SCOTTISH RE GROUP LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2011

(These financial statements are unaudited.)

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Summary of Results

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

For the three and six month periods ended June 30, 2011, SRGL reported consolidated net losses of $181.0 million and $158.9 million, respectively, which were primarily driven by the $153.3 million loss from the consummation on May 27, 2011 of the Orkney I Unwind Transaction (as explained in Note 7, "Collateral Finance Facilities"). In addition to the effects of the Orkney I Unwind Transaction, SRGL's results of operations for the three month period ended June 30, 2011 were also adversely affected by increased death claims on reinsured policies and negative reinsurance administration adjustments associated with certain reinsurance treaties.

While the Orkney I Unwind Transaction generated a U.S. GAAP net loss, it improved the financial strength of the Company's principal reinsurance operating entity, Scottish Re (U.S.), Inc. ("SRUS"), and was a factor in the decision by the Delaware Department of Insurance (the "Department") to release SRUS from regulatory supervision on June 23, 2011. Refer to Note 1, "Organization and Business-*Regulatory Considerations*", for information on SRUS and the Department's regulatory supervision of SRUS.

The Company's results of operations for the three and six month periods ended June 30, 2011, compared to consolidated net income of $74.6 million and $174.3 million, respectively, for the three and six month periods ended June 30, 2010, which 2010 results were primarily driven by an increase in the market value of the Company's invested assets.

On June 8, 2011, the shareholders of SRGL approved the Merger Agreement and the related Merger (each as defined in Note 9, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares"), which, upon the effectiveness of the Merger, will result in the cancellation of all of the outstanding ordinary shares of SRGL, the payment of Merger consideration of $0.30 per ordinary share to shareholders (other than the Investors and Merger Sub (each as defined in Note 9, "Mezzanine Equity - Convertible Cumulative Participating Preferred Shares"), any of their wholly-owned subsidiaries, and any shareholders that have exercised dissenter's rights under the laws of the Cayman Islands), and the issuance of a like number of new ordinary shares all of which will be owned by affiliates of the Investors. Refer to Note 9, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares", and Note 14, "Subsequent Events", for additional information regarding the Merger Agreement and the related Merger.

As of June 30, 2011, we had $93.7 million of unrestricted assets in SRGL and Scottish Annuity & Life Insurance Company (Cayman) Ltd. ("SALIC"), a wholly-owned subsidiary of SRGL, as compared to $106.1 million of unrestricted assets in SRGL and SALIC as of December 31, 2010. The unrestricted assets of SRGL and SALIC represent cash, cash equivalents, and fixed-maturity investments not held in trust accounts. These unrestricted assets were available to meet the obligations of SRGL and SALIC. There can be no assurances that the amount of unrestricted assets held by SRGL and SALIC will not decrease from period to period.

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

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Fixed-maturity investments held as trading securities, at fair value	$ 2,105,339	$ 3,111,724
Preferred stock held as trading securities, at fair value	66,573	67,897
Cash and cash equivalents	225,319	417,722
Other investments	18,968	16,459
Funds withheld at interest	578,611	584,617
Total investments[1]	2,994,810	4,198,419
Accrued interest receivable[2]	18,373	22,286
Reinsurance balances receivable	118,093	131,315
Deferred acquisition costs	181,851	269,352
Amounts recoverable from reinsurers	800,887	564,869
Present value of in-force business	28,936	31,941
Other assets	8,352	22,988
Total assets	$ 4,151,302	$ 5,241,170
LIABILITIES		
Reserves for future policy benefits	$ 1,456,174	$ 1,477,594
Interest-sensitive contract liabilities	1,371,394	1,415,580
Collateral finance facilities[3]	450,000	1,300,000
Accounts payable and other liabilities	59,468	54,827
Embedded derivative liabilities, at fair value	26,904	32,545
Reinsurance balances payable	89,595	91,634
Deferred tax liability	31,535	44,189
Long-term debt, at par value	129,500	129,500
Total liabilities	3,614,570	4,545,869
MEZZANINE EQUITY		
Convertible cumulative participating preferred shares (liquidation preference: $781.1 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: 2011 and 2010 – 4,806,083)	120,152	120,152
Additional paid-in capital	1,218,191	1,217,894
Retained deficit	(1,366,571)	(1,208,286)
Total Scottish Re Group Limited shareholders' (deficit) equity	(27,544)	130,444
Noncontrolling interest	8,419	9,000
Total (deficit) equity	(19,125)	139,444
Total liabilities, mezzanine equity and total (deficit) equity	$ 4,151,302	$ 5,241,170
[1] Includes total investments of consolidated variable interest entities ("VIEs")	$ 271,474	$ 1,108,193
[2] Includes accrued interest receivable of consolidated VIEs	451	1,040
[3] Reflects collateral finance facilities of consolidated VIEs	450,000	1,300,000

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF (LOSS) INCOME
(UNAUDITED)

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

	Three months ended		Six months ended	
	June 30, 2011	**June 30, 2010**	**June 30, 2011**	**June 30, 2010**
Revenues				
Premiums earned, net	$ 48,307	$ 117,169	$ 142,642	$ 219,692
Fee and other income	1,295	1,490	2,561	2,789
Investment income, net	34,550	44,580	73,803	88,577
Net realized and unrealized (losses) gains	(724)	83,431	25,002	166,408
Change in value of long-term debt at fair value	-	(18,033)	-	(15,246)
Gain on extinguishment of debt	260,000	-	260,000	-
Change in fair value of embedded derivatives assets and liabilities	485	2,704	5,641	432
Total revenues	343,913	231,341	509,649	462,652
Benefits and expenses				
Claims, policy benefits, and changes in policyholder reserves, net	75,023	103,437	172,289	212,762
Interest credited to interest-sensitive contract liabilities	12,320	13,452	24,346	26,582
Amortization of deferred acquisition costs and other insurance expenses, net	418,689	18,514	435,113	36,881
Operating expenses	12,711	12,266	24,070	29,943
Collateral finance facilities expense	14,209	7,824	20,422	15,947
Interest expense	1,444	1,328	3,122	2,622
Total benefits and expenses	534,396	156,821	679,362	324,737
(Loss) income before income taxes	(190,483)	74,520	(169,713)	137,915
Income tax benefit	9,517	35	10,847	36,429
Consolidated (loss) income	(180,966)	74,555	(158,866)	174,344
Net loss (income) attributable to noncontrolling interest	302	(451)	581	(691)
Net (loss) income attributable to Scottish Re Group Limited	(180,664)	74,104	(158,285)	173,653
Gain on redemption of non-cumulative perpetual preferred shares	-	3,878	-	3,878
Net (loss) income attributable to ordinary shareholders	$ (180,664)	$ 77,982	$ (158,285)	$ 177,531
Basic (loss) income per ordinary share	$ (2.64)	$ 1.12	$ (2.32)	$ 2.55
Diluted (loss) income per ordinary share	$ (2.64)	$ 0.36	$ (2.32)	$ 0.82

