

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT**

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

CONTENTS

	Page
Independent auditors' report	1
Consolidated balance sheets	2
Consolidated statements of (loss) income and comprehensive (loss) income	3
Consolidated statements of changes in shareholder's equity	4
Consolidated statements of cash flows	5
Notes to the consolidated financial statements	6-17



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INDEPENDENT AUDITORS' REPORT

**To the Shareholder and Board of Directors of
Annuity and Life Re (Holdings), Ltd.**

We have audited the accompanying consolidated balance sheets of Annuity and Life Re (Holdings), Ltd. (the "Company") as at December 31, 2011 and 2010 and the related consolidated statements of (loss) income and comprehensive (loss) income, changes in shareholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the appropriateness of accounting principles used and the reasonable of accounting significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at December 31, 2011 and 2010 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "Arthur Morris & Company".

Hamilton, Bermuda
July 18, 2012

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2011 and 2010

(Expressed in U.S. dollars)

ASSETS	2011	2010
Cash and cash equivalents (note 3)	\$ 17,794,771	\$ 17,074,248
Investments (notes 4 and 13)	15,287,226	13,477,872
Notes receivables (notes 5 and 9)	3,684,090	-
Interest receivable (notes 4 and 5)	577,248	-
Other assets	30,500	32,667
Insurance balance receivable	7,815	741,717
Deferred acquisition costs	423	101,851
TOTAL ASSETS	37,382,073	31,428,355
LIABILITIES		
Loans payable (note 6)	15,420,000	15,420,000
Reserve for losses and loss expenses (note 7)	664,981	229,651
Commissions payable (note 8)	120,857	181,529
Accounts payable and accrued expenses	34,257	34,800
Unearned premiums	2,011	494,371
TOTAL LIABILITIES	16,242,106	16,360,351
SHAREHOLDERS' EQUITY		
Share capital (note 9)	5,017,500	100
Additional paid-in-capital (note 9)	17,163,633	11,187,175
Accumulated other comprehensive income	514,278	1,538,547
(Deficit) Retained earnings	(1,555,444)	2,342,182
TOTAL SHAREHOLDER'S EQUITY	21,139,967	15,068,004
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	\$ 37,382,073	\$ 31,428,355

Approved by the Board:


 _____ Director

 _____ Director

The accompanying notes form an integral part of these consolidated financial statements.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

CONSOLIDATED STATEMENTS OF (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

UNDERWRITING INCOME	2011	2010
Premiums written	\$ 30,794	\$ 2,425,236
Change in unearned premiums	492,360	(494,371)
Net premiums earned	523,154	1,930,865
UNDERWRITING EXPENSES		
Losses and loss expenses (note 7)	724,458	51,100
Acquisition costs	111,460	404,859
Profit commission (note 8)	(60,672)	181,529
Total underwriting expenses	775,246	637,488
NET UNDERWRITING (LOSS) INCOME	(252,092)	1,293,377
NET INVESTMENT (LOSS) INCOME (notes 4 and 5)	(3,349,556)	635,107
OTHER INCOME	-	71
(LOSS) INCOME BEFORE OPERATING EXPENSES	(3,601,648)	1,928,555
OPERATING EXPENSES	(295,978)	(295,468)
NET (LOSS) INCOME	(3,897,626)	1,633,087
OTHER COMPREHENSIVE (LOSS) INCOME		
Holding (loss) gain on investments arising during the year	(1,024,269)	1,538,547
COMPREHENSIVE (LOSS) INCOME	\$ (4,921,895)	\$ 3,171,634

The accompanying notes form an integral part of these consolidated financial statements.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CHANGES IN
SHAREHOLDER'S EQUITY**

