

CONSOLIDATED FINANCIAL STATEMENTS

Scottish Annuity & Life Insurance Company (Cayman) Ltd.

*Years ended December 31, 2008 and 2007
with Report of Independent Auditors*

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Financial Statements
Years Ended December 31, 2008 and 2007

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Report of Independent Auditors

The Shareholder and Board of Directors
Scottish Annuity & Life Insurance Company (Cayman) Ltd.

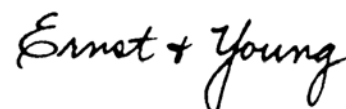
We have audited the accompanying consolidated balance sheets of Scottish Annuity & Life Insurance Company (Cayman) Ltd. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, comprehensive loss, shareholder's (deficit) equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Scottish Annuity & Life Insurance Company (Cayman) Ltd. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that Scottish Annuity & Life Insurance Company (Cayman) Ltd. will continue as a going concern. As more fully described in Note 2, the Company's primary operating subsidiary is operating its business in run-off under an Order of Supervision with the Delaware Department of Insurance, and the Company has reported a net loss for the year ended December 31, 2008 and has a shareholder's deficit at December 31, 2008. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. The 2008 consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As discussed in Note 2 to the financial statements, in 2007 the Company adopted FASB Interpretation No. 48 related to accounting for uncertainty in income taxes.

A handwritten signature of 'Ernst & Young' in a cursive script.

June 1, 2009

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Balance Sheets
(Expressed in Thousands of United States Dollars, except share data)

	December 31	
	2008	2007
Assets		
Fixed maturity investments, trading at fair value (2007 – available for sale at fair value, amortized cost – \$6,940,034).....	\$ 3,534,510	\$ 6,975,377
Preferred stock, trading at fair value (2007 – available for sale at fair value, cost – \$88,914).....	79,767	88,973
Cash and cash equivalents	726,843	704,229
Other investments	22,772	62,659
Funds withheld at interest	1,748,768	1,597,404
Total investments	6,112,660	9,428,642
Accrued interest receivable	33,970	52,658
Reinsurance balances receivable.....	346,322	348,110
Deferred acquisition costs.....	329,653	533,625
Amount recoverable from reinsurers	822,920	630,274
Present value of in-force business.....	40,105	41,859
Other assets	29,373	115,043
Current income tax receivable	8,811	11,345
Deferred tax asset.....	3,922	5,804
Assets held for sale	–	573,504
Total assets.....	\$ 7,727,736	\$ 11,740,864
Liabilities		
Reserves for future policy benefits	\$ 4,011,053	\$ 3,845,788
Interest-sensitive contract liabilities.....	2,025,554	2,560,785
Collateral finance facilities	2,550,500	3,530,879
Accounts payable and other liabilities	446,741	256,786
Reinsurance balances payable.....	246,860	147,359
Due to related party.....	72,305	52,035
Deferred tax liability	221	165
Long term debt.....	129,500	129,500
Liabilities held for sale	–	506,625
Total liabilities	9,482,734	11,029,922
Minority interest	6,967	9,025
Shareholder's (deficit) equity		
Ordinary shares, par value \$0.01:		
Issued 20,000,000 shares (2008 and 2007 – 20,000,000)	20,000	20,000
Additional paid-in capital	1,509,286	1,509,286
Accumulated other comprehensive income	–	23,747
Retained deficit.....	(3,291,251)	(851,116)
Total shareholder's (deficit) equity.....	(1,761,965)	701,917
Total liabilities, minority interest and shareholder's (deficit) equity	\$ 7,727,736	\$ 11,740,864

See Accompanying Notes to Consolidated Financial Statements

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Statements of Operations
(Expressed in Thousands of United States Dollars)

	Year Ended December 31	
	2008	2007
Revenues		
Premiums earned, net	\$ 1,596,817	\$ 1,716,693
Fee and other income.....	8,803	16,018
Investment income, net.....	348,175	538,063
Net realized and unrealized losses	(1,695,049)	(887,214)
Gain on extinguishment of third-party debt.....	19,437	20,043
Change in value of embedded derivatives, net	(216,041)	(43,627)
Total revenues.....	<u>62,142</u>	<u>1,359,976</u>
Benefits and expenses		
Claims and other policy benefits	1,536,532	1,433,117
Interest credited to interest-sensitive contract liabilities.....	75,581	135,366
Acquisition costs and other insurance expenses, net	549,181	347,489
Operating expenses.....	124,012	92,709
Collateral finance facilities expense	236,889	257,797
Interest expense	9,902	12,726
Total benefits and expenses	<u>2,532,097</u>	<u>2,279,204</u>
Loss before income taxes and minority interest	(2,469,955)	(919,228)
Income tax benefit	10,137	156,714
Loss before minority interest	<u>(2,459,818)</u>	<u>(762,514)</u>
Minority interest	1,855	(661)
Loss before continuing operations	(2,457,963)	(763,175)
Income (loss) from discontinued operations, net of taxes	17,828	(5,078)
Net loss	<u>\$ (2,440,135)</u>	<u>\$ (768,253)</u>

See Accompanying Notes to Consolidated Financial Statements

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Statements of Comprehensive Loss
(Expressed in Thousands of United States Dollars)

	Year Ended December 31	
	2008	2007
Net loss	\$ (2,440,135)	\$ (768,253)
Other comprehensive (loss) income, net of tax:		
Unrealized depreciation on investments	-	(683,383)
Reclassification adjustment for net realized and unrealized (gains) losses included in net loss.....	(23,628)	725,548
Net unrealized (depreciation) appreciation on investments, net of income taxes, deferred acquisition costs and minority interest of \$11,867 and (\$31,339).....	(23,628)	42,165
Cumulative translation adjustment	(119)	174
Other comprehensive (loss) income	(23,747)	42,339
Comprehensive loss	\$ (2,463,882)	\$ (725,914)

See Accompanying Notes to Consolidated Financial Statements

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Statements of Shareholder's (Deficit) Equity
(Expressed in Thousands of United States Dollars)

	Year Ended December 31	
	2008	2007
Share capital		
Ordinary shares:		
Beginning and end of year	\$ 20,000	\$ 20,000
Additional paid-in capital:		
Beginning of year	1,509,286	1,051,432
Capital contributed by parent.....	-	457,854
End of year.....	1,509,286	1,509,286
Accumulated other comprehensive income		
Unrealized appreciation (depreciation) on investments net of income taxes, deferred acquisition costs and minority interest:		
Beginning of year	23,628	(18,537)
Change in period.....	(23,628)	42,165
End of year.....	-	23,628
Cumulative translation adjustment:		
Beginning of year.....	119	(55)
Change in period (net of tax)	(119)	174
End of year.....	-	119
Total accumulated other comprehensive income.....	-	23,747
Retained deficit:		
Beginning of year	(851,116)	(65,400)
Net loss	(2,440,135)	(768,253)
Adjustment for FIN 48.....	-	(17,463)
End of year.....	(3,291,251)	(851,116)
Total shareholder's (deficit) equity.....	\$ (1,761,965)	\$ 701,917

See Accompanying Notes to Consolidated Financial Statements

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Statements of Cash Flows
(Expressed in Thousands of United States Dollars)

	Year Ended December 31	
	2008	2007
Operating activities		
Net loss	\$ (2,440,135)	\$ (768,253)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Net realized and unrealized losses	1,645,220	889,597
Gain on extinguishment of third-party debt.....	(19,437)	(20,043)
Changes in value of embedded derivatives, net.....	216,041	43,627
Amortization of discount on fixed maturity investments and preferred stock..	320	12,163
Amortization and impairments of deferred acquisition costs	195,065	64,266
Amortization and impairments of present value of in-force business.....	1,754	1,915
Amortization and impairments of deferred transaction costs	48,228	7,615
Depreciation of fixed assets	6,945	8,177
Minority interest	(1,855)	661
Changes in assets and liabilities:		
Accrued interest receivable.....	18,781	4,439
Reinsurance balances and risk fees receivable.....	195,340	(109,328)
Deferred acquisition costs.....	38,117	(65,868)
Deferred tax asset and liability	9,871	(191,444)
Other assets.....	75,288	14,584
Current income tax receivable and payable	2,258	(12,505)
Reserves for future policy benefits, net of amounts recoverable from reinsurers.	(112,427)	339,487
Funds withheld at interest	(151,364)	344,862
Interest-sensitive contract liabilities.....	(41,504)	(231,791)
Due to related party.....	20,270	98,796
Accounts payable and other liabilities	(27,447)	53,484
Net cash (used in) provided by operating activities	(320,671)	484,441
Investing activities		
Purchase of fixed maturity investments	(297,876)	(1,250,699)
Proceeds from sales of fixed maturity investments	1,518,343	268,651
Proceeds from maturity and return of capital of fixed maturity investments.....	539,411	549,150
Purchase of preferred stock	(2,285)	-
Proceeds from sale and maturity of preferred stock	3,167	19,878
Purchase of and proceeds from other investments, net.....	36,395	(360)
Purchase and impairment of fixed assets.....	(1,168)	(1,057)
Net cash provided by (used in) investing activities	1,795,987	(414,437)
Financing activities		
Deposits to interest-sensitive contract liabilities.....	(166)	2,382
Withdrawals from interest-sensitive contract liabilities.....	(837,934)	(289,798)
Proceeds from collateral finance facilities	-	411,471
Payments on collateral finance facilities	(960,942)	(168,484)
Proceeds from (repayment of) drawdown of Stingray facility.....	325,000	(265,000)
Capital contributed from parent.....	-	457,854
Net cash (used in) provided by financing activities	(1,474,042)	148,425
Net change in cash and cash equivalents	1,274	218,429
Cash and cash equivalents, beginning of year	725,569	507,140
Cash and cash equivalents, end of year	\$ 726,843	\$ 725,569

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Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Consolidated Statements of Cash Flows (continued)
(Expressed in Thousands of United States Dollars)

	Year Ended December 31	
	2008	2007
Interest paid	\$ 28,030	\$ 393
Taxes (refunded) paid	\$ (4,815)	\$ 16,059

See Accompanying Notes to Consolidated Financial Statements

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements
December 31, 2008

1. Organization and Business

Organization

Scottish Annuity & Life Insurance Company (Cayman) Ltd. (the “Company”, “we”, “our” and “SALIC”) was incorporated as an exempted company with limited liability on June 3, 1998 under the laws of the Cayman Islands. We are a wholly owned subsidiary of Scottish Re Group Limited (“SRGL”) and together with its subsidiaries (including SALIC) as applicable, “Scottish Re”) a holding company organized under the laws of the Cayman Islands with its principal executive office in Bermuda. On July 8, 1998, we received an unrestricted Class “B” insurer’s license under the insurance laws of the Cayman Islands. During 2002, we obtained an insurance permit to operate in Bermuda.

We are a reinsurer of life insurance, annuities and annuity-type products. These products are written by life insurance companies and other financial institutions located principally in the United States, as well as around the world. We refer to this portion of our business as Life Reinsurance. We have operating companies in Bermuda, Cayman Islands, Ireland and the United States.

Change in Strategic Focus

Scottish Re has faced a number of significant challenges over the past year which has required a change in strategic focus which has directly impacted our operations. These challenges have included:

- The continuing deterioration in the U.S residential housing market in general, and the market for sub-prime and Alt-A residential mortgage-backed securities specifically. These conditions have had, and will likely continue to have, a material adverse effect on the value of its consolidated investment portfolio and its capital, liquidity and collateral position;
- The negative outlooks placed on Scottish Re’s financial strength ratings by each of the rating agencies in November 2007, followed by the ratings action taken by Standard & Poor’s (“S&P”) in early 2008 lowering the financial strength ratings of Scottish Re’s operating subsidiaries from “BB+” to “BB” (marginal) and placing the ratings on CreditWatch with negative implications, as well as the subsequent ratings downgrades and negative outlooks placed on the financial strength ratings by other rating agencies (which ratings were subsequently lowered further), with the resulting material negative impact on Scottish Re’s ability to achieve the previous goal of attaining an “A-” or better rating by the middle of 2009; and
- The material negative impact of ratings declines and negative outlooks by rating agencies on Scottish Re’s ability to grow its life reinsurance businesses and maintain its core competitive capabilities.

In light of these circumstances, SRGL’s Board of Directors (the “Board”) instructed management to prepare an assessment of the various strategic alternatives that might be available to them to maximize shareholder value. On January 21, 2008 the Board established a special committee to evaluate the alternatives developed by management (the “Special Committee”). The Special Committee does not include any board members designated for election by SRGL Acquisition, LDC, an affiliate of Cerberus, or MassMutual Capital (or their affiliates), who together are Scottish Re’s majority shareholders. The Special Committee engaged a financial advisor and legal counsel to assist in their evaluation process. Subsequent to various meetings, the Special Committee recommended to the Board, at its regularly scheduled meeting on February 21, 2008, to accept management’s revised business strategy.

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

The Board unanimously adopted the Special Committee's recommendations, and Scottish Re announced on February 22, 2008 its pursuit of the following key strategies:

- Dispose of its noncore assets or lines of business, including the Life Reinsurance International Segment and the Wealth Management business;
- Develop, through strategic alliances or other means, opportunities to maximize the value of its core competitive capabilities within the Life Reinsurance North America Segment, including mortality assessment and treaty administration; and
- Rationalize its cost structure to preserve capital and liquidity.

These strategies materially impacted the conduct of our business going forward. In particular, we ceased writing new business, notified our existing clients that we would not be accepting any new reinsurance risks under existing treaties and thereby placing our remaining treaties into run-off. To facilitate an orderly run-off of these treaties, Scottish Re has taken steps to reduce expenses, including reducing staffing levels, and has taken the following actions:

- On March 31, 2008, Scottish Re entered into a binding letter of intent (the "March 31 LOI") with ING North America Insurance Corporation ("ING NA Corp."), ING America Insurance Holdings, Inc. ("ING NA Inc." and, together with ING NA Corp., "ING"), Security Life of Denver Insurance Company ("SLD") and Security Life of Denver International Limited ("SLDI" and, together with SLD, "the ING Companies"). Under the March 31 LOI, SLD consented to the recapture, as of March 31, 2008 (the "First Quarter Recapture"), by Scottish Re (U.S.), Inc. ("SRUS") as of March 31, 2008, of a prorata portion of the business that had been ceded in 2006 by SRUS to Ballantyne Re plc ("Ballantyne Re") for the purpose of collateralizing the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX ("Regulation XXX") for a portion of the business acquired by Scottish Re from the ING Companies at the end of 2004 (such portion related to the Ballantyne Re transaction, the "Ballantyne Business"). On May 6, 2008, Scottish Re completed this transaction and SRUS recaptured approximately 30% of the Ballantyne Business, effective as of March 31, 2008. Immediately following the consummation of this transaction, SLD recaptured the recaptured business from SRUS in exchange for consideration from SRUS to SLD, and then ceded the recaptured business to SLDI, which ceded the recaptured business to Scottish Re Life (Bermuda) Limited ("SRLB"). The business was in turn retroceded to Scottish Re (Dublin) Limited ("SRD"). In connection with this transaction, Scottish Re recorded a pre-tax net loss of \$0.2 million related to the consent fees paid.
- On June 30, 2008, Scottish Re entered into a binding letter of intent with the ING Companies (the "June 30th LOI"), pursuant to which SLD consented to the recapture (the "Second Quarter Recapture") by SRUS of a prorata portion of the Ballantyne Business effective as of June 30, 2008. On August 11, 2008, Scottish Re effectuated this transaction and SRUS recaptured approximately 15.5% of the Ballantyne Business. Immediately following the consummation of this transaction, SLD recaptured the recaptured business from SRUS in exchange for consideration from SRUS to SLD, and then ceded the recaptured business to SLDI, which ceded the recaptured business to SRLB. The business was in turn retroceded to SALIC. There was no net income impact related to this transaction.
- On July 11, 2008, Scottish Re completed the sale of its Wealth Management business and related entities with respect to the standalone company Scottish Annuity & Life Insurance Company (Bermuda) Ltd. and Scottish Annuity & Life International Insurance Company (Bermuda) Ltd. The sale of its Wealth Management business generated proceeds of \$4.4 million and resulted in a net loss of \$4.6 million.

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

- On July 18, 2008, Pacific Life Insurance Company concluded the purchase of Scottish Re Holdings Limited and the U.K. portion of the Life Reinsurance International Segment from Scottish Re for \$67.1 million after purchase price adjustments of \$4.1 million. \$26.8 million after purchase price adjustments of \$8.0 million is included in SALIC as a result of the novation of treaties in SALIC and recapture of treaties in SRD. The purchase of the Asia portion of the Life Reinsurance International Segment was completed on August 20, 2008, for an additional payment by Pacific Life Insurance Company of \$0.5 million. SRGL recorded an aggregate loss of \$31 million on these transactions in 2008 of which an aggregate gain of \$28.3 million is included in SALIC. In March 2009, the Singapore branch was closed and \$6.1 million of capital was returned to SALIC.
- In connection with the Clearwater Re Limited (“Clearwater Re”) collateral finance facility, on August 29, 2008, SRUS completed a full recapture, effective as of July 1, 2008, of the business ceded from SRUS to Clearwater Re and immediately retroceded the recaptured business, also effective as of July 1, 2008, from SRUS to an unaffiliated third-party reinsurer, which in turn was retroceded to Hannover Life Reassurance (Ireland) Limited (“Hannover (Ireland)”). In connection with the recapture transaction, the bank counterparties to the Clearwater Re collateral finance facility were repaid in full, thereby removing the related forbearance agreement. We also paid a \$4 million fee to the bank-counterparties and the facility, and the related forbearance agreement and its terms were terminated. Effective September 30, 2008, SRUS retroceded the remaining portion of the related defined block of business that it had retained at the time of the Clearwater Re transaction to the same third-party reinsurer, who in turn retroceded such business to Hannover (Ireland). On a consolidated basis, the Clearwater Re transactions and the retrocession of the remaining portion of the business originally held by SRUS resulted in a reduction of total assets and total liabilities of \$623.8 million and \$504.3 million, respectively, resulting in a pre-tax loss of \$119.5 million during the period ended September 30, 2008. The loss primarily comprised the write-off of deferred acquisition costs of \$75.1 million and a negative ceding commission of \$39.4 million, both of which are recorded in Acquisition costs and other insurance expenses, net. See Note 11, “Collateral Finance Facilities and Securitization Structures.”
- On September 30, 2008, Scottish Re entered into a binding letter of intent (the “September 30th LOI”) with the ING Companies and ING pursuant to which SLD consented to the recapture by SRUS, effective as of September 30, 2008 (the “Third Quarter Recapture”), of a prorata portion of the Ballantyne Business. On November 12, 2008, Scottish Re effectuated the Third Quarter Recapture, which comprised approximately 6.5% of the Ballantyne Business. Immediately following the Third Quarter Recapture, and effective as of September 30, 2008, SLD recaptured the recaptured business from SRUS and ceded it to SLDI, which in turn immediately retroceded it to SRLB, which in turn immediately retroceded it to SALIC. There was no net income impact related to this transaction.
- On October 15, 2008, Scottish Re entered into a series of transactions with an effective date of September 30, 2008, to unwind its collateral finance facility with HSBC Bank (“HSBC II”). In connection with the unwind transactions, HSBC was repaid in full, together with a payment of a \$6 million fee pursuant to the related forbearance agreement, and the facility and the forbearance agreement and its terms were terminated. Both the unwind and the related loss were recorded as components of fourth quarter 2008 results, as the unwind was not fully effectuated until October 2008. A pre-tax loss of \$10.3 million was recognized on this transaction primarily related to forbearance costs. See Note 11, “Collateral Finance Facilities and Securitization Structures.”

