

Enstar Group LTD  
Form 10-Q  
November 04, 2011  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

**▶ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended September 30, 2011**

**OR**

**• TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**

**001-33289 Commission File Number**

**ENSTAR GROUP LIMITED**

*(Exact name of registrant as specified in its charter)*

**Bermuda**  
*(State or other jurisdiction  
of incorporation or organization)*

**N/A**  
*(I.R.S. Employer  
Identification No.)*

**P.O. Box HM 2267**

**Windsor Place, 3rd Floor**

**18 Queen Street**

**Hamilton HM JX**

**Bermuda**

*(Address of principal executive office, including zip code)*

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(441) 292-3645

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 3, 2011, the registrant had outstanding 13,714,129 voting ordinary shares and 749,869 non-voting convertible ordinary shares, each par value \$1.00 per share.

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

As of September 30, 2011 and December 31, 2010

|   | September 30,<br>2011  | December 31,<br>2010 |
|---|--|----------------------|
|   | (expressed in thousands of U.S.<br>dollars, except share data) |                      |
| <b>ASSETS</b>   |  |                      |
| Short-term investments, available-for-sale, at fair value (amortized cost: 2011 \$ nil; 2010 \$7,209)   | \$   | \$ 7,263             |
| Short-term investments, trading, at fair value  | 410,694  | 507,978              |
| Fixed maturities, available-for-sale, at fair value (amortized cost: 2011 \$702,842; 2010 \$1,068,540)  | 716,656  | 1,094,947            |
| Fixed maturities, trading, at fair value  | 1,887,557  | 524,122              |
| Equities, trading, at fair value  | 81,535   | 60,082               |
| Other investments, at fair value  | 200,399  | 234,714              |
| <b>Total investments</b>  | <b>3,296,841</b>   | <b>2,429,106</b>     |
| Cash and cash equivalents   | 762,577  | 799,154              |
| Restricted cash and cash equivalents  | 452,429  | 656,200              |
| Accrued interest receivable   | 29,767   | 19,980               |
| Accounts receivable   | 24,627   | 24,790               |
| Income taxes recoverable  | 12,186   | 7,968                |
| Reinsurance balances receivable   | 1,939,300  | 961,442              |
| Funds held by reinsured companies   | 202,844  | 274,699              |
| Goodwill  | 21,222   | 21,222               |
| Other assets  | 33,818   | 41,343               |
| <b>TOTAL ASSETS</b>   | <b>\$ 6,775,611</b>  | <b>\$ 5,235,904</b>  |
| <b>LIABILITIES</b>  |  |                      |
| Losses and loss adjustment expenses   | \$ 4,739,841   | \$ 3,291,275         |
| Reinsurance balances payable  | 203,383  | 231,435              |
| Accounts payable and accrued liabilities  | 49,225   | 94,390               |
| Income taxes payable  | 6,160  | 50,075               |
| Loans payable   | 314,569  | 245,278              |
| Other liabilities   | 124,916  | 107,630              |
| <b>TOTAL LIABILITIES</b>  | <b>5,438,094</b>   | <b>4,020,083</b>     |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |  |                      |
| <b>SHAREHOLDERS EQUITY</b>  |  |                      |
| Share capital   |  |                      |
| Authorized, issued and fully paid, par value \$1 each (authorized 2011: 156,000,000; 2010: 156,000,000) |  |                      |
| Ordinary shares (issued and outstanding 2011: 13,521,018; 2010:12,940,021)                              | 13,521   | 12,940               |

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|  |              |              |
|--|--------------|--------------|
| Non-voting convertible ordinary shares:  |              |              |
| Series A (issued 2011: 2,972,892; 2010: 2,972,892)   | 2,973        | 2,973        |
| Series B, C and D (issued and outstanding 2011: 749,869; 2010: nil)  | 750          |              |
| Treasury shares at cost (Series A non-voting convertible ordinary shares 2011: 2,972,892; 2010: 2,972,892) | (421,559)    | (421,559)    |
| Additional paid-in capital   | 775,471      | 667,907      |
| Accumulated other comprehensive income   | 25,453       | 35,017       |
| Retained earnings  | 676,085      | 651,143      |
| <br>   |              |              |
| Total Enstar Group Limited Shareholders Equity   | 1,072,694    | 948,421      |
| Noncontrolling interest  | 264,823      | 267,400      |
| <br>   |              |              |
| TOTAL SHAREHOLDERS EQUITY  | 1,337,517    | 1,215,821    |
| <br>   |              |              |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY  | \$ 6,775,611 | \$ 5,235,904 |

See accompanying notes to the unaudited condensed consolidated financial statements