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

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

	Six months ended	
	June 30, 2011	**June 30, 2010**
Share capital:		
Ordinary shares:		
Beginning and end of period	$ 684	$ 684
Non-cumulative perpetual preferred shares:		
Beginning of period	120,152	125,000
Non-cumulative perpetual preferred shares redeemed	-	(4,848)
End of period	120,152	120,152
Additional paid-in capital:		
Beginning of period	1,217,894	1,217,535
Option expense	297	345
End of period	1,218,191	1,217,880
Retained deficit:		
Beginning of period	(1,208,286)	(1,447,375)
Net (loss) income attributable to Scottish Re Group Limited	(158,285)	173,653
Gain on redemption of non-cumulative perpetual preferred shares	-	3,878
End of period	(1,366,571)	(1,269,844)
Total Scottish Re Group Limited shareholders' (deficit) equity	$ (27,544)	$ 68,872
Noncontrolling interest:		
Beginning of period	9,000	7,668
Net (loss) income	(581)	691
End of period	8,419	8,359
Total shareholders' (deficit) equity	$ (19,125)	$ 77,231

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

(Expressed in Thousands of United States dollars)

	Six months ended June 30, 2011	Six months ended June 30, 2010
Operating activities		
Consolidated (loss) income	$ (158,866)	$ 174,344
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Net realized and unrealized gains	(25,002)	(166,408)
Change in value of long-term debt, at fair value	-	15,246
Changes in value of embedded derivative assets and liabilities	(5,641)	(432)
Amortization of deferred acquisition costs	3,786	11,493
Amortization of present value of in-force business	3,006	1,583
Amortization of deferred transaction costs	10,262	1,233
Depreciation of fixed assets	116	254
Option expense	297	345
Adjustments attributed to the Orkney I Unwind Transaction:		
Gain on extinguishment of debt	(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	6,006	16,801
Accrued interest receivable	3,913	(2,943)
Reinsurance balances receivable	13,222	35,858
Deferred acquisition costs	511	(3,751)
Other assets	(4,933)	23,993
Reserves for future policy benefits, net of amounts recoverable from reinsurers	(5,050)	(7,913)
Interest-sensitive contract liabilities	267	(3,123)
Accounts payable and other liabilities	4,641	(21,195)
Reinsurance balances payable	(2,039)	(26,788)
Net cash (used in) provided by operating activities	(584,688)	48,597
Investing activities		
Purchase of fixed-maturity investments	(254,046)	(416,122)
Proceeds from sales and maturity of fixed-maturity investments	1,281,113	433,765
Proceeds from sale and maturity of preferred stock	1,931	1,419
Purchase of and proceeds from other investments	(2,509)	875
Proceeds from sale of fixed investments	152	-
Net cash provided by investing activities	1,026,641	19,937
Financing activities		
Payments on collateral finance facilities	(590,000)	-
Withdrawals from interest-sensitive contract liabilities	(44,356)	(50,153)
Redemption of non-cumulative perpetual preferred shares	-	(970)
Net cash used in financing activities	(634,356)	(51,123)
Net change in cash and cash equivalents	$ (192,403)	$ 17,411
Cash and cash equivalents, beginning of period	417,722	390,025
Cash and cash equivalents, end of period	$ 225,319	$ 407,436

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

1. Organization and Business

Organization

Scottish Re Group Limited ("SRGL", the "Company", "we", "our", and "us") is a holding company incorporated under the laws of the Cayman Islands, 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. We have principal operating companies, holding companies, and collateral finance facilities in Bermuda, the Cayman Islands, Ireland, and the United States ("U.S."), 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>United States</u>
Scottish Holdings, Inc. ("SHI")
Scottish Re (U.S.), Inc. ("SRUS")
Scottish Re Life Corporation ("SRLC")
Orkney Holdings, LLC ("OHL")
Orkney Re, Inc. ("Orkney Re" and, together with OHL, "Orkney I")

Both OHL and Orkney Re are the process of dissolution following the completion of the Orkney I Unwind Transaction. As a result, we no longer consolidate these two dormant companies. Refer to Note 7, "Collateral Finance Facilities", for information regarding the Orkney I Unwind Transaction (as defined in Note 7) that we consummated on May 27, 2011.

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; however, no assurances can be given that we will be successful in executing this strategy.

While pursuing our run-off strategy, we may, if opportunities arise, purchase in privately-negotiated transactions, open market purchases, or by means of general solicitations, tender offers, or otherwise, additional amounts of our outstanding securities and other liabilities. Any such purchases will depend on a variety of factors including, but not limited to, available corporate liquidity, capital requirements, and indicative pricing levels. The amounts involved in any such transactions, individually or in the aggregate, may be material. For further discussion on our outstanding securities, refer to Note 8, "Debt Obligations and Other Funding Arrangements", and to Note 10, "Shareholder's Equity". Further, the Company continues to evaluate our run-off strategy and ways to increase enterprise value, including consideration from time to time of transactions for the sale or disposition of our businesses or assets, which transactions, individually or in the aggregate, may be material. Refer to Note 7, "Collateral Finance Facilities", for information regarding the Orkney I Unwind Transaction that we consummated on May 27, 2011.

