reduced by an amount equal to the absolute value of the shortfall resulting from application of the specific Condition failing to be met (or if more than one Condition was not met, application of the specific Condition that resulted in the greatest shortfall).

A reconciliation of statutory net income and capital and surplus determined in accordance with the AP&P Manual (the "NAIC basis") and the amounts determined in accordance with the Delaware Basis as of and for the year ended December 31, 2010 was as follows:

16. Statutory Requirements and Dividend Restrictions (continued)

(U.S. dollars in thousands)	December 31, 2010 Statutory Net Income		December 31, 2010 Statutory Capital & Surplus	
Financial statements - NAIC basis	$	49,397	$	221,876
Permitted increase in reserve credit		-		70,442
Financial statements – Delaware basis	$	49,397	$	292,318

By an order dated June 23, 2011, the Department determined that its supervision of SRUS no longer was required and formally released SRUS from the Amended Order, effective immediately. Concurrent with the release of the Amended Order, SRUS ceased utilizing the Permitted Practice and, therefore, has no reconciling items between the NAIC basis and the Delaware Basis as of December 31, 2011.

SRLC

SRLC did not utilize any permitted accounting practices during the years ended December 31, 2011 and 2010.

Orkney Re

Pursuant to its Certificate of Authority issued by the Department, Orkney Re established and maintained its reserves in accordance with U.S. GAAP, rather than the statutory reserves determined in accordance with the NAIC basis.

A reconciliation of statutory net income (loss) and capital and surplus (deficit) determined under the NAIC basis and the amounts determined under the Delaware basis as of and for the year ended December 31, 2010 was as follows:

(U.S. dollars in thousands)	December 31, 2010 Statutory Net Income (Loss)		December 31, 2010 Statutory Capital & Surplus (Deficit)	
Financial statements - NAIC basis	$	(18,094)	$	(56,479)
Permitted valuation basis adjustment		40,288		931,185
Financial statements – Delaware basis	$	22,194	$	874,706

As of December 31, 2011, Orkney Re had been dissolved. Refer to Note 9, “Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*”, for information regarding the Orkney I Unwind Transaction.

Orkney Re – Intent and Ability to Hold its Investments

In the fourth quarter of 2010, Orkney Re changed its intent to hold its investments for a period of time sufficient to recover the statutory accounting amortized cost values of its investments. This change in intent caused Orkney Re to record other-than temporary impairments (“OTTIs”) of approximately $115.0 million, which represented the difference between the amortized cost values and the fair values of Orkney Re’s investments. Orkney Re recorded the OTTIs as realized losses in its statutory accounting basis financial statements for the nine months ended September 30, 2010, but this change in intent and the resulting statutory basis losses did not affect our consolidated financial statements or the results of our operations because the investments were classified as held for trading and were already carried at fair value in our consolidated financial statements.

17. Related Party Transactions

In connection with the 2007 New Capital Transaction and the completion of the Merger, the Investors held all of our equity voting power at December 31, 2011, along with the right to designate members of our Board. Refer to Note 11, “Mezzanine Equity – Convertible Cumulative Participating Preferred Shares” for information regarding the 2007 New Capital Transaction and the Merger Agreement.

For the years ended December 31, 2011, 2010, and 2009, we had premiums earned of $17.1 million, $15.7 million, and $15.1 million, respectively, associated with MassMutual Capital. As of December 31, 2011 and 2010, we had a net receivable from MassMutual Capital of $3.7 million and $3.3 million, respectively.

We incurred $13.5 thousand, $17.0 thousand, and $15.0 thousand for Board fees payable to Babson Capital Management LLC, a subsidiary of MassMutual Capital, for the years ended December 31, 2011, 2010, and 2009, respectively.

We also incurred $2.4 million and $2.5 million for investment management fees payable to Babson Capital Management LLC for the years ended December 31, 2011 and 2010, respectively. Babson Capital Management LLC was appointed in the fourth quarter of 2009 as investment manager for all our invested assets, excluding investments held in securitization structures and certain company-directed investments.