**Table of Contents****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS****For the Three and Nine Month Periods Ended September 30, 2011 and 2010**

|   | Three Months Ended  |           | Nine Months Ended |           |
|---|---|-----------|-------------------|-----------|
|   | September   | September | September         | September |
|   | 30,   | 30,       | 30,               | 30,       |
|   | 2011  | 2010      | 2011              | 2010      |
|   | (expressed in thousands of U.S. dollars, except share and per share data) |           |                   |           |
| <b>INCOME</b>   |   |           |                   |           |
| Consulting fees   | \$ 1,623  | \$ 2,119  | \$ 7,704          | \$ 19,747 |
| Net investment income   | 18,966  | 20,165    | 60,436            | 69,284    |
| Net realized and unrealized (losses) gains  | (8,980)   | 10,635    | (348)             | 8,610     |
| Gain on bargain purchase  |   |           | 13,105            |           |
|   | 11,609  | 32,919    | 80,897            | 97,641    |
| <b>EXPENSES</b>   |   |           |                   |           |
| Net reduction in ultimate loss and loss adjustment expense liabilities:               |   |           |                   |           |
| Reduction in estimates of net ultimate losses   | (42,467)  | (20,890)  | (72,908)          | (57,936)  |
| Reduction in provisions for bad debt  | (2,399)   | (1,304)   | (4,071)           | (14,411)  |
| Reduction in provisions for unallocated loss adjustment expense liabilities           | (14,113)  | (10,171)  | (37,433)          | (30,832)  |
| Amortization of fair value adjustments  | 8,865   | 6,250     | 25,911            | 25,102    |
|   | (50,114)  | (26,115)  | (88,501)          | (78,077)  |
| Salaries and benefits   | 20,923  | 18,012    | 48,028            | 47,456    |
| General and administrative expenses   | 20,759  | 13,185    | 66,720            | 39,473    |
| Interest expense  | 2,435   | 2,961     | 6,098             | 8,160     |
| Net foreign exchange (gains) losses   | (8,878)   | (586)     | 388               | 1,387     |
|   | (14,875)  | 7,457     | 32,733            | 18,399    |
| <b>EARNINGS BEFORE INCOME TAXES AND SHARE OF NET EARNINGS OF PARTLY OWNED COMPANY</b> |   |           |                   |           |
|   | 26,484  | 25,462    | 48,164            | 79,242    |
| <b>INCOME TAXES</b>   | (4,436)   | (979)     | (6,028)           | (23,016)  |
| <b>SHARE OF NET EARNINGS OF PARTLY OWNED COMPANY</b>                                  |   |           |                   |           |
|   |   | 1,351     |                   | 10,704    |
| <b>NET EARNINGS</b>   | 22,048  | 25,834    | 42,136            | 66,930    |
| Less: Net earnings attributable to noncontrolling interest                            | (9,984)   | (4,391)   | (17,194)          | (17,136)  |
| <b>NET EARNINGS ATTRIBUTABLE TO ENSTAR GROUP LIMITED</b>                              | \$ 12,064   | \$ 21,443 | \$ 24,942         | \$ 49,794 |
| <b>EARNINGS PER SHARE BASIC:</b>  |   |           |                   |           |
| Net earnings attributable to Enstar Group Limited ordinary shareholders               | \$ 0.85   | \$ 1.56   | \$ 1.81           | \$ 3.64   |

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### EARNINGS PER SHARE DILUTED

|   |    |      |    |      |    |      |    |      |
|---|----|------|----|------|----|------|----|------|
| Net earnings attributable to Enstar Group Limited ordinary shareholders | \$ | 0.83 | \$ | 1.53 | \$ | 1.78 | \$ | 3.57 |
|---|----|------|----|------|----|------|----|------|

|   |  |            |  |            |  |            |  |            |
|---|--|------------|--|------------|--|------------|--|------------|
| Weighted average shares outstanding basic |  | 14,270,003 |  | 13,704,832 |  | 13,743,191 |  | 13,676,113 |
|---|--|------------|--|------------|--|------------|--|------------|

|   |  |            |  |            |  |            |  |            |
|---|--|------------|--|------------|--|------------|--|------------|
| Weighted average shares outstanding diluted |  | 14,559,164 |  | 14,019,768 |  | 14,025,144 |  | 13,956,948 |
|---|--|------------|--|------------|--|------------|--|------------|

See accompanying notes to the unaudited condensed consolidated financial statements

**Table of Contents****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Three and Nine Month Periods Ended September 30, 2011 and 2010**

|   | Three Months Ended<br>September 30,<br>2011 | September 30,<br>2010<br>(expressed in thousands of U.S. dollars) | Nine Months Ended<br>September 30,<br>2011 | September 30,<br>2010 |
|---|---|---|--|-----------------------|
| NET EARNINGS  | \$ 22,048                                   | \$ 25,834   | \$ 42,136                                  | \$ 66,930             |
| Other comprehensive income, net of tax:   |   |   |  |                       |
| Unrealized holding (losses) gains on investments arising during the period                          | (15,060)                                    | 29,161  | (485)                                      | 23,509                |
| Reclassification adjustment for net realized and unrealized losses (gains) included in net earnings | 8,980                                       | (10,635)  | 348  | (8,610)               |
| Decrease in defined benefit pension liability   |   |   | 272  |                       |
| Currency translation adjustment   | (25,526)                                    | 36,662  | (13,271)                                   | 19,546                |
| Total other comprehensive (loss) income:  | (31,606)                                    | 55,188  | (13,136)                                   | 34,445                |
| Comprehensive (loss) income   | (9,558)                                     | 81,022  | 29,000                                     | 101,375               |
| Less comprehensive income attributable to noncontrolling interest                                   | (3,262)                                     | (19,422)  | (13,623)                                   | (26,547)              |
| COMPREHENSIVE (LOSS) INCOME ATTRIBUTABLE TO ENSTAR GROUP LIMITED                                    | \$ (12,820)                                 | \$ 61,600   | \$ 15,377                                  | \$ 74,828             |

See accompanying notes to the unaudited condensed consolidated financial statements



