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**SCOTTISH RE GROUP LIMITED**

**FINANCIAL STATEMENTS**

**AS AT JUNE 30, 2009**

**(Original version issued on September 15, 2009)**

**(Restated version issued on November 16, 2009)**

*(These financial statements are unaudited.)*

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### Explanatory Note

Scottish Re Group Limited (“SRGL”, the “Company”, “we”, “our” and “us”) has restated its consolidated unaudited interim financial statements for the three and six months ended June 30, 2009, to restate the earnings per share for the three and six months ended June 30, 2008. Basic income (loss) per ordinary share and diluted income (loss) per ordinary share have been updated in the restated financial statements to include the impact of continuing and discontinued operations for the three and six months ended June 30, 2008. The restated financial statements highlight that the previously reported basic and diluted loss of \$6.81 per ordinary share for the three months ended June 30, 2008 included \$6.05 loss per ordinary share from continuing operations and \$0.76 loss per ordinary share from discontinued operations. The restated financial statements also highlight that the previously reported basic and diluted loss of \$17.56 per ordinary share for the six months ended June 30, 2008 included \$16.81 loss per ordinary share from continuing operations and \$0.75 loss per ordinary share from discontinued operations. The restatement to the financial statements for the three and six months ended June 30, 2009 are limited to disclosure matters on earnings per ordinary share for continuing and discontinued operations and do not result in any change to previously reported consolidated income (loss) or total shareholders’ deficit.

Posting of these restated financial statements to our website, amends the original unaudited interim financial statements for the three and six months ended June 30, 2009, that were posted on our website on September 15, 2009 (“the Original Report”).

The restated consolidated unaudited interim financial statements also include updated disclosures of subsequent events to include events up to and including the restated filing date of November 16, 2009. The original unaudited interim financial statements disclosed subsequent events up to and including the original filing date of September 15, 2009.

Although these restated unaudited interim financial statements to the Original Report are set forth in their entirety, these restated unaudited interim financial statements only amend the items described below and do not affect any other items in the Original Report.

The following items reflect the restated and updated sections of the consolidated unaudited financial statements:

- Consolidated Statements of Income (Loss) – Basic and diluted income (loss) per ordinary share (restated)
- Note 2 – Basis of Presentation - Earnings per Ordinary Share (restated)
- Note 10 – Earnings per Ordinary Share (restated)
- Note 15 – Subsequent Events (restated)

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

	June 30, 2009 (Unaudited)	December 31, 2008
<b>ASSETS</b>		
Fixed maturity investments, trading at fair value .....	\$ 2,879,314	\$ 3,781,104
Preferred stock, trading at fair value .....	81,136	79,767
Cash and cash equivalents .....	445,651	824,613
Other investments .....	22,619	22,772
Funds withheld at interest .....	554,447	1,748,768
Total investments .....	3,983,167	6,457,024
Accrued interest receivable .....	25,059	35,473
Reinsurance balances and risk fees receivable .....	151,456	353,579
Deferred acquisition costs .....	322,185	375,475
Amount recoverable from reinsurers .....	595,219	711,576
Present value of in-force business .....	39,356	40,105
Other assets .....	47,047	41,750
Current income tax receivable .....	8,702	8,811
Deferred tax asset .....	3,061	3,061
Total assets .....	<u>\$ 5,175,252</u>	<u>\$ 8,026,854</u>
<b>LIABILITIES</b>		
Reserves for future policy benefits .....	\$ 1,579,543	\$ 4,011,053
Interest sensitive contract liabilities .....	1,843,353	2,025,554
Collateral finance facilities .....	1,300,000	3,000,000
Accounts payable and other liabilities .....	116,244	459,792
Reinsurance balances payable .....	164,850	248,065
Deferred tax liability .....	221	221
Long term debt .....	129,500	129,500
Total liabilities .....	<u>5,133,711</u>	<u>9,874,185</u>
<b>MEZZANINE EQUITY</b>		
Convertible cumulative participating preferred shares, (liquidation preference, \$694.1 million) .....	555,857	555,857
Commitments and contingencies (Note 14)		
<b>SHAREHOLDERS' DEFICIT</b>		
Scottish Re Group Limited shareholders' deficit		
Ordinary shares, par value \$0.01:		
Issued 68,383,370 shares (2008 – 68,383,370) .....	684	684
Non-cumulative perpetual preferred shares, par value \$0.01:		
Issued: 5,000,000 shares (2008 – 5,000,000) .....	125,000	125,000
Additional paid-in capital .....	1,217,164	1,216,878
Retained deficit .....	(1,864,422)	(3,752,716)
Total Scottish Re Group Limited shareholders' deficit .....	(521,574)	(2,410,154)
Noncontrolling interest .....	7,258	6,966
Total shareholders' deficit .....	(514,316)	(2,403,188)
Total liabilities, mezzanine equity and total shareholders' deficit .....	<u>\$ 5,175,252</u>	<u>\$ 8,026,854</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

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

	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
<b>Revenues</b>				
Premiums earned, net .....	\$ 122,480	\$ 414,627	\$ 221,866	\$ 812,830
Fee and other income.....	1,062	3,758	3,412	6,399
Investment income, net.....	47,804	103,144	91,994	207,084
Net realized and unrealized gains (losses).....	133,134	(316,669)	21,873	(978,999)
Gain on Ballantyne Re de-consolidation .....	-	-	1,150,114	-
Gain on extinguishment of debt.....	-	-	53,545	-
Change in value of embedded derivatives, net .....	13,335	9,366	293,620	(2,141)
Total revenues.....	<u>317,815</u>	<u>214,226</u>	<u>1,836,424</u>	<u>45,173</u>
<b>Benefits and expenses</b>				
Claims and other policy benefits .....	62,739	409,440	(227,507)	753,118
Interest credited to interest sensitive contract liabilities .....	14,649	21,569	31,919	42,626
Acquisition costs and other insurance expenses, net ...	37,767	81,415	76,603	171,858
Operating expenses.....	12,174	38,104	38,669	78,020
Collateral finance facilities expense .....	10,315	76,602	22,366	137,629
Interest expense .....	1,737	2,177	3,675	5,060
Total benefits and expenses .....	<u>139,381</u>	<u>629,307</u>	<u>(54,275)</u>	<u>1,188,311</u>
<b>Income (loss) from continuing operations before income taxes .....</b>	<b>178,434</b>	<b>(415,081)</b>	<b>1,890,699</b>	<b>(1,143,138)</b>
Income tax (expense) benefit.....	(1,009)	1,305	(2,113)	(6,444)
<b>Income (loss) from continuing operations .....</b>	<b>177,425</b>	<b>(413,776)</b>	<b>1,888,586</b>	<b>(1,149,582)</b>
Loss from discontinued operations, net of related taxes.....	-	(52,177)	-	(51,777)
<b>Consolidated income (loss).....</b>	<b>177,425</b>	<b>(465,953)</b>	<b>1,888,586</b>	<b>(1,201,359)</b>
Net (income) loss attributable to noncontrolling interest .....	(551)	(17)	(292)	99
<b>Net income (loss) attributable to ordinary shareholders .....</b>	<b>\$ 176,874</b>	<b>\$ (465,970)</b>	<b>\$ 1,888,294</b>	<b>\$ (1,201,260)</b>
<b>Amounts attributable to ordinary shareholders (as restated):</b>				
Income (loss) from continuing operations (as restated) .....	\$ 176,874	\$ (413,793)	\$ 1,888,294	\$ (1,149,483)
Loss from discontinued operations (as restated).....	-	(52,177)	-	(51,777)
<b>Net income (loss) attributable to ordinary shareholders (as restated) .....</b>	<b>\$ 176,874</b>	<b>\$ (465,970)</b>	<b>\$ 1,888,294</b>	<b>\$ (1,201,260)</b>
<b>Income (loss) per ordinary share attributable to ordinary shareholders (as restated):</b>				
<b>Basic income (loss) per ordinary share</b>				
Income (loss) from continuing operations (as restated) .....	\$ 2.55	\$ (6.05)	\$ 27.22	\$ (16.81)
Loss from discontinued operations (as restated).....	\$ -	\$ (0.76)	\$ -	\$ (0.75)
<b>Net income (loss) attributable to ordinary shareholders (as restated) .....</b>	<b>\$ 2.55</b>	<b>\$ (6.81)</b>	<b>\$ 27.22</b>	<b>\$ (17.56)</b>

