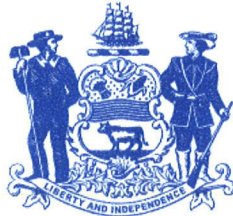


REPORT ON EXAMINATION
OF THE
SCOTTISH RE (U.S.), INC.
AS OF
DECEMBER 31, 2008



REPORT ON EXAMINATION
OF THE
SCOTTISH RE (U.S.), INC.
AS OF
DECEMBER 31, 2008

The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 1st day of July, 2010

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

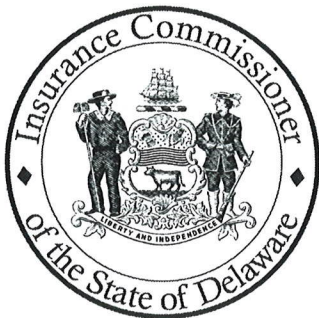
I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2008 of the

SCOTTISH RE (U.S.), INC.

is a true and correct copy of the document filed with this Department.

Attest By: Sonia C. Harris

Date: 1 July 2010



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 1st day of July 2010.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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SALUTATION

June 7, 2010

Honorable Alfred W. Gross
Chairman, Financial Condition (E)
Committee, NAIC
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

Honorable Karen Weldin Stewart, CIR-ML
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard

Dover, Delaware 19904

Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09-003, dated December 24, 2008, an examination has been made of the affairs, financial condition and management of

SCOTTISH RE (U.S.), INC.

hereinafter referred to as “Company or SRUS” incorporated under the laws of the State of Delaware as a stock company with its home office located at 1209 Orange Street, Wilmington, Delaware 19801. The examination was conducted at the main administrative office of the Company, located at 14120 Ballantyne Corporate Place, Suite 300, Charlotte, North Carolina 28277.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2005. This examination covered the period from January 1, 2006 through December 31, 2008, and consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This report is presented on the exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed rules established by the National Association of Insurance Commissioners' (NAIC) Committee on Financial Condition Examiners Handbook (Handbook), and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, an information systems review was performed by the consulting firm of INS Services, Inc.

In addition to items hereinafter incorporated as part of the written report, the following were checked and made part of the workpapers of this examination:

Fidelity bond and other insurance
Officers', employees' and agents' welfare and pension plans

This examination did not qualify for zone participation as no direct premiums are written. The examination was made in conjunction with the examination of the Company's owned subsidiaries, Scottish Re Life Corporation (SRLC) and Orkney Re, Inc. (ORE).

HISTORY

The Company was incorporated as the NRG American Life Reassurance Corporation on January 20, 1977 under the laws of the State of Delaware and commenced business on September 29, 1977. Its original Delaware Certificate of Authority was issued on January 20, 1977 and authorized the Company to transact the business of life insurance. In 1994 the Company was sold to NRG Acquisition Partners, L.P. and changed its name to Harbourton Reassurance, Inc. Scottish Holdings, Inc. (SHI) purchased the Company on September 30, 1999. The Company amended its certificate of incorporation to change its name to Scottish Re (U.S.) Inc., effective February 2, 2000. On December 22, 2003, the Company's parent, (SHI), purchased 95% of the outstanding capital stock of ERC Life Reinsurance Corporation [subsequently renamed SRLC from Employers Reinsurance Corporation (now owned by GE)]. On December 31, 2004, SHI contributed its interest in SRLC to the Company. Effective December 31, 2004, the Company acquired from ING America Insurance Holdings, Inc. (ING) 100% of the individual life reinsurance business written by Security Life of Denver Insurance Company and Security Life of Denver International Limited (subsidiaries of ING).

CAPITALIZATION

The Company has 50,000 authorized shares with 36,000 shares of stock outstanding at a par value of \$100 per share. There has been no change to the capital account during the period

under review. The following contributions were made to the surplus account during the exam period:

| <u>Year</u> | <u>Amount</u> |
|--------------|-----------------------------|
| 2006 | \$153,453,850 |
| 2007 | \$221,000,000 |
| 2008 | <u>\$140,739,661</u> |
| Total | <u>\$515,193,511</u> |

Contributed surplus in the prior examination was \$534,907,536. As noted above, contributed surplus during the period under examination was \$515,193,511. As of December 31, 2008, the Company had \$3,600,000 in capital, \$1,121,252,205 in contributed surplus, surplus notes totaling \$100,000,000 and a deferred gain on reinsurance of \$430,312,809.

MANAGEMENT AND CONTROL

The Company's bylaws were originally adopted January 20, 1977, amended October 8, 1982, December 8, 2003 and June 21, 2004. The bylaws state that the business and affairs shall be managed by a Board of Directors consisting of the number of Directors permitted by statute with the number determined by resolution of the Board of Directors or by the stockholders at the annual meeting. It is not necessary for the Directors to be stockholders.

The following constitute the Board of Directors as reflected in the 2008 refiled Annual Statement:

| <u>Name</u> | <u>Principal Occupation</u> |
|---------------------------|--|
| Paul Goldean** | President and Chief Executive Officer of SRGL |
| Meredith Alicia Ratajczak | President and Chief Executive Officer of SRUS, |

| | |
|--------------------------|---|
| Michael Steven Baumstein | SRLC and ORE Executive Vice President, Investments and Capital Markets, SRGL |
| Daniel Ryan Roth | Chief Financial Officer of SRGL |
| Larry Houston Roy* | Executive Vice President, Client Services, SRUS |
| *Resigned in 2009 | |
| ** Resigned in 2010 | |

The bylaws, as amended, stated that the officers of the Company shall include a President, a Secretary and a Treasurer. The Board of Directors may also choose senior vice presidents, vice presidents and one or more assistant secretaries and assistant treasurers. The same person may hold any number of offices.