**Table of Contents****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****For the Nine Month Periods Ended September 30, 2011 and 2010**

|  | Nine Months Ended<br>September 30,<br>2011                      2010<br>(expressed in thousands<br>of U.S. dollars) |              |
|--|---|--------------|
| <b>Share Capital - Ordinary Shares</b>   |   |              |
| Balance, beginning of period   | \$ 12,940   | \$ 13,581    |
| Issue of shares  | 539   | 47           |
| Share awards granted/vested  | 42  | 79           |
| Balance, end of period   | \$ 13,521   | \$ 13,707    |
| <b>Share Capital - Series A Non-Voting Convertible Ordinary Shares</b>             |   |              |
| Balance, beginning and end of period   | \$ 2,973  | \$ 2,973     |
| <b>Share Capital - Series B, C and D Non-Voting Convertible Ordinary Shares</b>    |   |              |
| Balance, beginning of period   | \$  | \$           |
| Preferred shares converted   | 750   |              |
| Balance, end of period   | \$ 750  | \$           |
| <b>Share Capital - Preference Shares</b>   |   |              |
| Balance, beginning of period   | \$  | \$           |
| Issue of shares  | 750   |              |
| Shares converted   | (750)   |              |
| Balance, end of period   | \$  | \$           |
| <b>Treasury Shares</b>   |   |              |
| Balance, beginning and end of period   | \$ (421,559)  | \$ (421,559) |
| <b>Additional Paid-in Capital</b>  |   |              |
| Balance, beginning of period   | \$ 667,907  | \$ 721,120   |
| Share awards granted/vested  | 168   | 5,286        |
| Issue of shares and warrants, net  | 105,439   | 501          |
| Amortization of share awards   | 1,957   | 599          |
| Balance, end of period   | \$ 775,471  | \$ 727,506   |
| <b>Accumulated Other Comprehensive Income Attributable to Enstar Group Limited</b> |   |              |
| Balance, beginning of period   | \$ 35,017   | \$ 8,709     |
| Foreign currency translation adjustments   | (9,623)   | 13,726       |
| Net movement in unrealized holdings gains (losses) on investments                  | (213)   | 11,308       |
| Decrease in defined benefit pension liability                                      | 272   |              |
| Balance, end of period   | \$ 25,453   | \$ 33,743    |

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| <b>Retained Earnings</b>                                |            |            |
|---|------------|------------|
| Balance, beginning of period                            | \$ 651,143 | \$ 477,057 |
| Net earnings attributable to Enstar Group Limited       | 24,942     | 49,794     |
| Balance, end of period                                  | \$ 676,085 | \$ 526,851 |
| <b>Noncontrolling Interest</b>                          |            |            |
| Balance, beginning of period                            | \$ 267,400 | \$ 274,271 |
| Return of capital                                       | (16,200)   | (32,963)   |
| Contribution of capital                                 |            | 28,742     |
| Dividends paid  |            | (7,000)    |
| Net earnings attributable to noncontrolling interest    | 17,194     | 17,136     |
| Foreign currency translation adjustments                | (3,647)    | 5,821      |
| Net movement in unrealized holding gains on investments | 76         | 3,591      |
| Balance, end of period                                  | \$ 264,823 | \$ 289,598 |

See accompanying notes to the unaudited condensed consolidated financial statements

**Table of Contents****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Nine Month Periods Ended September 30, 2011 and 2010**

|   | Nine Months Ended<br>September 30,          |                  |
|---|---|------------------|
|   | 2011  | 2010             |
|   | (expressed in thousands of<br>U.S. dollars) |                  |
| <b>OPERATING ACTIVITIES:</b>  |   |                  |
| Net earnings  | \$ 42,136                                   | \$ 66,930        |
| Adjustments to reconcile net earnings to cash flows used in operating activities: |   |                  |
| Gain on bargain purchase  | (13,105)                                    |                  |
| Share of undistributed net earnings of partly owned company                       |   | (10,704)         |
| Net realized and unrealized investment loss (gain)                                | 348   | (8,610)          |
| Share of net gain from other investments  | (7,331)                                     | (11,225)         |
| Other items   | 5,404                                       | (663)            |
| Depreciation and amortization   | 1,194                                       | 1,053            |
| Amortization of bond premiums and discounts                                       | 16,717                                      | 6,540            |
| Net movement of trading securities held on behalf of policyholders                | (1,039)                                     | 22,772           |
| Sales and maturities of trading securities  | 993,125                                     | 313,654          |
| Purchases of trading securities   | (1,535,777)                                 | (1,072,799)      |
| Changes in assets and liabilities:  |   |                  |
| Reinsurance balances receivable   | 88,289                                      | (18,743)         |
| Other assets  | 75,142                                      | (80,229)         |
| Losses and loss adjustment expenses   | (210,735)                                   | 184,212          |
| Reinsurance balances payable  | (29,683)                                    | 24,343           |
| Accounts payable and accrued liabilities  | (45,348)                                    | (19,142)         |
| Other liabilities   | (62,877)                                    | (27,541)         |
| <b>Net cash flows used in operating activities</b>                                | <b>(683,540)</b>                            | <b>(630,152)</b> |
| <b>INVESTING ACTIVITIES:</b>  |   |                  |
| Acquisitions, net of cash acquired  | (88,505)                                    | 155,435          |
| Sales and maturities of available-for-sale securities                             | 332,560                                     | 57,335           |
| Purchase of held-to-maturity securities   |   | (780,848)        |
| Maturity of held-to-maturity securities   |   | 786,651          |
| Movement in restricted cash and cash equivalents                                  | 210,968                                     | 73,354           |
| Funding of other investments  | (25,703)                                    | (89,426)         |
| Redemption of bond funds  | 66,925                                      |                  |
| Sale of investment in partly owned company  |   | 31,554           |
| Other investing activities  | (282)                                       | (467)            |
| <b>Net cash flows provided by investing activities</b>                            | <b>495,963</b>                              | <b>233,588</b>   |
| <b>FINANCING ACTIVITIES:</b>  |   |                  |
| Net proceeds from issuance of shares  | 105,921                                     |                  |
| Distribution of capital to noncontrolling interest                                | (16,200)                                    | (32,963)         |
| Contribution to surplus of subsidiary by noncontrolling interest                  |   | 28,742           |
| Dividends paid to noncontrolling interest   |   | (7,000)          |
| Receipt of loans  | 274,150                                     | 46,400           |
| Repayment of loans  | (207,016)                                   | (93,560)         |

