SCOTTISH RE GROUP LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2016

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Report of Independent Auditors

The Board of Directors and Shareholders of Scottish Re Group Limited

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Scottish Re Group Limited and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of comprehensive income, changes in shareholders' deficit, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Scottish Re Group Limited and its subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

The Company's Ability to Continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has recurring losses from operations and liquidity constraints that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

/s/ Ernst & Young LLP

Charlotte, North Carolina
May 10, 2017

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

	December 31, 2016	December 31, 2015
Assets		
Fixed-maturity investments held as trading securities, at fair value	$ 1,000,889	$ 1,218,972
Fixed-maturity investments held as available-for-sale securities, at fair value (amortized cost: 2016 – $477,409; 2015 – $343,251)	478,128	338,533
Cash and cash equivalents	194,920	166,277
Affiliated investments	-	44,235
Other investments	2,368	2,744
Funds withheld at interest	362,761	388,356
Total investments[1]	2,039,066	2,159,117
Accrued interest receivable[2]	9,219	9,865
Amounts recoverable from reinsurers	652,536	657,402
Reinsurance balances receivable	194,882	123,079
Deferred acquisition costs	23,531	26,992
Other assets	1,290	1,553
Total assets	$ 2,920,524	$ 2,978,008
Liabilities		
Reserves for future policy benefits	$ 1,392,659	$ 1,267,247
Interest-sensitive contract liabilities	765,610	824,796
Collateral finance facility, net of debt issuance costs[3]	447,978	447,359
Reinsurance balances payable	142,739	54,708
Accounts payable and other liabilities[4]	101,858	84,312
Deferred tax liabilities	-	25,870
Embedded derivative liabilities, at fair value	15,640	16,871
Long-term debt, at par value	86,500	86,500
Total liabilities	$ 2,952,984	$ 2,807,663
Mezzanine Equity		
Convertible cumulative participating preferred shares, par value $0.01: Shares issued and outstanding with $600.0 million initial stated value: 2016 – Nil; 2015 – 1,000,000 (liquidation preference: 2016 – Nil; 2015 – $901.2 million)	-	555,857
Shareholders' Deficit		
Ordinary shares, par value $0.01: Shares issued and outstanding: 2016 – 218,383,370; 2015 – 68,383,370	2,184	684
Non-cumulative perpetual preferred shares, par value $0.01: 3,246,776 shares issued and outstanding	81,169	81,169
Additional paid-in capital	1,772,547	1,218,190
Accumulated other comprehensive income (loss), net of taxes and deferred acquisition costs	628	(4,718)
Retained deficit	(1,888,988)	(1,680,837)
Total shareholders' deficit	(32,460)	(385,512)
Total liabilities, mezzanine equity, and shareholders' deficit	$ 2,920,524	$ 2,978,008

[1] Includes total investments of consolidated variable interest entity ("VIE")	$ 278,216	$ 275,730
[2] Includes accrued interest receivable of consolidated VIE	1,326	1,333
[3] Includes collateral finance facility, net of debt issuance costs, of consolidated VIE	448,056	447,579
[4] Includes accounts payable and other liabilities of consolidated VIE	76,602	64,573

See Accompanying Notes to Consolidated Financial Statements

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

	Year Ended	
	December 31, 2016	**December 31, 2015**
Revenues		
Premiums earned, net	$ 309,812	$ 312,680
Investment income, net	64,821	68,406
Net realized and unrealized gains (losses)	9,169	(12,600)
Change in value of embedded derivative assets and liabilities	1,231	(3,464)
Fees and other income	5,530	2,258
Total revenues	390,563	367,280
Benefits and expenses		
Claims, policy benefits, and changes in policyholder reserves, net	526,040	414,104
Interest credited to interest-sensitive contract liabilities	21,352	23,095
Other insurance expenses, including amortization and release of deferred acquisition costs and present value of in-force business, net	42,825	158,294
Operating expenses	17,344	20,259
Collateral finance facility expense	12,648	10,558
Interest expense	4,342	3,797
Total benefits and expenses	624,551	630,107
Income (loss) before income taxes	(233,988)	(262,827)
Income tax benefit (expense)	25,837	7,329
Net income (loss)	(208,151)	(255,498)
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on available-for-sale investments, net of taxes and deferred acquisition costs	5,346	(4,694)
Total other comprehensive income (loss), net of tax	5,346	(4,694)
Total comprehensive income (loss)	$ (202,805)	$ (260,192)

See Accompanying Notes to Consolidated Financial Statements

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

	Year Ended	
	December 31, 2016	**December 31, 2015**
Share capital:		
Ordinary shares:		
Beginning of year	$ 684	$ 684
Conversion of convertible cumulative participating preferred shares (par value)*	1,500	-
End of year	2,184	684
Non-cumulative perpetual preferred shares:		
Beginning and end of year	81,169	81,169
Additional paid-in capital:		
Beginning of year	1,218,190	1,218,190
Conversion of convertible cumulative participating preferred shares*	554,357	-
End of year	1,772,547	1,218,190
Accumulated other comprehensive income (loss):		
Beginning of year	(4,718)	(24)
Other comprehensive income (loss), net of taxes and deferred acquisition costs	5,346	(4,694)
End of year	628	(4,718)
Retained deficit:		
Beginning of year	(1,680,837)	(1,425,339)
Net income (loss)	(208,151)	(255,498)
End of year	(1,888,988)	(1,680,837)
Total shareholders' deficit	$ (32,460)	$ (385,512)

** Please refer to Note 9, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares", for more details on the conversion of the convertible cumulative participating preferred shares.*

See Accompanying Notes to Consolidated Financial Statements

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

	Year Ended	
	December 31, 2016	**December 31, 2015**
Operating activities		
Net income (loss)	$ (208,151)	$ (255,498)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Net realized and unrealized (gains) losses	(9,169)	12,600
Change in value of embedded derivative assets and liabilities	(1,231)	3,464
Amortization of discount on fixed-maturity investments – available-for-sale	772	195
Amortization and release of deferred acquisition costs	3,461	105,725
Amortization and release of present value of in-force business	-	21,048
Amortization of deferred finance facility costs	619	868
Depreciation of fixed assets	12	72
Changes in assets and liabilities:		
Funds withheld at interest	25,595	37,219
Accrued interest receivable	646	1,013
Reinsurance balances receivable	(71,803)	4,542
Other assets	938	352
Reserves for future policy benefits, net of amounts recoverable from reinsurers	130,278	(2,011)
Interest-sensitive contract liabilities	(17,359)	(22,780)
Reinsurance balances payable	88,031	(5,718)
Accounts payable and other liabilities, including deferred tax liabilities	(8,324)	2,836
Net cash used in operating activities	(65,685)	(96,073)
Investing activities		
Purchases of fixed-maturity investments – available-for-sale	(157,669)	(347,111)
Proceeds from sales and maturities of fixed-maturity investments – trading	235,893	466,158
Proceeds from sales and maturities of fixed-maturity investments – available-for-sale	22,838	11,420
Proceeds from sales of preferred stock	-	1,280
Purchases of and proceeds from affiliated investments, net	35,654	(2,125)
Purchases of and proceeds from other investments, net	376	213
Net cash provided by investing activities	137,092	129,835
Financing activities		
Withdrawals from interest-sensitive contract liabilities	(42,764)	(95,356)
Net cash used in financing activities	(42,764)	(95,356)
Net change in cash and cash equivalents	28,643	(61,594)
Cash and cash equivalents, beginning of year	166,277	227,871
Cash and cash equivalents, end of year	$ 194,920	$ 166,277
Interest paid	$ -	$ -
Income taxes paid	$ 106	$ 39

See Accompanying Notes to Consolidated Financial Statements

1. Organization, Business Strategy, and Lines of Business

Organization

Scottish Re Group Limited ("SRGL" and, together with SRGL's consolidated subsidiaries and, as a result of the application of FASB ASC 810-10 (as defined in Note 2, "Summary of Significant Accounting Policies – *Basis of Presentation*" herein), its consolidated VIE*, as applicable, the "Company", "we", "our", and "us") is a holding company incorporated under the laws of the Cayman Islands, and with its principal executive office located in Bermuda. Through its operating subsidiaries, the Company is principally engaged in the reinsurance of life insurance, annuities, and annuity-type products. All of the equity voting power of SRGL, along with the right to designate a controlling number of members of the SRGL Board of Directors (the "Board"), is controlled directly or indirectly by MassMutual Capital Partners LLC, a member of the MassMutual Financial Group ("MassMutual Capital") and SRGL Acquisition, LDC, an affiliate of Cerberus Capital Management L.P. ("Cerberus" and, together with MassMutual Capital, the "Investors"). As of December 31, 2016, SRGL's consolidated subsidiaries (consisting of operating companies, holding companies, and financing companies) and its consolidated VIE (a collateral finance facility), by jurisdiction, were as follows:

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

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

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

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

<u>United States of America ("U.S." or "United States")</u>
Scottish Holdings, Inc. ("SHI")
Scottish Re (U.S.), Inc. ("SRUS")

* *Orkney Re II is the consolidated VIE. References in the consolidated financial statements and accompanying notes to any discretionary acts of management or of any of the consolidated entities do not, unless explicitly stated otherwise, refer to any such acts by Orkney Re II.*

Business Strategy

In 2008, our insurance operating companies ceased writing new business and notified existing clients that new reinsurance risks no longer would be accepted under existing reinsurance treaties, thereby placing the reinsurance business into run-off (the "Closed Block"). We continue to manage the Closed Block, performing key activities and actively managing the business under the terms of the related reinsurance treaties.

Lines of Business

We have written reinsurance business that is wholly or partially retained in one or more of our reinsurance subsidiaries and have classified the reinsurance as Traditional Solutions or as Financial Solutions, as detailed in this Note. All such business currently is part of the Closed Block.

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

Traditional Solutions: Mortality risk on life insurance policies written by primary insurers (which business is often referred to as traditional life insurance). Our Traditional Solutions business includes reinsurance of primarily term life, ordinary life, universal life, variable life, and corporate owned life insurance products. We wrote our Traditional Solutions business predominantly on an automatic basis, meaning that we automatically reinsured all policies written by a ceding company that met the underwriting criteria specified in the treaty with the ceding company.

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

We generally wrote reinsurance for our Traditional Solutions and Financial Solutions businesses in the form of coinsurance, modified coinsurance ("modco"), or renewable term treaties. In a coinsurance or modco arrangement, we generally share proportionately in all material risks inherent in the underlying policies, including mortality, lapses, and investment experience. Under such agreements, we agree to indemnify the primary insurer for all or a portion of the risks associated with the underlying insurance policy or annuity contract in exchange for a proportionate share of the premiums thereon. Under our coinsurance arrangements, the assets supporting the reserves related to the liabilities reinsured are transferred to us, whereas in our modco arrangements, although we receive the investment income and risks associated with the assets, the assets are retained by the ceding company. Under our renewable term reinsurance arrangements, we only accept mortality risk (as defined in the applicable treaties) for which we receive a premium.

Going Concern

These consolidated financial statements 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.

The Company's management assesses whether conditions and events raise substantial doubt that the Company will be able to continue as a going concern. Assessment of whether substantial doubt exists requires management to evaluate whether conditions and events, considered in the aggregate, indicate that it is probable that the Company will be unable to meet its obligations as they become due within one year of the issuance of the consolidated financial statements. Our ability to continue as a going concern is, therefore, dependent upon our ability to successfully meet our obligations, satisfy ongoing regulatory requirements and maintain adequate capital and liquidity.

The Company incurred a net loss of $208.2 million for the year ended December 31, 2016, and have a shareholders' deficit of $32.5 million as of December 31, 2016. Adverse mortality experience on the Traditional Solutions yearly renewable term ("YRT") business has had a substantial negative impact on the operating results. Absent a significant improvement in the performance on the YRT business during 2017, the Company will incur additional capital strain, thereby further reducing available funds and eroding the Company's ability to pay the deferred interest on the Capital and Trust Preferred Securities (as defined herein) as such deferred interest payments become due during the first quarter of 2018. Accordingly, substantial doubt exists that the Company will be able to meet these deferred interest payments.

Management continues to monitor and evaluate alternatives to the current situation including, among others, alternative financing arrangements, expense reduction opportunities, opportunities for additional capital efficiencies, and the disposition of assets or entities. However, there currently are no strategies that both are probable of effectively being implemented and that would supply funds in such amounts and at such times as would be necessary to mitigate the conditions and events described above.