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

- On November 19, 2008, with an effective date of October 1, 2008, SRUS assigned and novated to SLD the reinsurance agreement and reinsurance trust agreement between SRUS and Ballantyne Re (the “Assignment”) as follows: (a) SRUS assigned to SLD its existing reinsurance agreement with Ballantyne Re (pursuant to which SRUS retroceded to Ballantyne Re the Ballantyne Business) (the “Pre-Assignment Reinsurance Agreement”) and its existing reinsurance trust agreement with Ballantyne Re, (b) immediately thereafter, SLD and Ballantyne Re amended and restated that reinsurance agreement (the “Post-Assignment Reinsurance Agreement”), pursuant to which SLD cedes directly to Ballantyne Re the remaining portion of the Ballantyne Business, and amended and restated that reinsurance trust agreement, pursuant to which SLD is the sole beneficiary of the reinsurance trust account maintained by Ballantyne Re, and (c) SLD and SRUS amended and restated their existing reinsurance agreement related to the Ballantyne Business to reflect these changes. There was no net income impact related to this transaction.
- Effective December 31, 2008, the ING Companies recaptured, on a prorata basis, 11.4% of the original Ballantyne Business (the “Fourth Quarter Recapture”). Immediately following the Fourth Quarter Recapture, and effective as of December 31, 2008, SLD ceded the recaptured business to SLDI, which in turn immediately retroceded it to SRLB, which in turn immediately retroceded it to SALIC. There was no net income impact related to this transaction. See Note 20, “Subsequent Events,” for further discussion related to the assumption of the business recaptured in connection with the First, Second, Third and Fourth Quarter Recaptures.
- Additionally, the fair value of the securities in certain qualifying reserve credit trust accounts has declined significantly such that, absent a permitted statutory accounting practice, SRUS would have been forced to take credit on its statutory financial statements for less than the full amount of the related obligations reinsured by SRUS to Orkney Re, Inc. (“Orkney Re”), Orkney Re II and SALIC. This shortfall in reserve credit would have placed significant financial stress upon the statutory capital position of SRUS and, in turn, the solvency of SALIC and SRGL. As a result, SRUS requested and received approval from the Delaware Department of Insurance (the “Department”) for a permitted accounting practice (the “Permitted Practice”), as of September 30, 2008, related to the Orkney Re and Orkney Re II securitizations, as well as, the reserve credit trusts with respect to reinsurance ceded to SALIC. The Permitted Practice relieved SRUS’s need to receive, and SALIC’s corresponding obligation to fund, additional capital contributions for the quarter. The value of this Permitted Practice may increase over time generally as a result of increases in statutory reserves or decreases in market values. In connection with the Permitted Practice, we agreed to contribute to SRUS \$30.3 million in capital prior to SRUS filing its third quarter 2008 financial statements and an additional \$7 million prior to SRUS filing its fourth quarter 2008 financial statements.
- Due to market value degradation and its impact on SRD’s solvency, we effectuated a transfer of a majority of the business in SRD to SALIC effective October 1, 2008. SALIC in return received modified coinsurance assets with respect to the ING business originally ceded to SRD, reserve credit trust assets with respect to business originally ceded from SRUS to SRD, which business also was transferred from SRD to SALIC and a \$70 million surplus note originally issued by SRUS to SRD. There was no net income impact related to this transaction.
- In connection with SRUS’s receipt, effective as of September 30, 2008, of the Permitted Practice, SRUS consented to the issuance by the Department on January 5, 2009 of an Order of Supervision against SRUS (the “Order of Supervision”), in accordance with 18 Del. C. §5942. The Order of Supervision requires, among other things, the Department’s consent to any transaction by SRUS outside the ordinary course of business or with its affiliates, and in large part formalizes certain reporting and processes already informally implemented between SRUS and the Department during 2008. The Order of Supervision, which

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

was set to lapse on April 5, 2009 (and every 90 days thereafter pursuant to Delaware regulation), subsequently was amended and replaced with a Continued and Amended Order of Supervision, dated April 3, 2009, which amends and clarifies certain matters contained within the original Order of Supervision.

- On January 22, 2009, SRGL, Scottish Holdings, Inc. (“SHI”), SRUS, SRLB and SRD (collectively, the “Sellers”) entered into a Master Asset Purchase Agreement (the “Purchase Agreement”) with Hannover Life Reassurance Company of America and its affiliate, Hannover (Ireland) (together, “Hannover Re”), and the ING Companies, pursuant to which Hannover Re agreed to purchase from the Sellers a block of individual life reinsurance business acquired in 2004 by Scottish Re from the ING Companies, which block consisted primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business (the “Acquired Business”). The Acquired Business does not include business formerly reinsured from SRUS to Ballantyne Re (i.e., the Ballantyne Business), as this business was novated and assigned to SLD effective October 1, 2008, as discussed above. In addition to the acquisition of the Acquired Business, the Purchase Agreement also related to the sale to Hannover Re of certain assets used by the Sellers in connection with the administration of the Acquired Business and retained business in its Life Reinsurance North America Segment and the transfer of certain employees from certain of the Sellers to Hannover Re. The closing of the transactions contemplated by the Purchase Agreement occurred on February 20, 2009. In connection with the Purchase Agreement, the transfer to Hannover Re of the Acquired Business generally was accomplished (i) through the recapture by the ING Companies from certain of the Sellers of the Acquired Business, and the cession immediately thereafter by the ING Companies to Hannover Re of the Acquired Business under new reinsurance agreements and (ii) in specific instances, by a novation of existing reinsurance agreements from certain of the Sellers to Hannover Re. These recapture and reinsurance transactions and the novation agreements each have an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent attributable to periods prior to January 1, 2009, and SRUS and SRLB have collateralized these obligations by depositing assets in trust accounts established for the benefit of SLD and SLDI. Following the transfer of assets with respect to the recaptures noted above, Scottish Re was released of associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities is estimated to result in a pre-tax noncash GAAP gain of approximately \$700 million after transaction expenses and related costs.
- On February 17, 2009, citing, among other things, the current economic conditions and the uncertainty of the conditions that lay ahead, the Insurance Commissioner of the State of Delaware (the “Insurance Commissioner”) issued an emergency order amending Delaware Insurance Regulation §1215 relating to Recognition of Preferred Mortality Tables for use in Determining Minimum Reserve Liabilities (the “Preferred Mortality Table Emergency Regulation”) and an emergency order amending Delaware Insurance Regulation §1212 relating to Valuation of Life Insurance Policies (the “X-Factor Emergency Regulation,” and together with the Preferred Mortality Table Regulation, the “Emergency Regulations”). Generally, the Preferred Mortality Table Emergency Regulation allows, upon receipt of the Commissioner’s approval, use of the 2001 CSO Preferred Class Structure Mortality Table as the minimum valuation standard for policies issued after January 1, 2004. In connection with this requirement, SRUS sought, and on February 26, 2009, obtained, the Department’s approval for use of the 2001 CSO Preferred Class Structure Mortality Table in accordance with the Preferred Mortality Table Emergency Regulation. The X-Factor Emergency Regulation relaxes existing constraints related to the X-factor assumptions used in the calculation of statutory reserves. The Emergency Regulations for statutory accounting purposes by their terms are effective for valuations on and after December 31, 2008. As at December 31, 2008, the effect of the Emergency Regulations on SRUS’, capital and surplus was a positive \$190 million. Accordingly, in the absence of the Emergency Regulations, SRUS’s risk-based capital as of December 31, 2008 may have resulted in further regulatory action against SRUS.

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- In order to further preserve liquidity, Scottish Re began deferring interest payments as of March 4, 2009 on floating rate capital securities and trust preferred securities issued and sold through certain statutory trusts that we previously established. See Note 12, “Debt Obligations and Other Funding Agreements.” Under the terms of these securities, Scottish Re is entitled to defer interest payments for up to 20 consecutive quarterly periods.
- Through negotiated repurchases, we extinguished the \$100 million payment obligation falling due on March 12, 2009, in respect of the Premium Asset Trust (“PATS”) funding agreement to which SALIC was a party for significant discount to par on an aggregate basis.

Following the satisfaction of the PATS funding agreement, our nearest term remaining debt obligations are the Stingray Investor Trust (“Stingray”) funding agreements, which are outstanding in the amount of \$325 million and mature in January 2015.

With the completion of the foregoing actions in Scottish Re, we plan to pursue our run-off strategy for the remaining business in our Life Reinsurance North America Segment, whereby we will continue to receive premiums, pay claims and perform key activities under our remaining reinsurance treaties. To succeed, this strategy will require us to maintain sufficient liquidity and meet ongoing regulatory capital requirements. While management believes the Company presently has sufficient liquidity and regulatory capital in the short term, our ability to pursue our run-off strategy over time will depend upon numerous factors, including, for example, the extent of market value losses on investments, mortality and lapse experience performing according to expectations, our ability to control expenses and the availability of funding sources as required. No assurances can be given that we will be successful in meeting our liquidity and capital needs going forward.

Business

We have two reportable segments: Life Reinsurance North America and Corporate and Other. The Life Reinsurance North America Segment has written reinsurance business that is wholly or partially retained in one or more of our reinsurance subsidiaries. We have ceased writing new business and, as noted above, have completed the sale of the Acquired Business, which was a large block of business in our Life Reinsurance North America Segment.

Life Reinsurance North America

In our Life Reinsurance North America Segment, we have assumed risks associated with primary life insurance, annuities and annuity-type policies. We reinsure mortality, investment, persistency and expense risks of United States life insurance and reinsurance companies. Most of the reinsurance assumed is through automatic treaties, but in 2006 we also began assuming risks on a facultative basis. The Life Reinsurance North America Segment suspended bidding for new business treaties on March 3, 2008, and issued notices of cancellation for all open treaties. See Note 20, “Subsequent Events,” for additional details on the Sale of a Block of Life Reinsurance North America Business and Run-Off strategy. The business we have written falls into two categories: Traditional Solutions and Financial Solutions, as detailed below.

Traditional Solutions: We reinsure the mortality risk on life insurance policies written by primary insurers. The business is often referred to as traditional life reinsurance. We wrote our Traditional Solutions business predominantly on an automatic basis. This means that we automatically reinsured all policies written by a ceding company that met the underwriting criteria specified in the treaty with the ceding company. As discussed herein, Scottish Re recently completed the sale to Hannover Re of the Acquired Business, which business generally was a part of our Traditional Solutions business.

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Financial Solutions: Financial Solutions include contracts under which we assumed the investment and persistency risks of existing, as well as newly written, blocks of business that improve the financial position of our clients by increasing their capital availability and statutory surplus. The products reinsured include annuities and annuity-type products, cash value life insurance and, to a lesser extent, disability products that are in a pay-out phase. This line of business includes acquired solutions products in which we provided our clients with exit strategies for discontinued lines of business, closed blocks of business, or lines of business not providing a good fit for a client's growth strategies.

Life insurance products that we reinsure include yearly renewable term, term with multi-year guarantees, ordinary life and variable life. Retail annuity products that we reinsure include fixed deferred annuities and equity indexed annuities.

For these products, we wrote reinsurance generally in the form of yearly renewable term, coinsurance or modified coinsurance. Under yearly renewable term, we share only in the mortality risk for which we receive a premium. In a coinsurance or modified coinsurance arrangement, we generally share proportionately in all material risks inherent in the underlying policies, including mortality, lapses and investments. Under such agreements, we agree to indemnify the primary insurer for all or a portion of the risks associated with the underlying insurance policy in exchange for a proportionate share of premiums. Coinsurance differs from modified coinsurance with respect to the ownership of the assets supporting the reserves. Under our coinsurance arrangements, ownership of these assets is transferred to us, whereas, in modified coinsurance arrangements, the ceding company retains ownership of these assets, but we share in the investment income and risk associated with the assets.

As discussed above, however, we have ceased writing new reinsurance treaties and generally no longer are accepting any new reinsurance risks under existing treaties or contracts with ceding companies.

Corporate and Other

Income in our Corporate and Other Segment is composed of investment income, including realized investment gains or losses, from invested assets not allocated to support reinsurance segment operations. General corporate expenses consist of unallocated overhead and executive costs and collateral finance facility expense.

2. Summary of Significant Accounting Policies

Basis of Presentation

Accounting Principles – Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Certain items in the prior year financial statements have been reclassified to conform to the current year presentation.

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. We have incurred a net loss of \$2,440 million for the year ended December 31, 2008 and shareholder's deficit of \$1,762 million as of December 31, 2008. Our operating results and financial condition have deteriorated due to, among other things, prevailing global credit market conditions throughout 2008 that have had a dramatic effect on the financial services industry and the global economy. The turmoil in the mortgage and broader credit markets has resulted in declines in the fair value of our invested assets, which contain a significant concentration of sub-prime and Alt-A residential mortgage-backed securities. These conditions generally have not improved during the first quarter of 2009 and, notwithstanding the unprecedented intervention of the United States and other governments in the global banking and financial markets, we do not expect these adverse market conditions and their impact on us to improve significantly in the near term.

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In the event that for any reason, we fail to comply with the Department's Order of Supervision, or in the event the financial condition of SRUS materially were to deteriorate, the Department may take action to seize control of SRUS under applicable insurance law. Such a seizure would place control of all management decisions of SRUS with the Department, including with respect to controlling cash flows, settling claims and paying obligations. The primary objective of the Department would be to protect the interests of the policyholders and ceding insurers with whom SRUS has contracted and would not be to protect the interests of SRGL, SALIC, the shareholders or any other stakeholders of the Company. A seizure of SRUS would have numerous consequences, including potentially triggering ceding company recapture rights on reinsurance agreements with us. Such seizure may also lead to the need for SALIC and SRGL to seek bankruptcy protection. Based upon management's preliminary analysis, in the event of bankruptcy, SRGL and SALIC may not have sufficient funds to pay creditors or the ability to execute an orderly run-off strategy.

As previously announced, Scottish Re changed its strategic focus in the first quarter of 2008 and has been pursuing a number of actions to preserve capital and mitigate growing liquidity demands. See Note 1, "Organization and Business." As a result, we ceased writing new reinsurance treaties and notified existing clients that we would not be accepting new risks on existing treaties. We took steps to reduce our operating expenses, including reducing staffing levels. Scottish Re also completed the sale of our Wealth Management business and Life Reinsurance International Segment in 2008, and the Acquired Business in 2009. Our current strategy is to runoff the remaining business under our existing reinsurance treaties.

Our ability to continue as a going concern is dependent upon our ability to successfully meet our obligations in a manner that addresses ongoing regulatory requirements and capital, liquidity and collateral needs. There can be no assurance that any of these actions will be successful in supplying funds in amounts and at times necessary to meet our liquidity requirements in future periods. These consolidated financial statements do not give effect to any adjustments to recorded amounts and their classification, which would be necessary should we be unable to continue as a going concern and, therefore, 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.

Consolidation – The consolidated financial statements include the assets, liabilities and results of operations of SALIC and its subsidiaries and all variable interest entities for which we are the primary beneficiary as defined in Financial Accounting Standards Board ("FASB") Interpretation No. 46R "Consolidation of Variable Interest Entities-An Interpretation of ARB No. 51" ("FIN 46R"). All significant intercompany transactions and balances have been eliminated on consolidation.

Estimates, Risks and Uncertainties – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates and assumptions used by management. Our most significant assumptions are for:

- investment valuation and impairments;
- accounting for derivative instruments;
- assessment of risk transfer for structured insurance and reinsurance contracts;
- estimates of premiums;
- valuation of present value of in-force business;
- establishment of reserves for future policy benefits;
- amortization of deferred acquisition costs;
- retrocession arrangements and amounts recoverable from reinsurers;

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- interest-sensitive contract liabilities; and
- income taxes, deferred taxes and determination of the valuation allowance.

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

All tabular amounts are reported in thousands of U.S. dollars, or as otherwise noted.

Fixed Maturity Investments, Preferred Stock, Other Investments, and Cash and Cash Equivalents

Effective January 1, 2008, we reclassified our available-for-sale securities to trading. Accordingly, as of January 1, 2008, the balance of unrealized appreciation on investments of \$35.5 million, which was previously included in accumulated other comprehensive loss, was reclassified and recorded in the Consolidated Statements of Operations caption “Net realized and unrealized losses.”

We carry securities at fair value on our Consolidated Balance Sheets. We maximize the use of observable inputs and minimize the use of nonobservable inputs when measuring fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of fixed maturity investments is calculated using independent pricing sources that utilize brokerage quotes, proprietary models and market-based information. The actual value at which such financial instruments actually could be sold or settled with a willing buyer may differ from such estimated fair values. Unrealized holding gains and losses on trading investments are included in earnings. Interest is recorded on the accrual basis based upon the stated coupon rate as a component of net investment income. For securities with uncertain cash flow, the investments are accounted for under the cost recovery method, whereby all principal and coupon payments received are applied as a reduction of the carrying value. Cash flows for trading securities are classified in Investing Activities on the Consolidated Statements of Cash Flows based on the nature and purpose for which the related securities were acquired. Investment transactions are recorded on the trade date, with balances pending settlement reflected in the Consolidated Balance Sheets as a component of cash and cash equivalents.

During the year ended December 31, 2007, fixed maturity investments were classified as available for sale and, accordingly, we carried these investments at fair value on our Consolidated Balance Sheets. The cost of fixed maturity investments was adjusted for prepayments, impairments and the amortization of premiums and discounts. We did not change the revised cost basis for subsequent recoveries in value. The unrealized appreciation (depreciation) was the difference between fair value and amortized cost and was recorded directly to equity with no impact to net income. The change in unrealized appreciation (depreciation) was included in accumulated other comprehensive loss in shareholder’s equity after deductions for adjustments for deferred acquisition costs and deferred income taxes. Investment transactions were recorded on the trade date, with balances pending settlement reflected in the Consolidated Balance Sheets as a component of cash and cash equivalents. Interest income was recorded on the accrual basis.

During the year ended December 31, 2007, Statement of Financial Accounting Standard (“SFAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (“SFAS No. 115”), and related accounting guidance, including FASB Staff Position FAS 115-1/124-1, “The Meaning of Other Than Temporary Impairments and Its Application to Certain Investments,” required that we evaluated, for each security where the estimated fair value is less than its amortized cost, whether we had the intent and ability to hold the security for a reasonable time for a forecasted recovery of the fair value up to the amortized cost of the investment. This required that we consider our capital and liquidity requirements, any contractual or regulatory obligations and the implications of our strategic initiatives that might indicate that securities may need to be sold before forecasted recovery of fair value occurs. For certain investments in beneficial interests in securitized financial assets of less than high quality with contractual

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cash flows, including asset-backed securities, Emerging Issue Task Force 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continued to Be Held by a Transferor in Securitized Financial Assets" ("EITF 99-20"), required a periodic update of our best estimate of cash flows over the life of the security. If the fair value of an investment in beneficial interests in a securitized financial asset was less than its cost or amortized cost and there had been a decrease in the present value of estimated cash flows since the last revised estimate, considering both their timing and amount, an other-than-temporary impairment charge was recognized. Interest income was recognized based on changes in the expected principal and interest cash flows reflected in the yield. Projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral. When a decline was considered to be other-than-temporary, the cost basis of the impaired asset was adjusted to its fair value and a corresponding realized investment loss is recognized in the Consolidated Statements of Operations.

Realized gains and losses arising on the sale of securities are determined on a specific-identification method. Realized gains and losses are stated net of associated deferred acquisition costs and income taxes.

We review available-for-sale securities with unrealized losses and test for other-than-temporary impairments on a quarterly basis. Factors involved in the determination of potential impairment include fair value as compared to cost, length of time the value has been below cost, creditworthiness of the issuer, forecasted financial performance of the issuer, position of the security in the issuer's capital structure, the presence and estimated value of collateral or other credit enhancement, length of time to maturity, interest rates, and our intent and ability to hold the security until the estimated fair value recovers.

Other investments include equity securities and structured loans, which are generally accounted for at fair value. Other investments represented approximately 0.4% and 0.7% of our investments as of December 31, 2008 and 2007, respectively.

Cash and cash equivalents include cash and fixed deposits with an original maturity, when purchased, of three months or less. Cash and cash equivalents are recorded at face value, which approximates fair value.

Statement of Cash Flows

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), certain items in the prior years in the Consolidated Statements of Operations and the assets and liabilities in the Consolidated Balance Sheets have been restated to exclude the results of our discontinued operations, namely the Life Reinsurance International Segment and the Wealth Management business. As permitted by SFAS No. 144, the Consolidated Statements of Comprehensive Loss, Shareholder's (Deficit) Equity, and Cash Flows remain unchanged.

We included the change in funds withheld at interest in our modified coinsurance arrangements as a change in operating activities in the Consolidated Statements of Cash Flows. The related interest and change in fair value of embedded derivatives is also included in cash flows from operating activities.