The officers serving at the time of the refiled Annual Statement were as follows:

| <u>Name</u> | <u>Office</u> |
|----------------------------|--|
| Meredith Alicia Ratajczak | President and Chief Executive Officer |
| Larry Houston Roy * | Executive Vice President, Client Services |
| Gregg Lawrence Klingenberg | Executive Vice President, General Counsel and Secretary |
| Andrew Richard Creighton | Senior Vice President, Chief Actuary |
| Brian Andrew Davis | Senior Vice President, Treasurer |
| Amy McNutt Woltman | Vice President, Assistant General Counsel, Assistant Secretary |
| Richard Vincent Plati | Assistant Treasurer, Assistant Controller |
| *Resigned in 2009 | |

Per review of the board minutes, it was noted the Company is in violation of Section 1304 of the Delaware Insurance Code (18 *Del. C.* § 1304) due to the fact that the Company is not obtaining approval of its investments by the Board of Directors or by a committee thereof charged with the supervision of investments and loans.

It is recommended the Company comply with 18 *Del. C.* § 1304 requiring the approval of investment transactions by the Board of Directors or by a committee thereof.

HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System. On May 7, 2007, SRGL completed a Securities Purchase Agreement with MassMutual Capital Partners LLC, a member of the MassMutual Financial Group, and SRGL Acquisition, LLC, an affiliate of Cerberus Capital Management, L.P. As a result, the above entities hold in aggregate, directly or indirectly 68.7% of the equity voting power along with the right to designate two-thirds of the Boards of Directors of SRGL. Massachusetts Mutual Life Insurance Company and Stephen Feinberg are the ultimate controlling persons of the Company by virtue of their ownership and/or control of MassMutual Capital Partners, LLC and Cerberus Capital Management, L.P., respectively.

Dividends

There were no dividends paid during the period covered by this examination.

MANAGEMENT AND SERVICE AGREEMENTS

Affiliated Agreements

The Company is a party to the following agreements with its parent, affiliates, and subsidiaries that have been approved by the Delaware Department of Insurance:

1. An Asset Management Services Fee Agreement dated January 1, 2001 whereby SRGL provides asset management services to the Company;
2. A Management Services Fee Agreement dated January 1, 2001 whereby SRGL provides management services to the Company;
3. A Support Services agreement dated December 31, 2007 whereby SHI provides services to the Company;

4. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to Scottish Annuity & Life Insurance Company (SALIC);
5. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to Scottish Annuity & Life International Insurance Company (Bermuda) Ltd. (SAIL);
6. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to Scottish Re Dublin (SRD);
7. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to SRGL;
8. A Support Services Agreement dated December 31, 2007 whereby the Company provided services to The Scottish Annuity Company (Cayman) Ltd. (SAC), which agreement was terminated effective June 30, 2008 upon the sale of this affiliate;
9. A Support Services Agreement dated December 31, 2007 whereby the Company provided services to Scottish Annuity & Life Insurance Company (Bermuda) Limited (SALIB). This agreement was terminated effective June 30, 2008 upon the sale of the this affiliate;
10. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to SRLC;
11. A Support Services Agreement dated December 31, 2007 whereby the Company provided services to Scottish Re Holdings Limited (SRH), which agreement was terminated effective June 30, 2008 upon sale of this affiliate;
12. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to SHI;
13. A Support Services Agreement dated December 31, 2007 whereby the Company provides services to Scottish Re Life (Bermuda) Limited (SRLB).

The net expense paid for services received and rendered pursuant these various agreements was \$7,243,585 for year ended December 31, 2008. These fees include lease payments that are reimbursed to SHI for the Charlotte, NC and Denver, CO administrative offices leases. The Denver, CO lease agreement is contracted with the Company's immediate parent, SHI, and does not include the Company as a lessee. For the year ending December 31, 2008, the Company reimbursed SHI \$488,387 for lease expense related to this location.

The Company is a party to a Tax Allocation Agreement dated February 11, 2005 as amended April 28, 2007 with ORE, OHL, SRLC, and SRLB and a Special Tax Agreement dated February 11, 2005 as amended and restated May 3, 2007 with ORE and OHL. Pursuant to this tax sharing agreement, the Company reported a net recoverable in the amount of \$7,585,536 which included \$10,012,792 due from ORE as of December 31, 2008. At the time of this report, the recoverable due after filing the consolidated income tax return in the amount of \$10,016,254 had not been received within 90 days of filing the return and the Company non-admitted the recoverable as of December 31, 2009 in compliance with SSAP No. 10, paragraph 13.

The Company is a party to a net worth maintenance agreement as restated February 1, 2002 with SALIC pursuant to which SALIC will make capital contributions to the Company as necessary in order for the Company's Risk-Based Capital ("RBC") level to remain above certain statutory minimums. The fee for the net worth maintenance agreement is charged based on cash flow testing and analysis. For the year ended December 31, 2008, the Company was charged \$3,556,000 for this agreement. The agreement does not state that the fees should be paid to SALIC on a periodic basis or the method of calculation.