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

These consolidated financial statements do not give effect to any adjustments to recorded amounts and their classification which would be necessary if a liquidation of the Company was imminent. Should this occur, we would be required to realize our assets and discharge our liabilities and commitments in other than the normal course of business and at amounts different from those reflected in the consolidated financial statements.

2. Summary of Significant Accounting Policies

Basis of Presentation

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

Consolidation - The consolidated financial statements include the assets, liabilities, and results of operations of SRGL and its subsidiaries, as well as that of the VIE (i.e., Orkney Re II, an Irish special purpose reinsurance vehicle) 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.

Estimates and Assumptions - The preparation of consolidated financial statements in accordance 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, and such estimates and assumptions could change in the future as different information becomes known, which could impact the amounts reported and disclosed herein.

The assumptions impact:

- investment valuations;
- accounting for embedded derivative instruments;
- assessment of risk transfer for structured insurance and reinsurance contracts;
- estimates of premiums;
- establishment of reserves for future policy benefits;
- amortization of deferred acquisition costs;
- retrocession arrangements and amounts recoverable from reinsurers;
- interest-sensitive contract liabilities; and
- income taxes, deferred taxes, and the determination of associated valuation allowances.

Where applicable, management periodically reviews and revises these estimates, as appropriate. Any adjustments made to these estimates are reflected in the period in which the estimates are revised.

Assessment of Risk Transfer

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

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

The following is a summary of our revenue recognition policies:

(i) Reinsurance premiums from traditional life policies and annuity policies with life contingencies generally are recognized as premiums when due from policyholders and are reported net of amounts retroceded. Policyholder benefits and expenses are provided to recognize profits over the estimated lives of the insurance policies. When premiums are due over a significantly shorter period than the period over which benefits are provided, any excess profit is deferred and recognized into earnings in a constant relationship to insurance in-force or, for annuities, the amount of expected future policy benefit payments;

(ii) Reinsurance assumed for interest-sensitive and investment type products is accounted for under the deposit method and does not generate premiums. For this business, we recognize as fees and other income the investment income on the assets that we receive from ceding companies, net of policy charges for the cost of insurance, policy administration, and surrenders that have been assessed against policy account balances during the period. Fee income is recorded on an accrual basis; and

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

Investments

Fixed-maturity investments classified as trading are carried at fair value, as described in Note 5, "Fair Value Measurements". As a result, unrealized gains and losses on investments classified as trading securities are included in earnings on the Consolidated Statements of Comprehensive Income. For further discussion on our trading investments, please refer to Note 4, "Investments – *Trading Investments*".

Fixed-maturity investments classified as available-for-sale are carried at fair value. The cost of our investments classified as available-for-sale is adjusted for prepayments, impairments, and the amortization of premiums and discounts. The unrealized appreciation (depreciation) on our investments classified as available-for-sale represents the difference between fair value and amortized cost and is recorded directly to equity with no impact to earnings. The change in unrealized appreciation (depreciation) is included in accumulated other comprehensive income (loss) in shareholders' deficit after deductions for adjustments for any associated deferred acquisition costs and deferred income taxes, where applicable. For further discussion on our available-for-sale investments, please refer to Note 4, "Investments – *Available-for-Sale*".

Realized gains and losses arising from the sale of investments classified as trading securities and available-for-sale securities 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 as Investing Activities in the accompanying Consolidated Statements of Cash Flows, even though the majority of our investments are classified as trading securities, because these investment transactions are not part of our primary operating activities.

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

Affiliated investments represent investments accounted for under the equity method, for which the resulting carrying value is deemed to approximate fair value. Please refer to Note 4, "Investments – *Affiliated Investments*", for more information on our investments accounted for under the equity method.

2. Summary of Significant Accounting Policies (continued)

Other investments represent policy loans, which are carried at the outstanding loan balances, and which are deemed to approximate fair value.

Funds withheld at interest are funds held by ceding companies under modco agreements whereby the assets supporting the statutory reserves of the ceding companies related to the liabilities reinsured to us are retained by the ceding companies; however, the assets are managed for our account, and we receive the benefit of the interest income earned thereon. The funds withheld at interest are equal to the net statutory reserve fund balances retained by the ceding company, and the amounts in the funding accounts are adjusted quarterly to equal the ceding companies' net statutory reserve balances. Interest accrues on these assets at rates defined by the treaty terms. In the event of an insolvency of a ceding company, we would make a claim on the assets at the ceding company supporting the contract liabilities. The underlying agreements are considered to include embedded derivative assets and liabilities, as further discussed in this Note under "*Embedded Derivatives*".

We include the change in funds withheld at interest as well as the change in value of embedded derivative assets and liabilities in Operating Activities in the accompanying Consolidated Statements of Cash Flows. In addition to our modco agreements, we have entered into various reinsurance treaties that, although considered funds withheld, do not transfer significant insurance risk and are accounted for using the deposit method.

Amounts Recoverable from Reinsurers

In the ordinary course of business, our reinsurance operating subsidiaries cede reinsured liabilities to other reinsurance companies, which transactions are referred to as retrocessions. These agreements minimize our net loss potential arising from large risks. In the normal course of business, we seek to limit our exposure to losses on any single insured life. Our initial retention limit was set at $0.5 million per life, but, for certain lines of business, our retention limit has increased to up to $3.0 million per life on certain issue years. The Company could look to increase the retention limit per life on further issue years in the future. Ceded reinsurance contracts, however, do not relieve us of our obligation to the (re)insurers from which we assumed the liabilities. The cost of reinsurance related to long duration contracts is recognized over the terms of the reinsured policies on a basis consistent with the accounting for those policies, except that the cost of reinsurance related to 100% retrocessions executed with the intent to exit a line of business is recognized immediately.

Amounts recoverable from reinsurers primarily consists of retroceded reserves. Amounts recoverable from reinsurers also includes the balances due from reinsurance companies for claims and policy benefits that will be recovered from reinsurers, based on contracts in-force, and are presented net of any reserve for uncollectible reinsurance that has been determined based upon a review of the financial condition of the reinsurers and other factors. The method for determining the reinsurance recoverable involves actuarial estimates as well as a determination of our ability to cede claims and policy benefits under our existing reinsurance contracts. The reserve for uncollectible reinsurance is based on an estimate of the amount of the reinsurance recoverable balance that we ultimately will be unable to recover due to reinsurer insolvency, a contractual dispute, or any other reason. As of December 31, 2016 and 2015, we had no reserves for uncollectible reinsurance.

Deferred Acquisition Costs

FASB ASC Topic 944, Financial Services – Insurance ("FASB ASC 944") applies to our deferred acquisition costs ("DAC"), which includes commissions and allowances as well as certain costs of policy issuance and underwriting. DAC previously capitalized related to long-duration traditional life insurance contracts that we reinsured is being amortized in proportion to the ratio of individual period premium revenues to total anticipated premium revenues over the lives of the policies. Such anticipated premium revenues are estimated using the same assumptions used for computing reserves for future policy benefits.

2. Summary of Significant Accounting Policies (continued)

DAC previously capitalized related to interest-sensitive life and investment-type policies that we reinsured is being amortized over the lives of the policies in relation to the present value of estimated gross profits from mortality and investment income, less interest credited and expense margins, without provision for adverse deviation. Every quarter, we update the estimated gross profits with the actual gross profits for each line of business, and, annually, we review the future estimated gross profits for each line of business to determine the recoverability of DAC balances based on future expectations. When newly-estimated gross profits change from previously-estimated gross profits, as a result of changes in the future estimates for mortality, persistency, maintenance expense, or interest, the cumulative DAC amortization is recalculated and adjusted by a cumulative charge or credit to current operations.

Any significant modifications or replacements of contracts that are considered to constitute a substantial contract change are accounted for as an extinguishment of the replaced contract, resulting in a release of any unamortized DAC. Additionally, any unearned revenue or deferred sales inducements associated with the replaced contract would also be released. In instances when business is terminated due to recapture or novation, the related DAC is fully recovered against current operations.

We perform periodic tests to determine that the DAC remains recoverable; if financial performance were to deteriorate to the point where a premium deficiency existed, the DAC amortization would be re-estimated and adjusted by a charge to current operations. Please refer to "*Reserves for Future Policy Benefits*" in this Note, and Note 6, "DAC", for more information on the release of unamortized DAC.

Present Value of In-force Business

The present value of in-force business ("PVIF") was established upon the acquisition of a book of business and was amortized over the expected life of the business, as determined at acquisition. The amortization each year was a function of the ratio of annual gross profits (or annual revenues) to total anticipated gross profits (or total anticipated revenues) expected over the life of the business, discounted at the locked-in assumed net credit rate of 4.9%. The carrying value of PVIF was reviewed at least annually for indicators of impairment in value.

The components of the activity associated with PVIF for the year ended December 31, 2015, were as follows:

(U.S. dollars in thousands)	**Year Ended December 31, 2015**
Balance at beginning of year	$ 21,048
Interest accrued	1,031
Amortization expense	(2,919)
GAAP Loss Recognition release	(19,160)
Balance at end of year	$ -

2. Summary of Significant Accounting Policies (continued)

The gross amount of PVIF, the accumulated interest accrued, and the accumulated amortization as of December 31, 2015, were as follows:

(U.S. dollars in thousands)	**December 31, 2015**
Gross amount of original PVIF	$ 56,272
Accumulated interest accrued	21,826
Accumulated amortization	(58,938)
GAAP Loss Recognition release	(19,160)
Net amount of PVIF	$ -

The release of PVIF for the year ended December 31, 2015 of the remaining balance of $19.2 million was attributable to the results the GAAP Loss Recognition analysis performed by the Company, as discussed in "*Reserves for Future Policy Benefits*" in this Note.

Reserves for Future Policy Benefits

FASB ASC 944 also applies to the traditional life policies with continuing premiums that we have reinsured. For these policies, reserves for future policy benefits are computed based upon expected mortality rates, lapse rates, investment yields, expenses, and other assumptions established at policy issue, including a margin for adverse deviation. Once these assumptions were made, they generally would not be changed over the life of the policies. We periodically review actual historical experience and future projections compared to the original assumptions used to establish reserves for future policy benefits.

We also determine whether actual experience and future projections indicate that existing policy reserves, together with the present value of future gross premiums, are sufficient to cover the present value of future benefits, settlement and maintenance costs, and to recover unamortized DAC and PVIF (as discussed further in this Note under "*Deferred Acquisition Costs*" and "*Present Value of In-force Business*"). Significant changes in experience or assumptions may require us to provide for expected losses by establishing additional net reserves.

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

During 2016, the Company performed its annual GAAP Loss Recognition procedures in accordance with FASB ASC Subtopic 944-60, Financial Services – Insurance – Premium Deficiency and Loss Recognition ("FASB ASC 944-60"). In accordance with FASB ASC 944-60, the Company determined that its current liability for future policyholder benefits was not sufficient to cover the present value of future benefits to be paid. As a result of this analysis, and in accordance with FASB ASC 944-60, the assumptions were unlocked and resulted in an increase to our reserves of approximately $120.6 million for the year ended December 31, 2016. This resulted in a negative pre-tax effect on operations for 2016 and is reported in the Consolidated Statements of Comprehensive Income under the caption, "Claims, policy benefits, and changes in policyholder reserves, net".

2. Summary of Significant Accounting Policies (continued)

During 2015, the Company performed its annual GAAP Loss Recognition procedures, in accordance with FASB ASC 944-60, and determined that its current liability for future policyholder benefits was not sufficient to cover the present value of future benefits to be paid and to recover unamortized acquisition costs. As a result of this analysis, and in accordance with FASB ASC 944-60, we released approximately $95.2 million of unamortized DAC and $19.2 million of unamortized PVIF for the year ended December 31, 2015. This resulted in a negative pre-tax effect on operations for 2015 and is reported in the Consolidated Statements of Comprehensive Income under the caption, "Other insurance expenses, including amortization and release of deferred acquisition costs and present value of in-force business, net". Please refer to Note 6, "DAC", and "*Present Value of In-force Business*" in this Note, for more information on the release of unamortized DAC and unamortized PVIF.

Assumptions and estimates used in establishing the reserve for future policy benefits were based on experience and industry studies and actuarial judgement at the time of issue. Because of the long-term nature of the reinsurance contracts, actual experience can vary from the original assumptions emphasizing the importance of the annual review of the reserve sufficiency.

