
SCOTTISH RE GROUP LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE QUARTERLY PERIOD ENDED
SEPTEMBER 30, 2008**

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SCOTTISH RE GROUP LIMITED
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Expressed in Thousands of United States Dollars, Except Share Data)

	September 30, 2008	December 31, 2007
ASSETS		
Fixed maturity investments, trading at fair value (2007 - available for sale at fair value, amortized cost \$7,394,615).....	\$ 4,648,588	\$ 7,432,118
Preferred stock, trading at fair value (2007 - available for sale at fair value, cost \$88,914)	74,933	88,973
Cash and cash equivalents	1,362,594	754,253
Other investments	29,461	62,658
Funds withheld at interest.....	2,272,198	1,597,404
Total investments.....	8,387,774	9,935,406
Accrued interest receivable	41,624	54,590
Reinsurance balances and risk fees receivable	217,987	359,259
Deferred acquisition costs	474,637	581,131
Amount recoverable from reinsurers	738,279	533,018
Present value of in-force business	40,297	41,859
Other assets.....	147,791	129,759
Current income tax receivable.....	10,176	10,965
Deferred tax asset	4,407	4,943
Segregated assets	57,261	-
Assets held for sale.....	-	1,170,133
Total assets	\$ 10,120,233	\$ 12,821,063
LIABILITIES		
Reserves for future policy benefits.....	\$ 3,988,000	\$ 3,845,789
Interest sensitive contract liabilities	2,617,950	2,560,785
Collateral finance facilities.....	3,567,713	3,980,379
Accounts payable and other liabilities	339,304	273,026
Reinsurance balances payable	472,132	137,935
Deferred tax liability.....	211	165
Long term debt	129,500	129,500
Segregated liabilities	57,261	-
Liabilities held for sale	-	981,875
Total liabilities.....	11,172,071	11,909,454
MINORITY INTEREST	7,685	9,025
MEZZANINE EQUITY		
Convertible cumulative participating preferred shares, (liquidation preference, \$661.1 million)	555,857	555,857
Total mezzanine equity.....	555,857	555,857
Commitments and contingencies (Note 12)		
SHAREHOLDERS' (DEFICIT) EQUITY		
Ordinary shares, par value \$0.01:		
Issued 68,383,370 shares (2007 – 68,383,370).....	684	684
Non-cumulative perpetual preferred shares, par value \$0.01:		
Issued: 5,000,000 shares (2007 – 5,000,000).....	125,000	125,000
Additional paid-in capital	1,216,473	1,214,886
Accumulated other comprehensive income	-	48,556
Retained deficit.....	(2,957,537)	(1,042,399)
Total shareholders' (deficit) equity.....	(1,615,380)	346,727
Total liabilities, minority interest, mezzanine equity and shareholders' (deficit) equity	\$ 10,120,233	\$ 12,821,063

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(Expressed in Thousands of United States Dollars, Except Share Data)

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Revenues				
Premiums earned, net	\$ 389,086	\$ 428,806	\$ 1,201,916	\$ 1,282,459
Fee and other income.....	1,161	5,661	7,560	12,288
Investment income, net.....	88,457	150,768	295,541	446,796
Net realized and unrealized losses.....	(475,380)	(185,174)	(1,454,379)	(190,434)
Change in value of embedded derivatives, net	(36,474)	(20,196)	(38,615)	(19,242)
Total revenues	<u>(33,150)</u>	<u>379,865</u>	<u>12,023</u>	<u>1,531,867</u>
Benefits and expenses				
Claims and other policy benefits	386,848	349,207	1,139,966	1,074,838
Interest credited to interest sensitive contract liabilities	16,301	29,978	58,927	101,700
Acquisition costs and other insurance expenses, net ...	215,191	89,838	387,049	269,336
Operating expenses.....	29,694	28,983	107,714	101,092
Collateral finance facilities expense	54,994	73,667	192,623	222,647
Interest expense	2,510	3,293	7,570	14,903
Total benefits and expenses	<u>705,538</u>	<u>574,966</u>	<u>1,893,849</u>	<u>1,784,516</u>
Loss before income taxes and minority interest.....	(738,688)	(195,101)	(1,881,826)	(252,649)
Income tax benefit	14,996	7,779	8,552	148,643
Loss before minority interest.....	(723,692)	(187,322)	(1,873,274)	(104,006)
Minority interest	1,038	227	1,137	501
Loss from continuing operations.....	(722,654)	(187,095)	(1,872,137)	(103,505)
Income (loss) from discontinued operations, net of related taxes	8,776	(2,980)	(43,001)	(17,092)
Net loss.....	(713,878)	(190,075)	(1,915,138)	(120,597)
Dividend declared on non-cumulative perpetual preferred shares	-	(2,266)	-	(6,797)
Deemed dividend on beneficial conversion feature related to convertible cumulative participating preferred shares	-	-	-	(120,750)
Net loss attributable to ordinary shareholders	\$ (713,878)	\$ (192,341)	\$ (1,915,138)	\$ (248,144)
Basic and diluted loss per ordinary share:				
Loss from continuing operations	\$ (10.57)	\$ (2.74)	\$ (27.38)	\$ (1.55)
Income (loss) from discontinued operations.....	\$ 0.13	\$ (0.04)	\$ (0.63)	\$ (0.25)
Net loss	\$ (10.44)	\$ (2.78)	\$ (28.01)	\$ (1.80)
Net loss attributable to ordinary shareholders	\$ (10.44)	\$ (2.81)	\$ (28.01)	\$ (3.71)
Weighted average number of ordinary shares outstanding	68,383,370	68,383,370	68,383,370	66,939,007

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2008</u>	<u>September 30, 2007</u>	<u>September 30, 2008</u>	<u>September 30, 2007</u>
Net loss	\$ (713,878)	\$ (190,075)	\$ (1,915,138)	\$ (120,597)
Other comprehensive loss:				
Unrealized depreciation on investments	-	(275,759)	-	(363,443)
Reclassification adjustment for net realized and unrealized gains (losses) included in net loss	-	140,002	(26,310)	145,684
Net unrealized appreciation (depreciation) on investments, net of income taxes, deferred acquisition costs and minority interest.....	-	(135,757)	(26,310)	(217,759)
Cumulative translation adjustment	(29,960)	2,436	(24,590)	5,826
Benefit plans.....	2,344	-	2,344	-
Other comprehensive loss.....	(27,616)	(133,321)	(48,556)	(211,933)
Comprehensive loss	<u>\$ (741,494)</u>	<u>\$ (323,396)</u>	<u>\$ (1,963,694)</u>	<u>\$ (332,530)</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Share capital:		
Ordinary shares:		
Beginning of period	\$ 684	\$ 606
Issuance to holders of HyCUs on conversion of purchase contracts	-	74
Issuance to holders of restricted stock awards	-	4
End of period	<u>684</u>	<u>684</u>
Non-cumulative perpetual preferred shares:		
Beginning and end of period	<u>125,000</u>	<u>125,000</u>
Additional paid-in capital:		
Beginning of period	1,214,886	1,050,860
Option and restricted stock unit expense	1,587	19,122
Issuance to holders of HyCUs on conversion of purchase contracts	-	143,675
Beneficial conversion feature related to convertible cumulative participating preferred shares	-	120,750
Accretion of beneficial conversion feature related to convertible cumulative participating preferred shares	-	(120,750)
Other	-	31
End of period	<u>1,216,473</u>	<u>1,213,688</u>
Accumulated other comprehensive income (loss):		
Unrealized appreciation (depreciation) on investments net of income taxes, deferred acquisition costs and minority interest		
Beginning of period	26,310	(19,624)
Change in period	(26,310)	(217,759)
End of period	<u>-</u>	<u>(237,383)</u>
Cumulative translation adjustment		
Beginning of period	24,590	22,826
Change in period (net of tax)	(24,590)	5,826
End of period	<u>-</u>	<u>28,652</u>
Benefit plans		
Beginning of period	(2,344)	(2,862)
Change in period (net of tax)	2,344	-
End of period	<u>-</u>	<u>(2,862)</u>
Total accumulated other comprehensive loss	<u>-</u>	<u>(211,593)</u>
Retained deficit:		
Beginning of period	(1,042,399)	(119,614)
Adoption of FIN 48 on January 1, 2007	-	(17,981)
Net loss	(1,915,138)	(120,597)
Dividends declared on non-cumulative perpetual preferred shares	-	(6,797)
End of period	<u>(2,957,537)</u>	<u>(264,989)</u>
Total shareholders' (deficit) equity	<u><u>\$ (1,615,380)</u></u>	<u><u>\$ 862,790</u></u>

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)