1. Organization and Business (continued)

Regulatory Considerations

We had been operating since 2009 with certain regulatory constraints with respect to SRUS, our primary U.S. reinsurance subsidiary. In connection with the receipt by SRUS in late 2008 of a permitted statutory accounting practice related to the reduction from liability for reinsurance ceded to an unauthorized assuming insurer (the "Permitted Practice"), SRUS and the Delaware Department of Insurance (the "Department") agreed to the formal supervision of SRUS and that such supervision would likely continue for as long as the Permitted Practice remained in place. Subsequently, SRUS consented to the issuance by the Department on January 5, 2009, of an Order of Supervision for SRUS (the "Order of Supervision"), in accordance with 18 Del. C. §5942. The Order of Supervision required, among other things, the Department's consent to any transaction by SRUS outside the ordinary course of business and to any transaction with or any distribution or payment to its affiliates. The original Order of Supervision subsequently was amended and replaced with an Extended and Amended Order of Supervision, dated April 3, 2009 (the "Amended Order"), which amended and clarified certain matters contained within the original Order of Supervision.

In connection with the Amended Order, SRUS generally was required to receive prior written consent from the Department in order to engage in any transaction outside of the ordinary course of business; make certain payments, or incur certain debts, obligations, or liabilities in any transaction of $1 million or greater (provided that this limitation does not apply to the payment of claims, premiums, and other third party reinsurance settlements, in each case of less than $10 million per payment); engage in new business; lend any of its funds; invest any of its funds in a manner that deviates from the plan filed with the Department; commute, novate, amend, or otherwise change any existing reinsurance contract or treaty; or engage in any transaction with any related party. 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 letters dated March 1, 2011 and April 1, 2011, SRUS requested that the Department rescind the Amended Order and, in connection therewith, notified the Department of SRUS' intention to discontinue utilization of the Permitted Practice. By 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. At June 30, 2011, SRUS had statutory capital and surplus of $373 million without the effect of the Permitted Practice. This represented a $73 million increase from SRUS' $300 million statutory capital and surplus at March 31, 2011, at which time the Permitted Practice was still being utilized, and a $131 million increase from SRUS' $242 million pro forma statutory capital and surplus at March 31, 2011 if the Permitted Practice had not been utilized.

Business

We have written reinsurance business that is wholly or partially retained in one or more of our reinsurance subsidiaries. We have assumed risks associated with primary life insurance, annuities, and annuity-type policies. We reinsure mortality, investment, persistency, and expense risks of life insurance and reinsurance companies based in the United States. We assumed most of the reinsurance through automatic treaties, but we also assumed certain risks on a facultative basis. The business we historically have written falls into two categories: Traditional Solutions and Financial Solutions, as detailed below.

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

Financial Solutions: Financial Solutions include contracts under which we assumed the investment and persistency risks of existing, as well as newly-written, blocks of business. The products reinsured include annuities

1. Organization and Business (continued)

and annuity-type products, cash value life insurance, and, to a lesser extent, disability products that are in a pay-out phase.

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

2. Basis of presentation

Accounting Principles - Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Accordingly, these consolidated interim financial statements do not include all the information and footnotes required by U.S. GAAP for annual financial statements. These unaudited consolidated interim financial statements should be read in conjunction with the consolidated financial statements and accompanying notes thereto for the year ended December 31, 2010.

Consolidation - The consolidated financial statements include the assets, liabilities, and results of operations of SRGL, its subsidiaries, and all variable interest entities for which we are the primary beneficiary, as defined in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 810-10, Consolidation – Overall ("FASB ASC 810-10"). All significant inter-company transactions and balances have been eliminated in consolidation. We 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 on May 27, 2011, and, as a result, we no longer consolidate Orkney I, a Delaware limited liability company. For further discussion of Orkney I, the Orkney I Unwind Transaction, and Orkney Re II, refer to Note 7, "Collateral Finance Facilities".

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

Noncontrolling Interest– 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 Topic 810, references in these consolidated financial statements to net income attributable to SRGL, net income attributable to ordinary shareholders, and shareholders' equity attributable to SRGL do not include the noncontrolling interest, which is reported separately.

Going Concern - These consolidated interim financial statements and the annual consolidated financial statements as of December 31, 2010 have been prepared using accounting principles applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. Our ability to continue as a going concern had been dependent upon our ability to comply with the Department's Amended Order for SRUS. Effective June 23, 2011, the Department released SRUS from the Department's Amended Order. The Report of Independent Auditors on the Company's consolidated financial

2. Basis of presentation (continued)

statements for the year ended December 31, 2010 contained an emphasis paragraph that referred to the substantial doubt about the Company's ability to continue as a going concern and that report remains unchanged.

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 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;
- long-term debt at fair value; 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.

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, and are currently evaluating the impact of the adoption on our financial position and results of operations; 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 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) are not relevant to financial

3. Recent Accounting Pronouncements (continued)

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 nonpublic entities, the effective date is for annual periods beginning after December 15, 2011, and for interim and annual periods thereafter. We are currently evaluating the impact of the adoption of ASU No. 2011-04 on our 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.

4. Investments

We carry our investments at fair value, as described in Note 5, “Fair Value Measurements”, and 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 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.

The portion of net unrealized gains and losses for the three months ended June 30, 2011 and 2010 that relates to trading securities still held at the reporting date was $2.7 million of net losses and $70.9 million of net gains, respectively.

The amount of net unrealized gains for the six months ended June 30, 2011 and 2010 that relates to trading securities still held at the reporting date was $20.8 million and $140.0 million, respectively.

5. Fair Value Measurements

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

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

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

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

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices, such as public equities and actively-traded mutual fund investments. We do not hold assets and liabilities classified under Level 1 fair value measurements.

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 assets and 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.