**Diluted income (loss) per ordinary share**

Income (loss) from continuing operations (as restated) .....	\$ 0.81	\$ (6.05)	\$ 8.65	\$ (16.81)
Loss from discontinued operations (as restated).....	\$ -	\$ (0.76)	\$ -	\$ (0.75)
<b>Net income (loss) attributable to ordinary shareholders (as restated) .....</b>	<b>\$ 0.81</b>	<b>\$ (6.81)</b>	<b>\$ 8.65</b>	<b>\$ (17.56)</b>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

(Expressed in Thousands of United States dollars)

	<u>Three months ended</u>		<u>Six months ended</u>	
	<u>June 30, 2009</u>	<u>June 30, 2008</u>	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<b>Net income (loss) attributable to ordinary shareholders .....</b>	<b>\$ 176,874</b>	<b>\$ (465,970)</b>	<b>\$ 1,888,294</b>	<b>\$ (1,201,260)</b>
Other comprehensive income (loss):				
Unrealized depreciation on investments .....	-	-	-	-
Reclassification adjustment for net realized and unrealized losses included in net (loss) income .....	-	-	-	(26,107)
Net unrealized depreciation on investments, net of income taxes and deferred acquisition costs.....	-	-	-	(26,107)
Cumulative translation adjustment .....	-	124	-	5,370
Other comprehensive income (loss) .....	-	124	-	(20,737)
Comprehensive income (loss).....	\$ 176,874	\$ (465,846)	\$ 1,888,294	\$ (1,221,997)
Comprehensive loss attributable to the noncontrolling interest .....	-	-	-	(203)
<b>Comprehensive income (loss) attributable to ordinary shareholders .....</b>	<b>\$ 176,874</b>	<b>\$ (465,846)</b>	<b>\$ 1,888,294</b>	<b>\$ (1,222,200)</b>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

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

	Six months ended	
	June 30, 2009	June 30, 2008
<b>Share capital:</b>		
<b>Ordinary shares:</b>		
Beginning and end of period.....	\$ 684	\$ 684
<b>Non cumulative perpetual preferred shares:</b>		
Beginning and end of period.....	125,000	125,000
<b>Additional paid-in capital:</b>		
Beginning of period .....	1,216,878	1,214,886
Option expense .....	286	1,226
End of period .....	1,217,164	1,216,112
<b>Accumulated other comprehensive income (loss):</b>		
Unrealized appreciation (depreciation) on investments net of income taxes and deferred acquisition costs		
Beginning of period .....	-	26,310
Change in period.....	-	(26,310)
End of period .....	-	-
Cumulative translation adjustment		
Beginning of period .....	-	24,590
Change in period (net of tax) .....	-	5,370
End of period .....	-	29,960
<b>Benefit plans</b>		
Beginning and end of period.....	-	(2,344)
<b>Total accumulated other comprehensive income (loss) .....</b>	<b>-</b>	<b>27,616</b>
<b>Retained deficit:</b>		
Beginning of period .....	(3,752,716)	(1,042,399)
Net income (loss).....	1,888,294	(1,201,260)
End of period .....	(1,864,422)	(2,243,659)
<b>Total Scottish Re Group Limited shareholders' deficit .....</b>	<b>\$ (521,574)</b>	<b>\$ (874,247)</b>
<b>Noncontrolling interest:</b>		
Beginning of period .....	6,966	9,025
Change in period (net of tax) .....	292	(302)
End of period .....	7,258	8,723
<b>Total shareholders' deficit .....</b>	<b>\$ (514,316)</b>	<b>\$ (865,524)</b>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)



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

(Expressed in Thousands of United States dollars)

	Six months ended	
	June 30, 2009	June 30, 2008
<b>Operating activities</b>		
Net income (loss) attributable to ordinary shareholders .....	\$ 1,888,294	\$ (1,201,260)
Adjustments to reconcile net income (loss) income to net cash used in operating activities:		
Net realized and unrealized (gains) losses .....	(21,873)	981,568
Gain on extinguishment of debt .....	(53,545)	-
Non cash gain on de-consolidation of Ballantyne Re .....	(1,150,114)	-
Changes in value of embedded derivatives, net .....	(293,620)	2,141
Amortization of discount on fixed maturity investments and preferred stock .....	-	281
Amortization of deferred acquisition costs .....	29,384	77,306
Amortization and write down of present value of in-force business .....	749	1,778
Write-off of fixed assets associated with the sale of the Acquired Business .....	6,289	-
Amortization of deferred transaction costs .....	1,536	14,688
Depreciation of fixed assets .....	861	4,980
Option expense .....	286	1,226
Net income (loss) attributable to noncontrolling interest .....	292	(99)
Changes in assets and liabilities:		
Accrued interest receivable .....	10,414	7,248
Reinsurance balances and risk fees receivable .....	118,908	85,181
Deferred acquisition costs .....	23,906	(27,825)
Deferred tax asset and liability .....	-	6,855
Other assets .....	(257,068)	4,788
Current income tax receivable and payable .....	109	(372)
Reserves for future policy benefits, net of amounts recoverable from reinsurers .....	(2,073,253)	85,433
Funds withheld at interest .....	1,194,321	(259,115)
Interest sensitive contract liabilities .....	(10,576)	(5,099)
Accounts payable and other liabilities .....	44,173	25,293
Net cash used in operating activities .....	(540,527)	(195,004)
<b>Investing activities</b>		
Purchase of fixed maturity investments .....	(426,077)	(223,176)
Proceeds from sales of fixed maturity investments .....	520,663	459,749
Proceeds from maturity and return of capital of fixed maturity investments .....	182,724	297,310
Proceeds from sale and maturity of preferred stock .....	2,503	2,800
Purchase of and proceeds from other investments .....	863	29,581
Purchase of fixed assets .....	-	(1,643)
Net cash provided by investing activities .....	280,676	564,621
<b>Financing activities</b>		
Deposits to interest sensitive contract liabilities .....	-	725
Withdrawals from interest sensitive contract liabilities .....	(119,111)	(175,850)
Payments on collateral finance facilities .....	-	(46,748)
Proceeds from drawdown of Stingray facility .....	-	325,000
Dividends paid on non-cumulative perpetual preferred shares .....	-	(2,266)
Net cash (used in) provided by financing activities .....	(119,111)	100,861
Net change in cash and cash equivalents .....	(378,962)	470,478
Cash and cash equivalents, beginning of period .....	824,613	822,851
Cash and cash equivalents, end of period .....	\$ 445,651	\$ 1,293,329

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2009

#### 1. Organization and Business

##### *Organization*

Scottish Re Group Limited is a holding company incorporated under the laws of the Cayman Islands with our principal executive office in Bermuda. Through our operating subsidiaries, we are principally engaged in the reinsurance of life insurance, annuities and annuity-type products. We have principal operating companies in Bermuda, the Cayman Islands, Ireland, and the United States.