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Operating activities		
Net loss	\$ (1,915,138)	\$ (120,597)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Net realized losses	1,452,516	192,494
Changes in value of embedded derivatives, net	38,615	19,242
Amortization of discount on fixed maturity investments and preferred stock	281	9,146
Amortization and write-downs of deferred acquisition costs	113,894	68,655
Amortization and write down of present value of in-force business	5,263	2,469
Amortization and write-downs of deferred transaction costs	21,389	11,219
Depreciation of fixed assets	6,593	8,360
Option and restricted stock unit expense	1,587	19,122
Minority interest	(1,137)	(501)
Changes in assets and liabilities:		
Accrued interest receivable	16,185	35
Reinsurance balances and risk fees receivable	557,123	(31,433)
Deferred acquisition costs	40,130	(69,563)
Deferred tax asset and liability	9,123	(183,555)
Other assets	(54,567)	30,122
Current income tax receivable and payable	893	(7,718)
Reserves for future policy benefits, net of amounts recoverable from reinsurers	(259,643)	245,807
Funds withheld at interest	(674,862)	305,850
Interest sensitive contract liabilities	(29,916)	(279,754)
Accounts payable and other liabilities	15,341	61,229
Net cash (used in) provided by operating activities	<u>(656,330)</u>	<u>280,629</u>
Investing activities		
Purchase of fixed maturity investments	(256,452)	(703,682)
Proceeds from sales of fixed maturity investments	1,289,752	164,187
Proceeds from maturity and return of capital of fixed maturity investments	466,327	476,523
Purchase of preferred stock	-	(1,899)
Proceeds from sale and maturity of preferred stock	3,167	15,052
Purchase of and proceeds from other investments, net	29,922	963
Proceeds from sale (purchase) of fixed assets	4,358	(3,281)
Net cash provided by (used in) investing activities	<u>1,537,074</u>	<u>(52,137)</u>
Financing activities		
Deposits to interest sensitive contract liabilities	700	7,541
Withdrawals from interest sensitive contract liabilities	(251,769)	(122,621)
Proceeds from issuance of convertible cumulative participating preferred shares	-	555,857
Proceeds from issuance to holders of HyCUs on conversion of purchase contracts	-	7,338
Redemption of convertible preferred shares	-	(7,338)
Dividends paid on redemption of convertible preferred shares	-	(222)
Proceeds from collateral finance facilities	-	431,514
Payments on collateral finance facilities	(412,666)	(188,527)
Proceeds from (repayment on) drawdown of Stingray facility	325,000	(275,000)
Proceeds from issuance of ordinary shares	-	78
Dividends paid on non-cumulative perpetual preferred shares	(2,266)	(6,797)
Net cash (used in) provided by financing activities	<u>(341,001)</u>	<u>401,823</u>

Net change in cash and cash equivalents.....	539,743	630,315
Cash and cash equivalents, beginning of period.....	822,851	622,756
Cash and cash equivalents, end of period.....	<u>\$ 1,362,594</u>	<u>\$ 1,253,071</u>

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business

Organization

Scottish Re Group Limited (“SRGL”, the “Company”, “we”, “our” and “us”) is a holding company incorporated under the laws of the Cayman Islands 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.

Change in Strategic Focus

We have faced a number of significant challenges over the past several years which has required us to change our strategic focus as previously disclosed. These challenges have included:

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

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

The Board unanimously adopted the Special Committee’s recommendations and we announced on February 22, 2008, our pursuit of the following key strategies:

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

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

- On March 31, 2008, we entered into a binding letter of intent (the “March 31 LOI”) with ING North America Insurance Corporation (“ING NA Corp.”), ING America Insurance Holdings, Inc. (“ING NA Inc.”), and together with ING NA Corp., “ING”), Security Life of Denver Insurance Company (“SLD”) and Security Life of Denver International Limited (“SLDI” and, together with SLD, the “ING Companies”). Under the March 31 LOI, SLD consented to the recapture (the “First Quarter Recapture”), as of March 31, 2008, of a pro-rata portion of the business that had been ceded by Scottish Re (U.S.), Inc. (“SRUS”) to Ballantyne Re plc (“Ballantyne Re”) for the purpose of collateralizing the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX (“Regulation XXX”) for a portion of the business acquired by us from the ING Companies at the end of 2004 (such portion related to the Ballantyne Re transaction, the “Ballantyne Business”). On May 6, 2008, we completed this transaction and recaptured approximately 30% of the Ballantyne Business, effective as of March 31, 2008. Immediately following the consummation of this transaction, SLD recaptured the recaptured business from SRUS in exchange for consideration from SRUS to SLD, and then ceded the recaptured business to SLDI, which ceded the recaptured business to Scottish Re Life (Bermuda) Limited (“SRLB”). The business was in turn retroceded to Scottish Re (Dublin) Limited (“SRD”). In connection with this transaction, we recorded a pre-tax net loss of \$0.2 million related to the consent fees paid.
- With respect to another of our securitization structures, Orkney Re II plc (“Orkney Re II”), in May 2008 we executed amendments to certain transaction documents to provide us increased flexibility in dealing with additional near term estimated fair value declines in the sub-prime and Alt-A securities held by Orkney Re II. The amendments eliminate certain priority of payment limitations and provide us with the ability to more effectively recapture business from Orkney Re II.
- On June 30, 2008, we entered into a binding letter of intent with the ING Companies (the “June 30th LOI”). The June 30th LOI related to the business that SRUS ceded to Ballantyne Re for the purpose of collateralizing the Regulation XXX reserve requirements for the Ballantyne Business. Pursuant to the June 30th LOI, SLD consented to the recapture (the “Second Quarter Recapture”) by SRUS of a pro-rata portion of the Ballantyne Business effective as of June 30, 2008. On August 11, 2008, we effectuated this transaction and recaptured approximately 15.5% of the Ballantyne Business. Immediately following the consummation of this transaction, SLD recaptured the recaptured business from SRUS in exchange for consideration from SRUS to SLD, and then ceded the recaptured business to SLDI, which ceded the recaptured business to SRLB. The business was in turn retroceded to Scottish Annuity & Life Insurance Company (Cayman) Ltd. (“SALIC”). There was no net income impact related to this transaction.
- 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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

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 SALIC.

- In connection with our Clearwater Re Limited (“Clearwater Re”) collateral finance facility, on August 29, 2008, we completed a full recapture, effective as of July 1, 2008, of the business ceded from SRUS to Clearwater Re and immediately retroceded the recaptured business, also effective as of July 1, 2008, from SRUS to an unaffiliated third party reinsurer, which in turn was retroceded to Hannover Life Reassurance (Ireland) Limited (“Hannover (Ireland)”). In connection with the recapture transaction, the bank counterparties to the Clearwater Re collateral finance facility were repaid in full, thereby removing the related forbearance agreement. We also paid a \$4 million fee to the bank-counterparties and the facility, and the related forbearance agreement and its terms, were terminated. Effective September 30, 2008, SRUS retroceded the remaining portion of the related defined block of business that it had retained at the time of the Clearwater Re transaction to the same third party reinsurer who in turn retroceded such business to Hannover (Ireland). On a consolidated basis, the Clearwater Re transactions and the retrocession of the remaining portion of the business originally held by SRUS resulted in a reduction of total assets and total liabilities of \$623.8 million and \$504.3 million, respectively, resulting in a pre-tax loss of \$119.5 million during the period ended September 30, 2008. The loss primarily was comprised of the write off of deferred acquisition costs of \$75.1 million and a negative ceding commission of \$39.4 million, both of which are recorded in Acquisition costs and other insurance expenses, net. See Note 13, “Termination of Forbearance Agreements with Counterparties.”
- On September 30, 2008, we entered into a binding letter of intent (the “September 30th LOI”) with ING and the ING Companies. Pursuant to the September 30th LOI, SLD consented to the recapture by SRUS, effective as of September 30, 2008 (the “Third Quarter Recapture”), of a pro-rata portion of the business that had been ceded by SRUS to Ballantyne Re for the purpose of collateralizing the Regulation XXX reserve requirements for the Ballantyne Business. On November 12, 2008, we effectuated the Third Quarter Recapture, which comprised approximately 6.5% of the Ballantyne Business. Immediately following the Third Quarter Recapture, and effective as of September 30, 2008, SLD recaptured the recaptured business from SRUS and ceded it to SLDI, which in turn immediately retroceded it to SRLB which in turn immediately retroceded it to SALIC. There was no net income impact related to this transaction.
- On October 15, 2008, we and certain of our subsidiaries entered into a series of transactions with an effective date of September 30, 2008, to unwind our collateral finance facility with HSBC Bank (“HSBC II”). In connection with the unwind transactions, HSBC was repaid in full, together with a payment of a \$6 million fee pursuant to the related forbearance agreement, and the facility and the forbearance agreement and its terms were terminated. Both the unwind and the related loss were recorded as components of fourth quarter 2008 results as the unwind was not fully effectuated until October 2008. A pre-tax loss of \$10.3 million was recognized on this transaction primarily related to forbearance costs. See Note 13, “Termination of Forbearance Agreements with Counterparties.”
- On November 19, 2008, with an effective date of October 1, 2008, SRUS assigned and novated to SLD the reinsurance agreement and reinsurance trust agreement between SRUS and Ballantyne Re (the “Assignment”) as follows: (a) SRUS assigned to SLD its existing reinsurance agreement with Ballantyne Re (pursuant to which SRUS retroceded to Ballantyne Re the Ballantyne Business) (the “Pre-Assignment Reinsurance Agreement”) and its existing reinsurance trust agreement with Ballantyne Re, (b) immediately thereafter, SLD and Ballantyne Re amended and restated that reinsurance agreement (the “Post-Assignment Reinsurance Agreement”), pursuant to which SLD cedes directly to Ballantyne Re the remaining portion of the Ballantyne Business, and amended and restated that reinsurance trust agreement, pursuant to which SLD is the sole beneficiary of the reinsurance trust account maintained by Ballantyne Re, and (c) SLD and

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

SRUS amended and restated their existing reinsurance agreement related to the Ballantyne Business to reflect these changes. There was no net income impact related to this transaction.