Derivatives

All derivative instruments are recognized either as assets or liabilities in the Consolidated Balance Sheets at fair value as required by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). The accounting for changes in the fair value of stand-alone derivatives that have not been designated as a hedge is included in net realized and unrealized losses in the Consolidated Statements of Operations. The gains or losses on derivatives designated as a hedge of our interest expense on floating rate securities are included in interest expense.

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Our funds withheld at interest arise on modified coinsurance and funds withheld coinsurance agreements. Derivatives Implementation Group Issue No. B36, "Embedded Derivatives: Bifurcation of a Debt Instrument that Incorporates Both Interest Rate and Credit Rate Risk Exposures that are Unrelated or Only Partially Related to the Creditworthiness of the Issuer of that Instrument," indicates that these transactions contain embedded derivatives. The embedded derivative feature in our funds withheld treaties is similar to a fixed-rate total return swap on the assets held by the ceding companies.

During the years ended December 31, 2008 and 2007, we also carried equity-indexed life reinsurance contracts, with account values credited with a return indexed to an equity index rather than established interest rates. Under Derivatives Implementation Group Issue No. B10, "Embedded Derivatives: Equity-Indexed Life Insurance Contracts," these transactions contained embedded derivatives. These contracts were recaptured in the fourth quarter of 2008, eliminating the associated embedded derivative balance of \$81.4 million and resulting in a pre-tax gain of \$35.2 million.

The fair value of these embedded derivatives at December 31, 2008, was a liability of \$347.5 million (2007–\$131.5 million) and is included in accounts payable and other liabilities. The change in fair value of embedded derivatives is reported in the Consolidated Statements of Operations under the caption "Change in value of embedded derivatives, net."

Assessment of Risk Transfer for Structured Insurance and Reinsurance Contracts

For both ceded and assumed reinsurance, risk transfer requirements must be met in order to obtain reinsurance status for accounting purposes, principally resulting in the recognition of cash flows under the contract as premiums and losses. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss for the assuming entity. To assess risk transfer for certain contracts, we generally develop expected discounted cash flow analyses at contract inception. If risk transfer requirements are not met, a contract is accounted for using the deposit method. Deposit accounting requires that consideration received or paid be recorded in the Consolidated Balance Sheet as opposed to premiums written or losses incurred in the Consolidated Statement of Operations and any nonrefundable fees earned based on the terms of the contract.

For each of our reinsurance contracts, the Company must determine if the contract provides indemnification against loss or liability relating to insurance risk, in accordance with applicable accounting standards. We must 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 a contract does not expose us to a reasonable possibility of a significant loss from insurance risk, we record the contract on a deposit method of accounting with the net amount payable/receivable reflected in other reinsurance assets or liabilities on the Consolidated Balance Sheets. Fees earned on the contracts are reflected as other revenues, as opposed to premiums, on the Consolidated Statements of Operations.

Revenue Recognition

- (i) Reinsurance premiums from traditional life policies and annuity policies with life contingencies generally are recognized as revenue when due from policyholders and reported net of amounts retroceded. Traditional life policies include those contracts with fixed and guaranteed premiums and benefits, and principally consist of whole life and term insurance policies.
- (ii) Benefits and expenses, net of amounts retroceded, are matched with net earned premiums so as to result in the recognition of profits over the life of the contracts. This is achieved by means of the

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provision for liabilities for future policy benefits and deferral and subsequent amortization of deferred acquisition costs.

- (iii) Reinsurance assumed for interest-sensitive and investment-type products does not generate premium but generates investment income on the assets we receive from ceding companies less policy charges for the cost of insurance, policy administration, and surrenders that have been assessed against policy account balances during the period.
- (iv) Fee income is recorded on an accrual basis.
- (v) Net investment income includes interest and dividend income together with amortization of market premium and discounts and is net of investment management and custody fees.

Present Value of In-Force Business

The present value of in-force business is established upon the acquisition of a book of business and is amortized over the expected life of the business as determined at acquisition. The amortization each year is a function of the ratio of annual gross profits or revenues to total anticipated gross profits or revenues expected over the life of the business, discounted at the assumed net credit rate (4.9% for 2008 and 2007). The carrying value is reviewed for premium deficiency at least annually for indicators of impairment in value.

Reserves for Future Policy Benefits

SFAS No. 60, "Accounting and Reporting by Insurance Enterprises" ("SFAS No. 60"), applies to our traditional life policies with continuing premiums. For these policies, reserves for future policy benefits are computed based upon expected mortality rates, lapse rates, investment yields, expenses and other assumptions established at policy issue, including a margin for adverse deviation. Once these assumptions are made for a given treaty or group of treaties, they will not be changed over the life of the treaty. We periodically review actual historical experience and relative anticipated experience compared to the assumptions used to establish reserves for future policy benefits. Further, we determine whether actual and anticipated experience indicates 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 acquisition costs. Significant changes in experience or assumptions may require us to provide for expected losses on a group of treaties by establishing additional net reserves. Because of the many assumptions and estimates used in establishing reserves and the long-term nature of the reinsurance contracts, the reserving process, while based on actuarial science, is inherently uncertain.

On certain lines of business, policy benefit reserves include an estimate of claims payable for incurred but not reported ("IBNR") losses. Those IBNR loss 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 losses as a percentage of current in-force.

Deferred Acquisition Costs

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

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Deferred acquisition costs (“DAC”) related to traditional life insurance contracts, substantially all of which relate to long-duration contracts, are amortized in proportion to the ratio of individual period premium revenues to total anticipated premium revenues over the life of the policy. Such anticipated premium revenues are estimated using the same assumptions used for computing liabilities for future policy benefits. The deferral of acquisition costs is established for limited premium policies under the same practices as used for traditional life policies, with the exception that any gross premium in excess of the net premium is deferred and recognized into income as a constant percentage of insurance in-force.

DAC related to interest-sensitive life and investment-type policies are deferred and amortized over the lives of the policies, in relation to the present value of estimated gross profits from mortality and investment income, less interest credited and expense margins without provision for adverse deviation. Each reporting period, we update the estimated gross profits with the actual gross profits for that period. When actual gross profits change from previously estimated gross profits, the cumulative DAC amortization is recalculated and adjusted by a cumulative charge or credit to current operations. When actual gross profits exceed those previously estimated, the DAC amortization will increase, resulting in a current period charge to earnings. The opposite result occurs when the actual gross profits are below the previously estimated gross profits. In such circumstances, we floor actual gross profits to zero. This is necessitated by the declining level of asset market values, which now flow through earnings under the trading classification.

In addition, we review the future estimated gross profit for each block of business to determine the recoverability of DAC balances based on future expectations. Changes in the assumptions for mortality, persistency, maintenance expense and interest could result in material changes to the financial statements. When expected future gross profits are below those previously estimated, the DAC amortization will increase, resulting in a current period charge to earnings. The opposite result occurs when the expected future gross profits are above the previously estimated future gross profits.

Total DAC amortization during a particular period may increase or decrease depending upon the relative size of the amortization change resulting from the adjustment to DAC for the update of actual gross profits and the re-estimation of expected future gross profits.

Modifications or exchanges of contracts that constitute a substantial contract change are accounted for as an extinguishment of the replaced contract, resulting in a release of unamortized deferred acquisition costs, unearned revenue and deferred sales inducements associated with the replaced contract.

The development and amortization of deferred acquisition costs for our products requires management to make estimates and assumptions. Actual results could differ materially from those estimates. Management monitors actual experience, and should circumstances warrant, will revise its assumptions and the related estimates.

Retrocession Arrangements and Amounts Recoverable From Reinsurers

In the ordinary course of business, our reinsurance subsidiaries cede reinsurance to other reinsurance companies. These agreements provide greater diversification of business and minimize the net loss potential arising from large risks. Ceded reinsurance contracts, do not relieve us of our obligation to the direct writing companies. The cost of reinsurance related to long-duration contracts is recognized over the terms of the reinsured policies on a basis consistent with the reporting of those policies.

In addition, we seek to limit in the ordinary course of business our exposure to losses on any single insured and to recover a portion of benefits paid by ceding reinsurance to other insurance enterprises or reinsurers under excess coverage and quota share contracts. In order to manage short-term volatility in our earnings and diversify our mortality exposure, we limit our exposure on any given life.

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Our initial North American life retention limit was set at \$500,000 per life. With the acquisition in December 2003 of ERC Life Reinsurance Corporation (subsequently renamed Scottish Re Life Corporation (“SRLC”)), we set a retention for that block of business at \$1,000,000 per life effective July 1, 2004. On December 31, 2004, we acquired the former individual life business of ING Re, which had managed a retention up to \$5,000,000. Effective January 1, 2005, we established a per life retention on the acquired business of \$2,000,000 while raising retention for new issues to \$1,000,000. This organic new business retention subsequently was increased to \$2,000,000 per life for 2007.

In May 2006, we entered into an agreement that provided \$155 million of collateralized catastrophe protection with Tartan Capital Management, a special purpose Cayman Islands company funded by a catastrophe bond transaction, for terrorism, nuclear, biological and chemical risks on our entire retained life reinsurance business. The coverage period ran from January 1, 2006 to December 31, 2008, and provided SALIC with protection from losses arising from higher-than-normal mortality levels within the United States, as reported by the U.S. Center for Disease Control and Prevention or other designated reporting agency. This coverage was based on a mortality index, which in turn was based on age- and gender-weighted mortality rates for the United States constructed from publicly available data sources, as defined at inception of the transaction, and which compared the mortality rates over consecutive two-year periods to a reference index value. We have not renewed this coverage due to the reduced size of our retained business.

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

The methods used to determine the reinsurance recoverable balance, and related bad debt provision, continually are reviewed and updated, and any resulting adjustments are reflected in earnings in the period identified. At December 31, 2008 and 2007, we had a reserve for uncollectible reinsurance of \$4.5 million and \$8.5 million, respectively.

Interest-Sensitive Contract Liabilities

The liabilities for interest-sensitive contract liabilities equal the accumulated account values of the policies or contracts as of the valuation date and include funds received plus interest credited less funds withdrawn and interest paid. 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.

SFAS No. 97, “Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments” (“SFAS No. 97”), applies to investment contracts, limited premium contracts, and universal life-type contracts. For investment and universal life-type contracts, future benefit liabilities are held using the retrospective deposit method, increased for amounts representing unearned revenue or refundable policy charges. Should the liabilities for future policy benefits plus the present value of expected future gross premiums for a product be insufficient to provide for expected future benefits and expenses for that product, deferred acquisition costs will be written off and thereafter, if required, a premium deficiency reserve will be established by a charge to income.

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Income Taxes

Income taxes are recorded in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). In accordance with SFAS No. 109, for all years presented we use the asset and liability method to record deferred income taxes. Accordingly, deferred income tax assets and liabilities are recognized that reflect the net tax effect of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, using enacted tax rates. Such temporary differences are primarily due to tax basis of reserves, deferred acquisition costs, unrealized investment losses and net operating loss carryforwards. A valuation allowance is applied to deferred tax assets if it is more likely than not that all, or some portion, of the benefits related to the deferred tax assets will not be realized.

On January 1, 2007, we adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the consolidated financial statements in accordance with SFAS No. 109. Under FIN 48, tax positions must meet a "more likely than not" recognition threshold at the effective date to be recognized in the consolidated financial statements. Our policy for recording interest and penalties associated with uncertain tax positions is to record such items as a component of income tax expense.

As a result of the implementation of FIN 48, we recorded a net decrease to our beginning retained earnings of \$18.0 million, reflecting the establishment of a FIN 48 liability of \$75.3 million (excluding previously recognized liabilities of \$6.5 million and including interest and penalties of \$8.9 million) offset by a \$57.3 million reduction of our existing valuation allowance. We had total unrecognized tax benefits (excluding interest and penalties) of \$72.6 million at January 1, 2007, the recognition of which would result in a \$15.3 million benefit.

Funds Withheld at Interest

Funds withheld at interest are funds held by ceding companies under modified coinsurance and coinsurance funds withheld agreements whereby we receive the interest income earned on the funds. The balance of funds held represents the statutory reserves of the ceding companies, with the assets supporting these reserves retained by the ceding company and managed for our account. Interest accrues to these assets at rates defined by the treaty terms. These agreements are considered to include embedded derivatives as further discussed in this Note. In addition to our modified coinsurance and funds withheld coinsurance agreements, we have entered into various financial reinsurance treaties that, although considered funds withheld, do not transfer significant insurance risk and are recorded on a deposit method of accounting.

Other Assets

Other assets primarily include unamortized debt issuance costs, collateral finance facility costs, certain deferred transaction costs, funds on deposit as security for certain collateral finance facilities, and fixed assets, including capitalized software. Capitalized software is stated at cost less accumulated amortization. Purchased software costs, as well as internal and external costs incurred to develop internal-use computer software during the application development stage, are capitalized.

As of December 31, 2008 and 2007, we had unamortized collateral finance facilities costs and debt issuance costs of approximately \$16.0 million and \$64.2 million, respectively. During 2008 and 2007, we amortized collateral finance facilities costs and debt issuance costs of \$5.9 million and \$6.1 million, respectively. In addition, we wrote off collateral finance facilities costs in 2008 related to Ballantyne Re (\$21.3 million), Clearwater Re (\$10.3 million), HSBC II (\$4.8 million) and our reinsurance facility (\$4.6 million). There were no write offs of collateral finance facilities costs in 2007. Deferred costs relating to the collateralized catastrophe protection with

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Notes to Consolidated Financial Statements (continued)
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Tartan were fully amortized in 2008. During 2008 and 2007, we amortized \$1.4 million and \$1.4 million of these deferred costs, respectively.

Other Liabilities

Other liabilities primarily relate to collateral facility accrued interest, the fair value of embedded derivatives, deferred guarantee fees and our FIN 48 tax liability.

3. New Accounting Pronouncements

FASB Statement No. 157, Fair Value Measurements

As of January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The adoption of SFAS No. 157 did not have a material impact on our consolidated financial statements.

FSP FAS No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly

In April 2009, the FASB issued FSP FAS No.157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP No. 157-4"). FSP No. 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, emphasizing that even if there has been significant decrease in the volume and level of activity for the asset or liability and regardless of valuation technique(s) used, the objective of a fair value measurement remains the same. FSP No. 157-4 shall be effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009 is not permitted. We are currently evaluating the potential impact of the adoption of FSP No.157-4 on our consolidated financial condition and results of operations.

FSP FAS No. 140-4 and FIN 46(R)-8, Enhanced Disclosure Requirements Related to Transfers of Financial Assets and Variable Interest Entities

In December 2008, the FASB issued FSP FAS No. 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" ("FSP No. 140-4"). FSP No. 140-4 amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"), to require additional disclosures regarding a transferor's continuing involvement with transferred financial assets in a securitization or asset-backed financing arrangement. FSP No. 140-4 also amends FIN 46 (revised December 2003), "Consolidation of Variable Interest Entities," to expand the disclosure requirements for variable interest entities ("VIEs") to include information regarding the decision to consolidate the VIE, the nature of and changes in risks related to a VIE, and the impact on the entity's financial statements due to the involvement with a VIE. Those variable interests required to comply with the guidance in FSP No. 140-4 include the primary beneficiary of the VIE, the holder of a significant variable interest and a sponsor that holds a variable interest. Further, FSP No. 140-4 requires enhanced disclosures for certain sponsors and holders of a significant variable interest in a qualifying special purpose entity. The provisions of FSP No. 140-4 are effective for the first reporting period ending after December 15, 2008, and comparative disclosures are not required. We included the enhanced disclosures required by FSP No. 140-4 in the notes to the consolidated financial statements beginning in the reporting period ended December 31, 2008.

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See Note 11, “Collateral Finance Facilities and Securitization Structures,” for more information regarding our involvement with VIEs.

FASB Statement No. 160, Noncontrolling Interest in Consolidated Financial Statements

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin (“ARB”) No. 51” (“SFAS No. 160”), which aims to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards surrounding noncontrolling interests, or minority interests, which are the portions of equity in a subsidiary not attributable, directly or indirectly, to a parent. The ownership interests in subsidiaries held by parties other than the parent shall be clearly identified, labeled and presented in the Consolidated Statement of Financial Position within equity, but separate from the parent’s equity. The amount of consolidated net income attributable to the parent and to the noncontrolling interest must be clearly identified and presented on the face of the Consolidated Statements of Income. Changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary must be accounted for consistently as equity transactions. A parent’s ownership interest in a subsidiary changes if the parent purchases additional ownership interests in its subsidiary, sells some of its ownership interests in its subsidiary, the subsidiary reacquires some of its ownership interests or the subsidiary issues additional ownership interests. When a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary must be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any noncontrolling equity investment rather than the carrying amount of that retained investment. Entities must provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect the adoption of SFAS No. 160 to have a material impact on our consolidated financial condition and results of operations.

FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, “Disclosures About Derivative Instruments and Hedging Activities” (“SFAS No. 161”). SFAS No. 161 establishes reporting standards that require enhanced disclosures about how and why derivative instruments are used, how derivative instruments are accounted for under FAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” and how derivative instruments affect an entity’s financial condition, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. We do not anticipate that SFAS No. 161 will have a material effect on our consolidated financial condition and results of operations.

FASB Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS No. 162”). This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.” We do not anticipate that SFAS No. 162 will have a material impact on our financial condition or results of operations.

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4. Discontinued Operations

Disposal of Wealth Management Business

On July 11, 2008, the sale of the Wealth Management business closed with respect to Scottish Annuity & Life Insurance Company (Bermuda) Ltd. and Scottish Annuity & Life International Insurance Company (Bermuda) Ltd. We generated proceeds of \$4.4 million and recognized a net loss of \$4.6 million on this sale.

Disposal of Life Reinsurance International Segment

On July 18, 2008, Pacific Life Insurance Company concluded the purchase of Scottish Re Holdings Limited and the U.K. portion of the Life Reinsurance International Segment from Scottish Re for \$67.1 million after purchase price adjustments of \$4.1 million. \$26.8 million after purchase price adjustments of \$8.0 million is included in SALIC as a result of the novation of treaties in SALIC and recapture of treaties in SRD. The purchase of the Asia portion of the Life Reinsurance International Segment was completed on August 20, 2008, for an additional payment by Pacific Life Insurance Company of \$0.5 million. Scottish Re recorded an aggregate loss of \$31 million on these transactions in 2008, of which an aggregate gain of \$28.3 million is included in SALIC. In March 2009, the Singapore branch was closed and \$6.1 million of capital was returned to SALIC.

The following table presents the assets and liabilities held for sale for the Wealth Management business as of December 31, 2007:

(U.S. dollars in thousands)	As of December 31, 2007
Fixed maturity investments, trading at fair value	\$ 12,252
Cash and cash equivalents	21,339
Total investments.....	33,591
Accrued interest receivable	94
Reinsurance balances and risk fees receivable	94,053
Deferred acquisition costs	23,767
Amount recoverable from reinsurers	563
Other assets.....	345
Current income tax receivable	104
Deferred tax asset	1,712
Segregated assets.....	419,275
Total assets held for sale.....	<u>\$ 573,504</u>
Reserves for future policy benefits.....	\$ 85,610
Accounts payable and other liabilities	1,361
Current income tax payable.....	379
Segregated liabilities	419,275
Total liabilities held for sale	<u>\$ 506,625</u>

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Notes to Consolidated Financial Statements (continued)
December 31, 2008

5. Investments

Effective January 1, 2008, our invested assets were classified as trading, and the balances in fixed maturity investments – available-for-sale and preferred stock – available-for-sale were transferred to trading securities. Additionally, as of January 1, 2008, the balance of unrealized appreciation on investments, which previously was included in accumulated other comprehensive income (loss), was reclassified and recorded in the Consolidated Statements of Operations caption “Net realized and unrealized losses.”

Trading investments are recorded at fair market value. Unrealized holding gains and losses on trading investments are included in earnings. Interest is recorded based upon the stated coupon rate as a component of net investment income. For securities with uncertain cash flow, the investments are accounted for under the cost recovery method, whereby all principal and coupon payments received are applied as a reduction of the carrying value. Cash flows for trading securities are classified in Investing activities on the Consolidated Statements of Cash Flows based on the nature and purpose for which the related securities were acquired.

The portion of net unrealized losses for the year ended December 31, 2008, that relates to trading securities still held at the reporting date is \$1,677 million.