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

Interest-sensitive Contract Liabilities

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

Accounts Payable and Other Liabilities

Accounts payable and other liabilities consisted of the following:

(U.S. dollars in thousands)	**December 31, 2016**	**December 31, 2015**
Collateral finance facility accrued interest	$ 42,916	$ 35,758
Deferred financial guarantor fees	33,685	28,816
Deferred interest on long-term debt, at par value	15,303	10,961
Accounts payable	9,880	8,735
Current income taxes payable	74	42
Total	$ 101,858	$ 84,312

2. Summary of Significant Accounting Policies (continued)

Income Taxes

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

For the years ended December 31, 2016 and 2015, we had no reserves for unrecognized tax positions. Historically, for reserves for uncertain tax positions, we prescribed a recognition threshold and measurement attribution for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. For any benefits to be recognized, we have concluded that a tax position is more likely than not to be sustained upon examination by relevant taxing authorities.

Embedded Derivatives

Our embedded derivative assets and liabilities are associated with funds withheld at interest, which arise on modco agreements. FASB ASC Section 815-15-55, Derivatives and Hedging – Embedded Derivatives – Implementation Guidelines and Illustrations, indicates that these transactions contain embedded derivatives. All embedded derivative instruments are recognized either as assets or liabilities in the Consolidated Balance Sheets at fair value, as required by FASB ASC Topic 815, Derivatives and Hedging. The embedded derivatives are similar to a fixed-rate total return swap on the assets held by the ceding companies. The change in the fair value of embedded derivative assets and liabilities is reported in the Consolidated Statements of Comprehensive Income under the caption, "Change in value of embedded derivative assets and liabilities".

3. Recent Accounting Pronouncements

In April 2015, the FASB issued Accounting Standards Update ("ASU") No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU No. 2015-03"). The objective of ASU No. 2015-03 was to reduce the complexity of disclosing debt issuance costs and debt discount and premium on the balance sheet by requiring that debt issuance costs related to a recognized debt liability by presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts.

For nonpublic companies, ASU No. 2015-03 was effective for annual periods beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption was permitted. We have adopted the provisions of ASU No. 2015-03 for the year ended December 31, 2016. Other assets and collateral finance facility line items on the Consolidated Balance Sheets have been reclassified for both 2016 and 2015 financial years to be consistent with the adoption of this standard, which resulted in a reduction of $2.0 million and $2.6 million for 2016 and 2015, respectively. The adoption of ASU No. 2015-03 did not have a material effect on the Company's consolidated financial position and results of operations. Please refer to Note 7, "Collateral Finance Facility and Securitization Structure", for more information on the effect of ASU No. 2015-03.

The Company has evaluated newly-issued FASB accounting pronouncements and revisions made to existing FASB accounting pronouncements during 2016. The Company has determined that none of the newly-issued FASB accounting pronouncements and revisions made to existing FASB accounting pronouncements during 2016 and effective for 2017 will have a material effect on the Company's consolidated financial position and results of operations.

4. Investments

Trading Investments

The estimated fair values of fixed-maturity investments held as trading securities as of December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	**December 31, 2016**	**December 31, 2015**
U.S. Treasury securities and U.S. government agency obligations	$ 17,682	$ 20,619
Corporate securities	293,161	388,367
Municipal bonds	26,167	29,646
Residential mortgage-backed securities	359,126	398,641
Commercial mortgage-backed securities	112,129	131,858
Asset-backed securities	192,624	249,841
Total	$ 1,000,889	$ 1,218,972

4. Investments (continued)

The contractual maturities of the fixed-maturity investments held as trading securities as of December 31, 2016 and 2015, were as follows (actual maturities may differ as a result of calls and prepayments):

(U.S. dollars in thousands)	Estimated Fair Value December 31, 2016	Estimated Fair Value December 31, 2015
Due in one year or less	$ 34,631	$ 49,979
Due after one year through five years	196,056	251,529
Due after five years through ten years	62,898	89,935
Due after ten years	43,425	47,189
	337,010	438,632
Residential mortgage-backed securities	359,126	398,641
Commercial mortgage-backed securities	112,129	131,858
Asset-backed securities	192,624	249,841
Total	$ 1,000,889	$ 1,218,972

Available-for-Sale Investments

The amortized cost and estimated fair value of fixed maturity securities classified as available-for-sale as of December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	December 31, 2016				
		Gross Unrealized			
	Cost or Amortized Cost	Gains	Temporary Losses	Other Than Temporary Losses	Estimated Fair Value
U.S. Treasury securities and U.S. government agency obligations	$ 23,701	$ -	$ (66)	$ -	$ 23,635
Corporate securities	285,453	2,710	(1,706)	-	286,457
Municipal bonds	-	-	-	-	-
Residential mortgage-backed securities	4,477	10	(39)	-	4,448
Commercial mortgage-backed securities	25,932	214	(476)	-	25,670
Asset-backed securities	137,846	298	(226)	-	137,918
Total securities	$ 477,409	$ 3,232	$ (2,513)	$ -	$ 478,128

4. Investments (continued)

(U.S. dollars in thousands)	December 31, 2015				
		Gross Unrealized			
	Cost or Amortized Cost	Gains	Temporary Losses	Other Than Temporary Losses	Estimated Fair Value
U.S. Treasury securities and U.S. government agency obligations ...	$ 22,109	$ -	$ (153)	$ -	$ 21,956
Corporate securities	201,607	304	(3,148)	-	198,763
Municipal bonds	-	-	-	-	-
Residential mortgage-backed securities	-	-	-	-	-
Commercial mortgage-backed securities	22,440	-	(459)	-	21,981
Asset-backed securities..................	97,095	6	(1,268)	-	95,833
Total securities	$ 343,251	$ 310	$ (5,028)	$ -	$ 338,533

The estimated fair value and gross unrealized losses of all investments classified as available-for-sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities and U.S. government agency obligations	$ 23,635	$ (66)	$ -	$ -	$ 23,635	$ (66)
Corporate securities	98,857	(1,660)	1,450	(46)	100,307	(1,706)
Municipal bonds	-	-	-	-	-	-
Residential mortgage-backed securities	979	(39)	-	-	979	(39)
Commercial mortgage-backed securities	10,101	(340)	1,705	(136)	11,806	(476)
Asset-backed securities................	28,033	(151)	22,035	(75)	50,068	(226)
Total available-for-sale fixed maturities	$ 161,605	$ (2,256)	$ 25,190	$ (257)	$ 186,795	$ (2,513)

4. Investments (continued)

(U.S. dollars in thousands)	December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities and U.S. government agency obligations	$ 21,456	$ (153)	$ -	$ -	$ 21,456	$ (153)
Corporate securities	152,308	(3,135)	94	(13)	152,402	(3,148)
Municipal bonds	-	-	-	-	-	-
Residential mortgage-backed securities	-	-	-	-	-	-
Commercial mortgage-backed securities	21,981	(459)	-	-	21,981	(459)
Asset-backed securities	94,256	(1,268)	-	-	94,256	(1,268)
Total available-for-sale fixed maturities	$ 290,001	$ (5,015)	$ 94	$ (13)	$ 290,095	$ (5,028)

The total number of securities classified as available-for-sale that had unrealized losses as of December 31, 2016 and 2015, were 155 and 247, respectively. The Company's unrealized losses on its fixed maturity investments were the result of interest rate increases. Since the decline in estimated fair value is attributable to changes in interest rates and not credit quality, the Company does not consider these investments other than temporarily impaired. The Company has the intent and ability to hold these maturities through a recovery of unrealized losses, or until maturity of the individual securities.

The contractual maturities of the fixed-maturity investments classified as available-for-sale securities as of December 31, 2016 and 2015, were as follows (actual maturities may differ as a result of calls and prepayments):

(U.S. dollars in thousands)	Cost or Amortized Cost December 31, 2016	Estimated Fair Value December 31, 2016
Due in one year or less	$ 5,156	$ 5,160
Due after one year through five years	113,792	114,072
Due after five years through ten years	181,782	182,338
Due after ten years	8,424	8,522
	309,154	310,092
Residential mortgage-backed securities	4,477	4,448
Commercial mortgage-backed securities	25,932	25,670
Asset-backed securities	137,846	137,918
Total	$ 477,409	$ 478,128

4. Investments (continued)

	Cost or Amortized Cost	Estimated Fair Value
(U.S. dollars in thousands)	**December 31, 2015**	**December 31, 2015**
Due in one year or less	$ 1,992	$ 2,007
Due after one year through five years	72,572	71,865
Due after five years through ten years	137,527	135,398
Due after ten years	11,625	11,449
	223,716	220,719
Residential mortgage-backed securities	-	-
Commercial mortgage-backed securities	22,440	21,981
Asset-backed securities	97,095	95,833
Total	$ 343,251	$ 338,533

Assets on Deposit

We are required to maintain assets on deposit with various U.S. regulatory authorities, in accordance with the statutory regulations of the individual jurisdictions, to support our insurance and reinsurance operations. As a result of the various regulatory limitations on how these assets may be invested and their unavailability for general corporate purposes, these assets are considered "restricted". We also have established trust funds* in connection with certain transactions for the benefit of the transaction counterparties, which amounts also include assets attributable to the VIE that we consolidate, Orkney Re II. As a result of the restrictions imposed on the foregoing assets in accordance with the respective reinsurance treaties and other agreements to which they relate, these assets (including the assets within the collateral finance facility that are held for the contractual obligations of that structure) are not available for general corporate purposes and also are considered "restricted". (Please also refer to Note 7, "Collateral Finance Facility and Securitization Structure" for additional information.)

The estimated fair value of the components of the restricted assets as of December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	**December 31, 2016**	**December 31, 2015**
Deposits with U.S. regulatory authorities	$ 4,578	$ 4,551
Trust funds* attributable to VIE	437,957	428,851
Trust funds*	649,511	675,407
Total	$ 1,092,046	$ 1,108,809

"Trust funds" in the above table reflects the fair value of assets held by ceding companies under modco arrangements and the fair value of assets we hold in segregated portfolios under coinsurance arrangements. The assets that comprise the "Trust funds" are included in fixed-maturity investments held as trading securities, fixed-maturity investments held as available-for-sale securities, cash and cash equivalents, and funds withheld at interest in the Consolidated Balance Sheets.

4. Investments (continued)

Net Investment Income

Net investment income for the trading securities and the available-for-sale securities for the years ended December 31, 2016 and 2015, was derived from the following sources:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Fixed-maturity investments, held as trading	$ 41,683	$ 55,864
Fixed-maturity investments, held as available-for-sale	13,301	4,321
Funds withheld at interest	11,963	11,733
Other investments	901	353
Investment expenses	(3,027)	(3,865)
Net investment income	$ 64,821	$ 68,406

Realized and Unrealized Gains (Losses)

The components of realized and unrealized gains (losses) and of the change in net unrealized appreciation (depreciation) on investments and other balances for the years ended December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Realized and unrealized gains (losses)		
Fixed-maturity investments		
Gross realized gains	$ 1,687	$ 6,706
Gross realized losses	(11)	(217)
Net unrealized gains (losses), trading securities	16,232	(21,278)
	17,908	(14,789)
Other		
Cerberus Affiliated Fund* - realized and unrealized gains (losses)	(8,581)	1,934
Realized gains (losses) on modco treaties	(937)	58
Other	779	197
	(8,739)	2,189
Net realized and unrealized gains (losses)	$ 9,169	$ (12,600)
Change in unrealized gains (losses) on available-for-sale investments, net		
Fixed-maturity investments	5,437	(4,694)
Change in deferred income taxes	(25)	-
Change in deferred acquisition costs	(66)	-
Unrealized gains (losses) on available-for-sale investments, net of taxes and deferred acquisition costs	$ 5,346	$ (4,694)

** Defined in "Affiliated Investments" in this Note.*

4. Investments (continued)

Affiliated Investments

Affiliated investments represent investments accounted for under the equity method, in accordance with FASB ASC Topic 323 Investments – Equity Method and Joint Ventures ("FASB ASC 323"), for which the resulting equity method carrying value is deemed to approximate fair value. The investments accounted for under the equity method represent executed subscription documents, signed by SALIC on March 26, 2012, pursuant to which SALIC committed to make an investment of up to an aggregate $30.0 million in an investment fund affiliated with and controlled, directly or indirectly, by Cerberus (the "Cerberus Affiliated Fund"). The Cerberus Affiliated Fund, which was included in Affiliated Investments on the accompanying Consolidated Balance Sheets, had costs and carrying values as of December 31, 2015, which was as follows:

(U.S. dollars in thousands)	December 31, 2015
Cost (Total Commitment)..........	$ 28,553
Carrying Value...........................	$ 44,235

On December 1, 2016, SALIC entered into an agreement to sell to a third-party purchaser, in a privately-negotiated transaction, its investment in the Cerberus Affiliated Fund for approximately $35.9 million. The cost (capital commitment) of the Cerberus Affiliated Fund by SALIC at the time of the transaction was approximately $28.9 million. The carrying value of the Cerberus Affiliated Fund at the time of the transaction was approximately $41.8 million. In accordance with FASB ASC Topic 323, the Company recorded a $5.9 million realized loss in the fourth quarter of 2016 on the Cerberus Affiliated Fund. The $5.9 million realized loss on the Cerberus Affiliated Fund investment is included in the Consolidated Statements of Comprehensive Income, under the caption, "Net unrealized and unrealized gains (losses)".