It is recommended that the Net Worth Maintenance Agreement be amended to specify any fees to be paid or payable, the method of calculating the fees payable and the respective due date in order to comply with the provisions of 18 Del. C. § 5005 (a)(1) and SSAP No. 25, Paragraph 6 of the NAIC Accounting Practices and Procedures Manual.

Non Affiliated Agreements

The Company utilizes an Investment Management Agreement, dated June 28, 2002, through its relationship as an indirect subsidiary of SALIC with General Re – New England

Scottish Re (U.S.), Inc.

Asset Management, Inc. (NEAM). NEAM provides investment management services, Schedule D accounting services and manages the Company's trust agreement deposits for its ceding reinsurance program with various unauthorized reinsurers. The Company also has custodial account agreements with Comerica Bank, Bank of New York Mellon, Fleet National Bank and Wilmington Trust to manage invested assets under various statutory deposits and trust agreements.

TERRITORY AND PLAN OF OPERATION

Territory:

The Company was licensed in 16 states as of December 31, 2008 but does not write direct business. The Company is an accredited reinsurer in 33 jurisdictions.

Plan of Operation:

The Company ceased assuming new insurance from direct writing insurers and is no longer entering into new reinsurance contracts. The Company was placed under an Order of Supervision by the Delaware Insurance Department in January, 2009.

The Company continues to assume insurance from direct writing insurers under existing reinsurance contracts in the following categories:

Traditional Solutions: The Company reinsured the mortality risk on life insurance policies written by primary insurers. This business was often referred to as traditional life reinsurance. The Company assumed this business predominately on an automatic basis with respect to newly written life insurance policies. This meant that the Company automatically reinsured all policies written by a ceding company that met the underwriting criteria specified in

the treaty with the ceding company. In the North American market, the direct sales force targeted the top 60 life insurance companies.

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

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements:

| <u>Year</u> | <u>Admitted Assets</u> | <u>Surplus</u> | <u>Premiums, Annuity Considerations and Deposits</u> | <u>Net Income</u> |
|-------------|------------------------|----------------|--|-------------------|
| 2008 | \$2,197,037,960 | \$167,348,079 | \$(339,829,318) | \$(125,301,401) |
| 2007 | \$2,950,562,632 | \$248,557,539 | \$764,769,986 | \$(345,574,735) |
| 2006 | \$3,090,603,561 | \$306,699,350 | \$74,764,095 | \$(208,032,470) |
| 2005 | \$2,766,063,610 | \$229,839,465 | \$636,375,169 | \$(263,485,561) |

The Company has experienced significant negative net income during the examination period, but has received significant statutory support from its parent. As noted in the Plan of Operation, the Company is not assuming new business.

NAIC FINANCIAL RATIOS

The Company's 2008 NAIC Financial Ratios from the Insurance Regulatory Information System (IRIS Ratios) were reviewed and it was noted that the Company received the following seven unusual values out of the twelve ratios reviewed:

- Net Change in Capital and Surplus
- Gross Change in Capital and Surplus
- Net Income to Total Income
- Adequacy of Investment Income
- Non-admitted to Admitted Assets
- Change in Premium
- Change in Reserving

Net Change in Capital and Surplus resulted in an actual value of (76%) versus a recommended minimum value of (10%). The result is due to the Company's recognition of other-than-temporary impairments of \$166.9 million throughout 2008. Gross Change in Capital and Surplus resulted in an actual value of (21%) versus a recommended minimum value of (10%). The result is due to the Company's recognition of other-than-temporary impairments of \$166.9 million throughout 2008. Net Income to Total Income (Including Realized Capital Gains and Losses) resulted in an actual value of "U" ("undefined" by the NAIC due to the ratio being negative) versus recommended value of 0%. This ratio resulted in a "U" value because net income, total revenue and realized capital gains/losses were all negative. Negative total revenue was driven by the OM Financial Life Insurance Company recapture which resulted in return premiums of (\$552.1) million. Additionally, as a result of significant declines in the fair value of invested assets, which contain a significant concentration of subprime and Alt-A residential mortgage-backed securities, the Company recorded other-than-temporary impairments of \$166.9 million in 2008. Adequacy of Investment Income resulted in an actual value of 123% versus recommended minimum value of 125%. The result is due to a decrease in net investment

income of (\$13.5) million which was primarily due to an overall decrease in average invested assets and the reinvestment of proceeds from sales of bonds into cash and cash equivalents which earn lower yields. Non-admitted to Admitted Assets resulted in an actual value of 11% versus a recommended maximum value of 10%. The result is due to the increase in non-admitted deferred taxes assets of \$26.5 million, from \$205.2 million as of December 31, 2007 to \$231.7 million as of December 31, 2008. Change in Premium resulted in an actual value of (147%) versus a recommended minimum value of (10%). The result is due to the decrease in premiums due to recapture of business by OM Financial Life Insurance Company recapture which resulted in return premiums of (\$552.1) million. In addition, there was an error on Schedule T in 2007. In 2008, the Company corrected Schedule T to report premiums on a cash basis as opposed to being reported on an incurred basis in 2007. Change in Reserving resulted in an actual value of (208%) versus a recommended minimum of (20%). The result is due to significant recapture and retrocession of existing blocks of business and a (\$99.0) million reduction in the asset adequacy reserve in 2008.

REINSURANCE

The Company operates as a professional reinsurer and no direct business was written during the period covered by this examination. The Company ceased assuming new insurance from direct writing insurers and is no longer entering into new reinsurance contracts. The Company continues to assume insurance from direct writing insurers under existing reinsurance contracts.