The estimated fair values of our fixed maturity investments and preferred stock at December 31, 2008 are as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2008
U.S. Treasury securities and U.S. government agency obligations	\$ 72,855
Corporate securities	1,541,975
Municipal bonds	49,549
Mortgage and asset-backed securities	1,870,131
Preferred stock.....	79,767
Total	\$ 3,614,277

The amortized cost, gross unrealized appreciation and depreciation, and estimated fair values of our fixed maturity investments and preferred stock at December 31, 2007 are as follows:

(U.S. dollars in thousands)	December 31, 2007			
	Amortized Cost or Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Estimated Fair Value
U.S. Treasury securities and U.S. government agency obligations	\$ 56,837	\$ 1,309	\$ –	\$ 58,146
Corporate securities	2,595,712	23,208	–	2,618,920
Municipal bonds	55,466	732	–	56,198
Mortgage and asset-backed securities.....	4,232,019	10,094	–	4,242,113
Preferred stock.....	88,914	59	–	88,973
Total.....	\$ 7,028,948	\$ 35,402	\$ –	\$ 7,064,350

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

The contractual maturities of the fixed maturities and preferred stock are as follows (actual maturities may differ as a result of calls and prepayments):

(U.S. dollars in thousands)	Estimated Fair Value
	Year Ended
	December 31,
	2008
Due in one year or less	\$ 152,310
Due after one year through five years.....	503,192
Due after five years through ten years	415,453
Due after ten years.....	673,191
	<hr/>
	1,744,146
Mortgage and asset-backed securities	1,870,131
Total	<hr/> <hr/> \$ 3,614,277

The contractual maturities of the fixed maturities and preferred stock at December 31, 2007 were as follows (actual maturities may differ as a result of calls and prepayments):

	December 31, 2007	
(U.S. dollars in thousands)	Amortized Cost or	Estimated
	Cost	Fair Value
Due in one year or less	\$ 143,243	\$ 143,381
Due after one year through five years.....	722,306	729,852
Due after five years through ten years	888,718	897,730
Due after ten years.....	1,042,662	1,051,274
	<hr/>	<hr/>
	2,796,929	2,822,237
Mortgage and asset-backed securities.....	4,232,019	4,242,113
Total.....	<hr/> <hr/> \$ 7,028,948	<hr/> <hr/> \$ 7,064,350

During the year ended December 31, 2007, we reviewed available-for-sale securities with material unrealized losses and tested for other-than-temporary impairments on a quarterly basis. Factors involved in the determination of potential impairment include fair value as compared to cost, length of time the fair value has been below cost, creditworthiness and forecasted financial performance of the issuer, position of the security in the issuer's capital structure, the presence and estimated value of collateral or other credit enhancement, length of time to maturity, the level and volatility of interest rates and our intent and ability to hold the security until the estimated fair value recovers. When a decline is considered to be "other-than-temporary," the cost basis of the impaired asset is adjusted to its fair value and a corresponding realized investment loss recognized in the Consolidated Statements of Operations.

U.S. GAAP requires that we evaluate, for each impaired security where the estimated fair value is less than its amortized cost, whether we have the intent and ability to hold the security for a reasonable time for a forecasted recovery of the fair value up to the amortized cost of the investment. This required us to consider our capital and liquidity requirements, any contractual or regulatory obligations, and the implications of our strategic initiatives that might indicate that securities may need to be sold before the forecasted recovery of fair value occurs.

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Notes to Consolidated Financial Statements (continued)
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We did not meet the necessary conditions to assert the intent and ability to hold securities with unrealized losses for a period of time sufficient to allow for a recovery in their value as of December 31, 2007. In accordance with SFAS No. 115, we recorded \$684.9 million as part of net realized investment losses in the Consolidated Statement of Operations during the fourth quarter of 2007 to recognize other-than-temporary impairments in securities that we no longer could positively assert our intent and ability to hold to recovery of fair value.

During the year ended December 31, 2007, fixed maturity investments and preferred stock available-for-sale securities with a fair value at the date of sale of \$288.6 million were sold.

During the year ended December 31, 2007, fixed maturity investments and preferred stock available-for-sale securities which were below amortized cost were sold at losses of \$12.5 million.

At December 31, 2007, our available-for-sale fixed income portfolio had 9,598 positions. Of these positions, there were none trading at an unrealized loss.

Due to other-than-temporary impairment charges recognized by us in the year ended December 31, 2007, there were no fixed maturity investments or preferred stock that have estimated fair values below amortized cost or cost as of December 31, 2007.

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

The analysis of realized (losses) gains and the change in net unrealized (depreciation) appreciation on investments and other balances for the years ended December 31, 2008 and 2007 are as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007
Gross realized gains (losses)		
Fixed maturities		
Gross realized gains.....	\$ 36,436	\$ 2,911
Gross realized losses.....	(27,785)	(13,035)
Net unrealized losses	(1,666,007)	-
Other-than-temporary impairments	-	(836,708)
	<u>(1,657,356)</u>	<u>(846,832)</u>
Preferred stock		
Gross realized gains.....	138	1
Gross realized losses.....	(87)	(1,732)
Net unrealized losses	(8,324)	-
Other-than-temporary impairments	-	(9,442)
	<u>(8,273)</u>	<u>(11,173)</u>
Other		
Foreign currency losses	(149)	(374)
Deferred acquisition costs.....	-	5,112
Write-off of Orkney Re II plc Series B Floating Rate Notes.....	(5,000)	-
Write-off of Orkney Re II plc Series C Floating Rate Notes.....	-	(30,000)
Realized losses on modco treaties	(19,374)	(2,582)
Other	(4,897)	(1,365)
Net realized and unrealized losses	<u>(1,695,049)</u>	<u>(887,214)</u>
Change in net unrealized (depreciation) appreciation on investments		
Fixed maturities	(35,436)	70,711
Preferred stock	(59)	2,793
Other	204	(454)
Change in deferred acquisition costs	5,442	(14,428)
Change in deferred income taxes.....	6,221	(16,457)
Change in net unrealized (depreciation) appreciation on investments	<u>(23,628)</u>	<u>42,165</u>
Total net realized and unrealized losses and change in net unrealized (depreciation) appreciation on investments and other balances	<u>\$ (1,718,677)</u>	<u>\$ (845,049)</u>

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
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Net investment income for the years ended December 31, 2008 and 2007 was derived from the following sources:

(U.S. dollars in thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007
Fixed maturities	\$ 266,777	\$ 412,058
Preferred stock	5,619	6,564
Funds withheld at interest	73,747	104,055
Other investments	16,219	35,005
Investment expenses	(14,187)	(19,619)
Net investment income	<u>\$ 348,175</u>	<u>\$ 538,063</u>

We are required to maintain assets on deposit with various regulatory authorities to support our insurance and reinsurance operations. These requirements are promulgated in the statutory regulations of the individual jurisdictions. The assets on deposit are available to settle insurance and reinsurance liabilities. We also utilize trust funds in certain transactions where the trust funds are established for the benefit of the ceding companies and generally take the place of letter of credit (“LOC”) requirements. At December 31, 2008 and 2007, such assets included fixed maturities of \$3,275 million and \$6,656 million, respectively, and cash and cash equivalents of \$547 million and \$589 million, respectively. This includes controlled assets within collateral finance facilities structures that we consolidate. See Note 11, “Collateral Finance Facilities and Securitization Structures.” The estimated fair value of these assets, as at December 31, 2008, totals \$1,529 million of investments (2007 – \$4,042 million) and \$385 million of cash and cash equivalents (2007 – \$440 million). These assets are held for the contractual obligations of these structures and for the regulatory obligations of our reinsurance operations and are not available for general corporate purposes.

The components of fair value of the total consolidated invested restricted assets at December 31, 2008 and 2007 are as follows:

(U.S. dollars in thousands)	December 31, 2008	December 31, 2007
Deposits with U.S. regulatory authorities.....	\$ 15,267	\$ 14,375
Trust funds	3,806,916	7,230,850
	<u>\$ 3,822,183</u>	<u>\$ 7,245,225</u>

6. Fair Value Measurements

We adopted SFAS No. 157 as of January 1, 2008. SFAS No. 157 establishes a framework for measuring fair value, 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 SFAS No. 157 are described below:

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

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
December 31, 2008

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

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

As required by SFAS No. 157, 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 stocks and actively traded mutual fund investments.

Level 2 includes those financial instruments that are valued by independent pricing services or valued using models or other valuation methodologies. These models primarily are 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 and equity securities; government or agency securities; certain mortgage and asset-backed securities; securities held as collateral; and segregated assets.

Level 3 is composed of financial instruments whose fair value is estimated based on nonbinding brokerage prices or internally developed models or methodologies utilizing significant inputs not based on, or corroborated by, readily available market information. This category primarily consists of certain less liquid fixed maturity and equity securities where we cannot corroborate the significant valuation inputs with market observable data. Additionally, our embedded derivatives, all of which are associated with reinsurance treaties, are classified in Level 3, since their values include significant unobservable inputs associated with actuarial assumptions regarding policyholder behavior. Embedded derivatives are reported with the host instruments in the Consolidated Balance Sheets.

At each reporting period, all assets and liabilities are classified 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 in its entirety requires judgment and considers factors specific to the asset or liability, such as the relative impact on the fair value as a result of including a particular input.

The majority of our fixed maturity and equity securities use Level 2 inputs for the determination of fair value. These fair values are obtained primarily from independent pricing services, when available, utilizing Level 2 inputs. Where pricing services do not provide fair values, the pricing services utilize proprietary pricing models to produce estimates of fair value primarily utilizing Level 2 inputs along with certain Level 3 inputs.

The proprietary pricing models include matrix pricing where we discount expected cash flows utilizing market interest rates obtained from third-party sources based on the credit quality and duration of the instrument to determine fair value. For securities that may not be reliably priced using internally developed pricing models, broker quotes are obtained. These broker quotes represent an exit price, but the assumptions used to establish the fair value may not be observable and represent Level 3 inputs.

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
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The embedded derivatives in funds withheld at interest include the embedded derivatives resulting from assumed modified coinsurance (“modco”) or coinsurance funds withheld reinsurance arrangements. These values are based upon the difference between the fair value of the underlying assets backing the modco or funds withheld receivable and the fair value of the underlying liabilities.

The fair value of the assets generally is based upon observable market data using valuation methods similar to those used for assets held directly by us. The fair value of the liabilities is determined by using market observable swap rates as well as some unobservable inputs such as actuarial assumptions regarding policyholder behavior. These assumptions require significant management judgment.

The embedded derivatives in equity-indexed liabilities include the embedded derivatives resulting from the bifurcation of assumed equity-indexed annuity liabilities.

The fair value is determined by using the Income Approach as characterized by SFAS No. 157. This method estimates the value of future equity purchases using certain actuarial assumptions and margins. The actuarial assumptions include factors that generally are not observable, such as policyholder behavior, explicit risk margins related to noncapital market inputs, and future interest margins. These assumptions require significant management judgment.

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

	December 31, 2008			
(U.S. dollars in millions)	Total	Level 1	Level 2	Level 3
Investments.....				
Fixed maturity investments	\$ 3,534.5	\$ –	\$ 2,725.6	\$ 808.9
Preferred stock.....	79.8	–	31.2	48.6
Total assets at fair value	<u>\$ 3,614.3</u>	<u>\$ –</u>	<u>\$ 2,756.8</u>	<u>\$ 857.5</u>
Funds withheld at interest – embedded derivatives.....	(347.5)	–	–	(347.5)
Total liabilities at fair value.....	<u>\$ (347.5)</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ (347.5)</u>

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
Notes to Consolidated Financial Statements (continued)
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The following table presents additional information about assets measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)				
(U.S. dollars in millions)	Fixed Maturities	Funds Withheld at Interest – Embedded Derivatives	Interest- Sensitive Contract Liabilities – Embedded Derivatives	Total
Beginning balance at January 1, 2008	\$ 2,291.8	\$ (38.5)	\$ (93.0)	\$ 2,160.3
Total realized and unrealized gains (losses) included in net loss	(1,277.8)	(309.0)	11.6	(1,575.2)
Purchases, issuances and settlements	(124.0)	–	81.4	(42.6)
Transfers in and/ or out of Level 3	(32.5)	–	–	(32.5)
Ending balance at December 31, 2008	\$ 857.5	\$ (347.5)	\$ –	\$ 510.0

The portion of net unrealized losses for the year ended December 31, 2008, that relates to trading securities still held at the reporting date is \$1,247.6 million for Level 3.

We review the fair value hierarchy classifications quarterly. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur.

7. Fair Value of Financial Instruments

As discussed above, fair value of financial assets and liabilities is estimated under SFAS No. 157 using the following methods and assumptions:

(i) Fixed maturity investments and preferred stock are carried at fair value. See Note 6, “Fair Value Measurements,” for a description of the methodologies and assumptions used to determine the fair value of financial instruments carried at fair value.

(ii) Policy loans carrying value approximates to fair value.

(iii) Funds withheld at interest represent fixed maturity investments held by ceding companies, and the fair values are consistent with the methodologies and assumptions used to determine the fair value of fixed maturities carried at fair value.

(iv) Fair values for collateral finance facilities prioritize the utilization of market value observable inputs for any notes issued by the collateral finance facilities that are wrapped by guarantors; we defined the unit of value as the combination of the issued note and guarantee. As a result, the fair value of the collateral finance facilities incorporates the value of the guarantee, including consideration of the nonperformance risk of the guarantors.

(v) Fair values for our long-term debt were determined by a third-party service provider with reference to similar quoted securities.

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Notes to Consolidated Financial Statements (continued)
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(vi) Amounts payable under funding agreements are a component of interest-sensitive contract liabilities. Fair value was determined by a third-party service provider with reference to similar quoted securities.

(vii) Investment contracts exclude significant mortality risk and are a component of interest-sensitive contract liabilities. The fair value of investment contracts is based on the cash surrender value of the liabilities as an approximation of the exit market.

(viii) Embedded derivatives are carried at fair value. See Note 6, "Fair Value Measurements," for a description of the methodologies and assumptions used to determine the fair value of financial instruments carried at fair value.

(U.S. dollars in thousands)	December 31, 2008		December 31, 2007	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets				
Fixed maturity investments.....	\$ 3,534,510	\$ 3,534,510	\$ 6,975,377	\$ 6,975,377
Preferred stock	79,767	79,767	88,973	88,973
Policy loans	18,112	18,112	22,155	22,155
Funds withheld at interest (excluding cash).....	1,748,768	1,474,183	1,597,404	1,680,665
Liabilities				
Collateral finance facilities	\$ 2,550,500	\$ 1,769,650	\$ 3,530,879	\$ 3,428,682
Long-term debt	129,500	62,000	129,500	113,500
Amounts payable under funding agreements.....	425,159	185,000	100,320	70,320
Investment contracts	1,600,395	1,554,817	2,460,465	2,364,322
Embedded derivative	347,519	347,519	131,478	131,478

8. Funds Withheld at Interest

For agreements written on a modco basis and certain agreements written on a coinsurance funds withheld basis, asset values recorded in the Consolidated Balance Sheets are equal to the net statutory reserve fund balances with the assets backing the reserves retained by the ceding company and managed for our account, including the reporting of amortized costs and fair value on the portfolio. The amounts in the funding accounts are adjusted quarterly to equal the net statutory reserve balances.

At December 31, 2008 and 2007, funds withheld at interest were in respect of six contracts with four ceding companies. At December 31, 2008, we had three contracts with Lincoln Financial Group that accounted for \$535 million or 31% of the funds withheld balances. Additionally, we had one contract with SLDI that accounted for \$1,165 million or 67% of the funds withheld balances. The remaining contracts were with Illinois Mutual Insurance Company and American Founders Life Insurance Company. Lincoln National Life Insurance Company has financial strength ratings of "A+" from AM. Best, "AA-" from Standard & Poor's, "A2" from Moody's and "A+" from Fitch. In the event of insolvency of the ceding companies on these arrangements, we would need to make a claim on the assets supporting the contract liabilities. However, the risk of loss is mitigated by our ability to offset amounts owed to the ceding company with the amounts owed to us by the ceding company. Reserves for future policy benefits and interest-sensitive contract liabilities relating to these contracts amounted to \$1,749 million and \$1,597 million at December 31, 2008 and 2007, respectively.

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9. Deferred Acquisition Costs

The following reflects the amounts of policy acquisition costs deferred and amortized:

(U.S. dollars in thousands)	December 31	
	2008	2007
Balance beginning of year	\$ 533,625	\$ 554,162
Expenses deferred.....	16,676	43,700
Amortization expense	(226,090)	(54,921)
Deferred acquisition costs on unrealized gains and losses	5,442	(14,428)
Deferred acquisition costs on realized losses.....	—	5,112
Balance at end of year	\$ 329,653	\$ 533,625

Included in the 2008 amortization expense is the aggregate write-off of deferred acquisition costs on two significant recaptures of \$76 million and the retrocession of the Clearwater Re business of \$75 million.

10. Present Value of In-Force Business

A reconciliation of the present value of in-force business is as follows:

(U.S. dollars in thousands)	December 31	
	2008	2007
Balance at beginning of year	\$ 41,859	\$ 43,774
Amortization.....	(1,754)	(1,915)
Balance at end of year	\$ 40,105	\$ 41,859

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

(U.S. dollars in thousands)	
Year ending December 31	
2009	\$ 3,402
2010	3,565
2011	3,212
2012	2,811
2013	2,578
Thereafter	24,537
	\$ 40,105

11. Collateral Finance Facilities and Securitization Structures

Orkney Re, Inc.

On February 11, 2005, Orkney Holdings, LLC, a Delaware limited liability company (“Orkney I”), issued and sold in a private offering an aggregate of \$850 million Series A Floating Rate Insured Notes due February 11, 2035 (the “Orkney Notes”). Orkney I was organized for the limited purpose of issuing the Orkney Notes and holding the stock of Orkney Re, Inc., originally a South Carolina special purpose financial captive insurance company, now a Delaware special purpose captive insurance company (“Orkney Re”). SRUS holds all of the limited liability company interest in Orkney I and has contributed capital to Orkney I in the amount of \$268.5 million. Proceeds

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from this offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued by direct ceding companies between January 1, 2000 and December 31, 2003, and reinsured by SRUS to Orkney Re. Proceeds from the Orkney Notes have been deposited into a series of accounts that collateralize the notes and the reserve obligations of SRUS.

The holders of the Orkney Notes cannot require repayment from us or any of our subsidiaries, other than Orkney I. The timely payment of interest and ultimate payment of principal for the Orkney Notes is guaranteed by MBIA Insurance Corporation.

Interest on the principal amount of the Orkney Notes is payable quarterly at a rate equivalent to three-month LIBOR plus 0.53%. At December 31, 2008, the interest rate was 2.82% (2007 – 5.23%). Any payment of principal, including by redemption, or interest on the Orkney Notes is sourced from dividends from Orkney Re and the balances available in a series of trust accounts generally excluding amounts on deposit in a reinsurance trust account supporting the associated reserve requirements of SRUS. Dividends only may be made after filing with the Insurance Commissioner in accordance with the terms of Orkney Re’s licensing order and in accordance with applicable law. The Orkney Notes also contain a customary limitation on lien provisions and customary events of default provisions, which, if breached, could result in the accelerated maturity of the Orkney Notes. Orkney I has the option to redeem all or a portion of the Orkney Notes prior to and on or after February 11, 2010, subject to certain call premiums.

In accordance with FIN 46R, Orkney I is considered to be a variable interest entity, and we are considered to hold the primary beneficial interest following a quantitative analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Orkney I has been consolidated in our financial statements. The assets of Orkney I have been recorded as fixed maturity investments and cash and cash equivalents. Our Consolidated Statements of Operations show the investment return of Orkney I as investment income, and the cost of the facility is reflected in collateral finance facilities expense. Funds in the securitization structure are used for the sole purpose of the securitization structure and hence are not available for general corporate purposes. See Note 5, “Investments.”

To the extent that we continue to experience fair value declines in the sub-prime and Alt-A assets, we may need to recapture a prorata portion of the underlying business in Orkney I and find alternative collateral support for the recaptured business. No assurances can be given that we will be successful in securing alternative collateral support.