5. Fair Value Measurements (continued)

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

Long-term debt at fair value (i.e., outstanding Pass-Through Certificates held by third parties) had been valued using Level 2 inputs for the determination of fair value. The fair value was derived with reference to traded prices for identical liabilities. The Pass-Through Certificates were cancelled on September 2, 2010, following completion of the purchases by the Company of the entire $325 million in aggregate stated amount of Pass-Through Certificates. Refer to Note 8, "Debt Obligation and Other Funding Arrangement-*Stingray Investor Trust and Stingray Pass-Through Trust (together "Stingray").*

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

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

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

	June 30, 2011			
(U.S. dollars in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Investments				
Government securities	$ 32.1	$ -	$ 32.1	$ -
Corporate securities	993.6	-	893.6	100.0
Municipal bonds	57.9	-	53.0	4.9
Mortgage and asset-backed securities	1,021.7	-	630.6	391.1
Fixed-maturity investments	2,105.3	-	1,609.3	496.0
Preferred stock	66.6	-	10.5	56.1
Total assets at fair value	$ 2,171.9	$ -	$ 1,619.8	$ 552.1
Embedded derivative liabilities for Funds withheld at interest	(26.9)	-	-	(26.9)
Total liabilities at fair value	$ (26.9)	$ -	$ -	$ (26.9)

5. Fair Value Measurements (continued)

(U.S. dollars in millions)	December 31, 2010 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 for Funds withheld at interest	(32.5)	-	-	(32.5)
Total liabilities at fair value	$ (32.5)	$ -	$ -	$ (32.5)

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

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the six month period ended June 30, 2011

(U.S. dollars in millions)	Government securities	Corporate securities	Municipal bonds	Mortgage and asset-backed securities	Preferred stock	Embedded derivative liabilities, net, for Funds withheld at interest	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 income	-	(0.7)	0.6	8.0	0.1	5.6	13.6
Purchases	-	19.5	-	2.0	-	-	21.5
Issuances	-	-	-	-	-	-	-
Settlements	-	(32.6)	(0.1)	(116.3)	-	-	(149.0)
Transfers in and/or out of Level 3, net	-	(14.7)	4.4	(32.8)	-	-	(43.1)
Ending balance at June 30, 2011	$ -	$ 100.0	$ 4.9	$ 391.1	$ 56.1	$ (26.9)	$ 525.2

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 (losses) gains 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
Issuances	-	-	-	-	-	-	-
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

Changes in classifications impacting Level 3 financial instruments are reported as transfers in (out) of the Level 3 category as of the end of the quarter in which the transfer occurs. The portion of net unrealized gains and losses for the three and six months ended June 30, 2011 that relates to trading securities still held at the reporting date was $15.1 million in net losses and $4.8 million in net gains, respectively, for Level 3.

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 on a non-recurring basis, in addition to those disclosed in Note 5, “Fair Value Measurements” are as follows:

(i) Other investments primarily consist of policy loans, which are carried at the outstanding loan balances, and such balances are deemed to approximate fair value.

(ii) 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. We refined our fair value estimation methodology during 2010, under which the estimated fair value is equal to the carrying 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.

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

6. Fair Value of Financial Instruments (continued)

(iv) 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 7, "Collateral Finance Facilities", for information regarding the Orkney I Unwind Transaction.

(v) Fair values for long-term debt, at par were determined with reference to observable values of similar securities.

(U.S. dollars in thousands)	June 30, 2011 Carrying Value	June 30, 2011 Estimated Fair Value	December 31, 2010 Carrying Value	December 31, 2010 Estimated Fair Value
Assets				
Fixed-maturity investments	$ 2,105,339	$ 2,105,339	$ 3,111,724	$ 3,111,724
Preferred stock	66,573	66,573	67,897	67,897
Other investments	18,968	18,968	16,459	16,459
Funds withheld at interest	578,611	578,611	584,617	584,617
Liabilities				
Interest-sensitive contract liabilities	$ 1,371,394	$ 1,354,896	$ 1,415,580	$ 1,398,365
Collateral finance facilities	450,000	86,443	1,300,000	659,713
Embedded derivative liabilities	26,904	26,904	32,545	32,545
Long-term debt, at par value	129,500	78,581	129,500	61,072

7. Collateral Finance Facilities

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)	June 30, 2011 Orkney Re II
Assets	
Fixed-maturity investments	$ -
Funds withheld at interest	345.0
Cash and cash equivalents	1.3
All other assets	64.9
Total assets	$ 411.2
Liabilities	
Reserves for future policy benefits	$ 130.4
Collateral finance facilities	450.0
All other liabilities	24.6
Total liabilities	$ 605.0

7. Collateral Finance Facilities (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 are subject to a variety of restrictions on their use, as set forth in, and governed by, the transaction documents for the applicable collateral finance facilities and securitization structures to which they relate. The total investments of consolidated VIEs disclosed on the Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010, respectively, differ from the amounts shown in the above tables because the assets needed, based on current projections, to satisfy future policy benefits 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 consolidated VIE 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 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, now a Delaware special purpose captive insurance company. SRUS holds all of the limited liability company interest in OHL, and has 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 collateralize the notes and the reserve obligations of SRUS.

Initially, in accordance with FASB ASC 810-10, Orkney I was considered to be a variable interest entity, and we were considered to hold the primary beneficial interest (as we ceded to Orkney Re all of the business assumed by Orkney Re), 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, there were no assets or liabilities remaining in Orkney I and we determined that we are no longer the primary beneficiary. As a result, we no longer consolidated Orkney I as of June 30, 2011.

We were informed by Cerberus Capital Management, L.P. (“Cerberus”), one of our controlling shareholders, that one or more of its affiliates had acquired, from one or more unaffiliated third parties, $700 million in aggregate

7. Collateral Finance Facilities (continued)

principal amount of the Orkney Notes in the secondary market during 2009. None of the Company, SRUS, OHL, Orkney Re, or any of our other subsidiaries was a party to this purchase. No terms of the Orkney Notes or any of the underlying transaction documents were changed as a result of this purchase. For further discussion of Cerberus and its relationship to the Company, refer to Note 9, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares".

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 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 related business to obtain full novations of the reinsurance treaties from SRUS to Hannover Life Re such that SRUS no longer will be a party to such reinsurance treaties following such novations.

On the date of the closing of these transactions, SRUS affected the Orkney Recapture and received recapture consideration from Orkney Re, which recapture consideration was used in part to fund the ceding commission of $565 million due from SRUS to Hannover Life Re under the New Reinsurance Agreement. All assets thereafter remaining in the accounts at Orkney Re were released to OHL. The remaining assets were used by OHL to purchase 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 aggregate principal amount of $850.0 million of the Orkney Notes. Following the repurchase of the Orkney Notes, OHL immediately cancelled the Orkney Notes and thereafter paid a dividend of its remaining assets to its parent, SRUS.