Assumed

The Company reinsures mortality risk on a variety of life insurance products written by primary direct writers. The Company has excess retention pools to retrocede any risk over \$500,000 on a per life basis for its traditional life line of business on policies issued in 2004 and prior and in excess of \$1,000,000 on policies with 2005 issue dates.

The assumed business of \$4,555,496,969 is comprised of \$4,538,789,304 life reserves and \$16,707,665 accident and health reserves. The largest amount of premium was assumed from the following insurers (47% of total assumed):

| <u>Insurer</u> | <u>Reserves</u> |
|---|-----------------|
| Security Life of Denver Insurance Company | \$1,348,456,842 |
| Nationwide Life and Annuity Insurance Company | 243,996,591 |
| First Penn-Pacific Life Insurance Company | 157,408,879 |
| Protective Life Insurance Company | 142,961,960 |
| Protective Life Insurance Company of New York | 248,709,531 |

On January 22, 2009, (and effective October 1, 2008) OM Financial Life Insurance Company (F&G) and SRUS entered into a recapture agreement whereby F&G recaptured 100% of the reinsured contracts and related liabilities ceded to the Company. The reinsurance agreement entered into by F&G and the Company effective December 31, 2005 was terminated under the recapture agreement.

Ceded

The Company ceded \$3,308,633,915 life reserves at year end 2008 to affiliated and non-affiliate insurers. The largest amounts of reserves ceded (91%) are listed below:

| <u>Affiliated</u> | <u>Ceded Reserves</u> |
|---------------------------------|-----------------------|
| Orkney Re, Inc. | \$1,059,096,755 |
| Orkney Re II plc | \$272,909,082 |
| | |
| <u>Non-affiliated</u> | |
| London Life Reinsurance Company | \$753,966,502 |
| Union Hamilton Reinsurance Ltd. | \$929,636,645 |

The Company's business grew substantially in 2004 through the acquisition of the reinsurance business of ING Re (Security Life of Denver). In 2008, numerous transactions were executed to recapture portions of the ING Re business and subsequently retrocede the business from ING Re to a Scottish Re affiliate.

ORE was formed as a Special Purpose Captive Insurance Company under the laws of the State of South Carolina. In 2007, ORE was re-domiciled and authorized in Delaware as a Special Purpose Captive Insurance Company. ORE establishes and maintains its reserves in accordance with U.S. GAAP as permitted by Delaware rather than the statutory reserves prescribed by the NAIC. However, the reserve credit taken by SRUS associated with the business ceded to ORE is calculated based on statutory reserves.

As a result of the deteriorating condition of SRGL, primarily caused by the depreciation in the value of assets collateralizing statutory reserve credits for business ceded to affiliated off-shore reinsurance companies, the following transactions were executed in 2008:

Clearwater Re Limited (Prior year ceded reserves \$1,806,722,277)

Business previously ceded to Clearwater Re Limited (CRL) was recaptured and ceded to London Life Re effective July 1, 2008 (90%) and an additional 10% of CRL related business was ceded to London Life Re effective September 30, 2008. The entire treaty was retroceded from London Life Re to Hannover Re.

Ballantyne Re plc (Prior year ceded reserves \$353,642,936)

The reserve credit for business ceded to Ballantyne Re plc (BRE) was collateralized by the trust account within the Special Purpose Vehicle that contained subprime and Alt-A residential mortgage-backed securities. The value of these trust account assets declined significantly during the latter part of 2007 and this decline continued into 2008. The Company executed a series of transactions to alleviate the potential for reserve credit shortfalls precipitated by the decline in asset value. In each of these transactions, the business was recaptured from BRE by SRUS and then recaptured from SRUS by Security Life of Denver (SLD), an insurance subsidiary of ING. SLD then ceded the business to Security Life of Denver International (SLDI), who in turn ceded to SRLB, who then ceded the business to SRD. This business is now external to SRUS.

On March 31, 2008, 29.5% of the original BRE block was recaptured, on June 30, 2008 15.5% was recaptured and on September 30, 2008 an additional 6.5% was recaptured. Effective October 1, 2008, the coinsurance agreement between the Company and BRE was novated to SLD.

SRD (Prior year ceded reserves \$833,741,675)

On September 30, 2008, the Company recaptured 100% of the business which was assumed from SLD and ceded to SRD in order to facilitate the “unwinding” of HSBCII (collateral finance facility which originally collateralized the reserves). SLD then ceded the recaptured business to SLDI, who in turn ceded the business to SRLB. SRLB retroceded the business to SRD.

ACCOUNTS AND RECORDS

The accounts and records reviewed included an evaluation of the Company's operational and organizational controls. The areas evaluated included computer systems, accounting systems, organizational structure, and the processing structure. The examination reviewed the Company's documented controls, but did not test controls. Substantive procedures were performed during the examination.

The following departures from the *NAIC Accounting Practices and Procedures Manual* were noted during the course of the current examination:

Uncollected Premiums and Agents' Balances in Course of Collection

During review of SRUS subsequent receipts, it was noted that the balance for Deferred Premiums and Agents' Balances and Installments Booked but Deferred and Not Yet Due included an overstatement in the amount of \$386,287. The net effect to surplus amounted to an overstatement of \$177,692 after consideration of the Company's retrocession. The Company noted that this entry should have been booked in December 2008 and that the entry was booked in the month that the omission was recognized, May 2009.