For as long as the Cypress Entities in the aggregate beneficially owned at least 2.5% of our outstanding voting shares on a fully-diluted basis, they were entitled to designate at least one individual for election to the Board. The Cypress Entities owned collectively 4.3% of our outstanding voting shares on a fully-diluted basis as of December 31, 2010, and had a representative on the Board. These shares were cancelled in exchange for Merger consideration as part of the Merger. Refer to Note 11, “Mezzanine Equity – Convertible Cumulative Participating Preferred Shares - *Merger Agreement*”, for information regarding the Merger.

During 2010, we sold our entire investment ($3.7 million) in Cypress Sharpridge Investments, Inc., which is an affiliate of the Cypress Entities. During the years ended December 31, 2010, and 2009, we received $0.4 million, and $0.7 million in dividend income, respectively, from our investment in Cypress Sharpridge Investments, Inc. Furthermore, included in Fixed-Maturity Investments as of December 31, 2010 were $2.0 million of bonds issued by affiliates of MassMutual Capital. We received $0.1 million in interest income in each of the years ended December 31, 2010, and 2009, respectively, on the bonds issued by affiliates of MassMutual Capital. These bonds were held in the Orkney I portfolios and were transferred to Hannover Life Re as part of the Orkney I Unwind Transaction. Refer to Note 9, “Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*” for information regarding the Orkney I Unwind Transaction.

As disclosed in Note 9, “Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*”, Cerberus acquired from one or more unaffiliated third parties $700.0 million in aggregate principal amount of the Orkney Notes in 2009. Orkney I paid interest amounts of $3.2 million and $6.2 million on the Orkney Notes that were owned by Cerberus during 2011 and 2010, respectively. These Orkney Notes were repurchased by OHL, at a discount to the aggregate principal amount, as part of the Orkney I Unwind Transaction. Refer to Note 9, “Collateral Finance Facilities and Securitization Structures - *Orkney I Unwind Transaction*” for information regarding the Orkney I Unwind Transaction.

For further discussion on related party transactions, please refer to Note 18, “Subsequent Events – *Investment in Cerberus Affiliated Investment Fund*”.

18. 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 the financial statements on March 29, 2012.

Non-declaration of Dividends on Perpetual Preferred Shares

The Board resolved not to declare and pay a dividend on the Perpetual Preferred Shares on the January 15, 2012 and April 15, 2012 dividend payment dates.

Orkney Re II

On the scheduled interest payment date of February 11, 2012, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. As a result, Assured made guarantee payments on the Series A-1 Notes in the amount of $0.9 million.

Deferral of Interest Payments on the Capital and Trust Preferred Securities

Subsequent to December 31, 2011, we have accrued and deferred payment of an additional $1.5 million of interest on our floating rate capital securities and trust preferred securities. As of March 29, 2012, we have accrued and deferred payment on a total of $18.9 million of interest.

Perpetual Preferred Shares

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 by SRGL 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 ("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 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. As a result of the foregoing transactions, a gain on the redemption of Perpetual Preferred Shares of approximately $14.0 million will be recorded as a component of net income attributable to SRGL in the three month period ending March 31, 2012.

Internal Revenue Service Examination

On March 30, 2011, the Company was notified that the IRS would perform an examination of its consolidated U.S. life insurance company tax returns for 2004, 2007, 2008 (the "earlier tax years"), and 2009. This examination was prompted by an income tax refund of approximately $12.6 million that the Company received in relation to the earlier tax years and which required review by the Joint Committee.

18. Subsequent Events (continued)

The IRS has completed its fieldwork and identification of issues, but the examination process remains open as of March 29, 2012. The Company has received four Notices of Proposed Adjustment from the IRS, two of which previously had been identified by the Company and were reflected in the Company's 2010 tax return. None of the proposed adjustments, including those identified by the Company, will result in a cash tax liability to the IRS or impact the Company's Consolidated Statements of Operations. The Company does not anticipate any additional proposed adjustments from the IRS.

Once the IRS issues a final report, the case will be subject to the review and acceptance by the Joint Committee, which is statutorily required to review the submission of reports by the IRS in cases involving refunds of tax in excess of $2.0 million. The Company does not intend to recognize any of the outstanding proposed adjustments until the Joint Committee has closed the case.

Investment in Cerberus Affiliated Investment Fund

On March 26, 2012, SALIC executed subscription documents pursuant to which SALIC committed to make an investment of up to an aggregate $30 million in an investment fund affiliated with and controlled, directly or indirectly, by Cerberus.