Approximately $700 million of the aggregate principal amount of the Orkney Notes purchased by OHL were held by affiliates of Cerberus, and were purchased by OHL at a 35% discount to par, whereas the Orkney Notes held by unaffiliated noteholders were purchased at a 10% discount to par. Under the terms of the Registration Rights and Shareholders Agreement, dated May 2007 among the Company, MassMutual Capital Partners LLC, a member of the MassMutual Financial Group ("MassMutual Capital"), Cerberus and certain other 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

7. Collateral Finance Facilities (continued)

through March 31, 2011 and the negotiated interest for the period from January 1, 2011 through May 27, 2011, on the ceding commission that was paid to Hannover Life Re were to be 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 sheet and statement of operations:

Impact of the Orkney I Unwind Transaction
Condensed Consolidated Balance Sheet

(U.S. dollars in thousands)		**June 30, 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)
Reserves		-
Other liabilities		(3,860)
Total liabilities	$	(853,860)
SHAREHOLDERS' (DEFICIT)		(153,292)
Total liabilities, and shareholders' (deficit)	$	(1,007,152)

7. Collateral Finance Facilities (continued)

Impact of the Orkney I Unwind Transaction
Condensed Statement of Operations

(U.S. dollars in thousands)	Six Months Ended June 30, 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 of business and is contractually obligated to utilize commercially reasonable efforts to facilitate the novation of the underlying business from the Company to Hannover Life Re.

Orkney Re II

On December 21, 2005, Orkney Re II, whose issued ordinary shares are held by a share trustee and its nominees in trust for charitable purposes, issued, in a private offering, $450 million of debt 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 million of Series B Floating Rate Notes (the "Series B Notes"), all due December 31, 2035 (collectively, the "Orkney Re II Notes"). The Orkney Re II Notes are listed on the Irish Stock Exchange. Proceeds from this 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.

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

In addition to $5 million of the Series B Notes, Orkney Re II also issued to SALIC $30 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.

Interest on the principal amount of the Orkney Re II Notes is payable quarterly at a rate equivalent to three-month LIBOR plus 0.425% for the Series A-1 Notes, three-month LIBOR plus 0.73% for the Series A-2 Notes, and three-month LIBOR plus 3.0% for the Series B Notes. As of June 30, 2011, the interest rate on the a) Series A-1

7. Collateral Finance Facilities (continued)

Notes was 0.69% (compared to 0.71% as of December 31, 2010), b) Series A-2 Notes was 1.00% (compared to 1.02% as of December 31, 2010), and c) Series B Notes was 3.27% (compared to 3.29% as of December 31, 2010). The Orkney Re II Notes also contain customary limitations on lien provisions and customary events of default provisions, which, if breached, could result in the accelerated maturity of the Orkney Re II Notes. Orkney Re II has the option to redeem all or a portion of the Orkney Re II Notes, subject to certain call premiums and available (unencumbered) funds.

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

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, 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 June 30, 2011, Assured made guarantee payments on the Series A-1 Notes in the cumulative amount of $6.6 million over the duration of the scheduled interest payment dates. For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes, refer to Note 14, “Subsequent Events”.

8. Debt Obligations and Other Funding Arrangements

Long-term debt consisted of:

(U.S. dollars in thousands)	June 30, 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.*

A summary of the terms of the long-term debt, at par value (the "Capital and Trust Preferred Securities"), as more fully described below, is shown in the following table:

(U.S. dollars in thousands)	Capital Securities Due 2032*	Preferred Trust Securities Due 2033*	Trust Preferred Securities Due 2033*	Trust Preferred Securities Due 2034*	Trust Preferred Securities Due December 2034*
Issuer of long-term debt	Capital Trust*	Capital Trust II*	GPIC Trust*	Capital Trust III*	SFL Trust I*
Long-term debt outstanding	$17,500	$20,000	$10,000	$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 as of June 30, 2011	4.25%	4.20%	4.15%	4.05%	3.75%
Interest rate as of 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 has been deferred as of June 30, 2011	10	10	10	10	10
Maximum deferral date	Dec 4, 2032	Oct 29, 2033	Sept 30, 2033	June 17, 2034	Dec 15, 2034

**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 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 interest may be deferred, and maximum deferral date) as the Capital Securities Due 2032.

8. Debt Obligations and Other Funding Arrangements (continued)

Preferred Trust Securities Due 2033

On October 29, 2003, Scottish Holdings, Inc. Statutory Trust II, a Connecticut statutory business trust ("Capital Trust II"), issued and sold in a private offering an aggregate of $20 million Preferred Trust Securities (the "Preferred Trust Securities 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 interest may be deferred, and maximum deferral date) 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 million Trust Preferred Securities (the "Trust 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 interest may be deferred, and maximum deferral date) 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 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 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 interest may be deferred, and maximum deferral date) 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 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 Scottish Financial (Luxembourg) S.a.r.l ("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 interest may be deferred, and maximum deferral date) 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.

8. Debt Obligations and Other Funding Arrangements (continued)

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 to preserve liquidity. As of June 30, 2011, we have accrued and deferred payment of $14.5 million of interest on such securities. SHI and SALIC are restricted in their ability to make dividend payments in any period where interest payment obligations on these securities are not current.

For further discussion on the accrued and deferred payment on our Capital and Trust Preferred Securities subsequent to June 30, 2011, refer to Note 14, "Subsequent Events".

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

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

As of April 14, 2008, this facility was fully utilized and $325 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. The Interest Rate Swap was included in Other Assets on our Consolidated Balance Sheets at a fair value of $25.9 million at December 31, 2009. Movements in the fair value of the Interest Rate Swap were included in net realized and unrealized income in the Consolidated Statements of Income.

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.

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

In January 2010, we acquired, in a privately-negotiated transaction, an additional $18.1 million of aggregate stated amount of Pass-Through Certificates. During July and August 2010, we acquired, through privately-negotiated transactions, an additional $55.5 million and $8 thousand, respectively, of aggregate stated amount of Pass-Through Certificates. In conjunction with the July acquisitions, we obtained consent from the sellers to

8. Debt Obligations and Other Funding Arrangements (continued)

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, we acquired another $24.7 million in aggregate stated amount of Pass-Through Certificates. On September 2, 2010, we cancelled the entire $325 million in aggregate stated amount of the Pass-Through Certificates. In connection with the cancellation, the corresponding $325 million of funding agreements were surrendered by the Stingray Investor Trust, and all unamortized debt issuance costs relating to Stingray, in the amount of $2.8 million, were written off. These were included in collateral finance facilities expenses in the Consolidated Statements of Income.