##### *Strategic Focus*

As noted in our audited consolidated financial statements and notes thereto for the year ended December 31, 2008, we have faced a number of significant challenges over the past several years which required us to change our strategic focus. On February 22, 2008, we announced our pursuit of the following key strategies:

- Disposal of our non-core assets or lines of business, including the Life Reinsurance International Segment and the Wealth Management business;
- Development, through strategic alliances or other means, of opportunities to maximize the value of our core competitive capabilities within the Company, including mortality assessment and treaty administration; and
- Rationalization of our cost structure to preserve capital and liquidity.

These strategies materially impacted the conduct of our business. 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 placed our remaining treaties into run-off.

During the remainder of 2008 and the first half of 2009, we took steps to execute on the strategies listed above. Below is a summary of 2008 dispositions, as well as events impacting our financial statements for the first half of 2009. For a complete list of 2008 strategic actions, see our audited consolidated financial statements and notes thereto for the year ended December 31, 2008.

- On July 11, 2008, we completed the sale of our Wealth Management business and related entities with respect to Scottish Annuity & Life Insurance Company (Bermuda) Ltd. and Scottish Annuity & Life International Insurance Company (Bermuda) Ltd., and on August 5, 2008, we completed the sale with respect to The Scottish Annuity Company (Cayman) Ltd. The sale of our Wealth Management business generated proceeds of \$9.3 million and resulted in a net loss of \$4.9 million.
- On July 18, 2008, Pacific Life Insurance Company ("Pacific Life") concluded the purchase of Scottish Re Holdings Limited and the U.K. portion of the Life Reinsurance International Segment for \$67.1 million after purchase price adjustments of \$4.1 million. 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 of \$0.5 million. We recorded an aggregate loss of \$31 million on these transactions in 2008. In March 2009, the Singapore branch was closed and \$6.1 million of capital was returned to Scottish Annuity & Life Insurance Company (Cayman) Ltd. ("SALIC").
- On January 22, 2009, the Company, Scottish Holdings, Inc. ("SHI"), Scottish Re (U.S.), Inc. ("SRUS"), Scottish Re Life (Bermuda) Limited ("SRLB") and Scottish Re (Dublin) Limited ("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 Security Life of Denver Insurance Company ("SLD") and Security Life of Denver International Limited ("SLDI" and together with SLD, the "ING Companies"), pursuant to which Hannover Re agreed to purchase from the Sellers a block of individual life reinsurance business acquired in 2004 from the ING Companies, which block consisted primarily of term life reinsurance, universal life with secondary

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2009

guarantees, and yearly renewable term business (the “Acquired Business”). The Acquired Business did not include business formerly reinsured from SRUS to Ballantyne Re, as this business was novated and assigned from SRUS to SLD effective October 1, 2008. 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 our 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 of the Acquired Business by the ING Companies from certain of the Sellers, 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 had an effective date of January 1, 2009. SRUS and SRLB remain responsible for certain 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 until September 30, 2009 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, we were released of associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities resulted in a pre-tax gain of \$703.6 million, after transaction expenses and related costs. This gain is also subject to certain contingencies, which reduced the pre-tax gain recognized in the six month period of 2009 to \$702.2 million, of which \$642.4 million and \$59.8 million were recognized in the first and second quarters of 2009, respectively. There is also the potential for an additional \$1.4 million gain to be recognized on the second half of the year. These gains have limited impact on our current liquidity position. See Note 12, “Sale of a Block of Life Reinsurance North America Business” for a summary of the components of the pre-tax gain, including additional details on the gain contingencies.

- As of January 1, 2009, Ballantyne Re plc (“Ballantyne Re”) no longer is consolidated within the financial statements of SRGL. Pursuant to the Purchase Agreement, Hannover Re explicitly agreed to assume the mortality risk for all recaptures of business from Ballantyne Re. Assumption by Hannover Re of this obligation constituted a reconsideration event related to the consolidation of Ballantyne Re under FIN 46R. We subsequently completed a primary beneficiary analysis and have concluded that we no longer are the primary beneficiary of Ballantyne Re as defined within FIN 46R. The impact of de-consolidating Ballantyne Re resulted in a one-time non-cash gain of \$1,150 million in the first quarter of 2009, with no impact on our current or future liquidity position. For further discussion on the impact of the de-consolidation of Ballantyne Re, see Note 13, “Collateral Finance Facilities” in these financial statements.
- In order to further preserve liquidity, we 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. Under the terms of these securities, we are entitled to defer interest payments for up to 20 consecutive quarterly periods. See Note 7, “Debt and Other Funding Agreements”.
- Through negotiated repurchases, we extinguished on an aggregate basis 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, resulting in a gain on the extinguishment of \$53.5 million in the first quarter of 2009. See Note 7, “Debt and Other Funding Agreements”.

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2009

#### Regulatory Considerations

In addition to executing on our areas of strategic focus, we continue to operate with certain regulatory considerations.

- The fair value of the securities in certain qualifying reserve credit trust accounts has declined significantly in recent periods 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 plc ("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. In connection with SRUS' receipt 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 formalized certain reporting obligations and processes already informally implemented between SRUS and the Department during 2008. The original Order of Supervision, which was set to lapse on April 5, 2009, subsequently was amended and replaced with an Extended and Amended Order of Supervision, dated April 3, 2009 (the "Amended Order") which amends and clarifies certain matters contained within the original Order of Supervision. See Note 11, "Regulatory and Ratings Agencies".
- 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 Insurance 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 Insurance Commissioner'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. For statutory accounting purposes, the Emergency Regulations by their terms are effective for valuations on and after December 31, 2008. As at March 31, 2009, the implementation of the Emergency Regulations resulted in a \$227 million increase in SRUS' statutory capital and surplus. Accordingly, in the absence of the Emergency Regulations, SRUS' 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 was effective until September 1, 2009, or until adopted pursuant to the Delaware Administrative Procedures Act. For further discussion on the Emergency Regulations, see Note 15, "Subsequent Events".

#### Run-off Strategy

With the completion of the previously described strategic actions and continued compliance with the supervision requirements of the Department, we expect to continue to pursue our run-off strategy for the remaining

## SCOTTISH RE GROUP LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2009

business, whereby we continue to receive premiums, pay claims and perform key activities under our remaining reinsurance treaties. Through expense reductions and management of investments and reinsurance cash flows, our goal is to continue our reinsurance and other obligations 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 the strategic alternatives outlined above, the special committee formed by our Board of Directors (the "Board") on January 21, 2008 was terminated on February 28, 2009.

While pursuing our runoff strategy, we may from time to time, if opportunities arise, purchase in privately negotiated transactions, open market purchases, or otherwise, additional amounts of our outstanding debt, non-voting preferred securities, and other liabilities. Any such purchases will depend on a variety of factors including but not limited to available corporate liquidity, capital requirements and indicative pricing levels. The amounts involved in any such transactions, individually or in the aggregate, may be material. There can be no assurances that we will enter into any such transactions in the future.

#### *Business*

We have 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. With the sale of the Wealth Management business and Life Reinsurance International segment in 2008, together with the sale of the Acquired Business in our Life Reinsurance North America segment in the first quarter of 2009, operating decisions and performance assessment of the Company is now performed without reference to any separate segments. Accordingly, we do not present information about distinct operating segments for periods after January 1, 2009.

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. We suspended bidding for new business on March 3, 2008, and at that time, we began issuing notices cancelling the acceptance of new reinsurance risks for all open treaties. The business we historically have written falls into two categories: Traditional Solutions and Financial Solutions, as detailed below.

*Traditional Solutions:* We reinsure the mortality risk on life insurance policies written by primary insurers. The business 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, we recently completed the sale to Hannover Re of the Acquired Business, which business generally was a part of our Traditional Solutions business.