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

	2011	2010
Share capital		
Balance at beginning of year	\$ 100	\$ 250,000
Reclassification of capital stock to additional paid-in-capital (note 9)	-	(249,900)
Issuance of shares during the year (note 9)	5,017,400	-
Balance at end of year	5,017,500	100
Additional paid-in-capital		
Balance at beginning of year	11,187,175	10,937,275
Reclassification of capital stock to additional paid-in-capital (note 9)	-	249,900
Additional paid-in-capital during the year (note 9)	5,976,458	-
Balance at end of year	17,163,633	11,187,175
Accumulated other comprehensive income		
Balance at beginning of year	1,538,547	1,538,547
Change in accumulated other comprehensive income	(1,024,269)	-
Balance at end of year	514,278	1,538,547
(Deficit) Retained earnings		
Balance at beginning of year	2,342,182	709,095
Net (loss) income for the year	(3,897,626)	1,633,087
Balance at end of year	(1,555,444)	2,342,182
TOTAL SHAREHOLDER'S EQUITY	\$ 21,139,967	\$ 15,068,004

The accompanying notes form an integral part of these consolidated financial statements.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income for the year	\$ (3,897,626)	\$ 1,633,087
Adjustments to reconcile net income from continuing operations to cash used in operating activities:		
Net realized gain on sale of investments	(300,736)	-
Impairment loss on investments	5,616,237	-
Changes in assets and liabilities:		
Interest receivable	(577,248)	-
Other assets	2,167	70,891
Insurance balance receivable	733,902	(741,717)
Deferred acquisition cost	101,428	(101,851)
Reserve for losses and loss expenses	435,330	(38,466)
Commissions payable	(60,672)	181,529
Accounts payable and accrued expenses	(543)	9,427
Unearned premiums	(492,360)	494,371
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,559,879	1,507,271
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(2,142,772)	(11,939,325)
Proceeds from sale of investments	1,303,416	-
NET CASH USED IN INVESTING ACTIVITIES	(839,356)	(11,939,325)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from loans	-	15,420,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	-	15,420,000
INCREASE IN CASH AND CASH EQUIVALENTS	720,523	4,987,946
CASH AND CASH EQUIVALENTS – Beginning of year	17,074,248	12,086,302
CASH AND CASH EQUIVALENTS – End of year	\$ 17,794,771	\$ 17,074,248

Material non-cash transactions: Investing activities, see (note 9)

The accompanying notes form an integral part of these consolidated financial statements.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

1. BUSINESS ACTIVITY

Annuity and Life Re (Holdings), Ltd. ("Holdings") was incorporated under the laws of Bermuda on December 2, 1997. Its principal activity is that of investment holding.

Holdings is wholly owned by Pope Investments II LLC (the "Parent"), a managed limited liability company registered in Delaware.

The financial statements include the accounts of Holdings and its wholly owned subsidiary, Annuity and Life Reassurance, Ltd. ("ALRE"), a Class 3A and long-term insurer under the Insurance Act, 1978 of Bermuda and related regulations. ALRE has not written any long-term business since December 31, 2005 and does not intend to continue writing any long-term business in the near future.

As of January 1, 2010, ALRE expanded its scope to include property and casualty reinsurance activities (General Business). Effective April 28, 2010, ALRE obtained a license from the Bermuda Monetary Authority ("BMA") as a Class 3A and Class C Insurer pursuant to Section 4 of the Insurance Act of 1978. The license includes a condition for ALRE to meet and maintain relevant solvency margins, liquidity and other ratios applicable under Bermuda law. It also restricts ALRE to write any insurance business as a direct insurer without obtaining prior written approval from the BMA.

During 2010, ALRE entered into a Property Quota Share retrocession agreement. Under the terms of this agreement, the Company assumes a 4% quota share of losses relating to reinsurance policies, binders, certificates and contracts issued or renewed between January 1, 2010 and December 31, 2010 as allocated by the ceding reinsurer to its US Property Catastrophe and retrocessional excess of loss reinsurance account business and its United States of America industry loss warranty account.

Holdings and ALRE are collectively referred to herein as the "Company."

During 2011, the Company completed its registration as a listed company on the Bermuda Stock Exchange's (BSX) mezzanine market. The Directors believe that a listing on the Mezzanine Market will raise the profile of the Company in North America enabling a wider range of investors to hold the Company's shares. This will also give the Company strategic access to capital markets and consequently will enable it to raise further funds in the future to develop its business.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

The significant accounting policies are as follows:

(a) Basis of consolidation

The consolidated financial statements include the accounts of Holdings and ALRE. All significant inter-company accounts and transactions have been eliminated upon consolidation.