9. 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 million in us in exchange for 1,000,000, in the aggregate, newly-issued Convertible Cumulative Participating Preferred Shares. The gross proceeds were $600 million less $44.1 million in closing costs, which resulted in aggregate net proceeds of $555.9 million. Each Convertible Cumulative Participating Preferred Share has a par value of $0.01 per share with an initial stated value and liquidation preference of $600 per share, as adjusted for the accretion of dividends or the payment of dividends or distributions as described further below.

As of June 30, 2011, the Investors hold in the aggregate approximately 68.7% of our equity voting power, along with the right to designate two-thirds of the members of our Board. Refer to the "Merger Agreement" section within this note and Note 14, "Subsequent Events", for additional information.

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 (i.e., May 7, 2016), 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-of-control event.

We have accounted for the Convertible Cumulative Participating Preferred Shares in accordance with FASB ASC Subtopic 470-20, Debt – Debt with Conversion and Other Options ("FASB 470-20"), which incorporates EITF D-98: "Classification and Measurement of Redeemable Securities". Dividends on the Convertible Cumulative Participating Preferred Shares are cumulative and accrete daily on a non-compounding basis at a rate of 7.25% per annum on the stated value of $600 million, whether or not there are profits, surplus, or other funds available for the payment of dividends. Such dividends will be made solely by increasing the liquidation preference of the Convertible Cumulative Participating Preferred Shares. As of June 30, 2011, the amount of dividends accreted pursuant to the terms of the Convertible Cumulative Participating Preferred Shares is $181.1 million in the aggregate, or $181.13 per share.

Redemption of the Convertible Cumulative Participating Preferred Shares is contingent upon a change of control as defined in the Certificate of Designations for the Convertible Cumulative Participating Preferred Shares.

9. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares (continued)

Since neither liquidation nor a change of control is currently probable, the accreted dividends have not been accrued in our consolidated financial statements.

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

To the extent that the Convertible Cumulative Participating Preferred Shares so participate on an as-converted basis in dividends paid on ordinary shares, a corresponding reduction will be made to the liquidation preference for the Convertible Cumulative Participating Preferred Shares. The Convertible Cumulative Participating Preferred Shares have a liquidation preference equal to their initial stated value, as adjusted for (x) the accretion of dividends and (y) any cash payment or payment in property of dividends or distributions, which liquidation preference is calculated and payable (as more specifically described below) upon the occurrence of a Liquidation Event (as defined below) or one or more change-of-control events..

Upon the occurrence of a Liquidation Event, each holder of Convertible Cumulative Participating Preferred Shares, by reason of its ownership thereof, shall be entitled to receive out of the assets of SRGL available for distribution to our shareholders, prior and in preference to any payment or distribution of assets of SRGL to holders of our ordinary shares, an amount equal to the greater of (i) the aggregate liquidation preference attributable to the outstanding Convertible Cumulative Participating Preferred Shares of such holder, plus an amount equal to the sum of all accreted dividends through the payment date of such liquidation preference amount, or (ii) the amount that the holder of the Convertible Cumulative Participating Preferred Shares would have been entitled to receive with respect to such Liquidation Event if it had exercised its right to convert all of its Convertible Cumulative Participating Preferred Shares for ordinary shares immediately prior to the date of such Liquidation Event.

Upon a change-of-control event, the holders of Convertible Cumulative Participating Preferred Shares may require us to redeem all or a portion of the Convertible Cumulative Participating Preferred Shares at a redemption price equal to the greater of (i) the stated value of such portion of the outstanding Convertible Cumulative Participating Preferred Shares, plus an amount equal to the sum of all accreted dividends thereon through the earlier of (A) the date of payment of the consideration payable upon a change-of-control event, or (B) the fifth anniversary of the issue date of the Convertible Cumulative Participating Preferred Shares (i.e., May 7, 2012), 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-of-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-of-control event.

The liquidation preference of the Convertible Cumulative Participating Preferred Shares (including any adjustments thereto), whether on a Liquidation Event or a change-of-control event, 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

9. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares (continued)

shares, and to each class or series of our shares, the terms of which expressly provide that such class or series ranks senior to the Convertible Cumulative Participating Preferred Shares as to payment of dividends and distribution of assets upon a Liquidation Event and all classes of our preferred shares outstanding as of the completion of the 2007 New Capital Transaction.

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

Pursuant to our Securities Purchase Agreement, dated November 26, 2006 (the "Purchase Agreement"), with the Investors, certain representations and warranties were provided relating to our statutory accounting records. As discussed in Note 13, "Commitments and Contingencies-*Indemnification*", certain statutory accounting errors were discovered in 2006 which have resulted in an indemnification claim against us by the Investors. Resolution of this claim could result in a change in the conversion formula on these securities. Refer to Note 14, "Subsequent Events", for information regarding the Merger Agreement and its impact on such indemnification claim.

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 under the Companies Law (2010 Revised) of the Cayman Islands (the "Companies Law") will be valued in accordance with the procedures set forth under the Companies Law. The Merger consideration to all such ordinary shares was to be funded solely by the Investors. 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.

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.

9. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares (continued)

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). Refer to Note 14, "Subsequent Events", for additional information regarding the Merger Agreement.

In connection with a closing of the Merger, the Investors will be 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 13, "Commitments and Contingencies-*Indemnification*".

10. Shareholders' 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 and non-cumulative Perpetual Preferred Shares during the six months ended June 30, 2011 and year ended December 31, 2010:

	Six Months Ended June 30, 2011	Year Ended December 31, 2010
Ordinary shares		
Beginning and end of year	68,383,370	68,383,370
Non-cumulative Perpetual Preferred Shares		
Beginning of year	4,806,083	5,000,000
Non-cumulative Perpetual Preferred Shares redeemed	-	(193,917)
End of year	4,806,083	4,806,083

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.