- Effective December 31, 2008, the ING Companies recaptured, on a pro-rata basis, 11.4% of the original Ballantyne Business (the “Fourth Quarter Recapture”). Immediately following the Fourth Quarter Recapture, and effective as of December 31, 2008, SLD ceded the recaptured business to SLDI, which in turn immediately retroceded it to SRLB, which in turn immediately retroceded it to SALIC. There was no net income impact related to this transaction. See Note 18, “Subsequent Events” for further discussion related to the assumption of the business recaptured in connection with the First, Second, Third and Fourth Quarter Recaptures.
- Additionally, the fair value of the securities in certain qualifying reserve credit trust accounts has declined significantly, such that, absent a permitted statutory accounting practice, SRUS would have been forced to take credit on its statutory financial statements for less than the full amount of the related obligations reinsured by SRUS to Orkney Re, Inc. (“Orkney Re”), Orkney Re II and SALIC. This shortfall in reserve credit would have placed significant financial stress upon the statutory capital position of SRUS and, in turn, the solvency of SALIC and SRGL. As a result, SRUS requested and received approval from the Delaware Department of Insurance (the “Department”) for a permitted accounting practice (the “Permitted Practice”), as of September 30, 2008, related to the Orkney Re and Orkney Re II securitizations as well as the reserve credit trusts with respect to reinsurance ceded to SALIC. The Permitted Practice relieved SRUS’ need to receive, and SALIC’s corresponding obligation to fund additional capital contributions for the quarter. The value of this Permitted Practice may increase over time generally as a result of increases in statutory reserves or decreases in market values. In connection with the Permitted Practice, SALIC agreed to contribute to SRUS \$30.3 million in capital prior to SRUS filing its third quarter 2008 financial statements and an additional \$7 million prior to SRUS filing its fourth quarter 2008 financial statements.
- Due to market value degradation and its impact on SRD’s solvency, we effectuated a transfer of a majority of our business in SRD to SALIC effective October 1, 2008. SALIC in return received modified coinsurance assets with respect to the ING business originally ceded to SRD, reserve credit trust assets with respect to business originally ceded from SRUS to SRD, which business also was transferred from SRD to SALIC, and a \$70 million surplus note originally issued by SRUS to SRD. There was no net income impact related to this transaction.
- In connection with SRUS’ receipt, effective as of September 30, 2008, of the Permitted Practice, SRUS consented to the issuance by the Department on January 5, 2009 of an Order of Supervision against SRUS (the “Order of Supervision”), in accordance with 18 Del. C. §5942. The Order of Supervision requires, among other things, the Department’s consent to any transaction by SRUS outside the ordinary course of business or with its affiliates, and in large part formalizes certain reporting and processes already informally implemented between SRUS and the Department during 2008. The Order of Supervision, which was set to lapse on April 5, 2009 (and every 90 days thereafter pursuant to Delaware regulation), subsequently was amended and replaced with a Continued and Amended Order of Supervision, dated April 3, 2009, which amends and clarifies certain matters contained within the original Order of Supervision.
- On January 22, 2009, the Company, Scottish Holdings, Inc. (“SHI”), SRUS, SRLB and SRD (collectively, the “Sellers”) entered into a Master Asset Purchase Agreement (the “Purchase Agreement”) with Hannover Life Reassurance Company of America and its affiliate, Hannover (Ireland) (together, “Hannover Re”), and the ING Companies, pursuant to which Hannover Re agreed to purchase from the Sellers a block of individual life reinsurance business acquired in 2004 by us from the ING Companies, which block consisted primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business (the “Acquired Business”). The Acquired Business does not include business formerly

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

reinsured from SRUS to Ballantyne Re, as this business was novated and assigned to SLD effective October 1, 2008, as discussed above. In addition to the acquisition of the Acquired Business, the Purchase Agreement also related to the sale to Hannover Re of certain assets used by the Sellers in connection with the administration of the Acquired Business and our 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 by the ING Companies from certain of the Sellers of the Acquired Business, and the cession immediately thereafter by the ING Companies to Hannover Re of the Acquired Business under new reinsurance agreements and (ii) in specific instances, by a novation of existing reinsurance agreements from certain of the Sellers to Hannover Re. These recapture and reinsurance transactions and the novation agreements each have an effective date of January 1, 2009. SRUS and SRLB remain responsible for liabilities and obligations to SLD and SLDI under their reinsurance agreements with these parties to the extent attributable to periods prior to January 1, 2009 and SRUS and SRLB have collateralized these obligations by depositing assets in trust accounts established for the benefit of SLD and SLDI. Following the transfer of assets with respect to the recaptures noted above, we were released of associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities is estimated to result in a pre-tax non-cash GAAP gain of approximately \$700 million, after transaction expenses and related costs.

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

- Through negotiated repurchases, we extinguished the \$100 million payment obligation falling due on March 12, 2009, in respect of the Premium Asset Trust (“PATS”) funding agreement to which SALIC was a party for a significant discount to par on an aggregate basis.

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

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

Business

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

Life Reinsurance North America

In our Life Reinsurance North America Segment, we have assumed risks associated with primary life insurance, annuities and annuity-type policies. We reinsure mortality, investment, persistency and expense risks of United States life insurance and reinsurance companies. Most of the reinsurance assumed is through automatic treaties, but in 2006 we also began assuming risks on a facultative basis. The Life Reinsurance North America Segment suspended bidding for new business treaties on March 3, 2008, and issued notices of cancellation for all open treaties. See Note 24 “Subsequent Events” for additional details on the Sale of a Block of Life Reinsurance North America Business and Run-Off strategy. The business we have written falls into two categories: Traditional Solutions and Financial Solutions, as detailed below.

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

1. Organization and Business (continued)

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

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

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

Corporate and Other

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

2. 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. The results for the interim period are not necessarily indicative of the results to be expected for the full year ending December 31, 2008. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our 2007 Annual Report on Form 10-K for the year ended December 31, 2007 ("2007 Annual Report").

Going Concern - These consolidated financial statements have been prepared using accounting principles applicable to a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. We have incurred a net loss of \$713.9 million and \$1,915.1 million for the three and nine months ended September 30, 2008 and shareholders' deficit of \$1,615.4 million as of September 30, 2008. Our operating results and financial condition have deteriorated due to, among other things, prevailing global credit market conditions throughout 2008 that have had a dramatic effect on the financial services industry and the global economy. The turmoil in the mortgage and broader credit markets have resulted in declines in the fair value of our invested assets, which contain a significant concentration of sub-prime and Alt-A residential mortgage-backed securities. These conditions have generally worsened during the fourth quarter of 2008 and, notwithstanding the unprecedented intervention of the United States and other governments in the global banking and financial markets, we do not expect these adverse market conditions and their impact on us to improve significantly in the near term.

In the event that for any reason, we fail to comply with the Department's Order of Supervision, or in the event the financial condition of SRUS materially were to deteriorate, the Department may take action to seize control of SRUS under applicable insurance law. Such a seizure would place control of all management decisions of SRUS with the Department, including with respect to controlling cash flows, settling claims and paying obligations. The primary objective of the Department would be to protect the interests of the policyholders and ceding insurers with

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

3. New Accounting Pronouncements (continued)

whom SRUS has contracted and would not be to protect the interests of SRGL, SALIC, the shareholders or any other stakeholders of the Company. A seizure of SRUS would have numerous consequences, including potentially triggering ceding company recapture rights on reinsurance agreements with us. Such seizure may also lead to the need for SALIC and SRGL to seek bankruptcy protection. Based upon management's preliminary analysis, in the event of bankruptcy, SRGL and SALIC may not have sufficient funds to pay creditors or the ability to execute an orderly run-off strategy.

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

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

Consolidation - The consolidated financial statements include the assets, liabilities and results of operations of 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.

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

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

3. New Accounting Pronouncements (continued)

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

Statement of Cash Flows

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

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

3. New Accounting Pronouncements

FASB Statement No. 157, Fair Value Measurements

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

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

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

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

In December 2008, the FASB issued FSP FAS No. 140-4 and FIN 46(R)-8, “Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities” (“FSP No. 140-4”). FSP No. 140-4 amends FASB Statement No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (“SFAS No. 140”) to require additional disclosures regarding a transferor’s continuing involvement with transferred financial assets in a securitization or asset-backed financing arrangement. FSP No. 140-4 also amends FIN 46 (revised December 2003) “Consolidation of Variable Interest Entities,” to expand the disclosure requirements for variable interest entities (“VIEs”) to include information regarding the decision to consolidate the VIE, the nature of and changes in risks related to a VIE, and the impact on the entity’s financial statements due to the involvement with a VIE. Those variable interests required to comply with the guidance in FSP No. 140-4 include the primary beneficiary of the VIE, the holder of a significant variable interest

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

3. New Accounting Pronouncements (continued)

and a sponsor that holds a variable interest. Further, FSP No. 140-4 requires enhanced disclosures for certain sponsors and holders of a significant variable interest in a qualifying special purpose entity. The provisions of FSP No. 140-4 are effective for the first reporting period ending after December 15, 2008, and comparative disclosures are not required. We included the enhanced disclosures required by FSP No. 140-4 in the notes to the consolidated financial statements beginning in the reporting period ended December 31, 2008.