(b) Cash and cash equivalents

Cash and cash equivalents are carried at market value, and consist of money market funds and short-term investments, with original maturities of 90 days or less.

(c) Premiums written

Premiums are recognized as revenue on a pro-rata basis over the periods of the respective policies or contracts of reinsurance. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums. Premiums which are subject to adjustment are estimated based upon available information. Any variances from the estimates are recorded in the periods in which they become known.

(d) Reserve for losses and loss expenses

Long-term Business

The development of reserves for policy benefits and for claims incurred but not reported ("IBNR") for the Company's long-term products requires management to make estimates and assumptions regarding mortality, lapse, persistency, expenses and investment experience. Such estimates are primarily based on historical experience and information provided by ceding companies. Actual results could differ materially from those estimates. Management monitors actual experience and, where circumstances warrant, revises its assumptions and the related reserve estimates. In certain instances, the Company continues to be liable for claims arising on novated contracts which pre-date the novation agreement.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Reserve for losses and loss expenses (continued)

General Business

The liability for losses and loss adjustment expenses in relation to the Company's general reinsurance activities includes an amount determined from loss reports and individual cases received from the ceding reinsurer and an amount, based on past experience and based on the study performed by an independent actuary, for losses incurred but not reported. These estimates are continually reviewed and are necessarily subject to the impact of future changes in such factors as claim severity and frequency. While management believes that the amount is adequate, the ultimate liability may be in excess of, or less than, the amounts provided and any adjustments will be reflected in the periods in which they become known.

(e) Acquisition costs and profit commission

Acquisition costs, primarily commission and brokerage expenses, represent those costs which vary with and are primarily related to the acquisition of the general reinsurance contracts. These costs are deferred and are amortized over the period during which related premiums are earned.

Profit commission is accrued in accordance with the terms of the Property Quota Share retrocession agreement in an amount based upon the net income on the contract as recorded in the financial statements.

The Company conducts a premium deficiency analysis whereby deferred acquisition costs are reviewed to determine if they are recoverable from future income including investment income. If such costs are estimated to be unrecoverable, they are expensed. The Company determined no such deficiency existed as at December 31, 2011.

(f) Investments

Investments are carried at their fair value with the unrealized gain or loss reported as accumulated other comprehensive income on the consolidated balance sheets. A decline in the fair value of any available for sale security below its cost that is deemed other than temporary is charged to earnings, resulting in the establishment of a new cost basis for the security.

Realized gains and losses on investments are recognized in the consolidated statements of (loss) income and comprehensive (loss) income using the specific identification method. Interest income is recognized on an accrual basis.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Investments (continued)

Other-than-temporary Impairments on Investments

An impairment is considered to be other-than-temporary if the Company (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). A "credit loss" is recognized when the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security. If there is an intent to sell the impaired security, then the full OTTI is recognized in earnings in the period. If there is no intent to sell the impaired security but there is a credit loss then the credit loss portion of the unrealized loss is recognized in earnings with the remainder recognized in other comprehensive income. During the year, the Company recognized an other-than-temporary impairment in the amount of \$5,616,237 (2010 - \$nil).

(g) Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes that the amounts included in the consolidated financial statements reflect the Company's best estimates and assumptions, actual results could differ from these estimates.

3. RESTRICTED ASSETS

The Company's cash and cash equivalents includes an amount of \$1,908,381 (2010 - \$9,586,533) which is held in a trust account restricted in accordance with the Company's Property Quota Share retrocession agreement with the ceding reinsurer. The agreement provides that the Company has a maximum liability equal to 300% of its reinsurance premiums written. During 2011, the ceding reinsurer agreed to release \$8.1 million from the trust account and move these funds to the Company's investment account.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