HSBC II

On December 22, 2005, we entered into an agreement with HSBC for a 20-year collateral finance facility (“HSBC II”) that provided up to \$934 million of financing for the purpose of collateralizing intercompany reinsurance obligations on a portion of the business acquired from the ING Companies subject to Regulation XXX reserve requirements. Simultaneously, we entered into a total return swap with HSBC under which we were entitled to the total return of the investment portfolio of the trust established for this facility. In accordance with FIN 46R, the trust associated with this facility was considered to be a variable interest entity, and we were deemed to hold the primary beneficial interest in the trust following a quantitative analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, the trust has been consolidated in our financial statements. The total return swap represents a variable interest in the underlying trust, and therefore all fair value movements eliminate upon consolidation. Our Consolidated Statements of Operations show the investment return of the trust as investment income, and the cost of the facility is reflected in collateral finance facilities expense. Funds in this facility were used solely for the purpose of the facility and hence were not available for general corporate purposes.

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On June 30, 2008, we executed a forbearance agreement with HSBC in respect of the HSBC II facility as previously disclosed whereby HSBC agreed to forbear taking action until December 15, 2008. In order to achieve forbearance, we agreed to certain economic and noneconomic terms, including forbearance payments to HSBC, the contribution by SALIC of additional collateral to the transaction, limitations on future fundings by HSBC under the facility, and the requirement to achieve certain milestones set by HSBC related to, among other things, the sale of our Life Reinsurance North America Segment, all of which significantly increased constraints on our available capital and liquidity.

In connection with the HSBC II facility, on September 30, 2008, Scottish Re entered into a binding letter of intent (the "HSBC II LOI") with ING and the ING Companies. Pursuant to the HSBC II LOI, SLD consented to the recapture by SRUS of the business (such recaptured business, the "HSBC II Recaptured Business") that had been ceded by SRUS to SRD for the purpose of collateralizing (with financing provided by the HSBC II collateral finance facility) the Regulation XXX reserve requirements for a portion of the business originally acquired by us from the ING Companies at the end of 2004 (such portion related to the HSBC II collateral finance facility, the "HSBC II Business") effective as of September 30, 2008 (the "HSBC II Recapture").

On October 15, 2008, we and certain of our subsidiaries entered into a series of transactions with an effective date of September 30, 2008 to unwind the HSBC II facility. In connection with the unwind transactions, HSBC was repaid in full from assets within the collateral finance facility that secured the obligations to HSBC. We also paid a \$6 million fee pursuant to the related forbearance agreement and paid a make-whole fee of \$4 million (reduced from the amount contractually owed to HSBC), and the facility and the forbearance agreement and its terms were terminated. Following the consummation of the HSBC II Recapture, SLD recaptured the HSBC II Recaptured Business from SRUS and then ceded the HSBC II Recaptured Business to SLDI, which ceded the HSBC II Recaptured Business to SRLB.

SLDI agreed to provide, or cause the provision of, one or more letters of credit ("LOCs") in order to provide SLD with statutory financial statement credit for the excess reserves associated with the HSBC II Recaptured Business over the economic reserves held in an account related thereto. In conjunction with the HSBC II Recaptured Business, the ING Companies initially provided approximately \$650 million of LOCs, with an obligation to provide additional LOCs as needed. As consideration, we agreed to bear the costs of the LOCs by paying to SLD a facility fee based on the face amount of such LOCs outstanding as of the end of the preceding calendar quarter. Upon closing the Purchase Agreement for the Acquired Business, the obligation to pay these LOC fees transferred to Hannover Re. The recapture transaction recorded during the period ended September 30, 2008, based on the signed HSBC II LOI, resulted in no impact to the Consolidated Balance Sheets or Consolidated Statements of Operations on a consolidated GAAP basis. On October 15, 2008, when the HSBC II collateral facility was unwound, we returned to HSBC \$558.5 million to relieve the liabilities and fees associated with the facility. This resulted in a pre-tax loss of \$10.3 million. Both the unwind and the related GAAP loss were recorded as components of fourth quarter 2008 results because the unwind was not effectuated until October 2008.

On December 19, 2008, the second phase of the unwind was effected through the retrocession by SLDI of the recaptured business to SRLB. The HSBC II Recaptured Business and related LOC payment obligations were part of the Acquired Business sold to Hannover Re. Assets returned to SRUS in conjunction with the recapture consisted primarily of assets released from the economic account of the associated Reinsurance Trust (supporting the relevant economic reserves).

Ballantyne Re plc

On May 2, 2006, Ballantyne Re plc, a special purpose vehicle incorporated under the laws of Ireland ("Ballantyne Re"), issued in a private offering \$1.74 billion of debt to external investors and \$178 million of debt to SALIC.

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Interest on the principal amount of the Ballantyne Notes is payable in intervals ranging from every 28 days to monthly to annually, depending on the note, initially at a rate equivalent to one-month LIBOR plus 0.61% for the Class A-1 Floating Rate Notes (and after May 2, 2022, one-month LIBOR plus 1.22%), one-month LIBOR plus 0.31% for the Class A-2 Floating Rate Guaranteed Notes Series A (and after May 2, 2027, one-month LIBOR plus 0.62%), one-month LIBOR plus 0.36% for the Class A-2 Floating Rate Guaranteed Notes Series B (and after May 2, 2027, one-month LIBOR plus 0.72%), 4.99%, 4.99%, 5.00% and 5.01% for Series A, Series B, Series C, and Series D of the Class A-3 Notes, respectively (with the rate on the Class A-3 Notes to reset every 28 days), 7.51% for the Class B-1 Subordinated Notes, one-month LIBOR plus 2.00% for the Class B-2 Subordinated Floating Rate Notes, and a variable rate based on performance of the underlying block of business for the Class C-1 Subordinated Variable Interest Rate Notes and the Class C-2 Subordinated Variable Interest Rate Notes

The holders of the Ballantyne Notes cannot require repayment from us or any of our subsidiaries. The timely payment of the scheduled interest payments and the principal on the maturity date of Series A of the Class A-2 Notes and Series A, Series B, Series C, Series D and, if issued, Series E of the Class A-3 Notes has been guaranteed by Ambac Assurance UK Limited (“Ambac”). The timely payment of the scheduled interest payments and the principal on the maturity date of Series B of the Class A-2 Notes and, if issued, Series F of the Class A-3 Notes has been guaranteed by Assured Guaranty (UK) Ltd (“Assured” and, together with Ambac in respect of the Ballantyne Re transaction, the “Financial Guarantors”).

Beginning with the scheduled interest payment date on January 2, 2009, and continuing until February 3, 2009, Ballantyne Re was unable to make scheduled interest payments on the Class A Notes. Failure to make such payments in full when due constitutes an event of default under the Ballantyne Re indenture (“EOD”). During this default period, Ambac made guarantee payments on the Class A-2 Notes and Class A-3 Notes in the aggregate amount of \$2.4 million and Assured made guarantee payments on the Class A-2 Notes in the aggregate amount of \$0.8 million. On February 9, 2009, a partial recapture of the business was completed by the ceding insurer, thereby lowering the reserve funding requirement and allowing for more available assets to make interest payments. On the following date, Ballantyne Re paid all deferred and accrued interest on the Class A-1 Notes in full, and repaid the Financial Guarantors for all guarantee payments made during the default period (plus interest). As a result of the EOD, the Financial Guarantors continue to have certain enhanced contractual rights under the transaction documents, and additional fees will be accrued for the guarantee coverage.

In accordance with FIN 46R, Ballantyne Re is considered to be a variable interest entity, and we are considered to hold the primary beneficial interest following a quantitative analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Ballantyne Re is consolidated in our financial statements. The assets of Ballantyne Re are recorded as fixed maturity investments and cash and cash equivalents. Our Consolidated Statements of Operations include the investment return of Ballantyne Re as investment income, and the cost of the securitization structure is reflected in collateral finance facilities expense. Funds in the securitizations are fully used for the sole purpose of the securitizations and hence are not available for general corporate purposes. See Note 5, “Investments.”

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Under the contractual terms of the Ballantyne Re indenture, Ballantyne Re is required to writeoff all or a portion of the accrued interest and principal of the Class C-1 and Class C-2 Notes if the equity balance of Ballantyne Re (determined in accordance with International Financial Reporting Standards) falls below a specified amount as of September 30 of any year. In 2007, all of the Class C-2 Notes and a portion of the Class C-1 Notes were written off. As of September 30, 2008 and 2007, such equity balance remained below the specified amount primarily due to further fair market value declines on Ballantyne Re's investment portfolio. Under the terms of the Ballantyne Re Indenture, principal and accrued interest that were written off resulted in realized gains of \$21.9 million in 2008 and \$27.1 million in 2007, comprising \$19.4 million (2007 - \$20 million) of principal, net of the associated premium and discount, and \$2.5 million (2007 - \$7.1 million) of accrued interest, on the extinguishment of third-party debt in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" ("SFAS No. 140"). As at December 31, 2008, \$nil million (2007 - \$20.7 million) of Class C-1 Notes were outstanding.

Ballantyne Re Recaptures

In 2008, continued erosion in asset values in the Ballantyne Re structure created significant and material market value declines on the assets in Ballantyne Re. A majority of these assets in Ballantyne Re supported the reserve credit taken by SRUS on excess reserve obligations in respect of the business ceded by SRUS to Ballantyne Re. To avoid significant reserve credit shortfalls at SRUS arising from depressed asset values and the corresponding need for capital calls from SRUS under its net worth maintenance agreement from SALIC, we entered into negotiations with the ING Companies and the Financial Guarantors to relieve statutory reserve credit shortfalls from the Ballantyne Re structure and avoid future uncertainty relating to asset valuations. These negotiations led to a series of incremental recaptures from Ballantyne Re, and eventually, the full assignment to SLD of SRUS's reserve credit exposure to the Ballantyne Re structure.

We entered into a binding letter of intent (the "March 31st LOI") with the ING Companies, effective March 31, 2008. Under the March 31st LOI, SLD consented to the First Quarter Recapture, as of March 31, 2008, of a prorata portion of the business that had been ceded by SRUS to Ballantyne Re (all such recaptured business pursuant to the First Quarter Recapture and subsequent recaptures, collectively, the "Recaptured Business") for the purpose of collateralizing the Regulation XXX reserves for a portion of the business acquired by us from the ING Companies at the end of 2004 (such portion related to the Ballantyne Re transaction, the "Ballantyne Business"). On May 6, 2008, we completed this transaction and recaptured approximately 29.5% of the Ballantyne Business, effective as of March 1, 2008. Immediately following the consummation of this transaction, SLD recaptured the Recaptured Business from SRUS in exchange for an amount approximately equal to the assets released to SRUS on its recapture from Ballantyne Re, and then ceded the Recaptured Business to SLDI, which ceded the Recaptured Business to SRLB. The market value of the assets transferred to the ING Companies in connection with the First Quarter Recapture was \$174.6 million and consisted of assets retained within the economic account of the Ballantyne Re trust. These assets were transferred to the ING Companies and ultimately reinsured back to us on a modified coinsurance and funds withheld basis.

As previously disclosed in our interim consolidated financial statements for the period ended June 30, 2008, we entered into a binding letter of intent with the ING Companies (the "June 30th LOI"), effective June 30, 2008, pursuant to which SLD consented to the Second Quarter Recapture by SRUS of a prorata portion of the Ballantyne Business effective as of June 30, 2008. On August 11, 2008, we effectuated this transaction and SRUS recaptured approximately 15.5% of the Ballantyne Business. Immediately following the consummation of this transaction, SLD recaptured the Recaptured Business from SRUS in exchange for an amount approximately equal to the assets released to SRUS on its recapture from Ballantyne Re, and then ceded the Recaptured Business to SLDI, which ceded the Recaptured Business to SRLB. The market value of the assets transferred to the ING Companies in connection with the Second Quarter Recapture was \$95 million and consisted of assets retained within the economic

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account of the Ballantyne Re trust. These assets were transferred to the ING Companies and ultimately reinsured back to us on a modified coinsurance and funds withheld basis.

On September 30, 2008, we entered into a binding letter of intent (the "September 30th LOI") with the ING Companies pursuant to SLD consent to the recapture by SRUS, effective as of September 30, 2008, of a prorata portion of the Ballantyne Business. On November 12, 2008, we effectuated the Third Quarter Recapture, which comprised approximately 6.5% of the Ballantyne Business. Immediately following the consummation of this transaction, SLD recaptured the Recaptured Business from SRUS in exchange for an amount equal to approximately the assets released to SRUS on its recapture from Ballantyne Re, and then ceded it to SLDI, which in turn immediately retroceded it to SRLB, which in turn immediately retroceded to SALIC. The market value of the assets transferred to the ING Companies in connection with the Third Quarter Recapture was \$41.1 million and consisted of assets retained within the economic account of the Ballantyne Re trust. These assets were transferred to the ING Companies and ultimately reinsured back to us on a modified coinsurance and funds withheld basis.

Effective December 31, 2008 the ING Companies transacted the Fourth Quarter Recapture, which recaptured on a prorata basis approximately 11.4% of the original Ballantyne Business. Immediately following the Fourth Quarter Recapture, and effective as of December 31, 2008, SLD ceded the recaptured business to SLDI, which in turn immediately retroceded it to SRLB, which in turn immediately retroceded it to SALIC. The market value of the assets transferred was \$74.4 million.

As part of each of the recaptures discussed above, SLD ceded the Recaptured Business to SLDI, which ceded the Recaptured Business to SRLB, which in turn ceded the Recaptured Business to either SRD or SALIC. SLDI agreed to provide, or cause the provision of, one or more LOCs in order to provide SLD with statutory financial statement credit for the excess reserves associated with the Recaptured Business. The assets released from Ballantyne Re in conjunction with each recapture, which resided in an account at the ING Companies for the benefit of SRLB, and in turn SRD or SALIC, as applicable and the related liabilities were ceded to us on a modified coinsurance and funds withheld basis. In conjunction with the four recaptures, the ING Companies initially provided \$843 million of LOCs, with an obligation to provide additional LOCs as needed, which is expected to reach approximately \$926 million at the peak of the XXX reserve requirements. As partial consideration for each of the recaptures, we bore the costs of the LOCs by paying to SLD a facility fee based on the face amount of such LOCs outstanding. The cost of these LOCs was consistent with pricing from our 2004 acquisition agreement with the ING Companies, as amended on May 7, 2007. Upon closing the Purchase Agreement on February 20, 2009 for the Acquired Business, Hannover Re assumed the business related to the above referenced recaptures, as well as the obligation to pay these LOC fees. See Note 20, "Subsequent Events," for further discussion related to the sale of the Acquired Business and the related assumption of the Recaptured Business.

Ballantyne Re Assignment

In order to permanently remove SRUS's future exposure to reserve credit shortfalls related to Ballantyne Re, we negotiated a transaction with the ING Companies and the Financial Guarantors to transfer SRUS's reinsurance exposure to Ballantyne Re. On November 19, 2008, with an effective date of October 1, 2008, SRUS assigned and novated to SLD the reinsurance agreement and reinsurance trust agreement between SRUS and Ballantyne Re (the "Assignment") as follows: (a) SRUS assigned its existing reinsurance agreement with Ballantyne Re (pursuant to which SRUS retroceded to Ballantyne Re the Ballantyne Business) (the "Pre-Assignment Reinsurance Agreement") to SLD and assigned its existing reinsurance trust agreement with Ballantyne Re to SLD, (b) immediately thereafter, SLD and Ballantyne Re amended and restated that reinsurance agreement (the "Post-Assignment Reinsurance Agreement"), pursuant to which SLD cedes directly to Ballantyne Re the remaining portion of the Ballantyne Business, and amended and restated that reinsurance trust agreement, pursuant to which SLD is the sole beneficiary of the reinsurance trust account maintained by Ballantyne Re, and (c) SLD and SRUS amended and restated their existing reinsurance agreement related to the Ballantyne Business to reflect these

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changes. Despite the foregoing recaptures and assignment, we have not changed our holdings in the Preferred Shares and Class D Notes in Ballantyne Re.

Following the Assignment, SRUS remained obligated to administer the Ballantyne Business consistent with its obligation to administer the business acquired from the ING Companies at the end of 2004, of which the Ballantyne Business is a part, and SRUS was obligated to provide specified administrative services to Ballantyne Re. However, the obligation to provide reinsurance administration for the Ballantyne Business and the remainder of the business acquired from the ING Companies at the end of 2004 (i.e., the Acquired Business) was transferred to Hannover Re in connection with Hannover Re's acquisition of the Acquired Business.

As part of the Assignment, we also agreed that if SLD recaptured business from Ballantyne Re following the Assignment in order to continue to receive full credit for reinsurance, SLDI is entitled to cede the Recaptured Business to us, in which case we would bear the costs of the LOCs obtained to support that business as described above. Following the sale of the Acquired Business, Hannover Re assumed these obligations, and SLDI therefore has the right to cede the Recaptured Business to Hannover Re, and Hannover Re will bear the costs of the relevant LOCs.

The Assignment does not relieve SRUS of liability for breaches of its representations, warranties, covenants or other obligations that relate to periods before the effective date of the Assignment, and we and SRUS will remain responsible for certain ongoing covenants made for the benefit of Ballantyne Re and the Financial Guarantors. In addition, SRUS has agreed to indemnify and hold harmless SLD and its affiliates for losses and damages incurred arising from the exercise by Ballantyne Re of any right, or from any limitation on the ability of SLD to exercise any right or recover any amount, under the Post-Assignment Reinsurance Agreement to the extent it resulted from, generally certain breaches by SRUS under the Pre-Assignment Reinsurance Agreement, any action or omission by SRUS that causes certain tax events for Ballantyne Re or otherwise causes Ballantyne Re to be in breach of its representations, warranties or covenants or any arbitration award against SRUS that SLD pays on its behalf to avoid termination of the Post-Assignment Reinsurance Agreement.

Reinsurance Facility

On December 22, 2005, we entered into a long-term reinsurance facility ("Reinsurance Facility") with a third-party Bermuda-domiciled reinsurer that provided up to \$1 billion of collateral support for a portion of the business acquired from the ING Companies and subject to Regulation XXX reserve requirements. The Bermuda reinsurer provided reserve credit in the form of letters of credit or assets in trust equal to the U.S. statutory reserves. As of December 31, 2008, \$1 billion (2007 – \$904.6 million) of collateral support was being provided. All of the business included in this Reinsurance Facility formed a part of the Acquired Business, and as such, was acquired by Hannover Re, effective January 1, 2009, in connection with Hannover Re's acquisition of the Acquired Business. The transfer of the Reinsurance Facility to Hannover Re was accomplished through a series of novation agreements between and among SRUS, SRD, the ING Companies and Hannover Re. The facility is not considered a variable interest entity and consequently is not consolidated in our consolidated financial statements.

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Clearwater Re

On June 25, 2007, Clearwater Re Limited (“Clearwater Re”) was incorporated under the laws of Bermuda and issued in a private offering \$365.9 million of Floating Rate Variable Funding Notes due August 11, 2037 to external investors (the “Clearwater Re Notes”). Proceeds from this offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued between January 1, 2004 and December 31, 2006 and reinsured by SRUS. Clearwater Re replaced our first collateral finance facility with HSBC, which we historically referred to as “HSBC I” and which was terminated in its entirety in connection with the creation of the Clearwater Re facility. Prior to its termination, the HSBC I facility had provided \$188.5 million of Regulation XXX reserve funding. Proceeds from the Clearwater Re Notes were deposited into a reinsurance credit trust to collateralize the statutory reserve obligations of the defined block of policies noted above. External investors committed to funding up to \$555 million of the ongoing Regulation XXX collateral requirements on this block.

Payment of interest and principal under the Clearwater Re Notes on the maturity date and following an event of default by Clearwater Re and related acceleration of the Clearwater Re Notes was guaranteed by SALIC and by SRGL. Interest on the principal amount of the Clearwater Re Notes was payable quarterly at a rate equivalent to three-month LIBOR plus a spread determined by SALIC’s insurance financial strength rating and SRGL’s senior unsecured credit rating.

In accordance with FIN 46R, Clearwater Re was considered to be a variable interest entity, and we are deemed to hold the primary beneficial interest following a quantitative analysis whereby it was determined that we would absorb a majority of the expected losses. As a result, Clearwater Re is consolidated in our financial statements. The assets of Clearwater Re have been recorded as fixed maturity investments and cash and cash equivalents. Our Consolidated Statements of Operations include the investment return of Clearwater Re as investment income and the cost of the facility is reflected in collateral finance facilities expense. Funds in the Clearwater Re facility were fully used solely for the purpose of the facility and hence were not available for general corporate purposes. See Note 5, “Investments.”