It is recommended that the Company comply with the requirement of SSAP No. 51, Paragraph 23 of the *NAIC Accounting Practices and Procedures Manual* to subtract deferred premiums that have actually been collected.

Deferred Premiums and Agents' Balances and Installments Booked and Deferred and Not Yet Due

It was noted that the Company reports the balance on a gross basis and then sets up an offsetting liability on Line 9.3 of the Liability Page for the ceded portion.

It is recommended that the Company comply with the requirement of SSAP 61, Paragraph 25 of the *NAIC Accounting Practices and Procedures Manual* to report Deferred and Uncollected Premiums net of ceded premiums.

Prepaid Expenses

It was noted three contra liabilities totaling \$255,485 were identified which should have been shown as Prepaid Expenses at December 31, 2008.

It is recommended that the Company comply with the requirement of SSAP No. 29, Paragraph 2 of the *NAIC Accounting Practices and Procedures Manual* to classify all payments paid in advance of receiving future economic benefits anticipated by the payment, under "Aggregate write-ins for other than invested assets," where they would be treated as non-admitted assets in accordance with SSAP No. 4.

Remittances and Items Not Allocated

It was noted that the Company is offsetting credit suspense balances against unrelated debit suspense balances under Remittances and Items Not Allocated. This practice is not permitted under the *NAIC Annual Statement Instructions for Life, Accident and Health*.

It is recommended that the Company comply with the requirements of the *NAIC Annual Statement Instructions for Life, Accident and Health* regarding "Remittances and Items Not Allocated," that state: "Do not offset credit suspense balances by unrelated debit suspense balances. The latter, to the extent not offset by related liability items, should be entered as a separate item on Page 2."

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2008:

Assets
Liabilities, Surplus and Other Funds
Summary of Operations
Capital and Surplus Account

The financial statements as presented reflect the statutory financial statements as determined by this examination as of December 31, 2008.

Assets
December 31, 2008

| | <u>Assets</u> | Nonadmitted <u>Assets</u> | Net Admitted <u>Assets</u> | <u>Note</u> |
|--|--------------------------------|------------------------------|--------------------------------|-------------|
| Bonds | \$ 1,439,946,653 | \$ - | \$ 1,439,946,653 | |
| Preferred stocks | 40,457,659 | - | 40,457,659 | |
| Common stocks | 62,976,408 | - | 62,976,408 | |
| Cash and short-term investments | 186,423,839 | - | 186,423,839 | |
| Contract loans | 168,435 | - | 168,435 | |
| Other invested assets | 3,839,652 | - | 3,839,652 | |
| Receivables for securities | 34,797 | - | 34,797 | |
| Investment income due and accrued | 16,447,097 | - | 16,447,097 | |
| Uncollected premiums and agents' balances in course of collection | 155,588,921 | 21,174 | 155,567,747 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 1,305,227 | - | 1,305,227 | |
| Amounts recoverable from reinsurers | 93,347,451 | - | 93,347,451 | |
| Funds held by or deposited with reinsured companies | 2,950,889 | - | 2,950,889 | |
| Other amounts receivable under reinsurance contracts | 180,503,131 | 1,200,000 | 179,303,131 | |
| Current federal income tax recoverable | 7,585,535 | - | 7,585,535 | |
| Net deferred tax asset | 219,881,358 | 219,881,358 | - | |
| EDP equipment and software | 4,338,226 | 4,338,226 | - | |
| Furniture and equipment | 1,665,771 | 1,665,771 | - | |
| Receivable from parent, subsidiaries and affiliates | 31,485,323 | 24,801,883 | \$ 6,683,440 | |
| Leasehold improvements | 3,163,229 | 3,163,229 | - | |
| Prepaid assets | 25,541 | 25,541 | - | |
| Other assets nonadmitted | <u>\$ 870,432</u> | <u>\$ 870,432</u> | <u>-</u> | |
| Totals | <u><u>\$ 2,453,005,574</u></u> | <u><u>\$ 255,967,614</u></u> | <u><u>\$ 2,197,037,960</u></u> | |

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Liabilities, Surplus and Other Funds
December 31, 2008

| | | |
|--|--------------------------|---|
| Aggregate reserve for life contracts | \$ 1,413,958,289 | 1 |
| Aggregate reserve for accident and health contracts | 22,880,571 | |
| Liability for deposit-type contracts | 197,100 | |
| Contract claims: life | 25,170,599 | |
| Contract claims: accident and health | 1,517,579 | |
| Premiums and annuity considerations for life and accident and health contracts received in advance | 9,343 | |
| Surrender values on canceled contracts | 49,159,290 | |
| Provision for experience rating refunds | 14,910,958 | |
| Other amounts payable on reinsurance assumed and ceded | 344,030,528 | |
| Interest maintenance reserve | 11,010,205 | |
| Commissions and expense allowances payable on reinsurance assumed | 20,179,222 | |
| General expenses due or accrued | 11,907,188 | |
| Taxes, licenses and fees due or accrued | (588,314) | |
| Remittances and items not allocated | 47,726,166 | |
| Asset valuation reserve | 1,336,111 | |
| Reinsurance in unauthorized companies | 27,917,239 | |
| Payable to parent, subsidiaries and affiliates | 29,510,209 | |
| Funds held under coinsurance | 8,007,903 | |
| Payable for securities | 726,636 | |
| Accounts payable non-affiliate | <u>\$ 123,059</u> | |
| Total Liabilities | 2,029,689,881 | |
| Common capital stock | 3,600,000 | |
| Deferred gain on reinsurance | 430,312,809 | |
| Surplus notes | 100,000,000 | |
| Gross paid in and contributed surplus | 1,121,252,205 | |
| Unassigned funds (surplus) | <u>\$(1,487,816,935)</u> | |
| Total Capital and Surplus | <u>\$ 167,348,079</u> | |
| Total Liabilities, Surplus and Other Funds | <u>\$ 2,197,037,960</u> | |