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

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

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

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

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

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

4. Discontinued Operations

Disposal of Wealth Management Business

On July 11, 2008, the sale of the Wealth Management business closed with respect to Scottish Annuity & Life Insurance Company (Bermuda) Ltd. and Scottish Annuity & Life International Insurance Company (Bermuda) Ltd., and on August 5, 2008, the transaction closed with respect to The Scottish Annuity Company (Cayman) Ltd. We generated proceeds of \$9.3 million and recognized a net loss of \$4.9 million on this sale.

Disposal of Life Reinsurance International Segment

On July 18, 2008, Pacific Life Insurance Company concluded the purchase of Scottish Re Holdings Limited and the U.K. portion of the Life Reinsurance International Segment 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 Insurance Company of \$0.5 million. We recorded an aggregate loss of \$31 million on these transactions in fiscal year 2008. Pre-sale, the Life Reinsurance International Segment incurred a loss from operations of approximately \$7 million. Additionally, in March 2009, the Singapore branch was closed and \$6.1 million of capital was returned to SALIC.

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

(U.S. dollars in thousands)	As of December 31, 2007
Fixed maturity investments, trading at fair value	\$ 189,124
Cash and cash equivalents	68,598
Other investments	6
Funds withheld at interest	(68)
Total investments	257,660
Accrued interest receivable	3,219
Reinsurance balances and risk fees receivable	119,835
Deferred acquisition costs	39,634
Amount recoverable from reinsurers	29,519
Present value of in-force business	3,701
Other assets	10,471
Current income tax receivable	104
Deferred tax liability	2,045
Segregated assets	703,945
Total Assets held for sale	<u>\$ 1,170,133</u>
Reserves for future policy benefits	\$ 226,112
Accounts payable and other liabilities	14,585
Reinsurance balances payable	37,233
Segregated liabilities	703,945
Total Liabilities held for sale	<u>\$ 981,875</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

5. Investments

As described in Note 1 “Organization and Business”, significant market developments have materially affected our capital, liquidity and collateral position, and we have responded by changing our strategic focus and affecting an orderly run-off of our remaining business. As a result, on a consolidated GAAP basis, the invested assets and long term liabilities are no longer expected to be held until maturity or settlement. Therefore, effective January 1, 2008, our invested assets, previously classified as available-for-sale, are now classified as trading and the balances in fixed maturity investments - available-for-sale and preferred stock - available for sale were transferred to trading securities. Additionally, as of January 1, 2008, the balance of unrealized appreciation on investments of \$38.5 million, which was previously 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 flow, the investments are accounted for under the cost recovery method, whereby all principal and coupon payments received are applied as a reduction of the carrying value. Cash flows for trading securities are classified in Investing Activities on the consolidated 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 three and nine months ended September 30, 2008 that relates to trading securities still held at the reporting date is \$455.9 million and \$1,444.0 million, respectively.

6. Fair Value Measurements

We adopted SFAS No. 157 as of January 1, 2008. SFAS No. 157 establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and enhances disclosure requirements for fair value measurements.

The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

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

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

6. Fair Value Measurements (continued)

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 securities where we cannot corroborate the significant valuation inputs with market observable data. Additionally, our embedded derivatives, all of which are associated with reinsurance treaties, are classified in Level 3 since their values include significant unobservable inputs associated with actuarial assumptions regarding policyholder behavior. Embedded derivatives are reported with the host instruments in the consolidated balance 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 embedded derivatives in equity indexed liabilities include the embedded derivatives resulting from the bifurcation of assumed equity indexed annuity liabilities.

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

6. Fair Value Measurements (continued)

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

	September 30, 2008			
(U.S. dollars in millions)	Total	Level 1	Level 2	Level 3
Investments				
Fixed maturity investments	\$ 4,648.6	\$ -	\$ 3,382.6	\$ 1,266.0
Preferred stock.....	74.9	-	28.4	46.5
Total assets at fair value	<u>\$ 4,723.5</u>	<u>\$ -</u>	<u>\$ 3,411.0</u>	<u>\$ 1,312.5</u>
Funds withheld at interest – embedded derivatives.....	(88.7)	-	-	(88.7)
Interest sensitive contract liabilities – embedded derivatives	(81.4)	-	-	(81.4)
Total liabilities at fair value.....	<u>\$ (170.1)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (170.1)</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:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			
(U.S. dollars in millions)	Fixed Maturities & Preferred Stock	Funds Withheld at Interest – Embedded Derivatives	Interest Sensitive Contract Liabilities – Embedded Derivatives	Total
Beginning balance at January 1, 2008	\$ 2,552.6	\$ (38.5)	\$ (93.0)	\$ 2,421.1
Total realized and unrealized gains (losses) included in net loss	(1,134.9)	(50.2)	11.6	(1,173.5)
Purchases, issuances and settlements	(90.6)	-	-	(90.6)
Transfers in and/or out of Level 3	(14.6)	-	-	(14.6)
Ending balance at September 30, 2008.....	<u>\$ 1,312.5</u>	<u>\$ (88.7)</u>	<u>\$ (81.4)</u>	<u>\$ 1,142.4</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.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

7. Other Funding Arrangements

Stingray Drawdown

On January 12, 2005, we entered into a put agreement with Stingray for an aggregate value of \$325.0 million. Under the terms of the put agreement, we acquired an irrevocable put option to issue funding agreements to Stingray in return for the assets in a portfolio of 30 day commercial paper.

In accordance with FIN 46R, we are not considered to be the primary beneficiary and, as a result, we are not required to consolidate Stingray. We are not responsible for any losses incurred by the Stingray Pass Through Trust. Any funds drawn down on the facility are included in interest sensitive contract liabilities on our 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 September 30, 2008.

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 each invested \$300.0 million in us in exchange for 500,000 (1,000,000 in the aggregate) newly issued Convertible Cumulative Participating Preferred Shares. The gross proceeds were \$600.0 million less \$44.1 million in closing costs, which resulted in aggregate net proceeds of \$555.9 million. Each Convertible Cumulative Participating Preferred Share has a par value of \$0.01 per share with a liquidation preference of \$600 per share, as adjusted for dividends or distributions as described further below.

As of September 30, 2008, 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 of Directors.

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 will automatically 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 \$600.0 million. Dividends will only 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 period as this scenario is not deemed probable at this time. As of September 30, 2008, the amount of dividends not accrued pursuant to the terms of the Convertible Cumulative Participating Preferred Shares is \$61.1 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

SCOTTISH RE GROUP LIMITED

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September 30, 2008

8. Mezzanine Equity (continued)

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 of Directors, 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.

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 12 "Commitments and Contingencies" certain statutory accounting errors were discovered in the prior year which has resulted in an indemnification claim against us. Resolution of this claim could result in a change in the conversion formula on these securities.

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September 30, 2008

9. Income Taxes

Income tax benefit for the three months and nine months ended September 30, 2008 was \$15.0 million and \$8.6 million, respectively, compared to income tax benefit of \$7.8 million and \$148.6 million in the same periods in 2007. The change in our effective tax rate in the third quarter ended September 30, 2008 compared to the same period in 2007 is primarily related to a release of our valuation allowance which was established in previous periods on deferred tax assets for certain operating entities, as well as an increase in the valuation allowance related to other operating entities for which no current period benefit is being recognized and the release of the FIN 48 liability due to the expiration of certain statute of limitations.

At December 31, 2007, we had total unrecognized tax benefits (excluding interest and penalties) of \$187.1 million, the recognition of which would result in a \$17.1 million benefit. At September 30, 2008, we had total unrecognized tax benefits (excluding interest and penalties) of \$166.2 million, the recognition of which would result in a \$17.6 million benefit to the effective tax rate. The statute of limitations expired for the 2004 U.S. federal income tax year, which resulted in a reduction of our unrecognized tax benefits in the amount of \$21.9 million.

Our gross deferred tax asset is principally supported by the reversal of deferred tax liabilities. We have maintained a full valuation allowance against any remaining deferred tax asset in the U.S., U.K., Ireland and Singapore, 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 September 30, 2008, we remained subject to examination in the following major tax jurisdictions for the years indicated below:

<u>Major Tax Jurisdictions</u>	<u>Open Years</u>
U.S.	
Life Group	2005 through 2008
Non-Life Group	2005 through 2008
Ireland	2003 through 2008

10. Earnings per Ordinary Share

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. We determined that, in accordance with EITF 98-5, the non-cash beneficial conversion feature recorded on issue of the Convertible Cumulative Participating Preferred Shares amounting to \$120.8 million is to be treated as a deemed dividend and deducted from the net loss attributable to ordinary shareholders for the purposes of calculating earnings per share. 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 shares of ordinary shares outstanding plus the diluted effect of potential ordinary shares in accordance with the if-converted method.

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 shares of ordinary shares outstanding plus the diluted effect of potential ordinary shares in accordance with the if-

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

10. Earnings per Ordinary Share (continued)

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.