4. INVESTMENTS

The cost, gross unrealized gains, gross unrealized losses and market value of investments in marketable securities, excluding cash and cash equivalents, are as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Market Value
<u>2011</u>				
Equities	\$ 3,836,752	\$ -	\$ -	\$ 3,836,752
Bonds	10,936,196	514,278	-	11,450,474
	<hr/> \$ 14,772,948	\$ 514,278	\$ -	\$ 15,287,226 <hr/>
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Net Market Value
<u>2010</u>				
Equities	\$ 1,003,129	\$ 246,950	\$ -	\$ 1,250,079
Bonds	10,936,196	1,291,597	-	12,227,793
	<hr/> \$ 11,939,325	\$ 1,538,547	\$ -	\$ 13,477,872 <hr/>

The interest receivable relating to the bonds amounted to \$552,248 (2010 - \$nil).

The Company adopted the provisions of Accounting Standards Codification Topic ("ASC") No. 820 - "Fair Value Measurements" (ASC No 820). Under ASC No. 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e. the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. ASC 820 establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

4. INVESTMENTS (continued)

Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 assets and liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these assets and liabilities does not entail a significant degree of judgment.

Level 2 - Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The categorization of the Company's financial assets recorded at fair value based upon the fair value hierarchy as at December 31, 2011 are as follows:

Description	Level 1	Level 2	Level 3	Total
Fixed maturities, available for sale	\$ 11,450,474	\$ -	\$ -	\$ 11,450,474
Equity securities, available for sale	3,836,752	-	-	3,836,752
Total investments	\$ 15,287,226	\$ -	\$ -	\$ 15,287,226

There were no transfers between levels for the year ended December 31, 2011.

Net investment (loss) income comprised of:

	2011	2010
Interest income	\$ 1,965,945	\$ 635,207
Realized gain on sale of investments	300,736	-
Impairment loss on investments	(5,616,237)	-
	\$ (3,349,556)	\$ 635,207

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

5. NOTES RECEIVABLES

Notes receivables comprised of:

	2011	2010
Convertible note	\$ 2,000,000	\$ -
Note receivable	1,684,081	-
	<u>\$ 3,684,081</u>	<u>\$ -</u>

The convertible note earns interest at 5% per annum and is payable quarterly. The note matures on January 28, 2013.

The note receivable matured on March 11, 2012 and total collections amounted to \$1,704,545, which includes the interest earned up to that date.

The interest receivable relating to the convertible note amounted to \$25,000 (2010 - \$nil).

6. LOANS PAYABLE

During 2010, the Company issued a promissory note to the Parent in the amount of \$15,420,000. The Company has the option to make payments in amounts and times as it chooses until such time the Parent makes a demand for repayment, upon which the loan shall be due and payable within 5 business days of written demand from the Parent. The notes are unsecured and interest free.

7. RESERVE FOR LOSSES AND LOSS EXPENSES

The movement in the reserve for losses and loss expenses is summarized as follows:

	2011	2010
Long-term Business		
Provisions, beginning of year	\$ 192,117	\$ 268,117
Losses incurred related to prior years	(91,518)	-
Losses paid related to prior years	<u>(599)</u>	<u>(76,000)</u>
Provisions, end of year	<u>\$ 100,000</u>	<u>\$ 192,117</u>

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

7. RESERVE FOR LOSSES AND LOSS EXPENSES (continued)

	2011	2010
General Business		
Provisions, beginning of year	\$ <u>37,534</u>	\$ <u>-</u>
Losses incurred related to:		
Current year	<u>815,976</u>	<u>51,100</u>
Losses paid related to:		
Current year	(250,995)	(13,566)
Prior years	<u>(37,534)</u>	<u>-</u>
	<u>(288,529)</u>	<u>(13,566)</u>
Provisions, end of year	\$ <u>564,981</u>	\$ <u>37,534</u>
Total reserve for loss and loss expenses	\$ <u>664,981</u>	\$ <u>229,651</u>

8. COMMISSIONS PAYABLE

In accordance with the Property Quota Share retrocession agreement, the Company shall pay the profit commission due to the ceding reinsurer 24 months after the inception of the agreement. The profit commission accrued at year end amounted to \$120,857 (2010 - \$181,529).