On June 30, 2008, Scottish Re executed forbearance agreements with the relevant counterparties to the Clearwater Re facility, whereby the relevant counterparty agreed to forbear taking action until December 15, 2008. In order to achieve forbearance, we agreed to certain economic and noneconomic terms, including forbearance payments to the Clearwater Re counterparties, the contribution by SALIC of additional collateral to the transactions, limitations on future fundings by the Clearwater counterparties under the facility, and the requirement to achieve certain milestones set by the counterparties related to, among other things, the sale of our Life Reinsurance North America Segment, all of which significantly increased constraints on our available capital and liquidity.

On August 29, 2008, SRUS completed a full recapture, effective as of July 1, 2008, of the business ceded from SRUS to Clearwater Re and immediately retroceded the recaptured business, also effective as of July 1, 2008, from SRUS to an unaffiliated third-party reinsurer, which in turn has retroceded to Hannover (Ireland) (collectively, the “Clearwater Re Recapture Transaction”). Effective September 30, 2008, SRUS retroceded the remaining portion of the defined block of business that it had retained at the time of the Clearwater Re transaction to the same third-party reinsurer, which in turn retroceded such business to Hannover (Ireland). In connection with the Clearwater Re Recapture Transaction, the bank counterparties to the Clearwater Re facility were repaid in full with assets from within the facility, which secured the obligations owed to the bank counterparties. Such assets resided in the excess account of the associated reinsurance trust that supported the relevant excess reserves, and in a surplus account governed by an indenture. Assets returned to SRUS in conjunction with the Clearwater Re Recapture Transaction were primarily released from the economic account of the associated reinsurance trust that supported the relevant economic reserves. We also paid a \$4 million fee to the bank-counterparties and the facility, and the related forbearance agreement and its terms were terminated. On a consolidated GAAP basis, the Clearwater Re Recapture

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Transaction and the subsequent retrocession of a related portion of business resulted in a reduction of total assets and total liabilities of approximately \$624 million and \$504 million, respectively, resulting in a GAAP pre-tax loss of \$119.5 million during the quarter ended September 30, 2008. The loss primarily composed the write-off of deferred acquisition costs of \$75.1 million and a negative ceding commission of \$39.4 million. The foregoing transactions eliminated the associated reserve credit strain in SRUS and relieved significant pressure on our liquidity.

Consolidated Collateral Finance Facilities and Securitization Structures

The following table reflects the significant balances, after elimination entries, attributable to the collateral finance facilities and securitization structures providing collateral support to the Company as at and for the year ended December 31, 2008:

(U.S. dollars in millions)	As at and for the Year Ended December 31, 2008				
	Clearwater Re	Ballantyne Re	Orkney I	HSBC II	Total
Assets					
Investments.....	\$ –	\$ 641.8	\$ 887.6	\$ –	\$ 1,529.4
Cash and cash equivalents	0.3	235.9	148.9	–	385.1
All other assets	–	7.3	117.6	–	124.9
Total assets	\$ 0.3	\$ 885.0	\$ 1,154.1	\$ –	\$ 2,039.4
Liabilities					
Reserves for future policy benefits	\$ –	\$ 241.9	\$ 306.7	\$ –	\$ 548.6
Collateral finance facilities	–	1,700.5	850.0	–	2,550.5
All other liabilities	0.2	93.2	8.4	–	101.8
Total liabilities	\$ 0.2	\$ 2,035.6	\$ 1,165.1	\$ –	\$ 3,200.9
Revenues					
Premiums earned, net	\$ 48.5	\$ 170.0	\$ 99.4	\$ –	\$ 317.9
Investment income, net.....	14.1	89.9	47.3	14.4	165.7
Net realized (losses) gains	(12.4)	(961.8)	(239.7)	33.1	(1,180.8)
Gain on extinguishment of third-party debt	–	19.4	–	–	19.4
Total revenues	\$ 50.2	\$ (682.5)	\$ (93.0)	\$ 47.5	\$ (677.8)
Expenses					
Claims and other policy benefits	\$ 42.3	\$ 59.6	\$ 90.0	\$ –	\$ 191.9
Acquisition costs and other insurance expenses, net.....	39.6	41.9	22.2	–	103.7
Operating expenses.....	0.1	0.1	0.7	–	0.9
Collateral finance facilities expense	17.7	80.2	37.9	14.5	150.3
Total benefits and expenses.....	\$ 99.7	\$ 181.8	\$ 150.8	\$ 14.5	\$ 446.8

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The following table reflects the significant balances, after elimination entries, attributable to the collateral finance facilities and securitization structures providing collateral support to the Company as at and for the year ended December 31, 2007:

(U.S. dollars in millions)	As at and for the Year Ended December 31, 2007					
	Clearwater Re	Ballantyne Re	Orkney I	HSBC I	HSBC II	Total
Assets						
Investments	\$ 381.4	\$ 1,940.0	\$ 1,158.9	\$ –	\$ 561.9	\$ 4,042.2
Cash and cash equivalents	144.2	151.9	122.4	–	21.1	439.6
All other assets	94.7	68.3	124.9	–	11.2	299.1
Total assets	\$ 620.3	\$ 2,160.2	\$ 1,406.2	\$ –	\$ 594.2	\$ 4,780.9
Liabilities						
Reserves for future policy benefits	\$ 122.8	\$ 675.6	\$ 283.1	\$ –	\$ –	\$ 1,081.5
Collateral finance facilities	365.9	1,719.9	850.0	–	595.0	3,530.8
All other liabilities	7.7	35.9	12.2	–	–	55.8
Total liabilities	\$ 496.4	\$ 2,431.4	\$ 1,145.3	\$ –	\$ 595.0	\$ 4,668.1
Revenues						
Premiums earned, net	\$ 40.1	\$ 274.0	\$ 106.0	\$ –	\$ –	\$ 420.1
Investment income, net	7.8	144.2	69.2	6.5	31.1	258.8
Net realized (losses) gains	(1.5)	(604.6)	(63.4)	–	(34.5)	(704.0)
Gain on extinguishment of third-party debt	–	20.0	–	–	–	20.0
Total revenues	\$ 46.4	\$ (166.4)	\$ 111.8	\$ 6.5	\$ (3.4)	\$ (5.1)
Expenses						
Claims and other policy benefits	\$ 31.5	\$ 209.4	\$ 92.1	\$ –	\$ –	\$ 333.0
Acquisition costs and other insurance expenses, net	11.1	66.0	26.5	–	–	103.6
Operating expenses	0.1	0.6	0.6	–	–	1.3
Collateral finance facilities expense	8.8	114.5	57.4	7.1	33.8	221.6
Total benefits and expenses	\$ 51.5	\$ 390.5	\$ 176.6	\$ 7.1	\$ 33.8	\$ 659.5

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12. Debt Obligations and Other Funding Arrangements

Long-term debt consists of:

(U.S. dollars in thousands)	December 31	
	2008	2007
Capital securities due 2032.....	\$ 17,500	\$ 17,500
Preferred trust securities due 2033.....	20,000	20,000
Trust preferred securities due 2033	10,000	10,000
Trust preferred securities due 2034	32,000	32,000
Trust preferred securities due 2034	50,000	50,000
	\$ 129,500	\$ 129,500

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”). All of the common shares of the Capital Trust are owned by SHI, our wholly owned subsidiary.

The Capital Securities mature on December 4, 2032. They are redeemable in whole or in part at any time after December 4, 2007. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 4%. At December 31, 2008 and 2007, the interest rates were 5.43% and 8.70%, respectively. The Capital Trust may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 4, 2032. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the Debentures due December 4, 2032 (as described below).

The sole assets of the Capital Trust consist of \$18 million principal amount of Floating Rate Debentures (the “Debentures”) issued by SHI. The Debentures mature on December 4, 2032, and interest is payable quarterly at a rate equivalent to three-month LIBOR plus 4%. At December 31, 2008 and 2007, the interest rates were 5.43% and 8.70%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 4, 2032. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the Debentures at any time after December 4, 2007 and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI’s obligations under the Debentures and distributions and other payments due on the Capital Securities.

Preferred Trust Securities Due 2033

On October 29, 2003, Scottish Holdings, Inc. Statutory Trust II, a Connecticut statutory business trust (“Capital Trust II”) issued and sold in a private offering an aggregate of \$20 million Preferred Trust Securities (the “Preferred Trust Securities”). All of the common shares of Capital Trust II are owned by SHI.

Scottish Annuity & Life Insurance Company (Cayman) Ltd.
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The Preferred Trust Securities mature on October 29, 2033. They are redeemable in whole or in part at any time after October 29, 2008. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.95%. At December 31, 2008 and 2007, the interest rates were 5.38% and 8.65%, respectively. Prior to October 29, 2008, interest cannot exceed 12.45%. Capital Trust II may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than October 29, 2033. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the 2033 Floating Rate Debentures due October 29, 2033 (as described below).

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. The 2033 Floating Rate Debentures mature on October 29, 2033, and interest is payable quarterly at three-month LIBOR plus 3.95%. At December 31, 2008 and 2007, the interest rates were 5.38% and 8.65%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than October 29, 2033. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the 2033 Floating Rate Debentures at any time after October 29, 2008 and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI’s obligations under the 2033 Floating Rate Debentures and distributions and other payments due on the Preferred Trust Securities.

Trust Preferred Securities Due 2033

On November 14, 2003, GPIC Holdings Inc. Statutory Trust, a Delaware statutory business trust (“GPIC Trust”) issued and sold in a private offering an aggregate of \$10 million Trust Preferred Securities (the “2033 Trust Preferred Securities”). All of the common shares of GPIC Trust are owned by SHI.

The 2033 Trust Preferred Securities mature on September 30, 2033. They are redeemable in whole or in part at any time after September 30, 2008. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.90%. At December 31, 2008 and 2007, the interest rates were 5.33% and 8.60%, respectively. GPIC Trust may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than September 30, 2033. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the Junior Subordinated Notes due September 30, 2033 (as described below).

The sole assets of GPIC Trust consist of \$10.3 million principal amount of Junior Subordinated Notes (the “Junior Subordinated Notes”) issued by SHI. The Junior Subordinated Notes mature on September 30, 2033, and interest is payable quarterly at three-month LIBOR plus 3.90%. At December 31, 2008 and 2007, the interest rates were 5.33% and 8.60%, respectively. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than September 30, 2033. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the Junior Subordinated Notes at any time after September 30, 2008 and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI’s obligations under the Junior Subordinated Notes and distributions and other payments due on the trust preferred securities.

Trust Preferred Securities Due 2034

On May 12, 2004, Scottish Holdings, Inc. Statutory Trust III, a Connecticut statutory business trust (“Capital Trust III”) issued and sold in a private offering an aggregate of \$32 million Trust Preferred Securities (the “2034 Trust Preferred Securities”). All of the common shares of Capital Trust III are owned by SHI.

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The 2034 Trust Preferred Securities mature on June 17, 2034. They are redeemable in whole or in part at any time after June 17, 2009. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.80%. At December 31, 2008 and 2007, the interest rate was 5.23% and 8.50%, respectively. Prior to June 17, 2009, interest cannot exceed 12.50%. Capital Trust III may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than June 17, 2034. Any deferred payments would accrue interest quarterly on a compounded basis if SHI defers interest on the 2034 Floating Rate Debentures due June 17, 2034 (as described below).

The sole assets of Capital Trust III consist of \$33 million principal amount of Floating Rate Debentures (the "2034 Floating Rate Debentures") issued by SHI. The 2034 Floating Rate Debentures mature on June 17, 2034, and interest is payable quarterly at three-month LIBOR plus 3.80%. At December 31, 2008 and 2007, the interest rate was 5.23% and 8.50%, respectively. Prior to June 17, 2009, interest cannot exceed 12.50%. SHI may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than June 17, 2034. Any deferred payments would accrue interest quarterly on a compounded basis. SHI may redeem the 2034 Floating Rate Debentures at any time after June 17, 2009 and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SHI's obligations under the 2034 Floating Rate Debentures and distributions and other payments due on the 2034 Trust Preferred Securities.

Trust Preferred Securities Due 2034

On December 18, 2004, SFL Statutory Trust I, a Delaware statutory business trust ("SFL Trust I") issued and sold in a private offering an aggregate of \$50 million Trust Preferred Securities (the "December 2034 Trust Preferred Securities"). All of the common shares of SFL Trust I are owned by Scottish Financial (Luxembourg) S.a.r.l ("SFL").

The December 2034 Trust Preferred Securities mature on December 15, 2034. They are redeemable in whole or in part at any time after December 15, 2009. Interest is payable quarterly at a rate equivalent to three-month LIBOR plus 3.50%. At December 31, 2008, and 2007, the interest rate was 4.93% and 8.20%, respectively. Prior to December 15, 2009, interest cannot exceed 12.50%. SFL Trust I may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 15, 2034. Any deferred payments would accrue interest quarterly on a compounded basis if SFL defers interest on the 2034 Floating Rate Debentures due December 15, 2034 (as described below).

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. The December 2034 Floating Rate Debentures mature on December 15, 2034, and interest is payable quarterly at three-month LIBOR plus 3.50%. At December 31, 2008 and 2007, the interest rate was 4.93% and 8.20%, respectively. Prior to December 15, 2009, interest cannot exceed 12.50%. SFL may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than December 15, 2034. Any deferred payments would accrue interest quarterly on a compounded basis. SFL may redeem the December 2034 Floating Rate Debentures at any time after December 15, 2009 and in the event of certain changes in tax or investment company law.

SALIC has guaranteed SFL's obligations under the December 2034 Floating Rate Debentures and distributions and other payments due on the December 2034 Trust Preferred Securities.

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Other Funding Agreements

Stingray Drawdown

On January 12, 2005, we entered into the Stingray put agreement for an aggregate value of \$325 million. Under the terms of the put agreement, we acquired an irrevocable put option to issue funding agreements to Stingray in return for the assets in a portfolio of 30-day commercial paper.

In accordance with FIN 46R, we are not considered to be the primary beneficiary and, as a result, we are not required to consolidate Stingray. We are not responsible for any losses incurred by the Stingray Pass Through Trust. Any funds drawn down on the facility are included in interest-sensitive contract liabilities on our Consolidated Balance Sheets.

Since April 14, 2008, this facility has been fully utilized, and \$325.0 million of funding agreements have been issued to Stingray and remain outstanding as of December 31, 2008.

Premium Asset Trust Series 2004-4

On March 12, 2004, we entered into an unsecured funding agreement with the Premium Asset Trust for an aggregate of \$100 million (the "PATS"). The funding agreement had a stated maturity of March 12, 2009 and accrued interest at a rate of three-month LIBOR plus 0.922%, payable on a quarterly basis. The amount due under this funding agreement is included under interest-sensitive contract liabilities on the Consolidated Balance Sheets. As at December 31, 2008 and 2007, \$100 million was outstanding under this facility. See Note 20 "Subsequent Events".

The funding agreements are included in interest-sensitive contract liabilities in the accompanying Consolidated Balance Sheets.

Credit Facilities

On July 14, 2005, SALIC, SRD, SRUS and Scottish Re Limited ("SRL") entered into a \$200 million, three-year revolving unsecured senior credit facility with a syndicate of banks to provide capacity for borrowing and extending letters of credit. All outstanding letters of credit under this facility were canceled, and the facility was terminated effective January 19, 2007.

On November 30, 2006, SALIC and SRL entered into a one-year, \$5 million letter of credit facility with a single bank on a fully secured basis. This facility was amended on October 31, 2007 to a term of two years and to a limit of \$15 million. Outstanding letters of credit for SALIC at December 31, 2008 were \$75,000.

On March 9, 2007, SALIC entered into a \$100 million unsecured term loan facility with Ableco Finance LLC and Massachusetts Mutual Life Insurance Company, both of which are related parties to Cerberus and MassMutual Financial Group, respectively. This facility was terminated on May 7, 2007, in conjunction with the \$600 million equity investment by Cerberus and MassMutual Capital (each as defined below). The facility was not drawn down or utilized over the period it was in place.

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December 31, 2008

13. Shareholder's Equity

Ordinary Shares

We are authorized to issue 20,000,000 ordinary shares of par value \$1.00 each. As at December 31, 2008 and 2007, there were 20,000,000 ordinary shares outstanding. During the year ended December 31, 2008, SRGL did not contribute any capital to the Company. During the year ended December 31, 2007, SRGL contributed capital of \$457.8 million to the Company.

14. Reinsurance

Premiums earned are analyzed as follows for the year ended:

(U.S. dollars in thousands)	December 31	
	2008	2007
Premiums assumed	\$ 2,049,408	\$ 2,131,585
Premiums ceded.....	(452,591)	(414,892)
Premiums earned, net	\$ 1,596,817	\$ 1,716,693

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. Recapture of business previously ceded does not affect premiums ceded prior to the recapture of such business, but would reduce premiums, claims and commissions in subsequent periods.

Claims and other policy benefits are net of reinsurance recoveries of \$417.8 million and \$283.2 million during the years ended December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, there were no reinsurance ceded receivables associated with a single reinsurer with a carrying value in excess of 1% of total assets.

15. Employee Benefit Plans

401(k) Plan

SHI sponsors a 401(k) plan in the U.S. in which employee contributions on a pre-tax basis are supplemented by matching contributions. These contributions are invested, at the election of the employee, in one or more investment portfolios. Expenses for the 401(k) plan amounted to \$1.3 million and \$2.3 million in the years ended December 31, 2008 and 2007, respectively.

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16. Income Taxes

For the years ended December 31, 2008 and 2007, we have income tax (benefit) expense from continuing operations, by jurisdiction, as follows:

(U.S. dollars in thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007
Current tax (benefit) expense:		
U.S.	\$ -	\$ 5,441
Ireland.....	-	(3,538)
Other non-U.S.	32	5,971
Total current tax expense	<u>32</u>	<u>7,874</u>
Deferred tax (benefit) expense:		
U.S.	(9,957)	(168,621)
Ireland.....	(3,107)	3,936
Other non-U.S.	2,895	97
Total deferred tax benefit.....	<u>(10,169)</u>	<u>(164,588)</u>
Total worldwide tax benefit	<u>\$ (10,137)</u>	<u>\$ (156,714)</u>

The weighted-average expected tax provision has been calculated using the pre-tax accounting income (loss) in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. Reconciliation of the difference between the provision for income taxes and the expected tax provision at the weighted-average tax rate for the years December 31, 2008 and 2007 is provided below:

(U.S. dollars in thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007
Pre-tax loss	\$ (2,469,955)	\$ (919,228)
Expected tax provision at weighted-average rate	(559,126)	(178,222)
Change in valuation allowance	566,109	36,918
Intercompany note cancellation.....	(6,154)	(48,846)
Other and state taxes.....	(10,966)	33,436
Total tax benefit.....	<u>\$ (10,137)</u>	<u>\$ (156,714)</u>

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We are not subject to income taxation other than as stated above. There can be no assurance that there will not be changes in applicable laws, regulations or treaties, which might require us to change the way we operate or become subject to taxes. At December 31, 2008 and 2007, 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	Irish Operating Company	Irish Special Purpose Vehicle	Total
Operating loss carryforwards available at December 31, 2007	\$ 218,992	\$ 151,551	\$ 733,636	\$ 1,104,179
Operating losses accrued during 2008	151,651	281,924	762,503	1,196,078
Operating loss carry forwards available at December 31, 2008	<u>\$ 370,643</u>	<u>\$ 433,475</u>	<u>\$ 1,496,139</u>	<u>\$ 2,300,257</u>
Deferred tax asset for operating losses, before valuation allowance, at December 31, 2008	<u>\$ 126,893</u>	<u>\$ 54,185</u>	<u>\$ 374,034</u>	<u>\$ 555,112</u>

The operating loss carryforwards in our U.S. entities will expire, if not utilized, in years 2020 through 2028. The operating loss carryforwards in our Irish entities benefit from an unlimited carryforward period. These net operating loss carryforwards resulted primarily from current operations of SRUS, SRLC, SHI, SRD, Orkney Re and Ballantyne Re.

At December 31, 2008, we had an alternative minimum tax carryforward of approximately \$8.6 million. There are no foreign tax credit carryforwards.