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>Three months ended</u>		<u>Nine months ended</u>	
	<u>September 30, 2008</u>	<u>September 30, 2007</u>	<u>September 30, 2008</u>	<u>September 30, 2007</u>
(U.S. dollars in thousands, except share data)				
Numerator:				
Loss from continuing operations	\$ (722,654)	\$ (187,095)	\$ (1,872,137)	\$ (103,505)
Income (loss) on discontinued operations, net of related taxes	8,776	(2,980)	(43,001)	(17,092)
Net loss	(713,878)	(190,075)	(1,915,138)	(120,597)
Dividend declared on non-cumulative perpetual preferred shares	-	(2,266)	-	(6,797)
Dividend deemed or beneficial conversion feature	-	-	-	(120,750)
Net loss attributable to ordinary shareholders	<u>\$ (713,878)</u>	<u>\$ (192,341)</u>	<u>\$ (1,915,138)</u>	<u>\$ (248,144)</u>
Denominator:				
Denominator for basic and diluted loss per ordinary share - weighted average number of ordinary shares.....	68,383,370	68,383,370	68,383,370	66,939,007
Effect of dilutive securities*	-	-	-	-
Denominator for dilutive loss per ordinary share ...	<u>68,383,370</u>	<u>68,383,370</u>	<u>68,383,370</u>	<u>66,939,007</u>
Basic and diluted loss per ordinary share:				
Loss from continuing operations	\$ (10.57)	\$ (2.74)	\$ (27.38)	\$ (1.55)
Income (loss) from discontinued operations.....	\$ 0.13	\$ (0.04)	\$ (0.63)	\$ (0.25)
Net loss	\$ (10.44)	\$ (2.78)	\$ (28.01)	\$ (1.80)
Net loss attributable to ordinary shareholders	<u>\$ (10.44)</u>	<u>\$ (2.81)</u>	<u>\$ (28.01)</u>	<u>\$ (3.71)</u>

* 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, 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:

- Convertible Cumulative Participating Preferred Shares – 150,000,000 ordinary shares
- Stock options – 7,059,819 ordinary shares
- Warrants – 2,650,000 ordinary shares

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

11. Business Segments

We measure segment performance primarily based on income or loss before income taxes and minority interest. Our reportable segments are strategic business units that are primarily segregated by geographic region. We report segments in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information".

Our segments included in our continuing operations for the three months and nine months ended September 30, 2008 and 2007 are Life Reinsurance North America and Corporate and Other. See Note 4 "Discontinued Operations" for a discussion on the sale of the Life Reinsurance International Segment and the Wealth Management business, which was previously included in the Corporate and Other Segment.

The segment reporting for our continuing operations is as follows:

	Three Months Ended September 30, 2008		
	Life		
(U.S. dollars in thousands)	Reinsurance North America	Corporate & Other	Total
Premiums earned, net.....	\$ 389,086	\$ -	\$ 389,086
Fee and other income.....	1,161	-	1,161
Investment income, net.....	87,192	1,265	88,457
Net realized and unrealized losses.....	(465,113)	(10,267)	(475,380)
Change in value of embedded derivatives, net.....	(36,474)	-	(36,474)
Total revenues.....	<u>(24,148)</u>	<u>(9,002)</u>	<u>(33,150)</u>
Claims and other policy benefits.....	386,848	-	386,848
Interest credited to interest sensitive contract liabilities.....	16,301	-	16,301
Acquisition costs and other insurance expenses, net ...	213,846	1,345	215,191
Operating expenses.....	13,720	15,974	29,694
Collateral finance facilities expense.....	54,034	960	54,994
Interest expense.....	2,510	-	2,510
Total benefits and expenses.....	<u>687,259</u>	<u>18,279</u>	<u>705,538</u>
Loss from continuing operations before income taxes and minority interest.....	<u>\$ (711,407)</u>	<u>\$ (27,281)</u>	<u>\$ (738,688)</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

11. Business Segments (continued)

	Three Months Ended September 30, 2007		
	Life		
(U.S. dollars in thousands)	Reinsurance North America	Corporate & Other	Total
Premiums earned, net.....	\$ 428,806	\$ -	\$ 428,806
Fee and other income.....	5,661	-	5,661
Investment income, net.....	147,754	3,014	150,768
Net realized losses	(184,838)	(336)	(185,174)
Change in value of embedded derivatives, net	(20,196)	-	(20,196)
Total revenues.....	<u>377,187</u>	<u>2,678</u>	<u>379,865</u>
Claims and other policy benefits.....	349,207	-	349,207
Interest credited to interest sensitive contract liabilities	29,978	-	29,978
Acquisition costs and other insurance expenses, net ...	88,340	1,498	89,838
Operating expenses.....	12,841	16,142	28,983
Collateral finance facilities expense	72,525	1,142	73,667
Interest expense	3,180	113	3,293
Total benefits and expenses	<u>556,071</u>	<u>18,895</u>	<u>574,966</u>
Loss from continuing operations before income taxes and minority interest	<u>\$ (178,884)</u>	<u>\$ (16,217)</u>	<u>\$ (195,101)</u>

	Nine Months Ended September 30, 2008		
	Life		
(U.S. dollars in thousands)	Reinsurance North America	Corporate & Other	Total
Premiums earned, net.....	\$ 1,201,916	\$ -	\$ 1,201,916
Fee and other income.....	7,560	-	7,560
Investment income, net.....	292,486	3,055	295,541
Net realized and unrealized (losses) gains	(1,455,341)	962	(1,454,379)
Change in value of embedded derivatives, net	(38,615)	-	(38,615)
Total revenues.....	<u>8,006</u>	<u>4,017</u>	<u>12,023</u>
Claims and other policy benefits.....	1,139,966	-	1,139,966
Interest credited to interest sensitive contract liabilities	58,927	-	58,927
Acquisition costs and other insurance expenses, net ...	383,256	3,793	387,049
Operating expenses.....	44,700	63,014	107,714
Collateral finance facilities expense	190,049	2,574	192,623
Interest expense	7,570	-	7,570
Total benefits and expenses	<u>1,824,468</u>	<u>69,381</u>	<u>1,893,849</u>
Loss from continuing operations before income taxes and minority interest	<u>\$ (1,816,462)</u>	<u>\$ (65,364)</u>	<u>\$ (1,881,826)</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

11. Business Segments (continued)

(U.S. dollars in thousands)	Nine Months Ended September 30, 2007		
	Life		
	Reinsurance North America	Corporate & Other	Total
Premiums earned, net.....	\$ 1,282,459	\$ -	\$ 1,282,459
Fee and other income.....	12,288	-	12,288
Investment income, net.....	439,122	7,674	446,796
Net realized losses	(189,836)	(598)	(190,434)
Change in value of embedded derivatives, net	(19,242)	-	(19,242)
Total revenues.....	<u>1,524,791</u>	<u>7,076</u>	<u>1,531,867</u>
Claims and other policy benefits.....	1,074,838	-	1,074,838
Interest credited to interest sensitive contract liabilities	101,700	-	101,700
Acquisition costs and other insurance expenses, net ...	265,220	4,116	269,336
Operating expenses.....	38,260	62,832	101,092
Collateral finance facilities expense	210,466	12,181	222,647
Interest expense	9,468	5,435	14,903
Total benefits and expenses	<u>1,699,952</u>	<u>84,564</u>	<u>1,784,516</u>
Loss from continuing operations before income taxes and minority interest	<u>\$ (175,161)</u>	<u>\$ (77,488)</u>	<u>\$ (252,649)</u>

Capital expenditures of each reporting segment were not material in the periods noted.

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

Assets by segment for our continuing operations include:

(U.S. dollars in thousands)	September 30, 2008	December 31, 2007
Assets		
Life Reinsurance North America.....	\$ 9,891,080	\$ 11,546,033
Corporate and Other	229,153	104,897
Total.....	<u>\$ 10,120,233</u>	<u>\$ 11,650,930</u>

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

12. Commitments and Contingencies

Class Action and Shareholder Derivative Lawsuits

On August 2, 2006, a putative class action lawsuit was filed against us and certain of our 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 our 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 us, certain of our current and former officers and directors, and certain third parties. Two of the complaints were filed on August 7, 2006, and the remaining five complaints were filed on August 14, 2006, August 22, 2006, August 23, 2006, September 15, 2006, and October 3, 2006, respectively.

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

The complaint named us; Dean E. Miller, our former Chief Financial Officer; Scott E. Willkomm, our former Chief Executive Officer; Elizabeth Murphy, our former Chief Financial Officer; our former Board members Michael Austin, Bill Caulfeild-Browne, Robert Chmely, Michael French, Lord Norman Lamont, Hazel O'Leary, and Glenn Schafer; and certain third parties, including Goldman Sachs and Bear Stearns in their capacities as underwriters in various securities offerings by us and Ernst & Young LLP in their capacity as independent registered public accounting firm. The complaint was brought on behalf of a putative class consisting of investors who purchased our securities between February 17, 2005 and July 31, 2006. The complaint alleged violations of Sections 10(b) and 20(a) of the Exchange Act, Rule 10b-5, and Sections 11, 12(a) (2), and 15 of the Securities Act. The complaint sought an unspecified amount of damages, as well as other forms of relief. On March 7, 2007, we filed a motion to dismiss the putative class action lawsuit. On November 2, 2007, the court dismissed the Section 10(b) and Rule 10b-5 claims against Ernst & Young LLP, but gave the plaintiffs leave to amend. The court denied the motions to dismiss brought by the other named defendants. In May, 2008, the parties held an initial mediation at which no settlement was reached. On June 16, 2008, all claims brought in the action against Glenn Schafer were dismissed without prejudice. Also on June 16, 2008, the plaintiffs filed a motion for leave to file an amended complaint. On July 11, 2008, the plaintiffs filed an amended complaint in which they sought to expand the class period, renew Section 10(b) and Rule 10b-5 allegations against Ernst & Young LLP, and assert additional factual allegations. On July 18, 2008, Ernst & Young LLP moved to dismiss the replied Section 10(b) claim against it as well as the proposed expanded class period and, on July 23, 2008, we and the third-party underwriter defendants each filed motions to dismiss that portion of the amended complaint seeking to expand the class period. On July 30, 2008, the parties held a second mediation. On August 1, 2008, we and our former officers and directors named in the complaint reached agreement in principle with the plaintiffs to settle the lawsuit and on September 8, 2008, the court entered an order preliminarily approving the proposed settlement. In connection with the settlement, which was formally approved by the court on December 11, 2008, we contributed \$31.0 million, of which \$5.75 million was paid by us on October 7, 2008, and the additional \$25.25 million was paid by our insurance carriers.