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|   |            |            |
|---|------------|------------|
| Net cash flows provided by (used in) financing activities | 156,855    | (58,381)   |
| <b>TRANSLATION ADJUSTMENT</b>                             | (5,855)    | 12,277     |
| NET DECREASE IN CASH AND CASH EQUIVALENTS                 | (36,577)   | (442,668)  |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>     | 799,154    | 1,266,445  |
| CASH AND CASH EQUIVALENTS, END OF PERIOD                  | \$ 762,577 | \$ 823,777 |

### Supplemental Cash Flow Information

|                       |           |           |
|-----------------------|-----------|-----------|
| Net income taxes paid | \$ 59,700 | \$ 58,625 |
| <b>Interest paid</b>  | \$ 6,359  | \$ 8,103  |

See accompanying notes to the unaudited condensed consolidated financial statements

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**ENSTAR GROUP LIMITED**

**NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011 and December 31, 2010**

**(Tabular information expressed in thousands of U.S. dollars except share and per share data)**

**(unaudited)**

**1. BASIS OF PREPARATION AND CONSOLIDATION**

The Company's condensed consolidated financial statements have not been audited. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. Results of operations for subsidiaries acquired are included from the dates of their acquisition by the Company. The results of operations for any interim period are not necessarily indicative of the results for a full year. Inter-company accounts and transactions have been eliminated. In these notes, the terms we, us, our, or the Company refer to Enstar Group Limited and its direct and indirect subsidiaries. The following information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

***Adoption of New Accounting Standards***

Effective January 1, 2011, the Company adopted the new guidance issued by the U.S. Financial Accounting Standards Board ( FASB ), which provides additional guidance for performing Step 1 of the test for goodwill impairment when an entity has reporting units with zero or negative carrying values. As of September 30, 2011, none of the Company's reporting units were at risk of failing Step 1 of the test for goodwill impairment. Under the new guidance, Step 2 of the goodwill impairment test must be performed when adverse qualitative factors indicate that goodwill is more likely than not impaired. The adoption of the revised guidance did not have a material impact on the consolidated financial statements.

Effective January 1, 2011, the Company adopted the new guidance issued by FASB, which specifies that if a public entity presents comparative financial statements, the entity should disclose, in its supplementary pro-forma information, revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The adoption of the revised guidance did not have a material impact on the consolidated financial statements.

***Recently Issued Accounting Standards Not Yet Adopted***

In May 2011, FASB issued amendments to disclosure requirements for common fair value measurement. These amendments, effective for the interim and annual periods beginning on or after December 15, 2011 (early adoption is prohibited), result in a common definition of fair value and common requirements for measurement of and disclosure requirements under U.S. GAAP and International Financial Reporting Standards. Consequently, the amendments change some fair value measurement principles and disclosure requirements. The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.

In June 2011, FASB issued amendments to disclosure requirements for presentation of comprehensive income. This guidance, effective retrospectively for the interim and annual periods beginning on or after December 15, 2011 (early adoption is permitted), requires presentation of total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.



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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. BASIS OF PREPARATION AND CONSOLIDATION (cont d)**

In September 2011, FASB issued amendments that simplify the current two-step goodwill impairment test previously required by permitting entities to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would then perform the first step of the goodwill impairment test; otherwise, no further impairment test would be required. The amended guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (early adoption is permitted). The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.

The Company has determined that all other recently issued accounting pronouncements do not apply to its operations.

**2. ACQUISITIONS**

The Company accounts for acquisitions using the purchase method of accounting, which requires that the acquirer record the assets and liabilities acquired at their estimated fair value. The fair values of reinsurance assets and liabilities acquired are derived from probability weighted ranges of the associated projected cash flows, based on actuarially prepared information and management's run-off strategy. Any amendment to the fair values resulting from changes in such information or strategy will be recognized when the changes occur.

**Laguna**

On March 25, 2011, the Company, through its wholly-owned subsidiary, Kenmare Holdings Ltd., completed the acquisition of Laguna Life Limited, formerly known as CitiLife Financial Limited (Laguna), from Citigroup Insurance Holding Corporation (Citigroup), an affiliate of Citigroup Inc. Laguna is an Ireland-based life insurer that is in run-off. The purchase price was 15.0 million (approximately \$21.2 million) and was funded from available cash on hand. The previously disclosed purchase price of 30.0 million (approximately \$42.4 million) was reduced, prior to completion of the acquisition, after Citigroup received approval from Laguna's regulator to distribute 15.0 million (approximately \$21.2 million) to its shareholders.