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 June 30, 2011 ranged between 7.32% and 8.04%. During any dividend period, unless the full dividends for the current dividend period on all outstanding Perpetual Preferred

10. Shareholders' Equity (continued)

Shares have been declared or paid, no dividend may be paid or declared on our ordinary shares and no ordinary shares or other junior shares may be purchased, redeemed, or otherwise acquired for consideration. Declaration of dividends on the Perpetual Preferred Shares is prohibited if we fail to meet specified capital adequacy, net income, or shareholders' equity levels. In accordance with the terms of the Perpetual Preferred Shares, dividends on the Perpetual Preferred Shares generally may be funded only to the extent they are payable out of our distributable profits, and/or the proceeds of a new issue of shares, and/or out of the Share Premium Account (as defined in the Certificate of Designations) related to the Perpetual Preferred Shares.

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

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

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

Dividends on 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.

Dividends on Perpetual Preferred Shares

On April 14, 2008, we announced that, given our current financial condition, our Board in its discretion had decided not to declare a dividend on our Perpetual Preferred Shares for the April 15, 2008 dividend payment date. In addition, we announced that, pursuant to the Certificate of Designations for our Perpetual Preferred Shares, our Board may be precluded from declaring and paying dividends on the October 15, 2008 dividend payment date in the event we did not meet certain financial tests under the terms of the Perpetual Preferred Shares required for us to pay such dividends, which tests subsequently were not met for such dividend payment date. On July 3, 2008, the Board determined that in light of our financial condition and in accordance with the terms of the forbearance agreements with the relevant counterparties to certain of our then outstanding collateral finance facilities, we would suspend the cash dividend for the July 15, 2008 payment date. In 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

10. Shareholders' Equity (continued)

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 January 15, 2011 and April 15, 2011 dividend payment dates, the Board resolved, on management's recommendation, 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 June 30, 2011. For further discussion on the non-declaration of Perpetual Preferred Shares dividends, refer to Note 14, "Subsequent Events".

11. Income Taxes

The income tax benefit for the three months and six months ended June 30, 2011 was $9.5 million and $10.8 million, respectively. The net income of our Bermuda and Cayman entities are not subject to income tax. The net income of our U.S. and Irish entities did not generate a current tax expense, other than interest and penalties on accrued tax liabilities, due to the availability of tax losses from prior tax years. The utilization of tax losses results in a reduction in deferred tax assets and a corresponding reduction in the valuation allowance established against those deferred tax assets. The income tax benefit for the six months ended June 30, 2011 was principally due to a reduction in the valuation allowance that resulted from a decrease in our deferred acquisition costs that reverse after the expiration of net operating losses, which resulted from the Orkney I Unwind Transaction. For further discussion on the Orkney I Unwind Transaction, refer to Note 7, "Collateral Finance Facilities".

As of June 30, 2011, we had total unrecognized tax benefits (excluding interest and penalties) of $111.7 million, the recognition of which would result in a $3.9 million benefit at the effective tax rate for the applicable period. As of 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 benefit at the effective tax rate for the applicable period.

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

As of June 30, 2011, our deferred tax liabilities included $31.5 million of deferred tax liabilities that reverse after the expiration of net operating losses in applicable jurisdictions, and, therefore, cannot support deferred tax assets. As of December 31, 2010, the corresponding amount of deferred tax liabilities was $44.2 million.

We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of June 30, 2011, we remained subject to examination in the following major tax jurisdictions for the returns filed for the years indicated below:

Major Tax Jurisdictions	**Open Years**
U.S.	
Life Group	2007 through 2010
Non-Life Group	2007 through 2010
Ireland	2006 through 2010

11. Income Taxes (continued)

Net operating losses are being carried forward from closed years and could be examined by the Internal Revenue Service when utilized in an open year in the future. Additionally, to the extent that a net operating loss has been carried back to an otherwise closed year, that earlier year could be subject to examination as long as the loss year remains open. On March 30, 2011, SRUS was notified that the Internal Revenue Service will perform a limited scope examination of our consolidated U.S. life insurance tax returns for 2004, 2007, 2008, and 2009. As of June 30, 2011, this examination has been initiated and remains in progress.

12. Earnings per Ordinary Share

The following table sets forth the computation of basic and diluted earnings per ordinary share under the two-class method and the if-converted method, respectively, as required under FASB ASC 260.

	Three months ended		Six months ended	
(U.S. dollars in thousands, except share data)	**June 30, 2011**	**June 30, 2010**	**June 30, 2011**	**June 30, 2010**
Basic (loss) income attributable to ordinary shareholders				
Numerator:				
Net (loss) income attributable to ordinary shareholders	$ (180,664)	$ 77,982	$ (158,285)	$ 177,531
Amounts allocable to convertible cumulative participating preferred shares	-	(1,124)	-	(2,559)
Numerator for basic (loss) income per ordinary share	$ (180,664)	$ 76,858	$ (158,285)	$ 174,972
Denominator:				
Denominator for basic (loss) income per ordinary share - weighted average number of ordinary shares	68,383,370	68,383,370	68,383,370	68,383,370
Basic (loss) income from continuing operations attributable to ordinary shareholders	$ (2.64)	$ 1.12	$ (2.32)	$ 2.55

12. Earnings per Ordinary Share (continued)

Diluted (loss) income attributable to ordinary shareholders								
Numerator:								
Net (loss) income attributable to ordinary shareholders	$	(180,664)	$	77,982	$	(158,285)	$	177,531
Denominator:								
Denominator for basic (loss) income per ordinary share - weighted average number of ordinary shares		68,383,370		68,383,370		68,383,370		68,383,370
Effect of dilutive securities*		-		150,000,000		-		150,000,000
Denominator for dilutive (loss) income per ordinary share		68,383,370		218,383,370		68,383,370		218,383,370
Diluted (loss) income from continuing operations attributable to ordinary shareholders	$	(2.64)	$	0.36	$	(2.32)	$	0.82

* In accordance with FASB ASC 260, exercise of options and warrants or conversion of convertible securities is not assumed if the result would be anti-dilutive, such as when a loss from continuing operations is reported, or the exercise price of the stock options exceeds the market price of common stock. The conversion of the Convertible Cumulative Participating Preferred Shares had a potential dilutive effect and was included in the three month and six month periods ended June 30, 2010 dilutive net income attributable to ordinary shareholder calculations. Refer to Note 9, "Mezzanine Equity - Convertible Cumulative Participating Preferred Shares", for information regarding the Merger Agreement and its effect on the ordinary shares.