5. Fair Value Measurements

FASB ASC Topic 820, 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 in markets that are not active or inputs that are observable either directly or indirectly. These inputs can include quoted prices for similar instruments other than quoted prices in Level 1, quoted prices in markets that are not active, or other significant inputs that are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and are significant to the determination of estimated fair value of the instruments. Valuations are based primarily on techniques that utilize unobservable inputs or cannot be derived principally from, or corroborated by, observable market data. Unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

5. Fair Value Measurements (continued)

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

Level 1 primarily consists of financial instruments whose value is based on quoted market prices, such as public equities and actively-traded mutual fund investments. We had no securities classified as Level 1 under FASB ASC 820 as of December 31, 2016. We had one security classified as Level 1 under FASB ASC 820 as of December 31, 2015.

Level 2 includes those financial instruments that are traded in markets without quoted prices or 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, such as certain of the Company's corporate securities and mortgage and asset-backed securities. Additionally, the Company's embedded derivative liabilities were classified as 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 were classified as Level 2. These fair values were 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. The proprietary pricing models include matrix pricing where expected cash flows were discounted utilizing market interest rates obtained from third-party sources, based on the credit quality and duration of the instrument.

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

The fair values of the embedded derivative liabilities were determined based on the embedded derivatives contained in the modco agreements. The embedded derivatives are similar to a group of fixed rate total return swaps, whose fair values are based on the fair values of the applicable assets less the fair values of the related liabilities. The fair values of the underlying assets generally are based upon observable and unobservable 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 applied to the estimated future cash flows of the underlying agreements, as derived from best estimate actuarial models. The significant assumptions used in the projected cash flows are lapse rates and mortality rates. The lapse rate represents the probability that a policyholder will surrender a policy during a year. The lapse rate is based on experience studies on the underlying agreements and the structure of the business. The base lapse rate has historically ranged from 4% to 16%, the selection of which could significantly affect the fair values of the liabilities. Some agreements may also experience a shock lapse. A shock lapse is generally associated with a time period during which no penalty for withdrawal is applicable.

5. Fair Value Measurements (continued)

A shock lapse has historically ranged from 20% to 50%, the selection of which could significantly affect the fair values of the liabilities. The mortality rate is based on the "Annuity 2000 Mortality Table" developed by the Society of Actuaries. These assumptions are unobservable, which is why the resulting fair values of the embedded derivative liabilities were classified as Level 3.

Fair Value Measurements on a Recurring Basis

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

	December 31, 2016			
(U.S. dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Investments – trading				
U.S. Treasury securities and U.S. government agency obligations	$ -	$ 17,682	$ -	$ 17,682
Corporate securities	-	287,323	5,838	293,161
Municipal bonds	-	26,167	-	26,167
Residential mortgage-backed securities	-	99,982	259,144	359,126
Commercial mortgage-backed securities	-	112,118	11	112,129
Asset-backed securities	-	168,226	24,398	192,624
Fixed-maturity investments, held as trading	-	711,498	289,391	1,000,889
Investments – available-for-sale				
U.S. Treasury securities and U.S. government agency obligations	$ -	$ 23,635	$ -	$ 23,635
Corporate securities	-	286,457	-	286,457
Municipal bonds	-	-	-	-
Residential mortgage-backed securities	-	4,448	-	4,448
Commercial mortgage-backed securities	-	25,670	-	25,670
Asset-backed securities	-	137,859	59	137,918
Fixed-maturity investments, held as available-for-sale	-	478,069	59	478,128
Total assets at fair value	$ -	$ 1,189,567	$ 289,450	$ 1,479,017
Embedded derivative liabilities	-	-	(15,640)	(15,640)
Total liabilities at fair value	$ -	$ -	$ (15,640)	$ (15,640)

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5. Fair Value Measurements (continued)

(U.S. dollars in thousands)	December 31, 2015 Level 1	Level 2	Level 3	Total
Investments – trading				
U.S. Treasury securities and U.S. government agency obligations	$ -	$ 20,619	$ -	$ 20,619
Corporate securities	-	381,371	6,996	388,367
Municipal bonds	-	29,646	-	29,646
Residential mortgage-backed securities	-	130,792	267,849	398,641
Commercial mortgage-backed securities	-	131,737	121	131,858
Asset-backed securities	-	223,731	26,110	249,841
Fixed-maturity investments, held as trading	-	917,896	301,076	1,218,972
Investments – available-for-sale				
U.S. Treasury securities and U.S. government agency obligations	$ 500	$ 21,456	$ -	$ 21,956
Corporate securities	-	198,763	-	198,763
Municipal bonds	-	-	-	-
Residential mortgage-backed securities	-	-	-	-
Commercial mortgage-backed securities	-	21,981	-	21,981
Asset-backed securities	-	95,833	-	95,833
Fixed-maturity investments, held as available-for-sale	500	338,033	-	338,533
Total assets at fair value	$ 500	$ 1,255,929	$ 301,076	$ 1,557,505
Embedded derivative liabilities	-	-	(16,871)	(16,871)
Total liabilities at fair value	$ -	$ -	$ (16,871)	$ (16,871)

5. Fair Value Measurements (continued)

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

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended December 31, 2016

(U.S. dollars in thousands)	Corporate securities	Municipal bonds	Residential mortgage-backed securities	Commercial mortgage-backed securities	Asset-backed securities	Total assets at fair value	Total liabilities at fair value
Beginning balance as of January 1, 2016	$ 6,996	$ -	$ 267,849	$ 121	$ 26,110	$ 301,076	$ (16,871)
Total realized and unrealized gains (losses) included on trading securities in net income	(191)	-	(47)	2	15	(221)	1,231
Total unrealized gains (losses) included on available-for-sale securities in comprehensive net income (loss)	-	-	(742)	-	(2)	(744)	-
Purchases	-	-	-	-	-	-	-
Settlements	(1,067)	-	(23,088)	(113)	(1,352)	(25,620)	-
Amortization	100	-	15,172	1	65	15,338	-
Transfers in and/or out of Level 3, net	-	-	-	-	(379)	(379)	-
Ending balance as of December 31, 2016	$ 5,838	$ -	$ 259,144	$ 11	$ 24,457	$ 289,450	$ (15,640)

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) for the year ended December 31, 2015

(U.S. dollars in thousands)	Corporate securities	Municipal bonds	Residential mortgage-backed securities	Commercial mortgage-backed securities	Asset-backed securities	Total assets at fair value	Total liabilities at fair value
Beginning balance as of January 1, 2015	$ 24,654	$ 5,838	$ 269,575	$ 274	$ 38,851	$ 339,192	$(13,407)
Total realized and unrealized gains (losses) included on trading securities in net income	(505)	-	4,278	(4)	(1,686)	2,083	(3,464)
Total unrealized gains (losses) included on available-for-sale securities in comprehensive net income (loss)	-	-	-	-	-	-	-
Purchases	589	-	-	2,093	2,000	4,682	-
Settlements	(17,879)	-	(17,437)	(2,243)	(13,057)	(50,616)	-
Amortization	137	-	11,433	1	57	11,628	-
Transfers in and/or out of Level 3, net	-	(5,838)	-	-	(55)	(5,893)	-
Ending balance as of December 31, 2015	$ 6,996	$ -	$ 267,849	$ 121	$ 26,110	$ 301,076	$(16,871)

5. Fair Value Measurements (continued)

Changes in classifications impacting Level 3 financial instruments were reported in the above tables as transfers in (out) of the Level 3 category at the end of each quarterly period in which the transfers occurred. The portion of net unrealized gains that related to Level 3 trading and available-for-sale securities still held at the reporting date for the years ended December 31, 2016 and 2015 was $3.3 million and $6.0 million in net gains, respectively.

The following tables summarize the fair values, valuation techniques, and significant unobservable inputs of the Level 3 fair value measurements as of December 31, 2016 and 2015, respectively, for which we have been able to obtain quantitative information about the significant unobservable inputs used in those fair value measurements:

December 31, 2016

Assets (U.S. dollars in thousands)	Fair Value	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities	$ 1,761	Discounted Cash Flow	Liquidity/duration adjustment*	1.1% - 1.7%
Asset-backed securities...........	$ 10,228	Discounted Cash Flow	Liquidity/duration adjustment*	1.5% - 1.6%

December 31, 2015

Assets (U.S. dollars in thousands)	Fair Value	Valuation Technique	Significant Unobservable Inputs	Input Ranges
Corporate securities	$ 2,843	Discounted Cash Flow	Liquidity/duration adjustment*	1.0% - 1.5%
Asset-backed securities...........	$ 10,679	Discounted Cash Flow	Liquidity/duration adjustment*	1.5% - 1.6%

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

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

Fair Value Measurements on a Non-Recurring Basis

As discussed in the Note herein, the fair values of financial assets and liabilities were estimated in accordance with the framework established under FASB ASC 820. The methodology and assumptions for determining the fair value of financial instruments on a non-recurring basis presented, in addition to those disclosed in Note 2, "Summary of Significant Accounting Policies - *Investments*" were as follows:

(i) As disclosed in Note 2, "Summary of Significant Accounting Policies – *Investments*", cash and cash equivalents include cash and short-term investments with an original maturity, when purchased, of three months or less. The carrying value amount for cash and cash equivalents is a reasonable estimate of fair value, due to the short-term maturity of these investments. These assets in cash and cash equivalents were classified as Level 1 fair value measurements;

5. Fair Value Measurements (continued)

(ii) As disclosed in Note 2, "Summary of Significant Accounting Policies – *Investments*", affiliated investments represent investments accounted for under the equity method, for which the resulting carrying value was deemed to approximate fair value. Because the inputs for the values were unobservable, the investments accounted for under the equity method were classified as Level 3 fair value measurements. Please refer to Note 4, "Investments – *Affiliated Investments*", for more information on our investments accounted for under the equity method;

(iii) As disclosed in Note 2, "Summary of Significant Accounting Policies – *Investments*", other investments represent policy loans, which were carried at the outstanding loan balances and deemed to approximate fair value. Because the inputs for the values were unobservable, policy loans were classified as Level 3 fair value measurements;

(iv) As disclosed in Note 2, "Summary of Significant Accounting Policies – *Investments*", the funds withheld at interest were equal to the net statutory reserve fund balances retained by the ceding company, and the securities in the funding accounts consist of investments held by the ceding companies. The funding accounts were adjusted quarterly to equal the ceding companies' net statutory reserve balances. The methodologies and assumptions used to determine the fair values of the underlying securities generally were consistent with the fair value methodologies and assumptions we used to value our fixed-maturity investments carried at fair value, which included a combination of both Level 2 and Level 3 fair value measurements. As a result, the funds withheld at interest were classified as Level 3 in the fair value hierarchy. Changes in the fair values of the fixed-maturity investments held by the ceding companies were a component in the calculation of the embedded derivative liabilities, at fair value;

(v) The carrying value of the accrued interest receivable for accrued dividends and interest was a reasonable approximation of fair value, due to the short-term nature of assets. The accrued interest receivable was classified as Level 2;

(vi) The fair values of interest-sensitive contract liabilities, which liabilities exclude significant mortality risk and were accounted for under the deposit method, were based on the cash surrender values of the liabilities, which were deemed to approximate fair value. The interest-sensitive contract liabilities were classified as Level 3;

(vii) The fair values for the collateral finance facility were determined with reference to underlying business models and observable market inputs and were classified as Level 3; and

(viii) Fair values for long-term debt, at par value were determined with reference to observable prices of similar securities, and were classified as Level 2.