The purchase price and fair value of the net assets acquired in the Laguna acquisition were as follows:

|   |             |
|---|-------------|
| Purchase price  | \$ 21,223   |
| Net assets acquired at fair value                                   | \$ 34,328   |
| Excess of net assets over purchase price (gain on bargain purchase) | \$ (13,105) |

The gain on bargain purchase of approximately \$13.1 million, relating to the acquisition of Laguna, arose primarily as a result of the reassessment by the Company, upon acquisition, of the total required estimated costs to manage the business to expiry. The Company's assessment of costs was lower than the acquired costs recorded by the vendor in the financial statements of Laguna.





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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. ACQUISITIONS (cont d)**

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition:

|                                       |               |
|---------------------------------------|---------------|
| Cash                                  | \$ 13,274     |
| Investments:                          |               |
| Short-term investments, trading       | 1,154         |
| Fixed maturities, trading             | 30,765        |
| <b>Total investments</b>              | <b>31,919</b> |
| Reinsurance balances receivable       | 1,459         |
| Other assets                          | 1,325         |
| Losses and loss adjustment expenses   | (11,898)      |
| Accounts payable                      | (1,751)       |
| <br>Net assets acquired at fair value | <br>\$ 34,328 |

From March 25, 2011, the date of acquisition, to September 30, 2011, the Company has recorded \$2.4 million in revenues and \$nil net earnings related to Laguna in its consolidated statement of earnings.

**Clarendon**

On July 12, 2011, the Company, through its wholly-owned subsidiary, Clarendon Holdings, Inc., completed the acquisition of 100% of the shares of Clarendon National Insurance Company ( Clarendon ) from Clarendon Insurance Group, Inc., an affiliate of Hannover Re ( Hannover ). Clarendon is a New Jersey-domiciled insurer that is in run-off. Clarendon owns three other insurers, two domiciled in New Jersey and one domiciled in Florida, that are also in run-off. The purchase price was \$219.1 million and was financed in part by \$106.5 million under a four-year term loan facility provided by National Australia Bank Limited ( NAB ) and the remainder from available cash on hand.

In addition, on July 12, 2011, the Company, through its wholly-owned subsidiary, Fitzwilliam Insurance Limited ( Fitzwilliam ), in connection with the acquisition of Clarendon, entered into a reinsurance agreement with Hannover, which provides adverse development cover ( ADC ) to Clarendon to reinsure Hannover for the first \$80.0 million of the ADC. The Company provided a parental guarantee to Hannover in the amount of \$80.0 million supporting the obligations of Fitzwilliam.

The purchase price and fair value of the net assets acquired in the Clarendon acquisition were as follows:

|                                       |                |
|---------------------------------------|----------------|
| Purchase price                        | \$ 219,077     |
| <br>Net assets acquired at fair value | <br>\$ 219,077 |



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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. ACQUISITIONS (cont d)**

The following summarizes the preliminary estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition, pending finalization of certain valuations:

|  |                |
|--|----------------|
| Cash ..                                | \$ 138,518     |
| Restricted cash                        | 7,198          |
| Investments:                           |                |
| Short-term investments, trading        | 60,376         |
| Fixed maturities, trading              | 623,530        |
| Equities                               | 5,014          |
| <b>Total investments</b>               | <b>688,920</b> |
| Reinsurance balances receivable        | 1,065,341      |
| Accrued interest and other receivables | 9,655          |
| Losses and loss adjustment expenses    | (1,654,436)    |
| Insurance balances payable             | (1,942)        |
| Funds withheld                         | (26,277)       |
| Other liabilities                      | (7,900)        |
| <br>Net assets acquired at fair value  | <br>\$ 219,077 |

From July 12, 2011, the date of acquisition, to September 30, 2011, the Company has recorded \$3.0 million in revenues and a \$1.1 million net loss related to Clarendon in its consolidated statement of earnings.

Because Clarendon's revenues and net loss are included in the Company's statement of earnings for the three months ended September 30, 2011, the Company has not included pro forma financial information for such period. The following pro forma condensed combined income statement for the nine months ended September 30, 2011 combines the historical consolidated statements of earnings of the Company with those of Clarendon, giving effect to the business combinations and related transactions as if they had occurred on January 1, 2011.

| Nine Months Ended September 30, 2011 | Enstar<br>Group<br>Limited | Clarendon       | Proforma<br>Adjustments | Enstar Group<br>Limited -<br>Proforma |
|--------------------------------------|----------------------------|-----------------|-------------------------|---------------------------------------|
| Total income                         | \$ 80,897                  | \$ 9,720        | \$                      | \$ 90,617                             |
| Total expenses                       | (38,761)                   | (43,425)        | (4,562)(a)              | (86,748)                              |
| Noncontrolling interest              | (17,194)                   |                 |                         | (17,194)                              |
| <br>Net earnings (loss)              | <br>\$ 24,942              | <br>\$ (33,705) | <br>\$ (4,562)          | <br>\$ (13,325)                       |

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|   |            |
|---|------------|
| Net loss per ordinary share - basic         | \$ (0.97)  |
| Weighted average shares outstanding - basic | 13,743,191 |