*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.

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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.

## 2. Basis of presentation

### *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 period financial statements have been reclassified to conform to the current period presentation. These unaudited consolidated financial statements should be read in conjunction with both the audited consolidated financial statements and notes thereto for the year ended December 31, 2008.

**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. 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 the actions we have taken or plan to take as described in Note 1 above 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 if we were unable to continue as a going concern. We have a shareholders' deficit of \$521.6 million as of June 30, 2009.

In the event that for any reason we fail to comply with the Department's Amended Order, or in the event the financial condition of SRUS materially was 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.

**Consolidation** - The consolidated financial statements include the assets, liabilities and results of operations of SRGL 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 inter-company transactions and balances have been eliminated on consolidation. As at June 30, 2009, we consolidate two non-recourse securitizations: Orkney Re and Orkney Re II. Effective January 1, 2009, we no longer consolidated Ballantyne Re, see Note 13, "Collateral Finance Facilities".

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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;
- 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;
- 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.

Earnings per Ordinary Share (restated) – portions of the accompanying unaudited consolidated interim financial statements have been restated because after the issuance of the Original Report, the Company determined it should restate basic income (loss) per ordinary share and diluted income (loss) per ordinary share as reported in the Original Report to include the impact of continuing and discontinued operations for the three and six months ended June 30, 2008. The revised financial statements highlight that the previously reported basic and diluted loss of \$6.81 per ordinary share for the three months ended June 30, 2008 included \$6.05 loss per ordinary share from continuing operations and \$0.76 loss per ordinary share from discontinued operations. The restated financial statements also highlight that the previously reported basic and diluted loss of \$17.56 per ordinary share for the six months ended June 30, 2008 included \$16.81 loss per ordinary share from continuing operations and \$0.75 loss per ordinary share from discontinued operations.

All tabular amounts are reported in thousands of United States dollars, except share and per share data, or as otherwise noted.

### 3. Recent Accounting Pronouncements

#### *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 de-consolidation of the subsidiary

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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 included the enhanced disclosures required by SFAS No. 160 in our consolidated financial statements beginning in the reporting period ended March 31, 2009.

#### *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.

#### *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. The adoption of SFAS No. 161 did not have a material effect on our consolidated financial condition or 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 140-4 and FIN 46(R)-8, "*Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*" ("FSP 140-4"). FSP 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 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 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 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 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 140-4 in the notes to the consolidated financial statements beginning in the reporting period ended December 31, 2008, and there have been no significant changes to disclose in 2009.

#### *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



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periods ending before March 15, 2009 is not permitted. The adoption of FSP No. 157-4 did not have a material effect on our consolidated financial condition or results of operations.

#### *FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments*

In April 2009, the FASB issued FSP FAS No. 107-1 and APB No. 28-1, “*Interim Disclosures about Fair Value of Financial Instruments*” (FSP No. 107-1 and APB No. 28-1). FSP No. 107-1 and APB No. 28-1 was issued to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements, and for those disclosures at interim reporting periods to be in a format that summarized financial information. FSP No. 107-1 and APB No. 28-1 shall be effective for interim reporting periods ending after June 15, 2009, with early adoption permitted ending after March 15, 2009. We included the summarized financial information disclosure required by FSP No. 107-1 and APB No. 28-1 in the notes to the consolidated financial statements beginning in the interim reporting period ended June 30, 2009.

#### *FASB Statement No. 165, Subsequent Events*

In May 2009, the FASB issued SFAS No. 165, “*Subsequent Events*” (“SFAS No. 165”). This statement is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date, but before the financial statements are issued or are available to be issued. SFAS No. 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for the date – that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after the date in the set of financial statements being presented. The Company adopted SFAS No. 165 during the second quarter of 2009 and evaluated subsequent events through the date its financial statements are filed. The adoption of this standard did not have an impact on the Company’s financial position or results of operations.

#### *FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)*

In June 2009, the FASB issued SFAS No. 167, “*Amendments to FASB Interpretation No. 46(R)*” (“SFAS No. 167”). This statement amends Interpretation 46(R) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest or variable interests give it a controlling financial interest in a VIE. SFAS No. 167 also requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. This statement shall be effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently evaluating the potential impact of the adoption of SFAS No. 167 on our consolidated financial condition and results of operations.

#### *FASB Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*

In June 2009, the FASB issued SFAS No. 168, “*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*” (“FASB No. 168”). This statement is a replacement of SFAS No. 162 “*The Hierarchy of Generally Accepted Accounting Principles*” and aims to establish the *FASB Accounting Standards Codification* (“*Codification*”) as the source of authoritative accounting principles and the framework for selecting the principles used in the preparation of financial statements of non-governmental entities that are presented in conformity with U.S. GAAP. SFAS No. 168 is effective for financial statements for interim or annual periods ending on or after September 15, 2009. SFAS No. 168 will have no impact on our financial condition or results of operations.

#### **4. 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.

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Additionally, as of January 1, 2008, the balance of unrealized appreciation on investments of \$38.5 million, which previously was included in accumulated other comprehensive income (loss), was reclassified and recorded in the Consolidated Statement 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 flows, 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 Statement of Cash Flows based on the nature and purpose for which the related securities were acquired.

The portion of net unrealized losses for the six months ended June 30, 2009 that relates to trading securities still held at the reporting date is \$13.0 million. For the three months ended June 30, 2009, there was a reversal of earlier unrealized losses of \$120.2 million recognized in the first quarter of 2009 due to the market recovery of certain trading securities.

#### 5. Fair Value Measurements

The Company 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 FAS 157 are described below:

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

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

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

As required by 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 are primarily industry-standard models that consider various inputs, such as interest rate, credit spread and foreign exchange rates for the underlying financial instruments. All significant inputs are observable, or derived from observable, information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include: certain public and private corporate fixed maturity and equity securities; government or agency securities; certain mortgage and asset-backed securities; securities held as collateral; and segregated assets.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker 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

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securities where we cannot corroborate the significant valuation inputs with market observable data. Additionally, the Company's 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 sheet.

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.

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

	June 30, 2009			
(U.S. dollars in millions)	Total	Level 1	Level 2	Level 3
Investments				
Fixed maturity investments .....	\$ 2,879.3	\$ -	\$ 2,219.0	\$ 660.3
Preferred stock.....	81.1	-	31.6	49.5
Total assets at fair value .....	<u>\$ 2,960.4</u>	<u>\$ -</u>	<u>\$ 2,250.6</u>	<u>\$ 709.8</u>
Funds withheld at interest – embedded derivatives .....	(53.9)	-	-	(53.9)
Total liabilities at fair value.....	<u>\$ (53.9)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (53.9)</u>

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:

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**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

(U.S. dollars in millions)	Fixed Maturities & Preferred Stock	Funds Withheld at Interest – Embedded Derivatives	Total
Beginning balance at January 1, 2009.....	\$ 813.0	\$ (347.5)	\$ 465.5
Total realized and unrealized gains (losses) included in net loss.....	(95.6)	293.6	198.0
Purchases, issuances and settlements.....	(14.4)	-	(14.4)
Transfers in and/or out of Level 3.....	6.8	-	6.8
Ending balance at June 30, 2009.....	<u>\$ 709.8</u>	<u>\$ (53.9)</u>	<u>\$ 655.9</u>

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.

**6. 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 5, "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 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 non-performance 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.

(vi) Interest sensitive contract liabilities include amounts payable under funding agreements and investment contracts. The fair value for amounts payable under funding agreements was determined by a third party service provider with reference to similar quoted securities. The fair value of investment contracts, which exclude significant mortality risk, is based on the cash surrender value of the liabilities as an approximation of the exit market.