5. Fair Value Measurements (continued)

(U.S. dollars in thousands)	December 31, 2016 Carrying Balance	Level 1	Level 2	Level 3
		Estimated Fair Value		
Assets				
Cash and cash equivalents	$ 194,920	$ 194,920	$ -	$ -
Affiliated investments	-	-	-	-
Other investments	2,368	-	-	2,368
Funds withheld at interest	362,761	-	-	362,761
Accrued interest receivable	9,219	-	9,219	-
Liabilities				
Interest-sensitive contract liabilities	$ 765,610	$ -	$ -	$ 765,069
Collateral finance facility, excluding debt issuance costs	450,000	-	-	171,601
Embedded derivative liabilities, at fair value	15,640	-	-	15,640
Long-term debt, at par value	86,500	-	51,633	-

(U.S. dollars in thousands)	December 31, 2015 Carrying Balance	Level 1	Level 2	Level 3
		Estimated Fair Value		
Assets				
Cash and cash equivalents	$ 166,277	$ 166,277	$ -	$ -
Affiliated investments	44,235	-	-	44,235
Other investments	2,744	-	-	2,744
Funds withheld at interest	388,356	-	-	388,356
Accrued interest receivable	9,865	-	9,865	-
Liabilities				
Interest-sensitive contract liabilities	$ 824,796	$ -	$ -	$ 824,228
Collateral finance facility, excluding debt issuance costs	450,000	-	-	156,978
Embedded derivative liabilities, at fair value	16,871	-	-	16,871
Long-term debt, at par value	86,500	-	54,380	-

6. DAC

The components of DAC activity for the years ended December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Balance at beginning of year	$ 26,992	$ 132,717
DAC amortization expense	(2,120)	(11,385)
DAC unlocking	(1,250)	886
Shadow DAC	(91)	-
GAAP Loss Recognition release	-	(95,226)
Balance at end of year	$ 23,531	$ 26,992

The release of DAC for the year ended December 31, 2015 of approximately $95.2 million of unamortized DAC which was attributable to the results of the GAAP Loss Recognition analysis performed by the Company, as discussed in Note 2, "Summary of Significant Accounting Policies – *Reserves for Future Policy Benefits*".

7. Collateral Finance Facility and Securitization Structure

Orkney Re II

On December 21, 2005, Orkney Re II, whose issued ordinary shares are held by a share trustee and its nominees in trust for charitable purposes, issued in a private offering $450.0 million of debt primarily to external investors. The debt consisted of $382.5 million of Series A-1 Floating Rate Guaranteed Notes (the "Series A-1 Notes"), $42.5 million of Series A-2 Floating Rate Notes (the "Series A-2 Notes"), and $25.0 million of Series B Floating Rate Notes (the "Series B Notes"), all due December 31, 2035 (collectively, the "Orkney Re II Notes"). The Orkney Re II Notes are listed on the Irish Stock Exchange and proceeds from this private offering were used to fund the Valuation of Life Insurance Policies Regulation reserve requirements for a defined block of level premium term life insurance policies issued by third party ceding companies between January 1, 2004 and December 31, 2004, and reinsured by SRUS to Orkney Re II.

In addition to the private offering, Orkney Re II also issued to SALIC $5.0 million of the Series B Notes and $30.0 million of Series C Floating Rate Notes ("Series C Notes") due December 21, 2036. The Series C Notes accrue interest only until the Orkney Re II Notes are fully repaid. SRGL owns $0.5 million of Orkney Re II Series D Convertible Notes due December 21, 2036, and 76,190,000 Preference Shares of Orkney Re II of $1.00 each in capital. Proceeds from the Orkney Re II Notes, Series C Notes, Series D Convertible Notes, and Preference Shares were deposited into a series of accounts that collateralize the Orkney Re II Notes and the reserve obligations of SRUS.

In accordance with FASB ASC 810-10, Orkney Re II is considered to be a VIE, as we are considered to hold the primary beneficial interest. We cede to Orkney Re II all of the business assumed by Orkney Re II and would absorb a majority of the expected losses related to the insurance liabilities. As a result, Orkney Re II is consolidated in our consolidated financial statements.

7. Collateral Finance Facility and Securitization Structure (continued)

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

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015*
Assets		
Fixed-maturity investments held as available-for-sale securities, at fair value	$ 8,072	$ 8,435
Funds withheld at interest	376,623	370,696
Cash and cash equivalents	3,422	3,237
Embedded derivative assets	50,044	46,531
All other assets	5,211	-
Total assets	$ 443,372	$ 428,899
Liabilities		
Reserves for future policy benefits	$ 130,106	$ 133,042
Collateral finance facility, net of debt issuance costs	448,056	447,579
All other liabilities	78,030	66,082
Total liabilities	$ 656,192	$ 646,703

** Prior year results restated to disclose collateral finance facility, net of debt issuance costs, in accordance with ASU No. 2015-03.*

The assets listed in the foregoing table are subject to a variety of restrictions on their use, as set forth in and governed by the transaction documents for the Orkney Re II collateral finance facility and securitization structure. The total investments of the consolidated VIE disclosed in the accompanying Consolidated Balance Sheets include the deduction of the assets needed to satisfy future policy benefits, based on current projections ("economic reserves"). The following table provides a reconciliation of the aforementioned adjustments:

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015
Fixed-maturity investments held as available-for-sale securities, at fair value	$ 8,072	$ 8,435
Funds withheld at interest	376,623	370,696
Cash and cash equivalents	3,422	3,237
Embedded derivative assets	50,044	46,531
Total investments	$ 438,161	$ 428,899
Less: Economic reserves	(159,945)	(153,169)
Total investments in consolidated VIE	$ 278,216	$ 275,730

The reinsurance liabilities of Orkney Re II have been eliminated from the Consolidated Balance Sheets. For further discussion on Orkney Re II, please refer to Note 16, "Subsequent Events - *Orkney Re II – Settlement of Litigation*".

7. Collateral Finance Facility and Securitization Structure (continued)

Orkney Re II Event of Default, Acceleration and Foreclosure

Orkney Re II has been unable to make scheduled interest payments on the Series A-1 Notes and Series A-2 Notes on all scheduled quarterly interest payment dates since May 11, 2009. As of December 31, 2016, Assured Guaranty (UK) Ltd. (“Assured”) has made guarantee payments in the cumulative amount of $24.6 million on the Series A-1 Notes which are the subject of a financial guaranty policy issued by Assured in connection with the Orkney Re II transaction. Unlike the Series A-1 Notes, the Series A-2 Notes were not guaranteed under the Orkney Re II transaction and the amount of cumulative interest on the Series A-2 Notes was $3.7 million as of December 31, 2016. This amount of cumulative interest on the Series A-1 Notes and the Series A-2 Notes has been accrued by us in Accounts Payable and Other Liabilities in the Consolidated Balance Sheets. Interest on the Series A-1 Notes on which Assured is making guarantee payments is payable quarterly at a rate equivalent to three-month LIBOR plus 0.425%.

As of December 31, 2016, the interest rate on the Series A-1 Notes was 1.31% (compared to 0.78% as of December 31, 2015). Interest on the Series A-2 Notes, which are not guaranteed as part of the Orkney Re II transaction, is payable quarterly at a rate equivalent to three-month LIBOR plus 0.730%. As of December 31, 2016, the interest rate on the Series A-2 Notes was 1.62% (compared to 1.09% as of December 31, 2015). For further discussion on Orkney Re II and scheduled interest payments on the Series A-1 Notes and the Series A-2 Notes, please refer to Note 16, “Subsequent Events - *Orkney Re II – Scheduled Interest Payments*”.

8. Debt Obligations and Other Funding Arrangements

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

(U.S. dollars in thousands)	**December 31, 2016**	**December 31, 2015**
Capital Securities Due 2032*	$ 17,500	$ 17,500
Preferred Trust Securities Due 2033*	-	-
Trust Preferred Securities Due 2033*	-	-
Trust Preferred Securities Due 2034*	19,000	19,000
Trust Preferred Securities Due December 2034*	50,000	50,000
Long-term debt, at par value	$ 86,500	$ 86,500

**Defined below.*

8. Debt Obligations and Other Funding Arrangements (continued)

(U.S. dollars in thousands)	Capital Securities Due 2032*	Preferred Trust Securities Due 2033*	Trust Preferred Securities Due 2033*	Trust Preferred Securities Due 2034*	Trust Preferred Securities Due December 2034*
Issuer of long-term debt, at par value	Capital Trust*	Capital Trust II*	GPIC Trust*	Capital Trust III*	SFL Trust I*
Long-term debt outstanding	$17,500	$nil**	$nil***	$19,000****	$50,000
Maturity date	Dec. 4, 2032	Oct. 29, 2033	Sept. 30, 2033	June 17, 2034	Dec. 15, 2034
Redeemable (in whole or in part) after	Dec. 4, 2007	Oct. 29, 2008	Sept. 30, 2008	June 17, 2009	Dec. 15, 2009
Interest Payable	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly
Interest rate: 3-month LIBOR +	4.00%	3.95%	3.90%	3.80%	3.50%
Interest rate as of December 31, 2016	5.00%	4.95%	4.90%	4.80%	4.50%
Interest rate as of December 31, 2015	4.61%	4.56%	4.51%	4.41%	4.11%
Maximum number of quarters for which interest may be deferred	20	20	20	20	20
Number of quarters for which interest was deferred as of December 31, 2016	16	16	16	16	16

**Defined below.*
***Not included in this amount is $20.0 million of outstanding Preferred Trust Securities Due 2033 owned by SRGL, as further explained in this Note.*
****Not included in this amount is $10.0 million of outstanding Trust Preferred Securities Due 2033 owned by SRGL, as further explained in this Note.*
*****Not included in this amount is $13.0 million of outstanding Trust Preferred Securities Due 2034 owned by SRGL, as further explained in this Note.*

Capital Securities Due 2032

On December 4, 2002, Scottish Holdings Statutory Trust I, a Connecticut statutory business trust ("Capital Trust"), issued and sold in a private offering an aggregate of $17.5 million Floating Rate Capital Securities (the "Capital Securities Due 2032"). All of the common shares of the Capital Trust are owned by SHI, one of our wholly-owned subsidiaries. The sole assets of the Capital Trust consist of $18.0 million principal amount of Floating Rate Debentures (the "Debentures") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2016) as the Capital Securities Due 2032.

Preferred Trust Securities Due 2033

On October 29, 2003, Scottish Holdings, Inc. Statutory Trust II, a Connecticut statutory business trust ("Capital Trust II"), issued and sold in a private offering an aggregate of $20.0 million Preferred Trust Securities (the "Preferred Trust Securities Due 2033"). All of the common shares of Capital Trust II are owned by SHI.

The sole assets of Capital Trust II consist of $20.6 million principal amount of Floating Rate Debentures (the "2033 Floating Rate Debentures") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2016) as the Preferred Trust Securities Due 2033. On December 3, 2014, SRGL agreed to acquire, in a privately-negotiated transaction, the entire $20.0 million in aggregate liquidation amount of Preferred Trust Securities Due 2033, with a liquidation preference of $1,000 per security, at a purchase price of $665.00 per security.

8. Debt Obligations and Other Funding Arrangements (continued)

In accordance with FASB ASC Topic 405, Extinguishment of Liabilities ("FASB ASC 405"), the Company recorded a $8.5 million gain on the extinguishment of debt (which included $1.8 million in deferred and accrued interest that is now payable to SRGL following the acquisition) in the Consolidated Statements of Comprehensive Income in the fourth quarter of 2014.

Trust Preferred Securities Due 2033

On November 14, 2003, GPIC Holdings Inc. Statutory Trust, a Delaware statutory business trust ("GPIC Trust") issued and sold in a private offering an aggregate of $10.0 million Trust Preferred Securities (the "Trust Preferred Securities Due 2033"). All of the common shares of GPIC Trust are owned by SHI. The sole assets of GPIC Trust consist of $10.3 million principal amount of Junior Subordinated Notes (the "Junior Subordinated Notes") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2016) as the Trust Preferred Securities Due 2033.

On December 3, 2014, SRGL agreed to acquire, in a privately-negotiated transaction, the entire $10.0 million in aggregate liquidation amount of Trust Preferred Securities Due 2033, with a liquidation preference of $1,000 per security, at a purchase price of $665.00 per security. In accordance with FASB ASC 405, the Company recorded a $4.2 million gain on the extinguishment of debt (which included $0.9 million in deferred and accrued interest that is now payable to SRGL following the acquisition) in the Consolidated Statements of Comprehensive Income in the fourth quarter of 2014.