### Notes to the Nine Months Ended September 30, 2011 Pro Forma Condensed Consolidated Statement of Earnings:

Expenses:

|   |            |
|---|------------|
| (a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period | \$ (1,772) |
| (ii) Adjustment to recognize amortization of fair value adjustments                                     | (3,410)    |
| (iii) Adjustment to income taxes for proforma adjustments   | 620        |
|   | \$ (4,562) |

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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. ACQUISITIONS (cont d)**

The following pro forma condensed combined income statements for the three and nine months ended September 30, 2010 combines the historical consolidated statements of earnings of the Company with those of Clarendon, giving effect to the business combination and related transactions as if they had occurred on January 1, 2010.

| <b>Three Months Ended September 30, 2010</b>  | <b>Enstar<br/>Group<br/>Limited</b> | <b>Clarendon</b> | <b>Proforma<br/>Adjustments</b> | <b>Enstar<br/>Group<br/>Limited -<br/>Proforma</b> |
|---|-------------------------------------|------------------|---------------------------------|--|
| Total income                                  | \$ 32,919                           | \$ 9,194         | \$                              | \$ 42,113  |
| Total expenses                                | (8,436)                             | (8,813)          | (2,272) (a)                     | (19,521)   |
| Share of net earnings of partly owned company | 1,351                               |                  |                                 | 1,351  |
| Noncontrolling interest                       | (4,391)                             |                  |                                 | (4,391)  |
| <b>Net earnings (loss)</b>                    | <b>\$ 21,443</b>                    | <b>\$ 381</b>    | <b>\$ (2,272)</b>               | <b>\$ 19,552</b>                                   |
| Net earnings per ordinary share basic         |                                     |                  |                                 | \$ 1.43  |
| Net earnings per ordinary share diluted       |                                     |                  |                                 | \$ 1.39  |
| Weighted average shares outstanding basic     |                                     |                  |                                 | 13,704,832   |
| Weighted average shares outstanding diluted   |                                     |                  |                                 | 14,019,768   |

**Notes to the Three Months Ended September 30, 2010 Pro Forma Condensed Consolidated Statement of Earnings:**

Expenses:

|   |            |
|---|------------|
| (a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period | \$ (1,029) |
| (ii) Adjustment to recognize amortization of fair value adjustments                                     | (1,603)    |
| (iii) Adjustment to income taxes for proforma adjustments   | 360        |
|   | \$ (2,272) |

| <b>Nine Months Ended September 30, 2010</b> | <b>Enstar<br/>Group<br/>Limited</b> | <b>Clarendon</b> | <b>Proforma<br/>Adjustments</b> | <b>Enstar<br/>Group<br/>Limited -</b> |
|---|-------------------------------------|------------------|---------------------------------|---------------------------------------|
|---|-------------------------------------|------------------|---------------------------------|---------------------------------------|

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|   |                  |                   |                   | <b>Proforma</b>   |
|---|------------------|-------------------|-------------------|-------------------|
| Total income                                  | \$ 97,641        | \$ 18,190         | \$                | \$ 115,831        |
| Total expenses                                | (41,415)         | 171,537           | (7,445) (a)       | 122,677           |
| Share of net earnings of partly owned company | 10,704           |                   |                   | 10,704            |
| Noncontrolling interest                       | (17,136)         |                   |                   | (17,136)          |
| <b>Net earnings (loss)</b>                    | <b>\$ 49,794</b> | <b>\$ 189,727</b> | <b>\$ (7,445)</b> | <b>\$ 232,076</b> |
| <br>  |                  |                   |                   |                   |
| Net earnings per ordinary share basic         |                  |                   |                   | \$ 16.97          |
| Net earnings per ordinary share diluted       |                  |                   |                   | \$ 16.63          |
| <br>  |                  |                   |                   |                   |
| Weighted average shares outstanding basic     |                  |                   |                   | 13,676,113        |
| Weighted average shares outstanding diluted   |                  |                   |                   | 13,956,948        |

**Table of Contents****ENSTAR GROUP LIMITED****NOTES TO THE UNAUDITED CONDENSED****CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. ACQUISITIONS (cont d)****Notes to the Nine Months Ended September 30, 2010 Pro Forma Condensed Consolidated Statement of Earnings:**

Expenses:

|   |            |
|---|------------|
| (a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period | \$ (3,086) |
| (ii) Adjustment to recognize amortization of fair value adjustments                                     | (5,439)    |
| (iii) Adjustment to income taxes for proforma adjustments   | 1,080      |
|   | \$ (7,445) |

The foregoing pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place on January 1, 2011 or 2010, respectively.

**3. SIGNIFICANT NEW BUSINESS****Shelbourne RITC Transactions**

In December 2007, the Company, in conjunction with JCF FPK I L.P. ( JCF FPK ) and a newly-hired executive management team, formed U.K.-based Shelbourne Group Limited ( Shelbourne ) to invest in Reinsurance to Close or RITC transactions (the transferring of liabilities from one Lloyd's syndicate to another) with Lloyd's of London insurance and reinsurance syndicates in run-off. The Company owns approximately 56.8% of Shelbourne, which in turn owns 100% of Shelbourne Syndicate Services Limited, the Managing Agency for Lloyd's Syndicate 2008, a syndicate approved by Lloyd's of London on December 16, 2007 to undertake RITC transactions with Lloyd's syndicates in run-off.