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(vii) Embedded derivatives are carried at fair value. See Note 5, "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)	June 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Assets</b>				
Fixed maturity investments.....	\$ 2,879,314	\$ 2,879,314	\$ 3,781,104	\$ 3,781,104
Preferred stock .....	81,136	81,136	79,767	79,767
Policy Loans .....	18,669	18,669	18,112	18,112
Funds withheld at interest (excluding cash).....	554,447	505,204	1,748,768	1,474,183
<b>Liabilities</b>				
Collateral finance facilities .....	\$ 1,300,000	\$ 919,917	\$ 3,000,000	\$ 1,861,229
Long term debt.....	129,500	14,245	129,500	62,000
Interest sensitive contract liabilities.....	1,843,353	1,510,467	2,025,554	1,739,817
Embedded derivatives.....	53,899	53,899	347,519	347,519

**7. Debt and Other Funding Arrangements**

***Stingray Investor Trust***

On January 12, 2005, we entered into a put agreement with Stingray Investor Trust ("Stingray") 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 46(R), we are not considered to be the primary beneficiary of and, as a result, we are not required to consolidate Stingray. Any funds drawn down on the facility are included in interest sensitive contract liabilities on our Consolidated Balance Sheet.

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 June 30, 2009.

For further discussion on Stingray subsequent to June 30, 2009, see Note 15, "Subsequent Events".

***Premium Asset Trust Series 2004-4***

On March 12, 2004, SALIC entered into an unsecured funding agreement with the Premium Asset Trust for an aggregate of \$100 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 was included under interest sensitive contract liabilities on the Consolidated Balance Sheet.

Through negotiated repurchases, we extinguished the \$100 million payment obligation falling due on March 12, 2009, in respect of the PATs funding agreement. Such repurchases were completed for a total consideration of \$46.5 million compared to the \$100 million par value of the PATs. Consequently, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Liabilities – A Replacement of FASB Statement 125," the Company recorded a gain on the extinguishment of the PATs debt of \$53.5 million in the first

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quarter of 2009. The funding agreements were included in interest sensitive contract liabilities in the accompanying Consolidated Balance Sheet at December 31, 2008.

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

In order to further preserve liquidity, we began deferring interest payments as of March 4, 2009 on our floating rate capital securities and trust preferred securities issued and sold through certain statutory trusts established by us. These deferrals are permitted by terms of the indentures governing the securities and have been made at the discretion of our Board to preserve liquidity. We intend to continue to defer such interest payments to maximize liquidity. As of June 30, 2009, we have accrued and deferred payment of \$3.2 million of interest. SHI and SALIC are restricted in their ability to make dividend payments in any period where interest payment obligations are not current.

For further discussion on the accrued and deferred payment on our floating rate capital securities and trust preferred securities subsequent to June 30, 2009, see Note 15, "Subsequent Events".

#### *Non-declaration of Perpetual Preferred Shares dividends*

In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, we were precluded from declaring and paying dividends on the January 15, 2009 and April 15, 2009 dividend payment dates. The Certificate of Designations provides that whenever dividends on the Perpetual Preferred Shares have not been declared and paid for six or more dividend periods, the holders of the Perpetual Preferred Shares are entitled to elect two additional directors to the SRGL Board. See Note 15 "Subsequent Events – Non-declaration of Perpetual Preferred Shares dividends".

## 8. Mezzanine Equity

#### *Convertible Cumulative Participating Preferred Shares*

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

As of June 30, 2009, MassMutual Capital and Cerberus hold in the aggregate approximately 68.7% of our equity voting power, along with the right to designate two-thirds of the members of our Board.

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

We have accounted for the Convertible Cumulative Participating Preferred Shares in accordance with EITF D-98: "Classification and Measurement of Redeemable Securities". Dividends on the Convertible Cumulative Participating Preferred Shares are cumulative and accrete daily on a non-compounding basis at a rate of 7.25% per annum on the stated value of \$600 million. Dividends only will be paid in a liquidation preference scenario upon our liquidation or change-in-control prior to the ninth anniversary. There have been no dividends accrued in the

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period as this scenario is not deemed probable at this time. As of June 30, 2009, the amount of dividends not accrued pursuant to the terms of the Convertible Cumulative Participating Preferred Shares is \$94.1 million.

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

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

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

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

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

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Pursuant to our Securities Purchase Agreement, dated November 26, 2006 (the "Agreement"), with MassMutual Capital and Cerberus, certain representations and warranties were provided relating to our statutory accounting records. As discussed in Note 14 "Commitments and Contingencies", certain statutory accounting errors were discovered in 2006 which has resulted in an indemnification claim against us, by MassMutual and Cerberus. Resolution of this claim could result in a change in the conversion formula on these securities.

### 9. Income Taxes

Income tax expense for the three months ended June 30, 2009 was \$1.0 million, compared to income tax benefit of \$1.3 million for the same period in 2008. The change in our income tax expense for the quarter ended June 30, 2009, compared to the income tax benefit in the same period in 2008 was primarily related to reductions to penalties and interest on a FIN 48 position in 2008.

Income tax expense for the six months ended June 30, 2009 was \$2.1 million, compared to \$6.4 million for the same period in 2008. The change in income tax expense relates to an increase in the valuation allowance for the first quarter of 2008 compared to no valuation allowance increase in the current period.

At December 31, 2008, we had total unrecognized tax benefits (excluding interest and penalties) of \$167.9 million, the recognition of which would result in a \$16.9 million benefit to the effective tax rate. At June 30, 2009, we had total unrecognized tax benefits (excluding interest and penalties) of \$146.7 million, the recognition of which would result in a \$17.8 million benefit to the effective tax rate. The decrease in the total unrecognized tax benefits was due to the removal of the Ballantyne Re FIN 48 reserve.

The Company's deferred tax asset is principally supported by the reversal of deferred tax liabilities. We have maintained a full valuation allowance against any remaining net deferred tax asset in the U.S., given our inability to rely on future taxable income tax projections.

We file our tax returns as prescribed by the tax laws of the jurisdictions in which we operate. As of June 30, 2009, 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 2009
Non-Life Group .....	2005 through 2009
Ireland.....	2004 through 2009

### 10. Earnings per Ordinary Share (restated)

Basic earnings per share is computed based on the weighted average number of ordinary shares outstanding and assumes an allocation of net income to Convertible Cumulative Participating Preferred Shares for the period or portion of the period that this security is outstanding. Losses are not allocated to Convertible Cumulative Participating Preferred Shares. Under the provisions of SFAS No. 128, basic earnings per share are computed by dividing the net loss attributable to ordinary shareholders by the weighted average number of shares of our ordinary shares outstanding for the period. Diluted earnings per share is calculated based on the weighted average number of ordinary shares outstanding plus the diluted effect of potential ordinary shares in accordance with the if-converted method. In accordance with SFAS No. 128, the exercise of options and warrants or conversion of convertible securities is not assumed unless it would reduce earnings per share or increase loss per share.



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The following table sets forth the computation of basic and diluted earnings per ordinary share under the two-class method and the if-converted method, respectively, as required under SFAS No. 128 and EITF No. 03-06, "Participating Securities and the Two-Class Method under FASB Statement No. 128".