Trust Preferred Securities Due 2034

On May 12, 2004, Scottish Holdings, Inc. Statutory Trust III, a Connecticut statutory business trust ("Capital Trust III") issued and sold in a private offering an aggregate of $32.0 million Trust Preferred Securities (the "Trust Preferred Securities Due 2034"). All of the common shares of Capital Trust III are owned by SHI. The sole assets of Capital Trust III consist of $33.0 million principal amount of Floating Rate Debentures (the "2034 Floating Rate Debentures") issued by SHI, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2016) as the Trust Preferred Securities Due 2034.

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

Trust Preferred Securities Due December 2034

On December 18, 2004, SFL Statutory Trust I, a Delaware statutory business trust ("SFL Trust I") issued and sold in a private offering an aggregate of $50.0 million Trust Preferred Securities (the "Trust Preferred Securities Due December 2034" and, together with the Trust Preferred Securities Due 2034, the Trust Preferred Securities Due 2033, the Preferred Trust Securities Due 2033 and the Capital Securities Due 2032, the "Capital and Trust Preferred Securities"). All of the common shares of SFL Trust I are owned by SFL. The sole assets of SFL Trust I consist of $51.5 million principal amount of Floating Rate Debentures (the "December 2034 Floating Rate Debentures") issued by SFL, and have all the same features (maturity date, interest payable, interest rate, maximum number of quarters for which interest may be deferred, and the number of quarters for which interest was deferred as of December 31, 2016) as the Trust Preferred Securities Due December 2034.

8. Debt Obligations and Other Funding Arrangements (continued)

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 interest payments would accrue interest quarterly on a compounded basis.

Deferral of Interest Payments on the Capital and Trust Preferred Securities

We began deferring interest payments as of January 29, 2013 on the Capital and Trust Preferred Securities as permitted by the terms of the indentures governing the securities. As of December 31, 2016, we had accrued and deferred payments of $23.3 million in interest on the Capital and Trust Preferred Securities. Of these deferred payments, $8.0 million are attributable to SRGL, leaving a net amount of accrued deferred interest of $15.3 million on the Capital and Trust Securities due to external parties. SHI, SFL, and SALIC generally are restricted in their ability to make certain dividend payments and payments in respect of obligations ranking junior or *pari passu* to the Capital and Trust Preferred Securities in any period where interest payment obligations on these securities are not current.

For further discussion on the accrued and deferred payment on our Capital and Trust Preferred Securities subsequent to December 31, 2016, please refer to Note 16, "Subsequent Events - *Deferral of Interest Payments on the Capital and Trust Preferred Securities*".

9. Mezzanine Equity – Convertible Cumulative Participating Preferred Shares

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

The CCPP Shares were convertible at the option of the holder, at any time, into an aggregate of 150,000,000 ordinary shares (the "Ordinary Shares") of SRGL. We accounted for the 2007 issuance of the CCPP Shares to the Investors, in accordance with FASB ASC Subtopic 470-20, Debt – Debt with Conversion and Other Options ("FASB ASC 470-20"), which incorporates EITF D-98: "Classification and Measurement of Redeemable Securities". We were not required at any time to redeem the CCPP Shares for cash, except in the event of a liquidation or upon the occurrence of a change-in-control event.

On May 7, 2016 (i.e., the ninth anniversary of issuance), and in accordance with the CCPP Certificate of Designations, the CCPP Shares automatically converted into an aggregate of 150,000,000 Ordinary Shares of the Company.

We accounted for the conversion of the CCPP Shares in accordance with FASB ASC 470-20. As a result, and in accordance with the CCPP Certificate of Designations, the CCPP Shares were converted into an aggregate 150,000,000 Ordinary Shares, with each Ordinary Share having a par value of $0.01, representing an additional $1.5 million in the Ordinary Shares amount in the Company's Consolidated Balance Sheets. The remaining balance of the CCPP Shares amount of approximately $554.4 million that was previously classified under Mezzanine Equity in the Consolidated Balance Sheets, and was over and above the Ordinary Share conversion amount of $1.5 million as described earlier, was reclassified to Additional Paid-in Capital ("APIC").

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

The conversion of the CCPP Shares had no material impact on the results of operations of the Company and only impacted the Consolidated Balance Sheets and Consolidated Statements of Shareholders' Deficit.

The table below provides an illustration of the changes to the Company's Consolidated Balance Sheets as follows:

	May 6, 2016	Adjustment	May 7, 2016
(U.S. dollars in thousands)			
Total Mezzanine Equity			
Total Mezzanine Equity	$ 555,857	(555,857)	$ -
Total Mezzanine Equity	$ 555,857	$ (555,857)	$ -
Equity			
Share Capital	$ 684	$ 1,500	$ 2,184
APIC	1,218,190	554,357	1,772,547
Share Capital & APIC	$ 1,218,874	$ 555,857	$ 1,774,731

10. Shareholders' Deficit

Ordinary Shares

We are authorized to issue 590,000,000 ordinary shares with a par value of $0.01 per share.

As of December 31, 2016 and 2015, we had 218,383,370 and 68,383,370 Ordinary Shares issued and outstanding, respectively. The increase in Ordinary Shares of 150,000,000 is attributable to the conversion of the CCPP Shares on May 7, 2016, as discussed in Note 9, "Mezzanine Equity – Convertible Cumulative Participating Preferred Shares".

Perpetual Preferred Shares

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

In 2005, we issued 5,000,000 non-cumulative Perpetual Preferred Shares (the "Perpetual Preferred Shares"). Gross proceeds were $125 million, and related expenses were $4.6 million. As of December 31, 2016, we have repurchased and cancelled 1,753,224 Perpetual Preferred Shares. As of December 31, 2016 and 2015, we have 3,246,776 Perpetual Preferred Shares issued and outstanding.

The dividend rate on the Perpetual Preferred Shares may be at a fixed rate determined through remarketing of the Perpetual Preferred Shares for specific periods of varying length not less than six months or may be at a floating rate reset quarterly based on a predefined set of interest rate benchmarks. The quarterly floating rates for December 31, 2016 and 2015 were 6.49% and 6.38%, respectively. During any dividend period, unless the full dividends for the current dividend period on all outstanding Perpetual Preferred Shares have been declared or paid, no dividend may be paid or declared on the Ordinary Shares and no Ordinary Shares or other junior shares may be purchased, redeemed, or otherwise acquired for consideration by SRGL. Please refer to "*Dividends on Perpetual Preferred Shares*" in this Note for additional information.

10. Shareholders' Deficit (continued)

Dividends on Ordinary Shares

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

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

Dividends on Perpetual Preferred Shares

In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, our Board was precluded from declaring and paying a dividend in connection with all of the 2015 dividend payment dates and the January 15, April 15, and July 15, 2016 dividend payment dates.

In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, our Board was permitted to declare and pay a dividend for the October 15, 2016 payment date. Our Board resolved, in its discretion, not to declare and pay a dividend on the Perpetual Preferred Shares on the October 15, 2016 dividend payment date.

There can be no assurances when or whether, as a result of the application of the financial tests contained in the terms of the Perpetual Preferred Shares, our Board will be permitted to make subsequent dividend payments on the Perpetual Preferred Shares or, if permitted, when or whether our Board will choose in its discretion to make any such dividend payments on the Perpetual Preferred Shares. For further discussion on the non-declaration of dividends on our Perpetual Preferred Shares, please refer to Note 16, "Subsequent Events – *Non-declaration of Dividends on Perpetual Preferred Shares*".

Perpetual Preferred Shares – Right to Appoint Directors

Pursuant to the terms of, and subject to the procedures set forth in, the Certificate of Designations related to the Perpetual Preferred Shares (the "PPS Certificate of Designations"), 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, whether or not consecutive (a "Nonpayment"). Failure to declare and pay dividends on the July 15, 2009 dividend payment date marked the sixth dividend period for which dividends had not been declared and paid (i.e., a Nonpayment).

On September 18, 2015, the Company received correspondence from a purported beneficial holder of the Perpetual Preferred Shares, seeking to initiate the process for the election of directors by holders of the Perpetual Preferred Shares. Subsequently, we provided to our Transfer Agent and Registrar on October 9, 2015, a notice to holders of the Perpetual Preferred Shares addressing certain procedures related to the election of directors, including a request that holders of the Perpetual Preferred Shares nominate candidates for election to the Board and provide the names and contact information for such nominees. On November 5, 2015, the Company received a letter from Cede & Co., which included a written consent from the beneficial owner who had previously contacted the Company on September 18, 2015, purporting to designate such beneficial owner as a director of the Company. The written consent did not satisfy the requirements of the PPS Certificate of Designations and instead operated as a nomination of such person for potential election by holders of the Perpetual Preferred Shares. The Company notified the director nominee of such circumstances and reiterated a request for certain information regarding the director nominee as set out in the Company's October 9, 2015 notice. The Company provided the director nominee a Director Nominee Questionnaire seeking additional information required for holding an election pursuant to the PPS Certificate of Designations. Upon receipt of a completed Director Nominee Questionnaire, the Company would plan to proceed to convene a special meeting of the holders of Perpetual Preferred Shares to vote on the election of such director nominee. We have

10. Shareholders' Deficit (continued)

received no response to our request for required information from the director nominee. No other nominations were received in response to the Company’s October 9, 2015 request.

If and when dividends for at least four dividend periods, whether or not consecutive, following a Non-payment have been paid in full, this right will cease.

11. Reinsurance

Premiums Earned, Net

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

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015
Premiums assumed	$ 555,293	$ 586,934
Premiums ceded	(245,481)	(274,254)
Premiums earned, net	$ 309,812	$ 312,680

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

Claims, Policy Benefits, and Changes in Policyholder Reserves, Net

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

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015
Claims, policy benefits, and changes in policyholder reserves assumed	$ 745,800	$ 680,781
Claims, policy benefits, and changes in policyholder reserves ceded	(219,760)	(266,677)
Claims, policy benefits, and changes in policyholder reserves, net	$ 526,040	$ 414,104

12. Income Taxes

The income tax expense (benefit) from operations for the years ended December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Current tax expense (benefit):		
U.S.	$ -	$ -
Non-U.S.	33	(67)
Total current tax expense (benefit)	33	(67)
Deferred tax expense (benefit):		
U.S.	(25,870)	(5,672)
Non-U.S.	-	(1,590)
Total deferred tax expense (benefit)	(25,870)	(7,262)
Total tax expense (benefit)	$ (25,837)	$ (7,329)

The deferred tax benefit for the years ended December 31, 2016 and 2015 for the U.S. entities in the preceding table were principally caused by a reduction in the valuation allowance related to changes in the scheduling of deferred tax liabilities reversing over the next 15 years. The deferred tax benefit for the year ended December 31, 2016 for the U.S. entities represents a full release of the scheduled deferred tax liability that was held as of December 31, 2015. The scheduled deferred tax liability has been released due to changes in the scheduled release of GAAP reserves resulting from GAAP Loss Recognition, as discussed in Note 2, "Summary of Significant Accounting Policies – *Reserves for Future Policy Benefits*". The deferred tax benefit for the year ended December 31, 2015 for the non-U.S. entities in the preceding table was principally caused by a release of reserves for uncertain tax positions due to the expiration of the statute of limitations related to these positions.

The expected tax expense (benefit) at jurisdictional tax rates has been calculated using the pre-tax accounting income (loss) in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. The reconciliation of the difference between the expected tax expense (benefit) at the weighted average tax rate and the total tax benefit for the years ended December 31, 2016 and 2015 is provided below:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Loss before taxes	$ (233,988)	$ (262,827)
Expected tax (benefit) expense at jurisdictional tax rates	(50,834)	(72,886)
Change in valuation allowance	24,772	74,156
Change in U.S. Federal/State Enacted Tax Rates	424	(6,942)
Uncertain tax positions	-	(1,590)
Other and state taxes	(199)	(67)
Income tax (benefit) expense	$ (25,837)	$ (7,329)

12. Income Taxes (continued)

Any net incomes from the operations of our Cayman Island entities are not subject to income tax. The operations of our U.S., Bermuda, and Irish entities did not generate a current tax expense, other than potential interest and penalties on accrued tax liabilities for unrecognized tax benefits, due to operating performance and the availability of tax losses from prior tax years. The utilization of tax losses results in a reduction in deferred tax assets and a corresponding reduction in the valuation allowance established against those deferred tax assets.