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

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September 30, 2008

12. Commitments and Contingencies (continued)

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 \$285.0 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 \$344.0 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 have notified the Investors, 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 \$70.0 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, the Investors responded by notifying us of their concern that the corrections described above may constitute breaches of certain of the representations and warranties made by us in the 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 the Investors, based on changes in the valuation of SRGL using the assumptions and models used by the Investors at the time of their decision to invest in us. Furthermore, should any claim for indemnification be made by the Investors, the 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, the Investors 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 the Investors are convertible into our Ordinary Shares.

SCOTTISH RE GROUP LIMITED

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September 30, 2008

13. Termination of Forbearance Agreements with Counterparties

On May 30, 2008, we received notice from the counterparties to our Clearwater Re collateral finance facility that Clearwater Re was in breach of certain covenants to deliver financial statements in a timely manner. We were required to cure such breach within 30 days of notice or an event of default would have occurred in Clearwater Re. In addition, due to a decline in our consolidated shareholders' equity upon the filing of our Form 10-K for the year ended December 31, 2007, we were in breach of minimum net worth covenants in Clearwater Re and another of our collateral finance facilities, HSBC II. As of September 30, 2008, these facilities involved an aggregate of \$574.0 million of financing, of which \$548.3 million was borrowed and recorded in Collateral Finance Facilities, and had full recourse to SALIC. As a result, if we were unable to successfully negotiate with the relevant counterparties, both the Clearwater Re and HSBC II facilities could have defaulted with full recourse to SALIC and, in the case of Clearwater Re, also with full recourse to SRGL. On June 30, 2008, we executed forbearance agreements with the relevant counterparties to the Clearwater Re and HSBC II facilities whereby the relevant counterparties agreed to forbear taking action until December 15, 2008. In order to achieve forbearance, we agreed to certain economic and non-economic terms, including forbearance payments to the relevant counterparties, the contribution by SALIC of additional collateral to the transactions, limitations on future fundings by the relevant counterparties under the facilities, and the requirement to achieve certain milestones set by the counterparties related to, among other things, the sale of our Life Reinsurance North America Segment, all of which significantly increased constraints on our available capital and liquidity.

In connection with the Clearwater Re collateral finance facility, on August 29, 2008, we completed a full recapture, effective as of July 1, 2008, of the business ceded from SRUS to Clearwater Re and immediately retroceded the recaptured business, also effective as of July 1, 2008, from SRUS to an unaffiliated third party reinsurer. In connection with the recapture transaction, the counterparties to the Clearwater Re collateral finance facility were repaid in full. We also paid a \$4 million fee to the bank-counterparties and the facility, and the related forbearance agreement and its terms, were terminated. Effective September 30, 2008, SRUS retroceded the remaining portion of the defined block of business that it had retained at the time of the Clearwater Re transaction to the same third party reinsurer who in turn retroceded such business to Hannover (Ireland). Following these payments, Clearwater Re had remaining securities and cash totaling approximately \$101 million and, following its receipt of the requisite regulatory approval, Clearwater Re made a dividend payment to SALIC representing all remaining net assets except for \$250,000 of required capital. SALIC thereafter made a required capital contribution to SRUS of approximately \$70 million. From the residual amount received by SALIC from Clearwater Re, we posted additional collateral to HSBC of \$22.5 million (which amount was comprised of 50% of the additional capital previously contributed to Clearwater Re's surplus account in connection with the Clearwater Re forbearance agreement and 50% of the proceeds we received in connection with the replacement of the Clearwater Re collateral finance facility). Consequently, we wrote off the remaining unamortized balance of \$10.3 million of deferred finance costs at June 30, 2008 associated with the facility. After netting the foregoing payments and contributions, SALIC received approximately \$8.4 million in connection with the transactions associated with the Clearwater Re unwind. Effective September 30, 2008, SRUS retroceded the remaining 10% of the defined block of business that it had retained as part of the Clearwater transaction to a third party reinsurer. On a consolidated basis the Clearwater transactions and the retrocession of the remaining portion of the business held by SRUS resulted in a reduction of total assets and total liabilities of \$623.8 million and \$504.3 million, respectively, resulting in a pre-tax loss of \$119.5 million during the period ended September 30, 2008. The loss primarily comprised of the write off of deferred acquisition costs of \$75.1 million and a negative ceding commission of \$39.4 million both of which are recorded in acquisition costs and other insurance expenses, net.

On September 30, 2008, we entered into a binding letter of intent (the "HSBC II LOI") with ING and the ING Companies. Pursuant to the HSBC II LOI, SLD consented to the recapture by SRUS of the business (such recaptured business, the "HSBC II Recaptured Business") that had been ceded by SRUS to Scottish Re (Dublin) Limited for the purpose of collateralizing (with financing provided by the HSBC II collateral finance facility) the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX for a portion of the business acquired by us from SLD and SLDI at the end of 2004 (such portion related to the HSBC II collateral

SCOTTISH RE GROUP LIMITED

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September 30, 2008

13. Termination of Forbearance Agreements with Counterparties (continued)

finance facility, the “HSBC II Business”) effective as of September 30, 2008 (the “HSBC II Recapture”). On October 15, 2008, we effectuated the HSBC II Recapture. In connection therewith, HSBC was repaid in full, together with a payment of a \$6 million fee pursuant to the related forbearance agreement, and the facility and the forbearance agreement and its terms were terminated. Following the consummation of the HSBC II Recapture, SLD recaptured the HSBC II Recaptured Business from SRUS and then ceded the HSBC II Recaptured Business to SLDI, which ceded the HSBC II Recaptured Business to SRLB.

SLDI agreed to provide, or cause the provision of, one or more letters of credit (“LOCs”) in order to provide SLD with statutory financial statement credit for the excess of the U.S. statutory reserves associated with the HSBC II Recaptured Business over the economic reserves held in an account related thereto. As consideration, we agreed to bear the costs of the LOCs by paying to SLD a facility fee based on the face amount of such LOCs outstanding as of the end of the preceding calendar quarter. The recapture transaction recorded during the period ended September 30, 2008 based on the HSBC II LOI resulted in no impact to the balance sheet or income statement on a consolidated basis. On October 15, 2008, when the collateral facility related to the HSBC II recapture was unwound, we paid HSBC \$558.5 million to relieve the liabilities associated with the facility. This resulted in an immaterial loss to us. Both the unwind and the related loss will be recorded as components of fourth quarter 2008 results because the unwind was not effectuated until October 2008.

More specifically, pursuant to the Settlement Agreement, dated as of October 15, 2008, by and among SALIC, SRD, SRUS, SRGL, SLD, Comerica Bank & Trust, National Association (“Comerica”), HSBC and Structured Asset Repackaged Trust II, 2005-A (“STARTS”), the parties terminated the related swap and certain other of the transaction documents including the (i) the Trust Assignment Agreement, dated as of December 22, 2005, by and between SRD and STARTS, (ii) the Security Agreement, dated as of December 22, 2005, by and between SRD and STARTS, (iii) the Reinsurance Trust Agreement B, dated as of December 22, 2005, by and among SRD, SRUS and Comerica, (iv) the Security and Control Agreement B, dated as of December 22, 2005, by and among SRD, SRUS and The Bank of New York (now known as The Bank of New York Mellon, “BONY”), (v) the Investment Management Agreement B, dated as of December 22, 2005, by and among SRUS, SRD, Comerica and Principal Global Investors, LLC, (vi) the 1992 ISDA Master Agreement, the Schedule thereto and the Credit Support Annex to the Schedule, each dated as of June 28, 2004 and the letter agreement, dated as of December 22, 2005, confirming the terms of the total rate of return swap transaction, all by and between SALIC and HSBC and (vii) the forbearance agreement.

On December 19, 2008, we completed the second phase of the unwind by effecting a full recapture of the business ceded from SRUS to SRD, effective as of September 30, 2008, and immediately retroceded the recaptured business, also effective as of September 30, 2008, to SLD. SLD then ceded the recapture business to SLDI, which ceded the recaptured business to SRLB. Upon the full recapture, the following transaction documents were terminated effective as of December 19, 2008, (i) the Reinsurance Trust Agreement A, dated as of December 22, 2005, by and among SRD, SRUS and Comerica, (ii) the Security and Control Agreement A, dated as of December 22, 2005, by and among SRD, SRUS and The Bank of New York (now known as BONY) and (iii) the Investment Management Agreement A, dated as of December 22, 2005, by and among SRUS, SRD, Comerica and Principal Global Investors, LLC.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

14. Ballantyne Re Recapture and Assignment Transactions

On March 31, 2008, SRGL, SRUS, Scottish Re Life (Bermuda) Limited (“SRLB”), SRD and SALIC entered into the March 31 LOI with ING and the ING Companies. Under the LOI, SLD consented to the recapture, in one or more transactions, of a pro-rata portion of the business that had been ceded by SRUS to Ballantyne Re (all such recaptured business pursuant to the First Quarter Recapture and subsequent recaptures, collectively, the “Recaptured Business”) for the purpose of collateralizing the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX for a portion of the Ballantyne Business. The First Quarter Recapture and all subsequent recaptures to which SRUS was a party (the “Recaptures”) primarily were designed to allow SRUS to continue to receive full credit for reinsurance for the business ceded to Ballantyne Re.