(U.S. dollars in thousands, except share data)	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
<b>Basic income (loss) attributable to ordinary shareholders</b>				
<b>Numerator:</b>				
Income (loss) from continuing operations.....	\$ 176,874	\$ (413,793)	\$ 1,888,294	\$ (1,149,483)
Amounts allocable to convertible cumulative participating preferred shares....	(2,549)	-	(27,215)	-
Numerator for basic income (loss) per ordinary share .....	<u>\$ 174,325</u>	<u>\$ (413,793)</u>	<u>\$ 1,861,079</u>	<u>\$ (1,149,483)</u>
<b>Denominator:</b>				
Denominator for basic income (loss) per ordinary share - weighted average number of ordinary shares.....	68,383,370	68,383,370	68,383,370	68,383,370
Basic income (loss) from continuing operations attributable to ordinary shareholders.....	<u>\$ 2.55</u>	<u>\$ (6.05)</u>	<u>\$ 27.22</u>	<u>\$ (16.81)</u>
<b>Diluted income (loss) attributable to ordinary shareholders</b>				
<b>Numerator:</b>				
Income (loss) from continuing operations.....	\$ 176,874	\$ (413,793)	\$ 1,888,294	\$ (1,149,483)
Numerator for diluted income (loss) per ordinary share .....	<u>\$ 176,874</u>	<u>\$ (413,793)</u>	<u>\$ 1,888,294</u>	<u>\$ (1,149,483)</u>
<b>Denominator:</b>				
Denominator for basic income (loss) per ordinary share - weighted average number of ordinary shares.....	68,383,370	68,383,370	68,383,370	68,383,370
Effect of dilutive securities* .....	150,000,000	-	150,000,000	-
Denominator for dilutive income (loss) per ordinary share .....	<u>218,383,370</u>	<u>68,383,370</u>	<u>218,383,370</u>	<u>68,383,370</u>
Diluted income (loss) from continuing operations attributable to ordinary shareholders.....	<u>\$ 0.81</u>	<u>\$ (6.05)</u>	<u>\$ 8.65</u>	<u>\$ (16.81)</u>

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\* In accordance with SFAS No. 128, exercise of options and warrants or conversion of convertible securities is not assumed if the result would be anti-dilutive, such as when a loss from continuing operations is reported. As a result, if there is a loss from continuing operations, such as during the three and six months ended June 30, 2008, diluted EPS is computed in the same manner as basic EPS. Due to the anti-dilutive effect on EPS, the following securities could potentially dilute EPS in the future:

- Stock options – 4,914,092 ordinary shares

#### 11. Regulatory and Rating Agencies

##### *Order of Supervision*

In approving the Permitted Practice described above in Note 1, SRUS consented to the issuance by the Department on January 5, 2009 of an Order of Supervision, in accordance with 18 Del. C. §5942. The Order of Supervision subsequently was extended and amended 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 restrictions already were informally in place between SRUS and the Department during much of 2008.

##### *Ratings*

As discussed elsewhere herein, the financial strength ratings on the Company and its subsidiaries were lowered on several occasions since 2007, with a resulting material negative impact on our ability to achieve our previous goal of attaining an “A-” or better rating by the middle of 2009. Ratings at such levels also previously triggered the vesting of contractual recapture rights in respect of certain of our reinsurance business and resulted in the increase to a maximum “stepped up” rate of certain guarantor fees in respect of the securitization structures used to finance the Regulation XXX statutory reserve requirements associated with business ceded by SRUS to each of Orkney Re and Orkney Re II. In light of the foregoing and our pursuit of a run-off strategy for our remaining business, among other factors, the Company determined that it no longer intended to utilize capital for the payment of ratings fees to maintain the financial strength and other ratings on the Company and its operating subsidiaries at such levels. Accordingly, we notified each of the rating agencies in early June 2009 that the Company no longer will be compensating the agencies for their maintenance of such ratings.

Following this communication, on June 12, 2009, A.M. Best Company Inc. (“A.M. Best”) affirmed and then withdrew the financial strength ratings and issuer credit ratings of SALIC, Scottish Re Life Corporation and Orkney Re. At the same time, A.M. Best affirmed and then withdrew our issuer credit rating and the rating of our Perpetual Preferred Shares, as well as our indicative ratings of senior unsecured debt, subordinated debt and preferred stock. SRUS’ financial strength rating of E (Under Regulatory Supervision) and issuer credit rating of “rs” was unchanged.

On June 22, 2009, Fitch Ratings (“Fitch”) downgraded the issuer default rating of SRGL to “CC” from “CCC” and then withdrew its rating of SRGL. At the same time, Fitch affirmed and then withdrew the insurer financial strength rating of SRUS. Fitch also has withdrawn the insurer financial strength rating of SALIC and the rating of the Stingray Pass Through Trust and the Perpetual Preferred Shares. As such, Fitch has withdrawn all ratings of the Company and no longer will provide analytical coverage in respect of the Company and its affiliates.

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We expect similar actions in respect of our ratings to be taken in the near term by Standard & Poor's Corporation. For further discussion on the course of action taken by Moody's Investors Services, Inc. ("Moody's") on our Company's ratings, see Note 15, "Subsequent Events".

#### **12. Sale of a Block of Life Reinsurance North America Business**

As previously disclosed, we engaged in 2008 in a process to sell our entire Life Reinsurance North America Segment. In October 2008, the process led to exclusive negotiations with a prospective buyer; however, 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 we had completed the Purchase Agreement with Hannover Re to sell the Acquired Business.

Pursuant to the Purchase Agreement, Hannover Re purchased the Acquired Business, which was acquired in 2004 by us from the ING Companies. The Acquired Business consists primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business. When we originally purchased the Acquired Business in 2004, the ING Companies reinsured their individual life reinsurance business to us on a 100% indemnity reinsurance basis. A large portion of such business included guaranteed level premium term life insurance that was subject to the "Regulation XXX" reserve requirements and universal life policies with secondary guarantees subject to the "Regulation AXXX" reserve 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 business ceded by SRUS to Ballantyne Re as the reinsurance transaction with this special purpose reinsurance vehicle was novated and assigned from SRUS to SLD effective October 1, 2008. However, the Acquired Business does include the business recaptured from Ballantyne Re in connection with a series of recaptures during 2008 in which SRUS recaptured business from Ballantyne Re, which business then was recaptured by SLD which in turn ceded the recaptured business to SLDI who ceded it to SRLB (the foregoing recaptures, collectively, the "Ballantyne Recaptures"), as well as the business recaptured in connection with the unwind of our collateral finance facility with HSBC Bank (together with the Ballantyne Recaptures, the "ING Financings"). In connection with each of the ING Financings, SLD ceded the applicable recaptured business to SLDI, which ceded the 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 recaptured business in respect of the ING Financings. As partial consideration for each of the ING Financings, the Company agreed to bear the costs of the LOCs by paying SLD a facility fee based on the face amount of such LOCs outstanding. The cost of these LOCs was consistent with the pricing schedules from our 2004 acquisition agreement with ING Companies, as such schedule was amended on May 7, 2007. Upon closing the Purchase Agreement, Hannover Re assumed the business related to the ING Financings as part of the Acquired Business, as well as the obligation to pay the existing and any future increases in the related LOC fees.

In connection with the Purchase Agreement, the ING Companies and certain of the Sellers entered into recapture agreements (and, in specific instances, novations to Hannover Re of certain existing reinsurance agreements) with respect to the Acquired Business, and the ING Companies and Hannover Re subsequently entered into new reinsurance agreements with respect to the Acquired Business immediately thereafter. These recapture and reinsurance transactions and the novations had an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent 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 until September 30, 2009.