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Summary of Operations
December 31, 2008

| Income: | | <u>Note</u> |
|---|-------------------------|-------------------------|
| Premiums earned | \$ (339,829,318) | |
| Net investment income earned | 90,850,094 | |
| Amortization of interest maintenance reserve | 1,748,333 | |
| Commissions and expense allowances on reinsurance ceded | 61,099,108 | |
| Reserve adjustments on reinsurance ceded | (111,447,854) | |
| Fee income | 1,203,674 | |
| Net interest credited on funds withheld | (1,743,153) | |
| Miscellaneous income | <u>\$ (1,645,579)</u> | |
| Total income | | \$ (299,764,695) |
| Expenses: | | |
| Death benefits | \$ 240,471,429 | |
| Annuity benefits | 30,001,103 | |
| Disability benefits & benefits under accident & health contracts | 6,326,220 | |
| Surrender benefits & withdrawals for life contracts | 205,244,091 | |
| Increase in aggregate reserves for life & accident health contracts | (383,223,710) | |
| Commissions & expense allowances on reinsurance assumed | 129,126,215 | |
| General insurance expenses | 61,860,335 | |
| Insurance taxes, licenses and fees | 984,562 | |
| Increase in loading on deferred & uncollected premiums | (2,414) | |
| Brokerage fees | 1,186,514 | |
| Modco reserve adjustment on reinsurance assumed | <u>\$ (610,584,371)</u> | |
| Total expenses | | <u>\$ (318,610,026)</u> |
| Net income before federal income taxes incurred | | 18,845,331 |
| Federal income taxes incurred | | (26,815,962) |
| Net realized capital gains | | <u>\$ (170,962,694)</u> |
| Net income | | <u>\$ (125,301,401)</u> |

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

Capital and Surplus Account
December 31, 2007 to December 31, 2008

| | |
|---|------------------------|
| Surplus as regards policyholders, December 31, 2007 | \$248,557,539 |
| Net Income | <u>\$(125,301,401)</u> |
| <u>Additions:</u> | |
| Change in net deferred income tax | \$ 14,666,318 |
| Change in reserve on account of change in valuation basis | 43,206,127 |
| Paid in surplus | <u>140,739,661</u> |
| Total additions | <u>\$198,612,106</u> |
| <u>Deductions:</u> | |
| Change in net unrealized capital gains (losses) | (31,504,980) |
| Change in nonadmitted assets | (34,271,642) |
| Change in liability for reinsurance in unauthorized companies | (26,873,845) |
| Change in asset valuation reserve | (1,054,111) |
| Change in surplus as a result of reinsurance | (22,143,634) |
| Prior year OTTI | (15,262,221) |
| Prior year accounting correction | (5,747,963) |
| Prior year modco asset correction | <u>(17,661,769)</u> |
| Total deductions | <u>\$(154,520,165)</u> |
| Net change in surplus as regards policyholders for the year | <u>\$(81,209,460)</u> |
| Surplus as regards policyholders, December 31, 2008 | <u>\$167,348,079</u> |

The accompanying Notes are an integral part of the Financial Statements and Exhibits.

NOTES TO THE FINANCIAL STATEMENTS

Note 1 Aggregate reserve for life contracts.....\$1,413,958,289

The Delaware Department of Insurance contracted INS Consultants, Inc. (Consulting Actuary) to perform an actuarial review of the Company's reserves. The actuarial staff at the Company provided the Consulting Actuary with their statement of actuarial opinion and the supporting actuarial data and documents. No material exceptions were noted during that review; however, the consulting actuary recommended the following:

It is recommended the Company obtain actuarial reserve certifications on a more timely basis for all assumed reserves.

It is recommended Reserves calculated pursuant to the emergency regulations be properly allocated between the life insurance and miscellaneous reserve sections of Exhibit 5.

It is recommended the Company be consistent in the valuation basis used in determining both assumed and ceded reserves for policies with face amounts over SRUS' retention limit.

It is recommended the Company improve procedures for reporting reserve credits in Schedule S, such that they mirror the reserves reported by the ceding companies.

The following adjustments to reserves should be noted:

Permitted Practice

In connection with the filing of its statutory financial statement for the period ending September 30, 2008, the Company requested and received approval for a Permitted Practice from the Delaware Department of Insurance related to the reduction of the liability for reinsurance ceded to ORE and Orkney Re II plc (ORE II) (reinsurers). Specifically, the Company received permission to record a reserve credit on reinsurance business ceded by the Company to each reinsurer in an amount up to but not greater than the specific obligations under the reinsurance

agreements with reinsurers that the respective Trust Account was established to secure, provided that:

1. The original book value of all Eligible Securities on deposit in the applicable Trust Account (such book value to be determined at the time such securities were deposited to such Trust Account) is, when combined with any cash on deposit therein, not less than the specific obligations related to such Trust Account; and
2. The current fair market value of cash and Eligible Securities held in the applicable Trust Account is not less than the specific obligations related to such Trust Account calculated using the 2001 CSO (promulgated under Delaware Regulation 1213 and effective for use in Delaware as of January 1, 2004); and
3. The appointed actuary opines that sufficient experience exists to demonstrate that such 2001 CSO mortality basis provides reasonable margin relative to experience.