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During 2008, the Company did not incur or record any applicable deferred tax expense attributable to the undistributed earnings of its subsidiaries. As such, at December 31, 2008 Scottish Re has provided for all deferred taxes, if any, related to all the undistributed earnings of its subsidiaries. Our U.S. subsidiaries are subject to federal, state and local corporate income taxes and other taxes applicable to U.S. corporations. Upon distribution of current or accumulated earnings and profits in the form of dividends or otherwise from our U.S. subsidiaries to us, we would be subject to U.S. withholding taxes at a 30% rate. Significant components of our deferred tax assets and liabilities as of December 31, 2008 and 2007, all of which arise outside of our home country, were as follows:

(U.S. dollars in thousands)	December 31, 2008	December 31, 2007
Deferred tax asset		
Net operating losses.....	\$ 555,112	\$ 277,212
Reserves for future policy benefits.....	80,026	-
Unrealized depreciation on investments/other than temporary impairments....	153,938	26,968
Intangible assets.....	5,205	6,137
Alternative minimum tax credit.....	8,580	7,883
Capital loss carryforwards.....	1,733	11,009
Collateral finance facilities costs.....	7,993	932
Other.....	4,755	9,117
Total deferred tax asset.....	<u>817,342</u>	<u>339,258</u>
Deferred tax liability		
Deferred acquisition costs.....	(62,492)	(77,780)
Unrealized depreciation on investments.....	-	(5,413)
Reserves for future policy benefits.....	-	(64,868)
Present value of in-force.....	(13,636)	(14,232)
Other.....	(1,419)	(1,341)
Total deferred tax liability.....	<u>(77,547)</u>	<u>(163,634)</u>
Net deferred tax asset before valuation allowance.....	739,795	175,624
Valuation allowance.....	(736,094)	(169,985)
Total deferred tax asset.....	<u>\$ 3,701</u>	<u>\$ 5,639</u>

Certain errors in the 2007 deferred inventory balances were identified and corrected to conform with the 2008 presentation. These corrections were a result of an analysis of the Company's GAAP to tax differences. The corrections had no impact on the Company's net loss and shareholder's equity as of December 31, 2007.

At December 31, 2007, we had a valuation allowance of \$170.0 million established against our deferred tax assets. 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. Our valuation allowance increased by approximately \$566.1 million during the year ended December 31, 2008 to \$736.1 million, primarily due to the losses generated in the U.S. and Irish entities for which no current period benefit is being recognized.

We have maintained a full valuation allowance against any remaining deferred tax asset in the United States and Ireland, given our inability to rely on future taxable income tax projections.

Section 382 Event

The investments made by MassMutual Capital and Cerberus on May 7, 2007 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. As a result of this limitation, we wrote off

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\$142.6 million in 2007 of net operating losses that we will be unable to utilize prior to expiration with respect to our U.S. entities. Because we had previously established a valuation allowance against these net operating losses, there is not a significant tax expense associated with Section 382 limitations.

FIN 48

As a result of the implementation of FIN 48, we recorded a net decrease to our beginning retained earnings of \$18.0 million reflecting the establishment of a FIN 48 liability of \$75.3 million (excluding previously recognized liabilities of \$6.5 million and including interest and penalties of \$8.9 million) offset by a \$57.3 million reduction of our existing valuation allowance. We had total unrecognized tax benefits (excluding interest and penalties) of \$72.6 million at January 1, 2007, the recognition of which would result in a \$15.3 million benefit.

At December 31, 2007, we had total unrecognized tax benefits (excluding interest and penalties) of \$187.1 million, the recognition of which would result in a \$17.1 million benefit. At December 31, 2008, we had total unrecognized tax benefits (excluding interest and penalties) of \$166.0 million, the recognition of which would result in a \$15.0 million benefit to the effective tax rate. The statute of limitations expired for the 2004 U.S. federal income tax year, which resulted in a reduction of our unrecognized tax benefits in the amount of \$21.9 million.

The following is a rollforward of our FIN 48 unrecognized tax benefits from January 1, 2007 to December 31, 2008:

(U.S. dollars in thousands)	December 31, 2008	December 31, 2007
Total unrecognized tax benefits at beginning of year	\$ 187,142	\$ 72,625
Gross amount of decreases for prior year's tax position.....	(1,882)	-
Gross amount of increases for current year's tax position.....	2,646	114,705
Amount of decreases related to settlements.....	-	(165)
Reductions due to lapse of statutes of limitation	(21,945)	(59)
Foreign exchange and acquisitions	-	36
Total unrecognized tax benefits at end of year	<u>165,961</u>	<u>187,142</u>
Unrecognized tax benefits that, if recognized, would favorably impact the effective tax rate	<u>\$ 15,016</u>	<u>\$ 17,075</u>

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

(U.S. dollars in thousands)	December 31, 2008	December 31, 2007
Total interest & penalties in the Balance Sheet at beginning of year	\$ 13,281	\$ 9,238
Total interest and penalties in the Statement of Operations	2,514	4,043
Total interest & penalties in the Balance Sheet at end of year ..	<u>\$ 15,795</u>	<u>\$ 13,281</u>

It is reasonably possible that significant changes in the gross balance of unrecognized tax benefits may occur in the next 12 months due to tax years closing because the statutes of limitations have expired. The unrecognized tax benefits are expected to decrease by \$15.4 million in 2009.

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We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of December 31, 2008, we remained subject to examination in the following major tax jurisdictions for the years indicated below:

<u>Major Tax Jurisdictions</u>	<u>Open Years</u>
U.S.	
Life Group	2005 through 2008
Non-Life Group	2005 through 2008
Ireland	2004 through 2008

17. Commitments and Contingencies

Lease Commitments

We lease office space in the countries in which we conduct business under operating leases that expire at various dates through 2023. Total rent expense with respect to these operating leases for the years ended December 31, 2008 and 2007 was approximately \$2.4 million and \$2.7 million, respectively.

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

<u>(U.S. dollars in thousands)</u>	<u>Year Ending December 31</u>
2009	\$ 1,814
2010	1,569
2011	1,778
2012	1,831
2013	1,886
Thereafter	6,005
Total future lease commitments	<u>\$ 14,883</u>

Concentrations of Credit Risk

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

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

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We have significant exposure to the residential mortgage market in the United States due to our concentration of sub-prime and Alt-A mortgage-backed securities held in our investment portfolio. The slowing U.S. housing market, greater use of affordable mortgage products, and relaxed underwriting standards for some originators of sub-prime loans has led to higher delinquency and loss rates, especially for those issued during 2007 and 2008. These factors have caused a decrease in market liquidity and repricing of risk, which has led to estimated fair value declines from December 31, 2007 to December 31, 2008. We expect delinquency and loss rates in the sub-prime mortgage sector to continue to increase in the future. Tranches of securities will experience losses according to the seniority of the claim on the collateral, with the least senior (or most junior), typically the unrated residual tranche, taking the initial loss. The credit ratings of the securities reflect the seniority of the securities that we own. As sub-prime and Alt-A loan performance has deteriorated, the market has become increasingly illiquid and unbalanced, with an absence of buyers, causing market prices to decrease and a decline in the estimated fair value of our bonds below their amortized cost. We have recognized substantial amounts of realized losses due to other-than-temporary impairments on our sub-prime portfolio and further declines in fair values of these securities will adversely affect our financial condition. Refer to Note 20, "Subsequent Events," for details of fair value declines subsequent to December 31, 2008.

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.

Parent Company Contingencies

Class Action and Shareholder Derivative Lawsuits

On August 2, 2006, a putative class action lawsuit was filed against SRGL and certain of its current and former officers and directors in the U.S. District Court for the Southern District of New York on behalf of a putative class consisting of investors who purchased SRGL's publicly traded securities between December 16, 2005 and July 28, 2006. Between August 7, 2006 and October 3, 2006, seven additional related class action lawsuits were filed against SRGL, certain of its current and former officers and directors, and certain third parties. Two of the complaints were filed on August 7, 2006, and the remaining five complaints were filed on August 14, 2006, August 22, 2006, August 23, 2006, September 15, 2006, and October 3, 2006, respectively.

Each of the class actions filed sought an unspecified amount of damages, as well as other forms of relief. On October 12, 2006, all of the class actions were consolidated. On December 4, 2006, a consolidated class action complaint was filed.

The complaint named SRGL; Dean E. Miller, its former Chief Financial Officer; Scott E. Willkomm, its former Chief Executive Officer; Elizabeth Murphy, its former Chief Financial Officer; SRGL's former Board members Michael Austin, Bill Caulfeild-Browne, Robert Chmely, Michael French, Lord Norman Lamont, Hazel O'Leary, and Glenn Schafer; and certain third parties, including Goldman Sachs and Bear Stearns in their capacities as underwriters in various securities offerings by SRGL and Ernst & Young LLP in its capacity as independent registered public accounting firm. The complaint was brought on behalf of a putative class consisting of investors who purchased SRGL's securities between February 17, 2005 and July 31, 2006. The complaint alleged violations of Sections 10(b) and 20(a) of the Exchange Act, Rule 10b-5, and Sections 11, 12(a) (2), and 15 of the Securities Act. The complaint sought an unspecified amount of damages, as well as other forms of relief. On March 7, 2007, SRGL filed a motion to dismiss the putative class action lawsuit. On November 2, 2007, the court dismissed the

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Section 10(b) and Rule 10b-5 claims against Ernst & Young LLP, but gave the plaintiffs leave to amend. The court denied the motions to dismiss brought by the other named defendants. In May, 2008, the parties held an initial mediation at which no settlement was reached. On June 16, 2008, all claims brought in the action against Glenn Schafer were dismissed without prejudice. Also on June 16, 2008, the plaintiffs filed a motion for leave to file an amended complaint. On July 11, 2008, the plaintiffs filed an amended complaint in which they sought to expand the class period, renew Section 10(b) and Rule 10b-5 allegations against Ernst & Young LLP, and assert additional factual allegations. On July 18, 2008, Ernst & Young LLP moved to dismiss the replied Section 10(b) claim against it, as well as the proposed expanded class period and, on July 23, 2008, SRGL and the third-party underwriter defendants each filed motions to dismiss that portion of the amended complaint seeking to expand the class period. On July 30, 2008, the parties held a second mediation. On August 1, 2008, SRGL and its former officers and directors named in the complaint reached agreement in principle with the plaintiffs to settle the lawsuit and, on September 8, 2008, the court entered an order preliminarily approving the proposed settlement. In connection with the settlement, which formally was approved by the court on December 11, 2008, SRGL contributed \$31 million, of which \$5.75 million was paid by SRGL on October 7, 2008, and the additional \$25.25 million was paid by SRGL's insurance carriers.

In addition, on or about October 20, 2006, a shareholder derivative lawsuit was filed against certain of SRGL's current and former directors in the U.S. District Court for the Southern District of New York. The derivative lawsuit alleged, among other things, that defendants improperly permitted SRGL to make false and misleading statements to investors concerning SRGL's business and operations, thereby exposing SRGL to liability from class action suits alleging violations of the U.S. securities laws. The derivative lawsuit asserted claims against the defendants for breach of fiduciary duty, abuse of control, gross mismanagement, constructive fraud, and unjust enrichment. On January 8, 2007, SRGL filed a motion to dismiss the derivative lawsuit. On May 7, 2007, the motion was granted and the lawsuit was dismissed without prejudice. The plaintiff declined to submit an amended complaint and, on May 30, 2007, the court dismissed the case with prejudice.

Indemnification

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

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

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

Pursuant to the Agreement with MassMutual Capital and Cerberus, we made certain representations and warranties regarding the statutory financial statements of each of our insurance subsidiaries, including SRD and SRUS, for the years ended 2003, 2004 and 2005 and, with respect to SRUS but not SRD, the first three quarters of 2006, including that these statements were prepared in conformity with applicable statutory accounting practices and fairly present in accordance with such practices, in all material respects, the statutory financial condition of the relevant insurance subsidiary at the respective dates. In light of our discovery of the corrections described above, we

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have notified MassMutual Capital and Cerberus, as required by the terms of the Agreement, of the overstatement of statutory surplus in SRD at year-end 2004 and the understatement of such statutory surplus at year-end 2005, resulting in a cumulative overstatement for the two-year period at year-end 2005 of approximately \$70 million on an after-tax basis, and the understatement of statutory surplus in SRUS for the year ended 2005 of approximately \$14.5 million on an after-tax basis. On November 16, 2007, MassMutual Capital and Cerberus responded by notifying us of their concern that the corrections described above may constitute breaches of certain of the representations and warranties made by us in the Agreement. Under the Agreement, in the event of a claim for losses resulting from a diminution in value, such losses would be determined by an independent investment banking firm of national reputation, agreed upon by us and MassMutual Capital and Cerberus, based on changes in the valuation of SRGL using the assumptions and models used by MassMutual Capital and Cerberus at the time of their decision to invest in us. Furthermore, should any claim for indemnification be made by MassMutual Capital and Cerberus, the Agreement provides that any decision regarding defending or settling such claim will be taken by a committee of independent directors of SRGL's Board. In their November 16, 2007 correspondence, MassMutual Capital and Cerberus requested that we convene a committee of independent directors. No action has since been taken by us or the investors in respect of this claim. At this time, we do not know what the amount of any indemnifiable losses would be, if any, or what potential defenses or other limitations on indemnification may be available to us under those circumstances. The Agreement provides that any indemnification claim would be satisfied by adjusting the conversion amount at which the Convertible Cumulative Participating Preferred Shares issued to MassMutual Capital and Cerberus are convertible into SRGL's Ordinary Shares.

18. Statutory Requirements and Dividend Restrictions

Statutory Requirements for Non-U.S. Subsidiaries

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

Our Bermuda insurance companies are required to maintain a minimum capital of \$0.25 million. There are no statutory restrictions on the payment of dividends from retained earnings by any of the Bermuda subsidiaries, as the minimum statutory capital and surplus requirements are satisfied by the share capital and additional paid-in capital of each of the Bermuda subsidiaries.

Under The Insurance Law of the Cayman Islands, SALIC must maintain a minimum net capital worth of \$0.24 million. There are no statutory restrictions on the payment of dividends from retained earnings by any of the Cayman subsidiaries, as the minimum statutory capital and surplus requirements are satisfied by the share capital and additional paid-in capital of each of the Cayman subsidiaries.

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SRD is required by the Irish Financial Services Regulatory Authority (“IFSRA”) to maintain a minimum level of paid-up share capital. IFRSA has put certain restrictions in place on the ability of SRD to make dividend payments from profits available for distribution within the meaning of the Companies (Amendment) Act, 1983. On July 15, 2006, Statutory Instrument 380 of 2006 transposed into Irish law European Union Council Directive 2005/68/EC. The Directive establishes a regulatory regime for reinsurance organizations and defines minimum requirements for certain liabilities, assets backing these liabilities and surplus. As at December 31, 2008, SRD had surplus of 48% of liabilities, with a majority of our reinsurance operations novated to SALIC, as discussed below, effective October 1, 2008.

Due to market value degradation and its impact on SRD’s regulatory solvency, the Company effectuated a transfer of a majority of its business in SRD to SALIC, effective October 1, 2008. SALIC, in return received modified coinsurance assets with respect to ING Business originally ceded to SRD and the residual interests in reserve credit trust assets with respect to business originally ceded from SRUS to SRD (such trust assets remain in trust for the benefit of, and to support the business now ceded to SALIC by, SRUS). SALIC is a party to a net worth maintenance agreement with SRD, pursuant to which SALIC effectively guarantees SRD’s regulatory solvency. In the fourth quarter of 2008, the Irish insurance regulator notified the Company that corrective action needed to be taken with respect to SRD’s solvency calculations. Absent this transfer, SALIC’s obligations under such net worth maintenance agreement would have been triggered, and the Company likely would have needed to seek bankruptcy protection. A significant portion of the business transferred from SRD to SALIC is included in the Acquired Block sold to the Buyers. Following the closing of transactions contemplated by the Purchase Agreement with Hannover Re, SRD no longer reinsures any insurance or reinsurance liabilities either from third parties or its affiliates. Consequently, there can be no assurances that SRD will retain its license in the future. In such an event, the operating loss carryforwards for SRD disclosed in Note 16, “Income Taxes,” may be lost.

Statutory Requirements for U.S. Subsidiaries

Our U.S. subsidiaries file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by insurance regulators. Except as otherwise noted in the statutory financial statements of SRUS, the state of Delaware adheres to NAIC risk-based capital (“RBC”) requirements for Delaware-domiciled life and health insurance companies. As of December 31, 2008 and 2007, SRUS, SRLC and Orkney Re exceeded all minimum RBC requirements on a Delaware basis. The maximum amount of dividends that can be paid by SRUS, SRLC and Orkney Re (Delaware-domiciled insurance companies) without prior approval of the Insurance Commissioner is subject to restrictions relating to statutory surplus and operating earnings. The maximum dividend payment that may be made without prior approval is limited to the greater of the net gain from operations for the preceding year or 10% of statutory surplus as of December 31 of the preceding year not exceeding earned surplus. The applicable statutory provisions only permit an insurer to pay a shareholder dividend from unassigned surplus. SRUS, SRLC and Orkney Re cannot pay dividends in 2009 without prior approval of the Insurance Commissioner.

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The following table presents, for each of our U.S. reinsurance subsidiaries, the statutory capital and surplus as of December 31, 2008 and 2007, and the statutory net earned income (loss) for the years ended December 31, 2008 and 2007. The amounts shown in the table are those reflected in each company's most recent statutory financial statement filings with insurance regulators.

(U.S. dollars in thousands)	Statutory Capital & Surplus		Statutory Net Earned Income (Loss)	
	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007
Scottish Re (U.S.), Inc.	\$ 197,366	\$ 232,301	\$ (114,767)	\$ (380,864)
Scottish Re Life Corporation.....	\$ 66,445	\$ 93,186	\$ (19,421)	\$ 7,396
Orkney Re, Inc.	\$ 727,890	\$ 844,994	\$ (185,630)	\$ (55,286)

The Company action level risk-based capital percentage at December 31, 2008 as filed with regulators on March 1, 2009 for SRUS, SRLC and Orkney Re was 206%, 237%, and 1,665%, respectively. Subsequent to the 2008 U.S. statutory filings, the Company identified certain SRUS and SRLC intercompany balances as not being timely settled at December 31, 2008. As a result, these intercompany balances are nonadmitted assets for statutory accounting purposes. The impact of nonadmitting these intercompany balances reduces the Company action level risk-based capital percentages for SRUS and SRLC by 32% and 25%, respectively. Such intercompany balances have been or will be subsequently settled in the first half of 2009. The 2008 U.S. statutory filings are subject to audit and consequently may be subject to further negative or positive adjustments.

All other regulated insurance entities are in excess of their minimum regulatory capital requirements as of December 31, 2008.

During the year ended December 31, 2007, we redomesticated Orkney Re from South Carolina to Delaware. The statutory financial statements of Orkney Re are now presented on the basis of accounting practices prescribed or permitted by the Delaware Department of Insurance (the "Department"). The Department recognizes only statutory accounting practices prescribed or permitted by the state of Delaware for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under Delaware Insurance Law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures ("AP&P") Manual has been adopted as a component of prescribed or permitted practices by the state of Delaware. Orkney Re establishes and maintains its reserves in accordance with U.S. GAAP as permitted by the Department rather than the statutory reserves prescribed by the NAIC AP&P Manual. Orkney Re's risk-based capital as of December 31, 2007 would not have triggered a regulatory event had it not used the permitted practice. Orkney Re's RBC as of December 31, 2008 would have triggered a regulatory event had it not been permitted to use GAAP reserves instead of maintaining statutory reserves as prescribed by the NAIC AP&P Manual.