JCF FPK is a joint investment program between Fox-Pitt, Kelton, Cochran, Caronia & Waller (USA) LLC ( FPK ) and J.C. Flowers II, L.P. (the Flowers Fund ). The Flowers Fund is a private investment fund advised by J.C. Flowers & Co. LLC. J. Christopher Flowers, one of the Company's largest shareholders and formerly a member of the Company's board of directors, is the Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC. In addition, an affiliate of the Flowers Fund controlled approximately 41% of FPK until its sale of FPK in December 2009.

In February 2011, Lloyd's Syndicate 2008 entered into RITC agreements with two Lloyd's syndicates with total gross insurance reserves of approximately \$129.6 million. The capital commitment to Lloyd's Syndicate 2008 with respect to these two RITC agreements amounted to £21.3 million (approximately \$34.1 million), which was fully funded by the Company from available cash on hand.

**Claremont**

On September 1, 2011, the Company, through its wholly-owned subsidiary, Fitzwilliam, entered into a novation agreement with another of its wholly-owned subsidiaries, Claremont Liability Insurance Company ( Claremont ), and certain of its reinsurers with respect to three specific quota share contracts. Under the novation agreement, Fitzwilliam replaced those companies as reinsurer of Claremont on the quota share contracts in exchange for total assets and liabilities of approximately \$22.5 million.

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### Insurance Australia Group

On September 20, 2011, the Company, through its wholly-owned subsidiary, Gordian Run-off Limited ( Gordian ), acquired an inwards reinsurance portfolio from Insurance Australia Group Ltd via an Australian Federal Court approved scheme. Gordian received total assets and assumed total net reinsurance liabilities of approximately \$8.6 million (approximately \$8.8 million Australian dollars).



**Table of Contents****ENSTAR GROUP LIMITED****NOTES TO THE UNAUDITED CONDENSED****CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. RESTRICTED CASH AND CASH EQUIVALENTS**

Restricted cash and cash equivalents were \$452.4 million and \$656.2 million as of September 30, 2011 and December 31, 2010, respectively. The restricted cash and cash equivalents are used as collateral against letters of credit and as guarantees under trust agreements. Letters of credit and guarantees are issued to ceding insurers as security for the obligations of insurance subsidiaries under reinsurance agreements with those ceding insurers.

**5. INVESTMENTS***Available-for-sale*

The amortized cost and estimated fair values of the Company's fixed maturity securities and short-term investments classified as available-for-sale were as follows:

|                                 | Amortized<br>Cost | Gross<br>Unrealized<br>Holding<br>Gain | Gross<br>Unrealized<br>Holding<br>Losses<br>Non-OTTI | Fair<br>Value |
|---------------------------------|-------------------|--|--|---------------|
| <b>As at September 30, 2011</b> |                   |  |  |               |
| U.S. government and agency      | \$ 27,460         | \$ 685                                 | \$ (16)  | \$ 28,129     |
| Non-U.S. government             | 178,832           | 4,769                                  | (327)  | 183,274       |
| Corporate                       | 446,791           | 7,954                                  | (1,875)  | 452,870       |
| Residential mortgage-backed     | 15,312            | 307                                    | (117)  | 15,502        |
| Commercial mortgage-backed      | 12,904            | 2,882                                  | (20)   | 15,766        |
| Asset backed                    | 21,543            | 75                                     | (503)  | 21,115        |
|                                 | \$ 702,842        | \$ 16,672                              | \$ (2,858)   | \$ 716,656    |

|                                | Amortized<br>Cost | Gross<br>Unrealized<br>Holding<br>Gain | Gross<br>Unrealized<br>Holding<br>Losses<br>Non-OTTI | Fair<br>Value |
|--------------------------------|-------------------|--|--|---------------|
| <b>As at December 31, 2010</b> |                   |  |  |               |
| U.S. government and agency     | \$ 65,115         | \$ 766                                 | \$ (92)  | \$ 65,789     |
| Non-U.S. government            | 248,487           | 8,832                                  | (314)  | 257,005       |
| Corporate                      | 695,372           | 16,513                                 | (1,615)  | 710,270       |
| Residential mortgage-backed    | 20,036            | 305                                    | (234)  | 20,107        |
| Commercial mortgage-backed     | 19,667            | 2,083                                  | (11)   | 21,739        |
| Asset backed                   | 27,072            | 574                                    | (346)  | 27,300        |
|                                | \$ 1,075,749      | \$ 29,073                              | \$ (2,612)   | \$ 1,102,210  |



**Table of Contents****ENSTAR GROUP LIMITED****NOTES TO THE UNAUDITED CONDENSED****CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. INVESTMENTS (cont d)**