Prescribed Practice

On February 17, 2009, citing, among other things, the current economic conditions and the uncertainty of the conditions that lay ahead, the Delaware Insurance Commissioner issued an emergency order amending 18 Del. Admin. Code § 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 18 Del. Admin. Code § 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, the Company 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 effect of the Emergency Regulation decreased the reserves by \$282.1 million and increased surplus by \$189.9 million. The effect of the Permitted Practice decreased reserves by \$231.0 million and increased surplus by \$197.2. The total effect on reserves was a reduction in the amount of \$513.1 million and the total effect on surplus was an increase of \$387.1 million.

The Company made manual adjustments to its statutory reserve calculation process to implement the revised valuation bases, by quantifying the impact of the changes in valuation based on its MoSes models.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company's compliance with all prior examination recommendations was reviewed for each account in the current examination. The first recommendation was also recommended in the prior examination report.

SUMMARY OF RECOMMENDATIONS

Management and Control

It is recommended the Company comply with 18 *Del.C.* § 1304 regarding the required approval of investment transactions by the Board of Directors or by a committee thereof.

Management and Service Agreements

It is recommended that the Net Worth Maintenance Agreement be amended to specify any fees to be paid or payable, the method of calculating the fees payable and the respective due date in order to comply with the provisions of 18 *Del.C.* § 5005 (a)(1) of the Delaware Insurance Code, “affiliated transactions and agreements required to be filed with the Commissioner” and SSAP No. 25, paragraph 6 of the *NAIC Accounting Practices and Procedures Manual*. (Page 8)

Accounts and Records

It is recommended that the Company comply with the requirement of SSAP No. 51, Paragraph 23 of the *NAIC Accounting Practices and Procedures Manual* to subtract deferred premiums that have actually been collected. (Page 16)

It is recommended that the Company comply with the requirement of SSAP 61, Paragraph 25 of the *NAIC Accounting Practices and Procedures Manual* to report Deferred and Uncollected Premiums net of ceded premiums. (Page 17)

It is recommended that the Company comply with the requirement of SSAP No. 29, Paragraph 2 of the *NAIC Accounting Practices and Procedures Manual* to classify all payments paid in advance of receiving future economic benefits anticipated by the payment, under "Aggregate write-ins for other than invested assets," where they would be treated as non-admitted assets in accordance with SSAP No. 4. (Page 17)

It is recommended that the Company comply with the requirements of the *NAIC Annual Statement Instructions for Life, Accident and Health* regarding "Remittances and Items Not Allocated", that state: “Do not offset credit suspense balances by unrelated debit suspense

balances. The latter, to the extent not offset by related liability items, should be entered as a separate item on Page 2.” (Page 17)

Aggregate Reserve for Life Contracts

It is recommended the Company obtain actuarial reserve certifications on a more timely basis for all assumed reserves. (Page 23)

It is recommended reserves calculated pursuant to the emergency regulations be properly allocated between the life insurance and miscellaneous reserve sections of Exhibit 5. (Page 23)

It is recommended the Company be consistent in the valuation basis used in determining both assumed and ceded reserves for policies with face amounts over SRUS’ retention limit. (Page 23)

It is recommended the Company improve procedures for reporting reserve credits in Schedule S, such that they mirror the reserves reported by the ceding companies. (Page 23)

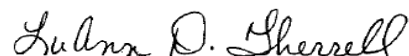
CONCLUSION

The following schedule reflects the results of this examination and the results of the prior examination with changes between the examination periods:

| <u>Description</u> | <u>December 31, 2005</u> | <u>December 31, 2008</u> | <u>Increase (Decrease)</u> |
|---------------------|--------------------------|--------------------------|--------------------------------|
| Assets | \$2,761,505,486 | \$2,197,037,960 | \$(564,467,526) |
| Liabilities | \$2,533,325,625 | \$2,029,689,881 | \$(503,635,744) |
| Capital and Surplus | \$ 228,179,861 | \$ 167,348,079 | \$(60,831,782) |

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. is acknowledged.

Respectfully submitted,



Lu Ann D. Therrell, CFE
Examiner In-Charge
State of Delaware

SUBSEQUENT EVENTS

Prior to the filing of the Annual Statement, the Company settled capital contributions receivable from SHI of \$6,683,443 that were included in receivables from parent, subsidiaries and affiliates at December 31, 2008.

On January 22, 2009, the Company and certain of its Scottish Re affiliates (Scottish Re) entered into a Master Asset Purchase Agreement (Purchase Agreement) with Hannover Life Reassurance Company of America and its affiliate (together, Hannover Re), Security Life of Denver (SLD), a subsidiary of ING (together ING Companies). Hannover Re agreed to purchase from Scottish Re a block of individual life reinsurance business acquired in 2004 by Scottish Re from the ING Companies. This block consisted primarily of term life reinsurance, universal life with secondary guarantees, and yearly renewable term business (Acquired Business). The Acquired Business does not include business formerly reinsured with Ballantyne Re. The closing of the transaction, which included certain customary conditions to closing and the receipt of required governmental and regulatory approvals, occurred on February 20, 2009.