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A reconciliation of Orkney Re's statutory balances as of December 31, 2008 and 2007 is as follows:

	December 31, 2008	
(U.S. dollars in thousands)	Statutory Net Earned Income (Loss)	Statutory Capital & Surplus
Financial statements – Delaware basis.....	\$ (185,630)	\$ 727,890
Permitted valuation basis adjustment.....	(81,903)	(832,957)
Financial statements – NAIC basis	\$ (267,533)	\$ (105,067)

	December 31, 2007	
(U.S. dollars in thousands)	Statutory Net Earned Income (Loss)	Statutory Capital & Surplus
Financial statements – Delaware basis.....	\$ (55,286)	\$ 844,994
Permitted valuation basis adjustment.....	(36,620)	(751,054)
Financial statements – NAIC basis	\$ (91,906)	\$ 93,940

The fair value of the securities in our qualifying reserve credit trust accounts has declined significantly due to the continued market value degradation in the U.S. capital markets. As a result of this decline, and even after giving effect to several of the transactions noted above, at the end of the third quarter 2008, absent a statutory accounting permitted practice, SRUS estimated there would be a shortfall in reserve credit. This shortfall in reserve credit would have placed significant financial stress upon the statutory capital position of SRUS and, in turn, the solvency of SALIC and SRGL because of obligations under certain net worth maintenance agreements in which SALIC pledged to maintain minimum capital and surplus levels of SRUS. As a result, SRUS requested and received approval from the Department for a permitted practice (the "Permitted Practice") with effect beginning as of September 30, 2008 related to SRUS' ongoing ability to take reserve credit for reinsurance ceded to Orkney Re I and Orkney Re II securitizations as well as the reinsurance currently ceded to SALIC. The Permitted Practice relieved SRUS of the need to receive, and SALIC of the corresponding obligation to fund, additional capital contributions. The value of this Permitted Practice may increase over time generally as a result of increases in statutory reserves or decreases in market values. In connection with the Permitted Practice, SALIC agreed to contribute to SRUS \$30.3 million in capital prior to SRUS filing its third quarter 2008 financial statements and an additional \$7 million prior to SRUS filing its fourth quarter 2008 financial statements.

In approving the Permitted Practice, the Company and the Department agreed to the formal supervision of SRUS towards the end of 2008, and that such supervision would likely continue for as long as the Permitted Practice remained in place. Subsequently, on January 5, 2009, the Department issued an order of supervision (the "Order of Supervision") against SRUS, in accordance with 18 Del. C. §5942. The Order of Supervision, which pursuant to Delaware law was scheduled to expire on April 5, 2009, was amended and replaced with a Continued and Amended Order of Supervision, dated April 3, 2009 (the "Amended Order"). Pursuant to the Amended Order, the Company generally must receive prior written consent from the Department in order to engage in any transaction outside of the ordinary course of business; make certain payments or incur certain debts, obligations or liabilities in any transaction of \$1,000,000 or greater (provided that this limitation generally does not apply to the payment of claims, premiums and other third-party reinsurance settlements, in each case of less than \$10 million per payment); engage in new business; lend any of its funds; invest any of its funds in a manner that deviates from the plan filed with the Department; commute, novate, amend or otherwise change any existing reinsurance contract or treaty; or engage in any transaction with any related party. Many of these processes already were informally in place between SRUS and the Department during much of 2008.

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On February 17, 2009, citing, among other things, the current economic conditions and the uncertainty of the conditions that lay ahead, the Insurance Commissioner issued an emergency order amending Delaware Insurance Regulation §1215 relating to Recognition of Preferred Mortality Tables for use in Determining Minimum Reserve Liabilities (the “Preferred Mortality Table Emergency Regulation”) and an emergency order amending Delaware Insurance Regulation §1212 relating to Valuation of Life Insurance Policies (the “X-Factor Emergency Regulation”) and, together with the Preferred Mortality Table Regulation, the “Emergency Regulations”). Generally, the Preferred Mortality Table Emergency Regulation allows, upon receipt of the Commissioner’s approval, use of the 2001 CSO Preferred Class Structure Mortality Table as the minimum valuation standard for policies issued after January 1, 2004. In connection with this requirement, SRUS sought and on February 26, 2009, obtained the Department’s approval for use of the 2001 CSO Preferred Class Structure Mortality Table in accordance with the Preferred Mortality Table Emergency Regulation. The X-Factor Emergency Regulation relaxes existing constraints related to the X-factor assumptions used in the calculation of statutory reserves. The Emergency Regulations by their terms are effective for valuations on and after December 31, 2008. As at December 31, 2008, the effect of the Emergency Regulations on SRUS’s capital and surplus was a positive \$190 million. Accordingly, in the absence of the Emergency Regulations, SRUS’s risk-based capital as of December 31, 2008 may have resulted in further regulatory action against SRUS. As provided in each of the emergency orders, the Insurance Commissioner exposed each of the Emergency Regulations for public comment, which comment periods expired on April 6, 2009. Each emergency order pursuant to which the respective Emergency Regulation was promulgated remains effective until September 1, 2009, or until the applicable Emergency Regulation is adopted pursuant to the Delaware Administrative Procedures Act. In the event one, or both, of the Emergency Regulations expires without being adopted, and absent any other sufficient regulatory developments or concessions in its place, SRUS may become subject at such time to additional regulatory action.

A reconciliation of SRUS’s statutory balances as of December 31, 2008 is as follows:

	December 31, 2008	
(U.S. dollars in thousands)	Statutory Net Earned Income (Loss)	Statutory Capital & Surplus
Financial statements – Delaware basis.....	\$ (114,767)	\$ 197,366
Permitted increase in reserve credit	–	(197,206)
Prescribed mortality table	–	(43,206)
Prescribed X-Factor relief	–	(146,662)
Financial statements – NAIC basis	\$ (114,767)	\$ (189,708)

SRUS did not utilize any permitted or prescribed practices during and as of the year ended December 31, 2007. SRLC did not utilize any permitted or prescribed practices during and as of the years ended December 31, 2008 and 2007.

19. Related-Party Transactions

The amount due from/to related party represents amounts owed from/to Scottish Re. The amounts outstanding are unsecured, interest-free and generally settled on a quarterly basis. The majority of the balance relates to intercompany transactions with Scottish Re, including general advances, net worth maintenance and service fees, and reinsurance business retroceded by SRUS to Orkney Re II plc, a special purpose vehicle consolidated by Scottish Re.

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We and our operating subsidiaries are supported by net worth maintenance agreements that require the Company and Scottish Re to provide appropriate capital and liquidity to each operating subsidiary as required by regulators, rating agencies or creditors. In exchange, each operating subsidiary pays a net worth maintenance fee to the Company and Scottish Re. Net worth maintenance fees, investment management fees and corporate management fees charged by Scottish Re amounted to \$69.6 million and \$52.8 million in 2008 and 2007, respectively.

The Company and its subsidiaries carry out administrative and accounting responsibilities for the parent and other affiliated companies and charged service fees of \$10.5 million and \$13.2 million in 2008 and 2007, respectively. These amounts are netted against operating expenses in the Consolidated Statement of Loss.

On December 21, 2005, Orkney II, an orphan special purpose vehicle incorporated under the laws of Ireland 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 to external investors.

Orkney II has been consolidated in the financial statements of SRGL; however, in accordance with FIN 46R, we are not considered to be the primary beneficiary and as a result, we are not required to consolidate Orkney II. Concurrent with the offering to external investors, Orkney II issued to the Company \$5.0 million Series B Floating Rate Notes due December 31, 2035 (the "Series B Notes") and \$30.0 million Series C Floating Rate Notes due December 31, 2036 (the "Series C Notes" and, together with the Series B Notes, the "Orkney II Notes"). Interest on the principal amount of the Series B Notes is payable quarterly at a rate equivalent to three-month LIBOR plus 3.0%. At December 31, 2008, the interest rate on the Series B Notes was 5.29%. The Series B Notes are listed on the Irish Stock Exchange. Proceeds from this offering were used to fund the Regulation XXX reserve requirements for a defined block of level premium term life insurance policies issued between January 1, 2004 and December 31, 2004 reinsured by SRUS to Orkney II. Proceeds from the Orkney II Notes have been deposited into a series of trusts that in part collateralize the notes. As part of the reinsurance agreement between Orkney II and SRUS, SRUS retrocedes \$111.3 million of reserves (2007 – \$97.3 million), which is recorded as a component of "Amount recoverable from reinsurers". In addition, SRUS recorded a payable to Orkney II of \$6.5 million for premiums due, net of claims (2007 – \$9.7 million), which is recorded as a component of "Reinsurance balances and risk fees receivable."

Also during 2007, due to continued market value decline in the Orkney II investment portfolio and the subsequent effect on its ability to repay the lower tranches of debt, the Company recognized an other-than-temporary impairment charge to write off its \$30 million investment in the Series C Notes. During 2008, the Company recognized an other-than-temporary impairment charge to write off its \$5 million investment in the Series B Notes.

In connection with the May 2007 transaction with MassMutual Capital and Cerberus, MassMutual Capital and Cerberus hold in the aggregate approximately 68.7% of SRGL's equity voting power at December 31, 2008, along with the right to designate two-thirds of the members of SRGL's Board.

For the years ended December 31, 2008 and 2007, we had premiums earned of \$121.7 million and \$121.4 million, respectively with MassMutual Capital. As at December 31, 2008, we had a net payable to MassMutual Capital of \$5.7 million (2007 – \$1.8 million).

We also incurred \$0.2 million and \$0.1 million for investment management fee expenses for management of our Clearwater Re assets payable to Babson Capital Management LLC, an affiliate of MassMutual Capital, for the years ended December 31, 2008 and 2007, respectively.

Pursuant to the Registration Rights and Shareholders Agreement executed among SRGL, MassMutual, Cerberus and Cypress, for as long as the Cypress Entities in the aggregate beneficially own at least 2.5% of SRGL's outstanding voting shares on a fully diluted basis, they will be entitled to designate at least one individual for

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election to the Board. The Cypress Entities owned collectively 4.3% of SRGL's outstanding voting shares on a fully diluted basis as at December 31, 2008 and 2007.

Included in Other Investments is \$4.7 million and \$7.1 million at December 31, 2008 and 2007, respectively, for investment in Cypress Sharpridge Investments, Inc., which is an affiliate of the Cypress Entities. During the years ended December 31, 2008 and 2007, we received \$0.4 million and \$1 million, respectively, in dividend income from our investment in Cypress Sharpridge Investments.

20. Subsequent Events

Ballantyne Re

Beginning with the scheduled interest payment date on January 2, 2009, and continuing until February 3, 2009, Ballantyne Re was unable to make scheduled interest payments on the Class A Notes. Failure to make such payments in full when due constitutes an event of default under the Ballantyne Re indenture ("EOD"). During this default period, Ambac made guarantee payments on the Class A-2 Notes and Class A-3 Notes in the aggregate amount of \$2.4 million, and Assured made guarantee payments on the Class A-2 Notes in the aggregate amount of \$0.8 million. On February 9, 2009, a partial recapture of the business was completed by the ceding insurer, thereby lowering the reserve funding requirement and allowing for more available assets to make interest payments. On the following date, Ballantyne Re paid all deferred and accrued interest on the Class A-1 Notes in full, and repaid Ambac and Assured for all guarantee payments made during the default period (plus interest). As a result of the EOD, Ambac and Assured continue to have certain enhanced contractual rights under the transaction documents and additional fees will be accrued for the guarantee coverage.

Order of Supervision for SRUS

In approving the Permitted Practice, SRUS consented to the issuance by the Department on January 5, 2009 of an Order of Supervision against it, in accordance with 18 Del. C. §5942. The Order of Supervision subsequently was amended and continued on April 3, 2009 with the issuance of the Amended Order. Pursuant to the Amended Order, SRUS generally must receive prior written consent from the Department in order to engage in any transaction outside of the ordinary course of business; make certain payments or incur certain debts, obligations or liabilities in any transaction of \$1 million or greater (provided that this limitation does not apply to the payment of claims, premiums and other third-party reinsurance settlements, in each case of less than \$10 million per payment); engage in new business; lend any of its funds; invest any of its funds in a manner that deviates from the plan filed with the Department; commute, novate, amend or otherwise change any existing reinsurance contract or treaty; or engage in any transaction with any related party. Many of these processes already were informally in place between SRUS and the Department during much of 2008.

Sale of a Block of Life Reinsurance North America Business

As previously disclosed, we engaged in a process to sell our entire Life Reinsurance North America Segment. In October 2008, following exclusive negotiations with a prospective buyer, a satisfactory transaction for the sale of the entire Life Reinsurance North America Segment could not be reached, primarily as a result of the historic disruption in the financial markets. Thereafter, in an effort to find ways to address our capital, liquidity and collateral needs and the concerns of regulators, we pursued the sale of a specific block of individual life reinsurance in our North American business. These efforts culminated in the announcement on February 20, 2009 that Scottish Re had completed the Purchase Agreement with Hannover Re to sell this block of business.

Pursuant to the Purchase Agreement, Hannover Re purchased the Acquired Business, which was acquired in 2004 by Scottish Re from the ING Companies. The Acquired Business consists primarily of term life reinsurance,

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universal life with secondary guarantees, and yearly renewable term business. When Scottish Re originally purchased the Acquired Business in 2004, the ING Companies reinsured their individual life reinsurance business to Scottish Re on a 100% indemnity reinsurance basis. A large portion of such business included guaranteed level premium term life insurance that was subject to the XXX reserves requirements and universal life policies with secondary guarantees subject to the AXXX reserves requirements. Under our 2004 agreement with the ING Companies, the ING Companies were obligated to maintain collateral for the Regulation XXX and AXXX reserve requirements of the Acquired Business for the duration of such requirements, and financial incentives were provided to encourage us to replace this financing with alternative third-party financing.

The Acquired Business does not include the Ballantyne Business as this business was novated and assigned to SLD effective October 1, 2008. In connection with the Purchase Agreement, the ING Companies and certain of the Sellers entered into recapture agreements (and, in specific instances, novations to Hannover Re of certain existing reinsurance agreements) with respect to the Acquired Business, and the ING Companies and Hannover Re subsequently entered into new reinsurance agreements with respect to the Acquired Business immediately thereafter. These recapture and reinsurance transactions and the novations have an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent attributable to periods prior to January 1, 2009, and SRUS and SRLB have collateralized these obligations by depositing assets in trust accounts established for the benefit of SLD and SLDI.

The Purchase Agreement also relates to the purchase and sale of certain assets used by the Sellers in connection with their administration of the Acquired Business (the "Transferred Assets") and the transfer of certain employees from the Sellers to Hannover Re in connection therewith. Pursuant to the Purchase Agreement, the remaining lease on SRUS's Denver office location was assigned to Hannover Re, as was a portion of SRUS's Charlotte office location. In addition, Hannover Re entered into an administrative services agreement with SRUS pursuant to which Hannover Re will administer the accepted and ceded mortality business retained by SRUS and its affiliates. Similarly, Hannover Re entered into an administrative services agreement with the ING Companies pursuant to which Hannover Re will administer the Acquired Business and provide certain other administrative services to the ING Companies.

In accordance with the Purchase Agreement, payments were made as follows: (i) the Sellers made recapture payments to the ING Companies in an aggregate amount equal to \$1,325 million (adjusted for interim period earnings from January 1, 2009 to the date of closing), (ii) the ING Companies made initial premium payments to the Buyers in an aggregate amount equal to \$1,325 million (adjusted for interim period earnings from January 1, 2009 to the date of closing), and (iii) the Buyers made a payment to the Sellers in respect of the Transferred Assets in an amount equal to \$18 million.

Following the transfer of assets with respect to the recapture payments noted above, Scottish Re was released of associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities is estimated to result in a pre-tax noncash GAAP gain of approximately \$700 million, after transaction expenses and related costs to be recognized in our consolidated GAAP financial statements in 2009. The estimated gain is subject to certain refund contingencies as described below. Subsequent to the sale of the Acquired Business, we still retain a substantial shareholder's deficit. The disposal of the Acquired Business constitutes a reconsideration event related to the consolidation of Ballantyne Re under FIN 46R. See Note 11, "Collateral Finance Facilities and Securitization Structures." Consequently, we are currently evaluating whether we remain the primary beneficiary of Ballantyne Re as defined within FIN 46R. In the event we conclude we are no longer the primary beneficiary of Ballantyne Re, we would de-consolidate Ballantyne Re in 2009. The de-consolidation of Ballantyne Re would reduce our consolidated

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total assets and liabilities by approximately \$1,285 million and \$2,035 million, respectively, and result in a one-time noncash de-consolidation gain of approximately \$750 million. This gain would have no impact on our current or future liquidity position.

The Company, Hannover Re and the ING Companies agreed to use commercially reasonable efforts to transfer to Hannover Re certain retrocession agreements under which we and/or the ING Companies currently cede to third parties certain risks related to the Acquired Business. If a certain amount of such third-party retrocessionaires do not consent to such transfers prior to April 30, 2009, we are required under the Purchase Agreement to deposit into escrow with Hannover Re by May 14, 2009 a prorata amount related to such retrocession agreements for which such consent has not been obtained as of that date. Pursuant to the Purchase Agreement, in the event none of the retrocessionaires consent to transfer their agreements, the maximum potential escrow funding amount is \$136.3 million. In the event one or more retrocessionaire consents have not been obtained by December 31, 2009, the related escrow funds will be released to Hannover Re. Based upon the consents to transfer that were obtained prior to May 14, 2009, the escrow funding on that date was \$1.86 million and, therefore, the maximum potential escrow fund release to Hannover Re at December 31, 2009, will not exceed \$2.58 million. In an effort to further reduce the escrow funds and the potential year-end escrow release to Hannover Re, we will continue to use best efforts to obtain the remaining retrocessionaire consents prior to December 31, 2009. However, there can be no assurances that we will be successful in obtaining any additional consents.

Run-Off Strategy

We expect to follow a run-off strategy for the remaining business in our Life Reinsurance North America Segment, whereby we will continue to receive premiums, pay claims and perform key activities under our existing reinsurance treaties. Through expense reductions and management of investments and reinsurance cash flows, our goal is to meet our reinsurance and other obligations over time and to maintain a risk-based capital ratio above the company action level prescribed by Delaware law and above any risk-based capital-based recapture thresholds in our reinsurance agreements with ceding companies. No assurances can be given that we will be successful in implementing this strategy. In light of our run-off strategy, and given the completion of all of the actions taken over the past year, the Special Committee was terminated on February 28, 2009.

Premium Asset Trust Certificates Due March 12, 2009

Through negotiated repurchases, we extinguished the \$100 million payment obligation falling due on March 12, 2009, in respect of the PATS funding agreement to which we were a party for a significant discount to par on an aggregate basis. Following the satisfaction of the PATS funding agreement, our nearest term remaining debt obligations are the Stingray funding agreements, which are outstanding in the amount of \$325 million and mature in January 2015.

Deferral of Interest Payments on Floating Rate Capital Securities and Trust Preferred Securities

In order to further preserve liquidity, Scottish Re began deferring interest payments as of March 4, 2009 on the floating rate capital securities and trust preferred securities issued and sold through certain statutory trusts established by us (as outlined in Note 12 to the Consolidated Financial Statements). These deferrals are permitted by terms of the relevant transaction documents governing the securities and have been made at the discretion of the Board to preserve liquidity. Scottish Re intends to continue to defer such interest payments to maximize liquidity. To date, \$1.8 million of interest has been deferred.

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Ballantyne Re Recapture

Effective March 31, 2009, the ING Companies transacted the Fifth Recapture, on a prorata basis, of 3.6% of the original Ballantyne Business. Immediately following the Fifth Recapture, and effective as of March 31, 2009, SLD ceded the recaptured business to SLDI, which in turn immediately retroceded it to an affiliate of Hannover Re. The market value of the assets transferred was \$23.6 million.

Decline in Fair Values of Invested Assets

Investments have continued to deteriorate during 2009. As at April 30, 2009, our invested assets have experienced market value declines of approximately \$100.3 million since December 31, 2008 in addition to that recognized in our Consolidated Statement of Operations as a component of net realized and unrealized losses for the year ended December 31, 2008. In addition, the adverse market conditions have impacted the value of the underlying collateral used to secure our life reinsurance obligations and statutory reserves.

A large portion of the net realized and unrealized losses primarily are held in Ballantyne Re and Orkney Re; the two securitization structures that, although without recourse to us, are consolidated in our financial statements under U.S. GAAP. Changes in the fair value of investments within Orkney Re can adversely impact our reported financial results and the statutory reserve credit that SRUS is able to recognize for these transactions. Following the Assignment, Ballantyne Re no longer impacts the statutory reserve credit of SRUS. As of December 31, 2008, SRUS maintained risk-based capital levels in excess of statutory minimums on the basis of accounting practices permitted or prescribed by the Department, including the Permitted Practice and the Emergency Regulations.