On May 6, 2008, we completed this transaction and recaptured approximately 30% of the Ballantyne Business, effective as of March 31, 2008. This business was in turn recaptured by the ING Companies and ultimately ceded to SRD, utilizing almost the entire amount of the \$375.0 million of letters of credit made available by the ING Companies. As part of the LOI, we, along with the ING Companies, Ballantyne Re and the financial guarantors of certain of the debt securities issued by Ballantyne Re, agreed to enter into a novation and assignment of SRUS’s reinsurance agreement with Ballantyne Re to the ING Companies, with the aim of permanently relieving SRUS from its requirement to hold reserves with respect to the business ceded to Ballantyne Re.

On June 30, 2008, we entered into the June 30th LOI. The June 30th LOI relates to the business that SRUS ceded to Ballantyne Re for the purpose of collateralizing the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX for the Ballantyne Business. Pursuant to the June 30th LOI, SLD consented to the recapture by SRUS of a pro-rata portion of the Ballantyne Business effective as of June 30, 2008. On August 11, 2008, we effectuated the Second Quarter Recapture of approximately 15.5% of the Ballantyne Business and utilized almost the entire amount of the \$200.0 million of letters of credit made available by the ING Companies pursuant to the June 30 LOI.

On September 30, 2008, we entered into the September 30th LOI with the ING Companies. Pursuant to the September 30th LOI, SLD consented to the recapture of the Recaptured Business that had been ceded by SRUS to Ballantyne Re for the purpose of collateralizing the statutory reserve requirements of the Valuation of Life Insurance Policies Model Regulation XXX for the Ballantyne Business. On November 12, 2008, we effectuated the Third Quarter Recapture, which comprised approximately 6.5% of the Ballantyne Business.

Immediately following the consummation of each of the First Quarter Recapture, the Second Quarter Recapture and the Third Quarter Recapture, SLD recaptured the Recaptured Business from SRUS in exchange for consideration from SRUS to SLD described below. SLD then ceded the Recaptured Business to SLDI, which ceded the Recaptured Business to SRLB.

SLDI agreed to provide, or cause the provision of, one or more LOCs in order to provide SLD with statutory financial statement credit for the excess of the U.S. statutory reserves associated with the Recaptured Business over the economic reserves associated therewith, which are held in an account related thereto. As consideration, we agreed to bear the costs of the LOC by paying to SLD a facility fee based on the face amount of such LOCs outstanding as of the end of the preceding calendar quarter (the “LOC Fee”).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

14. Ballantyne Re Recapture and Assignment Transactions (continued)

On November 19, 2008, with an effective date of October 1, 2008, SRUS assigned and novated to SLD the reinsurance agreement and reinsurance trust agreement between SRUS and Ballantyne Re (the "Assignment") as follows: (a) SLD and SRUS terminated the portion of their existing reinsurance agreement that covered the Ballantyne Business, (b) SRUS assigned its existing reinsurance agreement with Ballantyne Re (pursuant to which SRUS retroceded to Ballantyne Re the Ballantyne Business) (the "Pre-Assignment Reinsurance Agreement") to SLD and assigned its existing reinsurance trust agreement with Ballantyne Re to SLD, and (c) immediately thereafter SLD and Ballantyne Re amended and restated that insurance agreement (the "Post-Assignment Reinsurance Agreement"), pursuant to which SLD cedes directly to Ballantyne Re the Ballantyne Business, and amended and restated that reinsurance trust agreement, pursuant to which SLD is the sole beneficiary of the reinsurance trust account maintained by Ballantyne Re.

Post-Assignment, SRUS remains obligated to administer the Ballantyne Business consistent with its obligation to administer the business acquired from the ING Companies at the end of 2004, of which the Ballantyne Business is a part, and SRUS is obligated to provide specified administrative services to Ballantyne Re. Specifically, SRUS and SLD entered into a new administrative services agreement that covers only the portion of the liabilities under the Ballantyne Business that is not ceded directly or indirectly to SRUS or one or more of its affiliates (the "Ballantyne ASA"). As of the effective time of the Assignment, all such liabilities not so reinsured with SRUS or its affiliates were ceded by SLD to Ballantyne pursuant to the Post-Assignment Reinsurance Agreement. The portion of the Ballantyne Business that was recaptured pursuant to the Recaptures continues to be administered pursuant to the existing Administrative Services Agreement, dated as of December 31, 2004, among SRUS, SLD and SLDI (as amended to clarify this distinction). See Note 18, "Subsequent Events" for additional information related to the administration of the Ballantyne Business.

The Assignment also involved amendments to certain of the agreements underlying the Ballantyne Re securitization transaction, including matters relating to services provided to Ballantyne Re and the delivery of financial and other information. Accordingly, pursuant to an amendment to the existing Support Services Agreement, dated as of November 19, 2008, between SHI and Ballantyne Re (the "Amended Services Agreement"), SHI assigned to SRUS, and SRUS assumed, SHI's obligations as support service provider to Ballantyne Re. Specifically, pursuant to the Amended Services Agreement, SRUS will provide to Ballantyne Re information technology support services, legal services, administrative support services, treaty administration and financial services, in each case as necessary or appropriate to support the business of Ballantyne Re. As compensation for the support services provided by SRUS during the term of the Amended Services Agreement, Ballantyne will pay to SRUS an annual service fee at the rate set forth in Section 4.1 of the Amended Services Agreement.

In connection with the Assignment, SRUS, Ambac Assurance UK Limited and Assured Guaranty (UK) Ltd (the foregoing two parties, the "Financial Guarantors") amended and restated the letter agreement among such parties, dated as of May 2, 2006 (the "Original SRUS Letter Agreement" and such letter agreement as so amended and restated, the "Amended and Restated SRUS Letter Agreement"). The Amended and Restated SRUS Letter Agreement restates and governs the parties' rights and obligations from and after the effective time of the Assignment. Specifically, the rights and obligations of the parties to the Original SRUS Letter Agreement prior to the effective time of the Assignment remain governed by the Original SRUS Letter Agreement, and on and after the closing of the Assignment the provisions of the Amended and Restated SRUS Letter Agreement replaces the rights and obligations of the parties set forth in the Original SRUS Letter Agreement. The Amended and Restated SRUS Letter Agreement takes into account certain changes occurring as a result of the Assignment, such as the assumption by SRUS of the role of service provider under the Amended Services Agreement.

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

14. Ballantyne Re Recapture and Assignment Transactions (continued)

Consistent with the Original SRUS Letter Agreement, SRUS made certain representations and warranties to the Financial Guarantors under the Amended and Restated SRUS Letter Agreement, such as those relating to SRUS's corporate authority and compliance with applicable law, and the accuracy of certain information relating to the reinsured business. SRUS also made certain covenants to the Financial Guarantors, including that SRUS would reimburse the Financial Guarantors in certain circumstances for certain expenses, and would agree to indemnify Ballantyne Re, the Financial Guarantors and their advisors for specified losses and liabilities that those parties incur. More specifically, SRUS would indemnify the Financial Guarantors and their advisors for such liabilities arising due to SRUS's fraud, bad faith or willful misconduct relating to the transaction or a breach by SRUS of any representation, warranty or covenant under the transaction documents to which it is a party, for the Financial Guarantors' costs in investigating an event of default, or for Ballantyne Re's failure to make any payment required to be made by it under the transaction documents (except as described below).

The Amended and Restated SRUS Letter Agreement expressly provides that SRUS will not be required to indemnify the Financial Guarantors (or their advisors) or Ballantyne Re for liabilities arising out of Ballantyne Re's failure to make any payments of premiums, fees and expenses that Ballantyne Re would be required to make in the ordinary course, payments of principal and interest on any notes issued in connection with the original Ballantyne securitization transaction, repayment of amounts due to the Financial Guarantors under the Guarantee Agreement, and liability caused by the Financial Guarantors' gross negligence or willful misconduct.

Also in connection with the Assignment, we and the Financial Guarantors, amended and restated the letter agreement among such parties, dated as of May 2, 2006 (the "Original SRGL Letter Agreement" and such letter agreement as so amended and restated, the "Amended and Restated SRGL Letter Agreement"). Similar to the Amended and Restated SRGL Letter Agreement, the Amended and Restated SRUS Letter Agreement restates and governs the parties' rights and obligations from and after the effective time of the Assignment. Specifically, the rights and obligations of the parties to the Original SRGL Letter Agreement prior to the effective time of the Assignment would remain governed by the Original SRGL Letter Agreement, and on and after the closing of the Assignment the provisions of the Amended and Restated SRGL Letter Agreement would replace the rights and obligations of the parties set forth in the Original SRGL Letter Agreement. Among other things, the Amended and Restated SRGL Letter Agreement provides that in the event SRUS, or any direct or indirect shareholder of SRUS, enters into a transaction involving the sale or transfer of the stock or substantially all of the assets of SRUS or a merger of SRUS, we will cause the counterparty to any such transaction to enter into a net worth maintenance agreement for the benefit of SRUS and its creditors that contains substantially the same terms (or better terms with respect to SRUS and its creditors) as the currently existing Net Worth Maintenance Agreement, dated as of February 1, 2002, as amended, by and between SALIC and SRUS, provided that such net worth maintenance agreement is from a counterparty and in a form reasonably satisfactory to the Financial Guarantors, and subject to the conditions that such counterparty be rated as of the closing of any such transaction described above not less than A2 by Moody's and not less than A by S&P.