The Purchase Agreement also related 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

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from the Sellers to Hannover Re in connection therewith. Pursuant to the Purchase Agreement, the remaining lease on SRUS' Denver office location was assigned to Hannover Re as was a portion of SRUS' Charlotte office location. In addition, Hannover Re entered into an administrative services agreement with SRUS pursuant to which Hannover Re administers 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 administers the Acquired Business and provides 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 corresponding initial premium payments to Hannover Re, and (iii) Hannover Re 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, we are released of all associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities resulted in a pre-tax gain of \$703.6 million, after transaction expenses and related costs. The gain was also subject to certain contingencies with escrow funding considerations as described below, thereby reducing the pre-tax gain recognized in the six months ending June 30, 2009 to \$702.2 million, of which \$642.4 million and \$59.8 million were recognized in the first and second quarters of 2009, respectively. There is also the potential for an additional \$1.4 million gain to be recognized on the second half of the year. This total gain is summarized as follows:

(U.S. dollars in millions)	<u>Balance Sheet</u>	<u>Statement of Operations</u>
Transfer of investments.....	\$ (1,468.7)	
Release of reserve for future policy benefits.....	1,902.9	
Decrease in accounts payable and other liabilities .....	1.7	
Decrease in reinsurance balances and risk fees receivable .....	(6.3)	
Decrease in reinsurance balances payable .....	4.7	
Increase in other assets.....	18.7	
Escrow funding .....	(1.4)	
<b>Decrease in claims and other policy benefits .....</b>	<b>\$ 451.6</b>	<b>\$ 451.6</b>
Decrease in accounts payable and other liabilities .....	275.5	
<b>Change in value of embedded derivatives.....</b>	<b>\$ 275.5</b>	<b>275.5</b>
Release in deferred acquisition costs .....	(24.9)	
<b>Acquisition costs and other insurance expenses, net .....</b>	<b>\$ (24.9)</b>	<b>(24.9)</b>
<b>Total pre-tax gain as at June 30, 2009.....</b>		<b>\$ 702.2</b>

In connection with the Purchase Agreement, 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 ceded to third parties certain risks related to the Acquired Business. If a certain amount of such third party retrocessionaires did not consent to such transfers prior to April 30, 2009, we were required under the Purchase Agreement to deposit into escrow with Hannover Re by May 14, 2009, a pro-rata amount related to such retrocession agreements for which consent had not been obtained as of that date. Pursuant to the Purchase Agreement, in the event none of the retrocessionaires consented to transfer their agreements, the maximum potential escrow funding amount was \$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. As of the escrow funding requirement date of May 14, 2009, the balance was \$1.9 million. As of June 30, 2009, the balance in this escrow

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has been reduced to \$1.4 million. In an effort to further reduce the escrow funds and the potential year-end escrow release to Hannover Re, we will continue our 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.

#### 13. Collateral Finance Facilities

##### *Ballantyne Re*

##### *De-consolidation of Ballantyne Re*

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

The securities we own and the rights we held under the reinsurance agreement with Ballantyne Re were considered variable interests. At inception, we evaluated the rights and obligations allocable to the variable interest holders and determined that we would absorb a majority of the expected losses. As a result, Ballantyne Re since inception was consolidated in our financial statements. The assets of Ballantyne Re were recorded as fixed maturity investments and cash and cash equivalents. Our Consolidated Statement of Operations included the investment return of Ballantyne Re as investment income, realized and unrealized gains and losses and the cost of the securitization structure were reflected in collateral finance facilities expense. Funds in the securitizations were fully used for the sole purpose of the securitizations and hence not available for general corporate purposes.

Ballantyne Re is consolidated in our December 31, 2008 consolidated financial statements for the three and six months ended June 30, 2008. Effective January 1, 2009, Ballantyne Re no longer is consolidated within the financial statements of SRGL. Pursuant to the Purchase Agreement for the disposal of the Acquired Business, Hannover Re explicitly agreed to assume the mortality risk for all recaptures of business from Ballantyne Re. Our disposal of the variable interest to absorb mortality risk recaptured from Ballantyne Re under the reinsurance agreement constituted a reconsideration event related to the consolidation of Ballantyne Re under FIN 46(R). We subsequently completed a primary beneficiary analysis and have concluded that we no longer are the primary beneficiary of Ballantyne Re as defined within FIN 46(R) and, as a result, no longer are consolidating Ballantyne Re into the financial statements of SRGL. The de-consolidation of Ballantyne Re has reduced our consolidated total assets and liabilities by approximately \$885 million and \$2,035 million, respectively, resulting in a one-time non-cash de-consolidation gain of \$1,150 million which we recognized in the first quarter of 2009. This one-time non-cash de-consolidation gain was increased from our previous estimate of \$750 million disclosed in our December 31, 2008 consolidated financial statements primarily for consideration of elimination entries related to our original investment in Ballantyne Re. This gain has no impact on our current or future liquidity position. The following exhibits reflect the significant balances attributable to Ballantyne Re as at the dates indicated below:

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	<b>June 30, 2009*</b>	<b>December 31, 2008**</b>
<b>(U.S. dollars in millions)</b>		
<b>Assets</b>		
Investments .....	\$ 753.8	\$ 641.8
Cash and cash equivalents .....	36.2	235.9
All other assets .....	21.8	7.3
Total assets .....	<u>\$ 811.8</u>	<u>\$ 885.0</u>
<b>Liabilities</b>		
Reserves for future policy benefits .....	\$ 218.8	\$ 241.9
Collateral finance facilities .....	1,700.0	1,700.0
All other liabilities .....	50.1	93.2
Total liabilities .....	<u>\$ 1,968.9</u>	<u>\$ 2,035.1</u>

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30, 2009*</b>	<b>June 30, 2008**</b>	<b>June 30, 2009*</b>	<b>June 30, 2008**</b>
<b>(U.S. dollars in millions)</b>				
<b>Revenues</b>				
Premiums earned, net .....	\$ 20.5	\$ 46.7	\$ 41.4	\$ 103.0
Investment income, net .....	9.0	22.4	18.2	50.9
Net realized and unrealized gains (losses) ....	33.3	(238.3)	(0.1)	(665.2)
Total revenues .....	<u>\$ 62.8</u>	<u>\$ (169.2)</u>	<u>\$ 59.5</u>	<u>\$ (511.3)</u>
<b>Expenses</b>				
Claims and other policy benefits .....	\$ 13.6	\$ 38.4	\$ 32.1	\$ (2.9)
Acquisition costs and other insurance expenses, net .....	5.4	11.7	10.6	25.6
Operating expenses .....	0.1	0.4	0.1	0.1
Collateral finance facilities expense .....	10.5	18.8	23.6	42.6
Total benefits and expenses .....	<u>\$ 29.6</u>	<u>\$ 69.3</u>	<u>\$ 66.4</u>	<u>\$ 65.4</u>

\*Balances and statement of operations are not consolidated in the unaudited consolidated interim financial statements as of June 30, 2009.

\*\*Balances and statement of operations are consolidated in the audited December 31, 2008 consolidated financial statements and the interim consolidated financial statements for the three and six months ended June 30, 2008.

As of June 30, 2009, we had no remaining direct loss exposure related to Ballantyne Re since our interests in the Ballantyne Re Class D Notes and Preferred Shares are valued at \$0 and are classified as trading securities in the Consolidated Balance Sheet as of June 30, 2009. The Class C Notes were contractually written-off during the fourth quarter of 2008.

Following the presentation of the de-consolidation of Ballantyne Re discussed herein, the Company does not intend in future periods to continue to disclose events or matters related to Ballantyne Re except if and to the extent such events have a material relevance to the Company's financial results or condition.

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As discussed in the Disclosure Document dated January 28, 2009 available on our website at [www.scottishre.com](http://www.scottishre.com), SRUS remains liable for breaches of its representations, warranties, covenants and other obligations that relate to periods before the assignment and novation to SLD of the reinsurance agreement with Ballantyne Re. In addition, the Company and SRUS remain responsible for certain ongoing covenants and indemnities made for the benefit of Ballantyne Re and the Financial Guarantors.