We are not subject to income taxation other than as stated earlier in this Note. There can be no assurance that there will not be changes in applicable tax laws, regulations, or treaties which might require us to change the way we operate or become subject to taxes. As of December 31, 2016 and 2015, we had tax operating loss carryforwards in our U.S. and Irish entities, as presented in the table below:

(U.S. dollars in thousands)	U.S. Life & Non-Life Groups	SRD	Orkney Re II	Total
Operating loss carryforwards available as of December 31, 2015	$ 953,157	$ 526,457	$ 401,944	$ 1,881,558
Operating loss incurred (utilized) during 2016	47,681	(16,286)	37,318	68,713
Operating loss carryforwards available as of December 31, 2016	$ 1,000,838	$ 510,171	$ 439,262	$ 1,950,271
Deferred tax asset for operating losses, before valuation allowance, as of December 31, 2016...........................	$ 349,365	$ 63,771	$ 109,815	$ 522,951

The operating loss carryforwards in our U.S. entities will expire, if not utilized, in years 2019 through 2036, while the operating loss carryforwards in our Irish entities benefit from an unlimited carryforward period. The net operating loss carryforward generated in the current and prior years resulted principally from the operations of SRUS, SHI, SRD, and Orkney Re II.

12. Income Taxes (continued)

The significant components of our deferred tax assets and liabilities as of December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015
Deferred tax assets		
Net operating losses (net of FASB ASC 740-10 and Section 382*)	$ 522,951	$ 499,020
Capital loss carryforwards	-	39,675
Embedded derivative liabilities	17,910	16,744
Deferred loss on reinsurance treaty	29,371	32,431
Accrued interest	5,492	4,000
Other	3,026	4,576
Total deferred tax assets	578,750	596,446
Deferred tax liabilities		
Deferred acquisition costs	(1,309)	(1,951)
Reserves for future policy benefits	(17,943)	(55,050)
Unrealized appreciation on investments	(19,696)	(16,702)
Deferred market discount	(16,756)	(10,601)
Other	-	(146)
Total deferred tax liabilities	(55,704)	(84,450)
Net deferred tax assets before valuation allowance	523,046	511,996
Valuation allowance	(523,046)	(537,866)
Net deferred tax liabilities	$ -	$ (25,870)

* *Described in this Note.*

We currently provide a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all, of our deferred tax assets will not be realized. We have maintained a full valuation allowance against any remaining deferred tax asset in the U.S. and Ireland, based on future taxable income projections and the scheduling of our current deferred tax liabilities. Our valuation allowance decreased by approximately $14.8 million during the year ended December 31, 2016, to $523.0 million. This decrease was principally caused by the release of the scheduled deferred tax liability during the year ended December 31, 2016, as discussed above.

Section 382 Event

The 2007 New Capital Transaction (as discussed in Note 9, “Mezzanine Equity – Convertible Cumulative Participating Preferred Shares”) qualified as a change in ownership under Section 382 of the Internal Revenue Code. Section 382 operates to limit the future deduction of net operating losses that were in existence as of the change in ownership. Because we had previously established a valuation allowance against these net operating losses, there was not a significant tax expense associated with Section 382 limitations.

FASB ASC Subtopic 740-10, Income Taxes – Overall

In 2016, there was no change to the amount of unrecognized tax benefits. In 2015, the statute of limitations expired for the 2011 U.S. income tax year, which resulted in a reduction of our unrecognized tax benefits in the amount of $0.7 million.

As of December 31, 2016 and 2015, we had total unrecognized tax benefits (excluding interest and penalties) of $1.5 million, the recognition of which is not expected to create a tax benefit at the effective tax rate, due to the full valuation allowance of $1.5 million established at implementation.

12. Income Taxes (continued)

The total unrecognized tax benefits figure (excluding interest and penalties) and the resulting tax benefit recognition figure did not change from December 31, 2016 and December 31, 2015, as no further expirations of the statute of limitations of the unrecognized tax benefits has occurred.

The roll-forward of our FASB ASC 740-10 unrecognized tax benefits for the years ended December 31, 2016 and 2015, were as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2016	Year Ended December 31, 2015
Total unrecognized tax benefits at beginning of year	$ 1,543	$ 2,233
Reductions due to lapse of statutes of limitation	-	(690)
Total unrecognized tax benefits at end of year	1,543	1,543
Tax benefit of unrecognized tax benefits if recognized at the effective tax rate	$ -	$ -

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

(U.S. dollars in thousands)	December 31, 2016	December 31, 2015
Total interest & penalties in the Consolidated Balance Sheets at beginning of year	$ -	$ 900
Total interest & penalties in the Consolidated Statements of Comprehensive Income	-	(900)
Total interest & penalties in the Consolidated Balance Sheets at end of year	$ -	$ -

We do not expect any significant changes in the gross balance of unrecognized tax benefits to occur in the next twelve months.

We file separate tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of December 31, 2016, we remained subject to examination in the following major tax jurisdictions for the years indicated in the table below:

Major Tax Jurisdictions	Open Years
U.S.	
Life Group	2013 through 2015
Non-Life Group	2013 through 2015
Ireland	2012 through 2015

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

12. Income Taxes (continued)

Net operating losses are being carried forward from closed years and could be examined by the applicable tax authorities if utilized in an open tax year in the future. Additionally, to the extent that a net operating loss is carried back to an otherwise closed year, that earlier year could be subject to examination as long as the loss year remains open.

13. Commitments and Contingencies

Concentrations of Credit Risk

The creditworthiness of counterparties is evaluated by us, taking into account credit ratings assigned by rating agencies and other factors. The credit approval process involves an assessment of factors including, among others, counterparty, country, and industry credit exposure limits..

The areas where significant concentrations of credit risk may exist include investments, amounts recoverable from reinsurers, and reinsurance balances receivable. We manage our credit risk in our investment portfolio by establishing and following investment guidelines complying with regulatory restrictions and limiting our exposure to individual issuers. We manage our credit risk in our reinsurance relationships by transacting with reinsurers that we consider financially sound, and if necessary, we may hold collateral in the form of funds, trust accounts, and/or irrevocable letters of credit. This collateral can be drawn upon for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis.

Ballantyne Re plc

Ballantyne Re plc ("Ballantyne Re"), which was previously a consolidated VIE of the Company, is a special purpose reinsurance vehicle incorporated under the laws of Ireland. In May 2006, Ballantyne Re issued, in a private offering, $1.74 billion of debt to third party investors, $178.0 million of Class C Notes to SALIC, $181.2 million in Preference Shares to SALIC, and $500,000 in Class D Notes to SRGL.

We have no remaining direct loss exposure related to Ballantyne Re since our interests in the Ballantyne Re Class D Notes and Preference Shares are valued at $0. The Class C Notes were fully written-off in 2008 under the contractual terms of the Ballantyne Re indenture.

SRUS remains liable for the accuracy and performance of certain 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, SRGL and SRUS remain responsible for certain ongoing covenants and indemnities made for the benefit of Ballantyne Re and the financial guarantors of certain of the notes issued by Ballantyne Re.

Indemnification of Our Directors, Officers, Employees, and Agents

We indemnify our directors, officers, employees, and agents against any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, by reason of the fact that they are our director, officer, employee, or agent, as provided in our Articles of Association. Since this indemnity generally is not subject to limitation with respect to duration or amount, we do not believe that it is possible to determine the maximum potential amount due under this indemnity in the future.

13. Commitments and Contingencies (continued)

Davis v. Scottish Re Group Limited, et al.

SRGL and SRUS (together, "Scottish Re") learned that a lawsuit was filed on or about November 20, 2013, in New York state court against Scottish Re, SRGL's shareholders and certain of their affiliates, and various former and current directors of Scottish Re (collectively, the "Defendant Parties"). The plaintiff, identified in the court documents as a holder of Perpetual Preferred Shares and a former holder of Ordinary Shares (please refer to Note 10, "Shareholders' Deficit" for information regarding the Perpetual Preferred Shares and the Ordinary Shares), alleges, among other things, claims against the Defendant Parties for breach of contract, breach of fiduciary duty, tortious interference, and derivative claims centered largely around the following events:

- the 2011 unwind of a formerly consolidated collateral finance facility and the associated acquisition by affiliates of Cerberus of debt related to the collateral finance facility;
- the completion in 2011 of a cash-out merger between SRGL and affiliates of the Investors;
- the cancellation by SRGL of Perpetual Preferred Shares acquired pursuant to cash tender offers made by SRGL in 2010 and 2012; and
- a purported distribution policy affecting the Perpetual Preferred Shares.

On February 21, 2014, Motions to Dismiss were filed with the court on behalf of the Defendant Parties pursuant to a briefing schedule previously agreed with the court and the plaintiff. Pursuant to that schedule, the plaintiff submitted on May 7, 2014 its opposition to the Motions to Dismiss. The Defendant Parties submitted replies in further support of their Motions to Dismiss on June 23, 2014. Oral arguments on the Motions to Dismiss were heard by the court on September 29, 2014.

Following oral arguments on the Motions to Dismiss on September 29, 2014, on October 7, 2014, the presiding judge issued a decision dismissing all claims against the Defendant Parties, with the exception of two breach of contract claims against SRGL. The judge directed that the plaintiff and SRGL engage in jurisdictional discovery limited to these two claims, after which the court would decide whether these claims should also be dismissed on jurisdictional grounds.

The plaintiff filed on October 28, 2014 his opening appellate brief challenging the court's October 7, 2014 decision. Following this, Scottish Re and the other Defendant Parties filed opposition briefs, and the plaintiff thereafter filed his reply brief. Oral arguments on the appellate brief were heard by the Appellate Division of the New York Supreme Court on June 9, 2015.

Jurisdictional discovery commenced on the two breach of contract claims concluded on October 26, 2015. Thereafter, the Company filed with the court its renewed Motion to Dismiss in respect of the two remaining claims. Pursuant to the schedule agreed with the court, the plaintiff's brief opposing the Motion to Dismiss was filed with the court on November 25, 2015 and the Company's reply was filed on December 16, 2015. A hearing on the Company's renewed Motion to Dismiss was held with the trial court on January 26, 2016.

On March 10, 2016, the appellate court issued a decision on the plaintiff's appeal argued before it on June 9, 2015, relating to the trial court's previous dismissal of eight of the ten claims originally brought by the plaintiff in this case. The appellate court's majority decision (representing three of the five justices) affirmed the trial court's dismissal of all but two of the claims on appeal against all defendants. With respect to the remaining claims, the appellate court remanded the matter to the trial court to allow the plaintiff to re-plead two breach of fiduciary duty claims against the three Directors of SRGL who remain in the case (the "Director Defendants"). The two dissenting justices would have affirmed the dismissal of all claims on appeal.

13. Commitments and Contingencies (continued)

On April 25, 2016, the plaintiff filed a motion with appellate court, seeking permission to appeal the dismissal of three derivative breach of fiduciary duty claims to the New York Court of Appeals. On May 12, 2016, the Director Defendants who remain in the case and SRGL's shareholders and certain of their affiliates filed an opposition brief to plaintiff's motion. On May 18, 2016, the plaintiff filed a reply brief in further support of his motion.

Notwithstanding the appellate court's March 10, 2016 decision remanding the matter to the trial court to allow the plaintiff to replead only two breach of fiduciary duty claims against the remaining Director Defendants, on May 3, 2016, the plaintiff filed an amended complaint with the trial court in which the plaintiff repleaded eight of the original ten claims, removing two of the original claims and adding a new claim against certain of the Defendant Parties. On June 7, 2016, the Director Defendants filed a Motion to Dismiss the repleaded breach of fiduciary duty claims. On July 14, 2016, the plaintiff filed his response to the Director Defendants' Motion to Dismiss the repleaded breach of fiduciary duty claims. The reply brief of the Director Defendants was filed on August 5, 2016. Oral arguments for the Director Defendant's Motion to Dismiss the repleaded breach of fiduciary duty claims were held on November 7, 2016. The trial court has not yet issued a decision on the Motion.

On July 7, 2016, the appellate court granted plaintiff's motion for leave to appeal the dismissal of the three derivative breach of fiduciary duty claims to the New York Court of Appeals. On September 27, 2016, the plaintiff filed his opening brief in the New York Court of Appeals. The response brief by the Director Defendants who remain in the case and SRGL's shareholders and certain of their affiliates was filed on November 17, 2016. The plaintiff's reply brief was filed on December 5, 2016. Oral argument has not yet been scheduled.