In connection with the Purchase Agreement, the transfer to Hannover Re of the Acquired Business generally was accomplished through the recapture by the ING Companies from Scottish Re of the Acquired Business, and the cession immediately thereafter by the ING Companies to Hannover Re of the Acquired Business under new reinsurance agreements. These recapture and reinsurance transactions have an effective date of January 1, 2009. Accordingly, the accompanying statutory financial statements of the Company for the period ending December 31, 2008, generally do not give effect to the results of the foregoing transaction.

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

In connection with the Company's receipt of the permitted accounting practice, the Company agreed to the entry by the Delaware Department of Insurance to an order of supervision, effective January 5, 2009 (Order of Supervision), in accordance with 18 *Del. C.* §5942. Pursuant to the Order of Supervision, 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 \$1,000,000 or greater; 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 Delaware Department of Insurance; commute, novate, amend or otherwise change any existing reinsurance contract or treaty; or engage in any transaction with any related party. The order of supervision does not operate to limit the Company's contractual obligations to its counterparties in respect of any accepted or retroceded reinsurance business. The Order of Supervision was amended and extended on April 3, 2009.

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 (Insurance Commissioner) issued an emergency order amending 18 Del. Admin. Code §1215 relating to Recognition of Preferred Mortality Tables for use in Determining Minimum Reserve Liabilities (Preferred Mortality Table Emergency Regulation) and an emergency order amending 18 Del. Admin. Code §1212 relating to Valuation of Life Insurance Policies (X-Factor Emergency Regulation), and together with the Preferred Mortality Table Regulation (Emergency Regulations). Generally, the Preferred Mortality Table Emergency Regulation allows, upon receipt of the Insurance Commissioner's approval, use of the 2001 CSO Preferred Class Structure Mortality Table as the minimum valuation standard for policies issued after January 1, 2004. In connection with this requirement, SRUS sought, and on February 26, 2009, obtained, the Insurance Commissioner's approval for use of the 2001 CSO Preferred Class Structure Mortality Table in accordance with the Preferred Mortality Table Emergency Regulation. The X-Factor Emergency Regulation relaxes existing constraints related to the X-factor assumptions used in the calculation of statutory reserves. The Emergency Regulations for statutory accounting

purposes by their terms are effective for valuations on and after December 31, 2008. At December 31, 2008, the implementation of the Emergency Regulations resulted in a \$190 million increase in SRUS' statutory capital and surplus. Accordingly, in the absence of the Emergency Regulations, SRUS' risk based capital as of December 31, 2008 may have resulted in further regulatory action against SRUS. As provided in each of the emergency orders, the Insurance Commissioner exposed each of the Emergency Regulations for public comment, which comment periods expired on April 6, 2009. Each emergency order pursuant to which the respective Emergency Regulation was promulgated remained effective until September 1, 2009, or until the applicable Emergency Regulation was adopted pursuant to the Delaware Administrative Procedures Act. In the event one, or, both, of the Emergency Regulations had expired without being adopted and absent any other sufficient regulatory developments or concessions in its place, SRUS would have become subject at such time to additional regulatory action. Both Emergency Regulations were adopted pursuant to the Delaware Administrative Procedures Act on September 1, 2009.

Subsequent to year end, the contract with Union Hamilton Reinsurance Ltd. (which was business assumed from SLD) was novated and Hannover Re replaced Scottish Re as the reinsurer. Ceded reserves in the amount of \$929,636,645 were reported by the Company for year-end 2008.

On March 26, 2009, the Company received an additional capital contribution from its indirect parent, SALIC of \$56.2 million. Total capital contributions amounted to \$58,871,737 through September 30, 2009.

In late June 2009, the Company exercised its contractual right and took control over certain assets that formerly were held in a reserve credit trust established by ORE II, as part of an

ongoing reinsurance agreement between the parties. The trust was established to provide the Company with reserve credit for the business ceded to ORE II, which is an unauthorized affiliated reinsurer. By taking possession of the trust assets and recording them as general account assets, as allowed by the reinsurance agreement, the Company will use these assets as collateral when considering the reserve credit for the business ceded to ORE II.

As a result of the continued stress in the markets for subprime and Alt-A residential mortgage-backed securities, the Company has recognized other-than-temporary impairments of \$8,860,947 related to such investment securities for the nine-month period ended September 30, 2009. Included in other-than-temporary impairments are \$7,670,944 of net realized capital gains and losses and a one-time negative cumulative effect adjustment of \$1,190,003, resulting from the adoption of SSAP 43R effective September 30, 2009. Other-than-temporary impairments included in net realized capital gains (losses) recognized on subprime and Alt-A residential mortgage-backed securities represents 45% of total other-than-temporary impairments for the nine-month period ended September 30, 2009.

Pursuant to the Company's tax sharing agreement with ORE, OHL, SRLC and SRLB, the Company reported a net recoverable in the amount of \$7,585,536 which included \$10,012,792 due from ORE as of December 31, 2008. At the time of this report, the recoverable due after filing the consolidated income tax return in the amount of \$13,803,587 had not been received within 90 days of filing the return. The Company nonadmitted the recoverable as of December 31, 2009 in compliance with SSAP No. 10, paragraph 13.

Subsequent to the examination period, the Company now utilizes an Investment Management Agreement, dated October 14, 2009, through its relationship as an indirect subsidiary of SALIC with Babson Capital Management LLC, an affiliate of Massachusetts

Scottish Re (U.S.), Inc.

Mutual Life Insurance Company. Use of Babson Capital Management LLC to provide investment management services for the Company's assets was approved by the Delaware Department of Insurance in connection with a Form D filing made by the Company.