9. SHARE CAPITAL

Effective September 21, 2011, Holdings increased its authorized share capital to 100,000,000 shares of \$1 par value from authorized shares of 100 of \$1 par value. As at December 31, 2011, Holdings had issued 5,017,500 shares (2010 - 100).

During 2011, Holdings issued 5,017,400 to the Parent and recorded an addition to paid in capital in the amount of \$5,976,458. These additions to shareholder's equity were settled through the transfer of investments and notes receivables with a fair value on the date of transfer of \$10,993,858 from the Parent to ALRE.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

10. WARRANTS

In 2003, the Company issued warrants to purchase an aggregate one million common shares of the Company at an exercise price of \$1.25 per share to Hartford Life, the ceding company under the Company's then largest guaranteed minimum death benefit reinsurance agreement. The warrants were issued in connection with the recapture of that agreement and expire on June 30, 2013, and are currently exercisable.

In connection with the recapture of the Company's GMDB/GMIB reinsurance agreement with CIGNA on October 26, 2004, the Company issued CIGNA a warrant dated as of September 30, 2004 to acquire one million common shares of the Company at an exercise price of \$1.00 per share. The warrant expires on September 30, 2014 and is currently exercisable.

As a result of the amalgamation, the warrant holders are entitled to the amalgamation consideration of \$0.4458 per share upon exercise date. As the exercise price of the respective warrants is greater than the amalgamation consideration, management believes that the warrants are worthless.

To date, the Company did not receive any expression from either Hartford Life or CIGNA of any intent to exercise the warrants described above.

11. CONTINGENCIES

As a result of significant operating losses, ALRE became unable to meet its monetary obligations under certain reinsurance treaties in 2002. Since that time ALRE has negotiated termination, recapture, and novation or coinsurance agreements for all reinsurance treaties with the applicable counterparties or independent third parties.

However, ALRE may be subject to contingencies for amounts that may be due under previously terminated or recaptured reinsurance agreements relating to deaths that occurred prior to such terminations or recaptures. ALRE has successfully executed complete releases on twenty-seven such contracts but has been unable to obtain them on the remaining eleven.

During 2011, ALRE paid a total of \$599 (2010 - \$76,000) in accordance with previously terminated or recaptured reinsurance agreements.

12. STATUTORY REQUIREMENTS AND DIVIDEND RESTRICTIONS

ALRE is required to comply with the provisions of the Companies Act that regulate the payment of dividends and the making of distributions from contributed surplus. ALRE may not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (i) the relevant company is, or would be after the payment, unable to pay its liabilities as they become due; or (ii) the realizable value of the relevant company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

12. STATUTORY REQUIREMENTS AND DIVIDEND RESTRICTIONS (continued)

ALRE must maintain long-term business assets of a value of at least \$250,000 greater than its long-term business liabilities. It is prohibited from declaring or paying dividends unless the value of its long-term business assets exceed the amount of its long-term business liabilities (as certified by an approved actuary), by the amount of the dividend and by at least \$250,000. Additionally, the amounts of any such dividend must not exceed the aggregate of that excess and other funds properly available for the payment of dividends, including funds arising out of its business aside from its long-term business. Any dividends paid out of contributed capital and in excess of 15% of the prior year's shareholder's capital must be approved by the Bermuda Monetary Authority.

No dividends were paid during 2011 and 2010.

In relation to its general business, ALRE as of December 31, 2011, met the required Minimum General Business Solvency Margin and the required Minimum Liquidity Ratio.

The required Minimum General Business Solvency Margin as of December 31, 2011 was \$1,000,000 (2010 - \$1,000,000) and the statutory capital and surplus at that date was \$20,940,259 (2010 - \$14,858,738).

The Minimum Liquidity Ratio is the ratio of the insurer's relevant assets to its relevant liabilities; the minimum allowable ratio is 75%. The Company's relevant assets in relation to its general business as of December 31, 2011 was \$36,653,214 (2010 - \$30,736,916) and 75% of its relevant liabilities as of December 31, 2011 was \$12,096,080 (2010 - \$12,115,000).