On July 11, 2016, the trial court issued a ruling that dismissed one of the two breach of contract claims. The plaintiff did not file an interlocutory appeal from the dismissal prior to the deadline for doing so. The plaintiff has not pursued discovery on the remaining claim.

Scottish Re has certain obligations to indemnify those Defendant Parties that are current or former directors for the reasonable cost of their defense of the Davis lawsuit.

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

For further discussion regarding the Davis litigation, please refer to Note 16, "Subsequent Events – *Commitments and Contingencies - Davis v. Scottish Re Group Limited, et al.*".

Other Contingencies

On January 20, 2016, SRUS initiated an arbitration proceeding against a third-party ceding company related to a dispute regarding the applicable premium tables and other related claims in respect of certain business ceded to SRUS from the third-party ceding company. The arbitration hearing is scheduled for the last week of June 2017.

On April 22, 2016, SRUS initiated an arbitration proceeding against a third-party ceding company seeking among other things, the enforcement of certain premium calculations under various YRT Reinsurance Agreements between the third-party ceding company and SRUS, as well as rescission of some YRT Reinsurance Agreements based upon misrepresentations and mismanagement by the third-party ceding company. On September 30, 2016, SRUS sent a notice to the third-party ceding company that SRUS was terminating the reinsurance for non-payment of premiums pursuant to the terms of the YRT Reinsurance Agreements. On October 20, 2016, SRUS received a counter-demand to the arbitration demand from the third-party ceding company alleging certain issues relating to premium calculation and certain claims ceded to SRUS. The parties expect that the final hearing will be held late 2017 or early 2018.

13. Commitments and Contingencies (continued)

For further discussion regarding the arbitration initiated on April 22, 2016, please refer to Note 16, "Subsequent Events – *Commitments and Contingencies – Other Contingencies*".

On October 6, 2016, SRUS received an arbitration demand from a third-party ceding company related to a YRT Reinsurance Agreement. The arbitration demand alleges certain issues relating to premium calculation and certain claims ceded to the Company. On October 21, 2016, SRUS responded to the arbitration demand, denying each of the allegations. SRUS also served a counter-demand on the third-party ceding company seeking, among other things, rescission of the YRT Reinsurance Agreement based upon misrepresentations and mismanagement by the third-party ceding company, and the enforcement of certain premium calculations under the YRT Reinsurance Agreement. The parties are in the process of selecting an arbitration panel.

For further discussion regarding the arbitration initiated on October 6, 2016, please refer to Note 16, "Subsequent Events – *Commitments and Contingencies – Other Contingencies*".

14. Statutory Requirements and Dividend Restrictions

Our insurance and reinsurance subsidiaries are subject to insurance laws and regulations in the jurisdictions in which they operate, which include Bermuda, the Cayman Islands, Ireland, and the United States. Certain of these regulations include restrictions that limit the amount of dividends or other distributions, such as loans or cash advances, available to shareholders of the reinsurance subsidiaries without prior approval of the insurance regulatory authorities.

The difference between financial statements prepared for insurance regulatory authorities and statements prepared in accordance with U.S. GAAP vary by jurisdiction; however, the primary differences are that financial statements prepared for some of the insurance regulatory authorities do not reflect DAC, limit the amount of deferred income tax net assets, limit or disallow certain assets, have different investment measurement methodologies, establish reserves for invested assets, and calculate benefit reserves by a defined, formulaic process, among other differences from U.S. GAAP.

Statutory Requirements for Non-U.S. Subsidiaries

Our Bermuda insurance company, SRLB, is required by the Bermuda Monetary Authority to maintain a minimum capital requirement of $500 thousand as of December 31, 2016, and, under The Insurance Law of the Cayman Islands, our Cayman licenced insurance company, SALIC, must maintain a minimum capital requirement of $400 thousand as of December 31, 2016. There were no statutory restrictions on the payment of dividends from retained earnings by any of the Bermuda or Cayman subsidiaries as the minimum statutory capital and surplus requirements were satisfied by the share capital and additional paid-in capital of each of the subsidiaries.

SRD is required by the Central Bank of Ireland (the "Central Bank") to maintain a minimum level of paid up share capital. The Central Bank has put certain restrictions in place on the ability of SRD to make dividend payments from profits available for distribution within the meaning of the Companies Act 2014. The Companies Act 2014, however, does not preclude a company from reclassifying its capital contributions to its retained loss account, creating a revenue reserve account. Accordingly, in December 2016, SRD reclassified its capital contributions to its retained loss account, creating a positive revenue reserve account. This enabled SRD to make a distribution by way of a return of capital to its parent, SALIC, of $7.0 million, in December 2016, which was approved by the Central Bank.

On July 15, 2006, Statutory Instrument 380 ("SI 380") of 2006 transposed into Irish law the European Union Council Directive 2005/68/EC, which establishes a regulatory regime for reinsurance organizations and defines minimum requirements for certain liabilities, assets backing those liabilities, and surplus. This regime came to end December 31, 2015. On January 1, 2016, SRD became subject to the requirements of the European Union (Insurance and Reinsurance) Regulations 2015 which transposed the Solvency II Directive 2009/138/EC (as amended) into Irish

14. Statutory Requirements and Dividend Restrictions (continued)

law and defines updated minimum requirements for certain liabilities, assets backing those liabilities, and surplus. As of December 31, 2016 and 2015, SRD's solvency ratio under the Solvency II regime was 180% and 292%, respectively. As of December 31, 2015, under Solvency I, SRD's solvency ratio was 285% which was reported to the Central Bank. These percentages were based on the available capital versus a minimum capital amount, which is required to be held under the respective Solvency regimes in effect at the time by the Central Bank.

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

Statutory Requirements for U.S. Subsidiaries

Our Delaware-domiciled reinsurance subsidiary, SRUS, prepares its statutory-basis financial statements on the basis of statutory accounting practices prescribed by the State of Delaware for determining and reporting the financial condition and results of operations of an insurance company and for determining solvency under the insurance laws of the State of Delaware. The Delaware Department of Insurance (the "Department") has adopted Statutory Accounting Principles, which are included in the National Association of Insurance Commissioners' ("NAIC") *Accounting Practices and Procedures Manual* ("AP&P Manual"), as a component of prescribed statutory accounting practices. SRUS did not utilize any prescribed or permitted accounting practices which differed from those prescribed by the NAIC AP&P Manual during the years ended December 31, 2016 and 2015.

The following table presents the statutory capital and surplus of our U.S. reinsurance subsidiary, SRUS, as of December 31, 2016 and 2015, and the statutory net gain (loss) for the years ended December 31, 2016 and 2015, as reflected in SRUS's most recent statutory financial statement filings with the Department.

(U.S. dollars in thousands)	**2016**	**2015**
Statutory Capital and Surplus.....	$ 56,720	$ 80,858
Statutory Net Gain (Loss)...........	$ 13,121	$ (83,846)

As of December 31, 2016 and 2015, SRUS exceeded all minimum risk-based capital ("RBC") requirements for life and health insurance companies under the laws of the State of Delaware. The company action level RBC percentage for SRUS as of December 31, 2016 and December 31, 2015 was 190% and 237%, respectively, each as filed with the Department. SALIC is a party to a net worth maintenance agreement with SRUS, pursuant to which SALIC effectively guarantees SRUS's regulatory solvency.

The payment of dividends by SRUS to its shareholder, SHI, is limited and can only be made from earned profits, unless prior approval is received from the Insurance Commissioner of the State of Delaware (the "Commissioner"). The maximum amount of dividends that may be paid by life insurance companies without prior approval of the Commissioner is also subject to restrictions relating to statutory surplus and net income. The maximum dividend payout that can be made by SRUS without prior approval of the Commissioner is limited to the greater of the net gain from operations for the preceding year or 10% of statutory surplus as of the preceding year-end, not exceeding earned surplus. The applicable statutory provisions only permit an insurer to pay a shareholder dividend from positive unassigned surplus. SRUS had an unassigned deficit as of December 31, 2016 and 2015. Accordingly, SRUS cannot pay a dividend in 2017 without the prior approval of the Commissioner. During the years ended December 31, 2016 and 2015, SRUS did not request or receive approval from the Commissioner to make, and did not make, any dividend payments to its shareholder.

15. Related Party Transactions

MassMutual Capital

For the years ended December 31, 2016 and 2015, we had premiums earned of $22.3 million and $21.3 million, respectively, associated with Massachusetts Mutual Life Insurance Company ("MassMutual Life"), the ultimate parent of MassMutual Capital, and with C.M. Life Insurance Company ("CM Life"), an affiliate of MassMutual Capital.

As of December 31, 2016 and 2015, we had net receivables from MassMutual Life and CM Life, of $5.3 million and $4.1 million, respectively.

We also incurred $1.7 million and $1.8 million for investment management fees payable to Barings LLC, an affiliate of MassMutual Capital, for the years ended December 31, 2016 and 2015, respectively.

For the year ended December 31, 2015, we incurred $0.2 million in legal fees payable to MassMutual Capital, associated with the indemnification of former directors for the reasonable cost of their defense of the Davis lawsuit, as discussed in Note 13, "Commitments and Contingencies – *Davis v. Scottish Re Group Limited, et al.*". There were no such fees incurred for the year ended December 31, 2016.

16. Subsequent Events

The subsequent events disclosed in these notes to the consolidated financial statements have been evaluated by management up to and including the filing of the consolidated financial statements on May 10, 2017.

Orkney Re II - Settlement of Litigation

On March 25, 2017, Orkney Re II agreed in principle to settle litigation brought by Assured, the guarantor of the Series A-1 Notes of Orkney Re II, in Assured's own right and in the right of Orkney Re II, against J.P. Morgan Investment Management, Inc. ("JPMIM"), the former investment manager of Orkney Re II, relating to the management of Orkney Re II's investment accounts, which were funded with the proceeds of the Orkney Re II Notes, as explained in Note 7, "Collateral Finance Facility and Securitization Structure".

Assured, suing in its own right and on behalf of Orkney Re II, commenced litigation against JPMIM in the Supreme Court of the State of New York on or about May 13, 2009. The legal proceedings have been ongoing since 2009, and up until the date of the settlement of March 25, 2017, there was no assurances over the outcome of the litigation.

Orkney Re II finalized the settlement litigation documentation and received $74.4 million in cash on April 17, 2017, in return for releases of all claims by Orkney Re II and Assured in the litigation. Neither SRGL or its consolidated subsidiaries are direct beneficiaries to any part of this settlement of litigation amount that Orkney Re II has received.

Orkney Re II – Scheduled Interest Payments

On the scheduled interest payment date of February 11, 2017, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes and the Series A-2 Notes. As a result, and pursuant to the financial guaranty policy issued by Assured (as discussed in Note 7, "Collateral Finance Facility and Securitization Structure – *Orkney Re II*"), Assured made guarantee payments on the Series A-1 Notes in the amount of $1.3 million. The unpaid interest amount for the Series A-2 Notes, which was not guaranteed under the Orkney Re II transaction, was $0.2 million. We have accrued the interest on both the Series A-1 Notes and the Series A-2 Notes.

16. Subsequent Events (continued)

Deferral of Interest Payments on the Capital and Trust Preferred Securities

We continued to accrue and defer payments of interest on our Capital and Trust Preferred Securities (as outlined in Note 8, “Debt Obligations and Other Funding Arrangements”). These deferrals are permitted by terms of the indentures governing the Capital and Trust Preferred Securities and have been made at the discretion of our Board. As of May 10, 2017, we had accrued and deferred payments on a total of $25.4 million of interest on our Capital and Trust Preferred Securities. Of these deferred payments, $8.9 million are attributable to SRGL, leaving a net amount of accrued deferred interest of $16.5 million on the Capital and Trust Securities due to external parties.

Non-declaration of Dividends on Perpetual Preferred Shares

Our Board resolved, in its discretion, not to declare and pay a dividend on the Perpetual Preferred Shares on the January 15, 2017 and April 15, 2017 dividend payment dates.

Commitments and Contingencies

Davis v. Scottish Re Group Limited, et al.

The trial court had scheduled a status conference for April 18, 2017, but this has been postponed to June 27, 2017.

Other Contingencies

For the arbitration initiated on April 22, 2016, the parties have tentatively agreed to a final hearing date during the week of February 5, 2018.

For the arbitration initiated on October 6, 2016, the parties have selected an arbitration panel. An organizational meeting was held on May 9, 2017, at which time the parties agreed to a final hearing date beginning on March 12, 2018.