#### *Orkney Re II*

##### *Orkney Re II Event of Default, Acceleration and Foreclosure*

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

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

Following these actions, on June 26, 2009, SRUS exercised its contractual right under its agreements with Orkney Re II to withdraw all assets from the reserve credit trust established by Orkney Re II for the benefit of SRUS. The withdrawn assets were deposited into SRUS segregated accounts pursuant to the terms of the reinsurance agreement between SRUS and Orkney Re II (the "Orkney Re II Reinsurance Agreement") where they are held in order to provide reserve credit to SRUS for the reinsurance liabilities that continue to be ceded to Orkney Re II and for certain other permissible uses under the Orkney Re II Reinsurance Agreement. The transfer of assets had no impact on our consolidated financial statements.

For further discussion on the Orkney Re II scheduled interest payments on the Series A-1 Notes, see Note 15, "Subsequent Events".

#### **14. Commitments and 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.

On October 12, 2006, all of the class actions were consolidated. On December 4, 2006, a consolidated class action complaint was filed.

The consolidated complaint which was brought on behalf of a putative class consisting of investors who purchased SRGL's securities between February 17, 2005 and July 31, 2006, alleged violations of various sections of the Securities Exchange Act of 1934, as amended, including section 10(b), and various rules and sections of the Securities Act of 1933, as amended. The complaint sought an unspecified amount of damages, as well as other forms of relief. SRGL and its former officers and directors named in the complaint reached agreement in principle with the plaintiffs on August 1, 2008 to settle the lawsuit. On September 8, 2008, the court entered an order preliminarily

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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 \$5.8 million was paid by SRGL on October 7, 2008, and the remaining \$25.3 million was paid by SRGL's insurance carriers.

#### *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 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 our Board of Directors. 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 our Ordinary Shares.

#### **15. Subsequent Events (restated)**

The subsequent events disclosed in these notes to the consolidated financials have been evaluated by management up to and including the filing of the restated financial statements on November 16, 2009. The original



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unaudited interim financial statements disclosed subsequent events up to the original filing date of September 15, 2009.

#### *Stingray and Stingray Pass-Through Trust*

On November 16, 2009, SALIC launched a cash tender offer to purchase any and all of the outstanding 5.902% Collateral Facility Pass-Through Certificates (the "Pass-Through Certificates") of the Stingray Pass-Through Trust (the "Pass-Through Trust"). The tender offer was made to the holders (the "Holders") of all or part of such Pass-Through Certificates not currently held by SALIC or any of our affiliates upon the terms and subject to the conditions set forth in the related Offer to Purchase and Consent Solicitation, dated November 16, 2009 (as it may be amended and supplemented from time to time, the "Offer to Purchase") and the related Consent and Letter of Transmittal, dated November 16, 2009 (as it may be amended and supplemented from time to time, the "Letter of Transmittal" and, together with the Offer to Purchase, the "Offer"). As of the date of the launch of the Offer, \$155.6 million in aggregate stated amount of Pass-Through Certificates were held by third party Holders and therefore subject to the Offer.

In conjunction with the Offer, SALIC also solicited the consent of a requisite percentage of the Holders (the "Requisite Consents") to proposed amendments to certain of the related transaction documents. The Offer is not conditioned upon receipt of the Requisite Consents, and no separate consideration is being offered or paid for the consents.

The aggregate consideration to be paid by SALIC in connection with the Offer, subject to any modification thereof and assuming 100% participation prior to November 30, 2009, is expected to be \$38.9 million (not including accrued income distributions to the date of settlement). We expect to fund this aggregate consideration from our available cash on hand. If we are successful in consummating all or a portion of the Offer, we will benefit from the reduced interest payments in future periods as well as from the reduced principal obligation reflected in the discounted purchase price. No assurances can be given that we will be successful in acquiring any of the Pass-Through Certificates pursuant to the Offer.

SALIC currently owns approximately \$169.4 million of aggregate stated amount of Pass-Through Certificates, which were purchased in negotiated transactions between August 3, 2009 and October 8, 2009 at an average price of approximately \$0.2196 per dollar of stated amount. Our maximum exposure to loss in respect of the Pass-Through Certificates owned by SALIC is \$37.2 million, representing the consideration for the Pass-Through Certificates. We are evaluating the possibility that we have become the primary beneficiary of Stingray and the Pass-Through Trust. In the event we have become the primary beneficiary (which determination may be unaffected by the success of the Offer), and if Stingray and the Pass-Through Trust remain outstanding at year end 2009, we may be required to consolidate Stingray and the Pass-Through Trust in our financial statements as at and for the year ended December 31, 2009. In the event that we are required to consolidate Stingray and the Pass-Through Trust, such consolidation would be recorded on a purchase accounting basis. Purchase accounting requires us to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in Stingray and the Pass-Through Trust at the acquisition date, measured at their fair values as of that date.

#### *Orkney I*

As discussed in the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2008, on February 11, 2005, Orkney Holdings, LLC, a Delaware limited liability company and subsidiary of SRUS ("Orkney I"), issued and sold in a private offering \$850 million in aggregate principal amount of Series A Floating Rate Insured Notes due February 11, 2035 (the "Orkney Notes") which bear interest at a rate of three month LIBOR plus 0.53%. The Orkney Notes are recourse only to the collateral pledged by Orkney I and are guaranteed by MBIA Insurance Corporation. Neither the Company, nor SALIC, nor any other affiliate is an obligor or guarantor on the Orkney Notes.

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We have been informed by Cerberus that subsequent to June 30, 2009, an affiliate of Cerberus acquired from one or more unaffiliated third parties \$700 million in aggregate principal amount of the Orkney Notes. Neither the Company, Orkney I, Orkney Re nor any of our other subsidiaries were a party to this purchase. No terms of the Orkney Notes or any of the underlying transaction documents were changed as a result of this purchase. In addition, management does not anticipate that the Cerberus affiliate's purchase of the Orkney Notes will have any material impact on our consolidated financial condition and results of operations.

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

Subsequent to June 30, 2009, we have accrued and deferred payment of an additional \$1.7 million of interest on our floating rate capital securities and trust preferred securities. As of November 16, 2009, we have accrued and deferred payment on a total of \$4.9 million of interest.

#### *Non-declaration of Perpetual Preferred Shares dividends*

In accordance with the relevant financial tests under the terms of the Perpetual Preferred Shares, we were precluded from declaring and paying dividends on the July 15, 2009 and October 15, 2009 dividend payment dates. Nonpayment of dividends on the July 15, 2009 date marked the sixth dividend period for which dividends have not been declared and paid. Pursuant to the terms of the Certificate of Designations related to the Perpetual Preferred Shares, the holders of the Perpetual Preferred Shares are entitled to elect two additional directors to our Board in the event dividends on the Perpetual Preferred Shares have not been declared and paid for six or more dividend periods.

#### *Orkney Re II*

On the scheduled interest payment dates of August 11, 2009 and November 12, 2009, Orkney Re II was unable to make scheduled interest payments on the Series A-1 Notes. Assured made guarantee payments on the Series A-1 Notes in the amount of \$1.4 million on August 11, 2009 and \$0.9 million on November 12, 2009, respectively.

#### *Ratings*

On August 18, 2009, Moody's downgraded the insurance financial strength ratings of SALIC to "Ca" from "C" and SRUS to "Ba3" from "Ba1", before withdrawing both ratings. At the same time, Moody's downgraded to "Ca" from "C" and then withdrew the senior secured rating of the Stingray Pass Through Trust and our preferred stock rating.

#### *Delaware Emergency Regulations*

The Emergency Regulations were adopted into law pursuant to the Delaware Administrative Procedures Act on September 1, 2009.