As part of the Assignment, we also agreed to obtain SLD's consent before appointing any future director to the board of directors of Ballantyne Re and to not appoint as a director any person currently or formerly affiliated with Scottish Re. See Note 18, "Subsequent Events".

The Assignment does not relieve SRUS of liability for breaches of its representations, warranties, covenants or other obligations that relate to periods before the effective date of the Assignment, and we and SRUS will remain responsible for certain ongoing covenants made for the benefit of Ballantyne Re and the Financial Guarantors.

In addition, SRUS has agreed to indemnify and hold harmless SLD and its affiliates for losses and damages incurred arising from the exercise by Ballantyne Re of any right, or from any limitation on the ability of SLD to exercise any right or recover any amount, under the Post-Assignment Reinsurance Agreement as a result of (a) any

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

14. Ballantyne Re Recapture and Assignment Transactions (continued)

breach of any representation, warranty or covenant of SRUS under the Pre-Assignment Reinsurance Agreement or any related transaction document, (b) any action or omission by any director, officer, employee, agent, representative, appointee, successor, or permitted assign of SRUS or any of its affiliates that causes a Tax Event (as defined in the Pre-Assignment Reinsurance Agreement) for Ballantyne Re or otherwise causes Ballantyne Re to be in breach of any representation, warranty or covenant under the Pre-Assignment Reinsurance Agreement or any related transaction document or (c) any arbitration award against SRUS that SLD pays on its behalf to avoid termination of the Post-Assignment Reinsurance Agreement.

15. Other Changes to Collateral Finance Facilities

As described in Note 13 "Termination of Forbearance Agreements with Counterparties", in connection with the Clearwater Re collateral finance facility, on August 29, 2008, we completed a full recapture, effective as of July 1, 2008, of the business ceded from SRUS to Clearwater Re and immediately retroceded the recaptured business, also effective as of July 1, 2008, from SRUS to an unaffiliated third party reinsurer, which in turn was retroceded to Hannover (Ireland). Effective September 30, 2008, SRUS retroceded the remaining portion of the defined block of business that it had retained at the time of the Clearwater Re transaction to the same third party reinsurer who in turn retroceded such business to Hannover (Ireland). In connection with the recapture transaction, the counterparties to the Clearwater Re collateral finance facility were repaid in full. We also paid a \$4 million fee to the bank-counterparties and the facility, and the related forbearance agreement and its terms, were terminated. Furthermore, in connection with the HSBC II forbearance agreement, on October 15, 2008, we and certain of our subsidiaries entered into a series of transactions with an effective date of September 30, 2008 to unwind the HSBC II collateral finance facility. In connection with the unwind transactions, HSBC was repaid in full, together with a payment of a \$6 million fee pursuant to the related forbearance agreement, and the facility and the forbearance agreement and its terms were terminated.

With respect to another of our securitization structures, Orkney Re II, in May 2008 we executed amendments to certain transaction documents to give us flexibility in dealing with additional near term estimated fair value declines in the sub-prime and Alt-A securities held by Orkney Re II. The amendments eliminate certain priority of payment limitations and provide us with the ability to recapture business from Orkney Re II.

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

16. Dividends on Perpetual Preferred Shares

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

16. Dividends on Perpetual Preferred Shares (continued)

In accordance with the Certificate of Designations, future dividends on the Perpetual Preferred Shares generally may be funded only to the extent they are payable out of our distributable profits, and/or the proceeds of a new issue of shares, and/or out of the Share Premium Account. At September 30, 2008, we had a shareholders' deficit of \$1,615.4 million and therefore lacked, and expect to continue to lack in the near to mid term, sufficient distributable profits to fund a dividend. 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, then the holders of the Perpetual Preferred Shares are entitled to vote for the election of two additional directors to the SRGL Board. The sixth nonpayment is expected to occur in connection with the July 15, 2009 dividend payment date.

17. NYSE Delisting and Securities and Exchange Commission Deregistration

Our ordinary shares (new symbol SKRRF – PINKS) and perpetual preferred shares (new symbol SKRUF – PINKS) were delisted from the New York Stock Exchange as of April 7, 2008, and, therefore, we have no further reporting obligations under Section 12(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We also had fewer than 300 holders of record of our securities as of January 1, 2008 and, as a result, our reporting obligations under Sections 13 and 15(d) of the Exchange Act, were suspended. On May 13, 2008, we filed a Form 15 indicating the suspension of our reporting obligations. As a result of the foregoing, notwithstanding the occurrence of material developments (either positive or negative), we are not required to make future public filings. Similarly, we no longer are required to issue press releases as we have in the past.

18. Subsequent Events

Ballantyne Re

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

Order of Supervision for SRUS

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

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

18. Subsequent Events (continued)

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, then the holders of the Perpetual Preferred Shares are entitled to vote for the election of two additional directors to the SRGL Board. The sixth nonpayment is expected to occur in connection with the July 15, 2009 dividend payment date.

Sale of a Block of Life Reinsurance North America Business

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

Pursuant to the Purchase Agreement, Hannover Re purchased the Acquired Business, which was acquired in 2004 by 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 XXX reserves requirements, and universal life policies with secondary guarantees subject to the AXXX reserves requirements. Under our 2004 agreement with the ING Companies, the ING Companies were obligated to maintain collateral for the Regulation XXX and AXXX reserve requirements of the Acquired Business for the duration of such requirements, and financial incentives were provided to encourage us to replace this financing with alternative third party financing.

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

18. Subsequent Events (continued)

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

Following the transfer of assets with respect to the recapture payments noted above, we were released of associated policyholder liabilities on the sale of the Acquired Business. The release of such liabilities is estimated to result in a pre-tax non-cash GAAP gain of approximately \$700 million, after transaction expenses and related costs to be recognized in our consolidated GAAP financial statements in 2009. The estimated gain is subject to certain refund contingencies as described below. Subsequent to the sale of the Acquired Business, we still retain a substantial shareholders' deficit. The disposal of the Acquired Business constitutes a reconsideration event related to the consolidation of Ballantyne Re under FIN 46R. Consequently, we are currently evaluating whether we remain the primary beneficiary of Ballantyne Re as defined within FIN 46R. In the event we conclude we are no longer the primary beneficiary of Ballantyne Re, we would de-consolidate Ballantyne Re in 2009. The de-consolidation of Ballantyne Re would reduce our consolidated total assets and liabilities by approximately \$1,285 million and \$2,035 million, respectively, and result in a one-time non-cash de-consolidation gain of approximately \$750 million. This gain would have no impact on our current or future liquidity position.

The Company, Hannover Re and the ING Companies agreed to use commercially reasonable efforts to transfer to Hannover Re certain retrocession agreements under which we and/or the ING Companies currently cede to third parties certain risks related to the Acquired Business. If a certain amount of such third party retrocessionaires do not consent to such transfers prior to April 30, 2009, we are required under the Purchase Agreement to deposit into escrow with Hannover Re by May 14, 2009 a pro-rata amount related to such retrocession agreements for which such consent has not been obtained as of that date. Pursuant to the Purchase Agreement, in the event none of the retrocessionaires consent to transfer their agreements the maximum potential escrow funding amount is \$136.3 million. In the event one or more retrocessionaire consents have not been obtained by December 31, 2009, the related escrow funds will be released to Hannover Re. Based upon the consents to transfer that have been obtained as of April 28, 2009, we currently estimate the actual escrow funding at May 14, 2009, and therefore the maximum potential escrow fund release to Hannover Re at December 31, 2009, not to exceed \$11 million. In an effort to further reduce the escrow funds and the potential year end escrow release to Hannover Re, we will continue to use best efforts to obtain the remaining retrocessionaire consents prior to December 31, 2009. However, there can be no assurances that we will be successful in obtaining any additional consents.

Run-Off Strategy

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

Premium Asset Trust Certificates Due March 12, 2009

Through negotiated repurchases, we extinguished the \$100 million payment obligation falling due on March 12, 2009, in respect of the PATS funding agreement to which SALIC was a party for a significant discount to par on an aggregate basis. Following the satisfaction of the PATS funding agreement, our nearest term remaining debt

SCOTTISH RE GROUP LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2008

18. Subsequent Events (continued)

obligations are the Stingray funding agreements which are outstanding in the amount of \$325 million and mature in January 2015.

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

In order to further preserve liquidity, 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 (as outlined in Note 12 to the Consolidated Financial Statements). 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. To date we have deferred \$1.8 million of interest.

Ballantyne Re Recapture

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

Decline in Fair Values of Invested Assets

Investments have continued to deteriorate during 2009. As at March 31, 2009, our invested assets have experienced market value declines of approximately \$574.5 million since September 30, 2008, in addition to that recognized in our Consolidated Statement of Operations as a component of net realized and unrealized losses for the nine months ended September 30, 2008. In addition, the adverse market conditions have impacted the value of the underlying collateral used to secure our life reinsurance obligations and statutory reserves.

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