13. TAXATION

The effective tax rate provided for in the consolidated financial statements is computed at a rate of zero. The Company's operations are based in Bermuda and as a result income is exempt from taxation. There is no income or capital gains tax payable by the Company.

Under current Bermuda law, the Company received from the Bermuda Minister of Finance, under The Exempted Undertakings Tax Protection Act 1966 of Bermuda, assurances to the effect that in the event of there being enacted by Bermuda any legislation imposing tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax shall not be applicable to them or to any of their respective operations or to their shares, debentures or other obligations until March 31, 2035. This is not to be construed so as to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda or to prevent the application of any tax payable in accordance with the provisions of The Land Tax Act 1967 of Bermuda or otherwise payable in relation to any property leased to the Company.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARY**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

13. TAXATION (continued)

Tax Related Risks and Uncertainties

If the IRS were to determine, under audit, that the Company is engaged in business in the United States, those entities could be subject to United States tax at regular corporate rates on their taxable income that is attributable to a permanent establishment, if any, in the United States plus an additional 30% "branch profits" tax on such income remaining after the regular tax. Such taxes would have a material effect on the Company's results of operations and financial condition.

14. FINANCIAL INSTRUMENTS AND RELATED RISKS

The Company's financial instruments consist of cash and cash equivalents, investments, notes receivables, interest receivable, insurance balance receivable, loans payable, reserve for losses and loss expenses, commissions payable and accounts payable and accrued expenses.

The carrying value of cash and cash equivalents, interest receivable, insurance balance receivable and accounts payable and accrued expenses approximates fair value due to their short term nature.

The carrying value of investments is at fair value based on available market information.

The carrying value of notes receivables is not at fair value. The terms are set out in note 5.

The loans payable is not at fair value and the terms of payment is set out in note 6.

The commission payable is not at fair value and is recorded in accordance with the Property Quota Share retrocession agreement.

The carrying value of reserves for losses and loss expenses is not at fair value and is recorded using management's best estimate together with the recommendations of the actuaries of the ultimate cost of settlement of losses.

The Company's investment activities expose it to various types of risk that are associated with the financial instruments and markets in which it invests. The most significant types of financial risks to which the Company is exposed to are market risk, credit risk and interest rate risk.

The nature and extent of the financial instruments outstanding at the balance sheet date and the risk management policies employed by the Company are discussed below:

(a) Market risk

The prices of the financial instruments in which the Company may invest can be highly volatile. Price movements are influenced by, among other things, changing supply and demand relationships, trade, fiscal programs and policies of governments, national and international political and economic events and policies.

**ANNUITY AND LIFE RE (HOLDINGS), LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Expressed in U.S. dollars)

14. FINANCIAL INSTRUMENTS AND RELATED RISKS (continued)

(b) Credit risk

A concentration of credit risk exists when there are significant contracts with individual counterparties or when groups of issuers or counterparties have similar business characteristics that would cause their ability to meet contract commitments to be adversely affected, in a similar manner, by changes in the economy or other market conditions. The Company conducts business with financial institutions believed to be well established and monitors credit risk on both an individual and group counterparty basis.

(c) Interest rate risk

The Company is exposed to interest rate risk on cash and cash equivalents held at financial institutions and note receivables with third parties. The Company is subject to significant amounts of risk due to fluctuations in the prevailing levels of market interest rates. The Company manages this risk by depositing cash in established financial institutions in economically stable countries and evaluating the financial position of the third parties involved.

(d) Concentration of risk

The Company's fixed maturity investment portfolio comprises two bonds issued by non-US government agencies which are rated Baa3 by Moody's. The failure of either of the issuers of these bonds to meet their contractual obligations would result in material losses to the Company.

15. SUBSEQUENT EVENTS

Management has evaluated subsequent events for recognition and disclosure to July 18, 2012, which is the date that the financial statements were available to be issued.

During February 2012, the Company repaid the loan from Parent in the amount of \$15,420,000 and made an additional advance to the Parent in the amount \$519,870. The loan is unsecured, interest free and due on demand.