13. Commitments and Contingencies

Indemnification

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

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

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

Pursuant to the Purchase Agreement with the Investors, we made certain representations and warranties regarding the statutory financial statements of each of our insurance subsidiaries, including SRD and SRUS, for the

13. Commitments and Contingencies (continued)

years ended 2003, 2004, and 2005 and, with respect to SRUS but not SRD, the first three quarters of 2006, including that these statements were prepared in conformity with applicable statutory accounting practices and fairly present, in accordance with such practices and in all material respects, the statutory financial condition of the relevant insurance subsidiary at the respective dates. In light of our discovery of the corrections described above, we notified the Investors, as required by the terms of the Purchase Agreement, of the misstatement of reported statutory surplus in SRD at year-end 2004 and year-end 2005 resulting in a cumulative overstatement for the two year period at year-end 2005 of approximately $70 million on an after-tax basis, and the understatement of statutory surplus in SRUS for the year ended December 31, 2005 of approximately $14.5 million on an after-tax basis. On November 16, 2007, the Investors responded by notifying us of their concern that the corrections described above may constitute breaches of certain of the representations and warranties made by us in the Purchase Agreement. Under the Purchase Agreement, in the event of a claim for losses resulting from a diminution in value, such losses would be determined by an independent investment banking firm of national reputation, agreed upon by us and the Investors, 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. Furthermore, should any claim for indemnification be made by the Investors, the Purchase Agreement provides that any decision regarding defending or settling such claim would be taken by a committee of independent directors of our Board of Directors. In their November 16, 2007 correspondence, the Investors requested that we convene a committee of independent directors. No action was taken by us or the Investors in respect of this claim since such time. We were not able to predict what the amount of any indemnifiable losses would be, if any, or what potential defenses or other limitations on indemnification would be available to us under those circumstances. Under the terms of the Purchase Agreement, 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. Refer to Note 9, “Mezzanine Equity - Convertible Cumulative Participating Preferred Shares”, for information regarding the Merger Agreement and the waiver of the indemnification claim by the Investors.

Ballantyne Re plc

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

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

As of June 30, 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 of the reinsurance agreement with Ballantyne Re. In addition, the Company and SRUS remain responsible for certain ongoing covenants and indemnities made for the benefit of Ballantyne Re and the financial guarantors of certain of the notes issued by Ballantyne Re.

Indemnification of Our Directors, Officers, Employees, and Agents

We indemnify our directors, officers, employees, and agents against any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, by reason of the fact that they are our director, officer, employee, or

13. Commitments and Contingencies (continued)

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.

French vs. Scottish Re

On December 1, 2010, Michael C. French, a former officer and director of the Company, filed a civil lawsuit against the Company, SRUS, and SRLC in the District Court for Dallas County, Texas. The lawsuit brings a claim for breach of contract based on Mr. French's alleged right to indemnification for defense costs he is incurring in connection with a Securities and Exchange Commission enforcement action brought against him in New York federal court. On January 3, 2011, the defendants removed the case to the U.S. District Court for the Northern District of Texas. On January 10, 2011, the defendants moved to dismiss the action for lack of personal jurisdiction as to all of the defendants and for failure to state a claim against SRUS and SRLC. In the alternative, the defendants requested that the case be transferred to the U.S. District Court for the Southern District of New York. On June 9, 2011, the court denied a motion for partial judgment on the pleadings previously filed by Mr. French as premature with leave to refile, declined to transfer the case to the U.S. District Court for the Southern District of New York, and denied the defendants' motion to dismiss as to SRGL, but as to SRUS and SRLC ordered jurisdictional discovery with leave to refile the motion to dismiss following completion of such discovery. Mr. French thereafter voluntarily withdrew all claims against SRUS and SRLC, leaving SRGL as the only named defendant in the action. We believe Mr. French's claim to be without merit and are vigorously defending our interest in the action. For further discussion regarding the French litigation, refer to Note 14, "Subsequent Events".

14. Subsequent Events

The subsequent events disclosed in these notes to the consolidated financial statements have been evaluated by management up to and including the publication of the financial statements on August 17, 2011.

Merger Agreement

As discussed more fully in Note 9 "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares-*Merger Agreement*" and in the Information Statement, the Merger Agreement imposes certain conditions to the obligations of the respective parties to close the Merger. Among these conditions is the receipt of required governmental consents and approvals, which, as of August 16, 2011, have been received. Additionally, it is 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 ordinary shareholders (the "Dissenting Shareholders") holding in excess of 10% of the outstanding ordinary shares (excluding Owned Shares). The Investors and Merger Sub have waived this condition, and the parties currently are in discussions regarding the scheduling of a closing date for the Merger, which is expected to occur prior to the end of August 2011. Upon the closing and effectiveness of the Merger, all existing ordinary shares will be cancelled and all shareholders (other than Dissenting Shareholders and the Investors and Merger Sub and any of their wholly-owned subsidiaries who hold ordinary shares) will be entitled to receive Merger consideration of $0.30 per ordinary share. The Company thereafter will have certain obligations under Section 238 of the Companies Law which could include participating in court proceedings in the Cayman Islands to determine the fair value of the Dissenting Shareholders' ordinary shares. Pursuant to the Merger Agreement, the payment of fair value to Dissenting Shareholders will be made by the Investors and not the Company.

14. Subsequent Events (continued)

Non-declaration of Dividends on Perpetual Preferred Shares

The Board resolved, on management's recommendation, not to declare and pay a dividend on the Perpetual Preferred Shares on the July 15, 2011 dividend payment date.

Orkney Re II

On the scheduled interest payment date of August 11, 2011, 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 $0.7 million.

Deferral of Interest Payments on the Capital and Trust Preferred Securities

Subsequent to June 30, 2011, we have accrued and deferred payment of an additional $0.2 million of interest on our floating rate capital securities and trust preferred securities. As of August 17, 2011, we have accrued and deferred payment on a total of $14.7 million of interest.

French vs. Scottish Re

On July 21, 2011, the parties participated in a mediation as required under the case schedule established by the court. As of August 17, 2011, the parties have not reached an agreement to settle the dispute and no further mediation dates currently are scheduled. As such, the matter remains unresolved as of the date hereof.