The following tables summarize the Company's fixed maturity securities and short-term investments classified as available-for-sale in an unrealized loss position as well as the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position:

|                                 | 000000<br>12 Months or Greater<br>Fair<br>Value | 000000<br>Unrealized<br>Losses | 000000<br>Less Than 12 Months<br>Fair<br>Value | 000000<br>Unrealized<br>Losses | 000000<br>Fair<br>Value | 000000<br>Total<br>Unrealized<br>Losses |
|---------------------------------|---|--------------------------------|--|--------------------------------|-------------------------|---|
| <b>As at September 30, 2011</b> |   |                                |  |                                |                         |   |
| U.S. government and agency      | \$  | \$                             | \$ 10,008                                      | \$ (16)                        | \$ 10,008               | \$ (16)                                 |
| Non-U.S. government             | 14,597  | (284)                          | 20,975   | (43)                           | 35,572                  | (327)                                   |
| Corporate                       | 64,040  | (1,295)                        | 57,029   | (580)                          | 121,069                 | (1,875)                                 |
| Residential mortgage-backed     | 1,579   | (110)                          | 353  | (7)                            | 1,932                   | (117)                                   |
| Commercial mortgage-backed      | 125   | (20)                           | 136  |                                | 261                     | (20)                                    |
| Asset backed                    | 13,731  | (503)                          |  |                                | 13,731                  | (503)                                   |
|                                 | \$ 94,072                                       | \$ (2,212)                     | \$ 88,501                                      | \$ (646)                       | \$ 182,573              | \$ (2,858)                              |

|                                | 000000<br>12 Months or Greater<br>Fair<br>Value | 000000<br>Unrealized<br>Losses | 000000<br>Less Than 12 Months<br>Fair<br>Value | 000000<br>Unrealized<br>Losses | 000000<br>Fair<br>Value | 000000<br>Total<br>Unrealized<br>Losses |
|--------------------------------|---|--------------------------------|--|--------------------------------|-------------------------|---|
| <b>As at December 31, 2010</b> |   |                                |  |                                |                         |   |
| U.S. government and agency     | \$ 801  | \$                             | \$ 22,976                                      | \$ (92)                        | \$ 23,777               | \$ (92)                                 |
| Non-U.S. government            | 7,710   | (32)                           | 31,128   | (282)                          | 38,838                  | (314)                                   |
| Corporate                      | 22,039  | (318)                          | 107,735  | (1,297)                        | 129,774                 | (1,615)                                 |
| Residential mortgage-backed    | 2,368   | (168)                          | 11,274   | (66)                           | 13,642                  | (234)                                   |
| Commercial mortgage-backed     | 530   | (10)                           | 1,516  | (1)                            | 2,046                   | (11)                                    |
| Asset backed                   | 10,554  | (346)                          | 87   |                                | 10,641                  | (346)                                   |
|                                | \$ 44,002                                       | \$ (874)                       | \$ 174,716                                     | \$ (1,738)                     | \$ 218,718              | \$ (2,612)                              |

As at September 30, 2011 and December 31, 2010, the number of securities classified as available-for-sale in an unrealized loss position was 118 and 136, respectively, with a fair value of \$182.6 million and \$218.7 million, respectively. Of these securities, the number of securities that had been in an unrealized loss position for twelve months or longer was 67 and 32, respectively. As of September 30, 2011, none of these securities were considered to be other than temporarily impaired. The Company has no intent to sell and it is not more likely than not that the Company will be required to sell these securities before their fair values recover above the adjusted cost. The unrealized losses from these securities were not as a result of credit, collateral or structural issues.



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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
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**5. INVESTMENTS (cont d)**

The contractual maturities of the Company's fixed maturity securities and short-term investments classified as available-for-sale are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | Amortized<br>Cost | Fair<br>Value | % of Total<br>Fair Value |
|--|-------------------|---------------|--------------------------|
| <b>As at September 30, 2011</b>        |                   |               |                          |
| Due in one year or less                | \$ 285,305        | \$ 285,373    | 39.8%                    |
| Due after one year through five years  | 361,334           | 372,234       | 52.0%                    |
| Due after five years through ten years | 3,563             | 3,682         | 0.5%                     |
| Due after ten years                    | 2,881             | 2,984         | 0.4%                     |
|  | 653,083           | 664,273       | 92.7%                    |
| Residential mortgage-backed            | 15,312            | 15,502        | 2.2%                     |
| Commercial mortgage-backed             | 12,904            | 15,766        | 2.2%                     |
| Asset backed                           | 21,543            | 21,115        | 2.9%                     |
|  | \$ 702,842        | \$ 716,656    | 100.00%                  |

|  | Amortized<br>Cost | Fair<br>Value | % of Total<br>Fair<br>Value |
|--|-------------------|---------------|-----------------------------|
| <b>As at December 31, 2010</b>         |                   |               |                             |
| Due in one year or less                | \$ 373,683        | \$ 379,203    | 34.4%                       |
| Due after one year through five years  | 625,463           | 643,252       | 58.3%                       |
| Due after five years through ten years | 5,307             | 5,539         | 0.5%                        |
| Due after ten years                    | 4,521             | 5,070         | 0.5%                        |
|  | 1,008,974         | 1,033,064     | 93.7%                       |
| Residential mortgage-backed            | 20,036            | 20,107        | 1.8%                        |
| Commercial mortgage-backed             | 19,667            | 21,739        | 2.0%                        |
| Asset backed                           | 27,072            | 27,300        | 2.5%                        |
|  | \$ 1,075,749      | \$ 1,102,210  | 100.0%                      |

The following tables set forth certain information regarding the credit ratings (provided by major rating agencies) of the Company's fixed maturity securities and short-term investments classified as available-for-sale:

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|  | Amortized<br>Cost | Fair<br>Value     | % of Total<br>Fair Value |
|--|-------------------|-------------------|--------------------------|
| <b><u>As at September 30, 2011</u></b> |                   |                   |                          |
| AAA                                    | \$ 212,574        | \$ 217,217        | 30.3%                    |
| AA                                     | 194,204           | 197,548           | 27.6%                    |
| A                                      | 246,491           | 252,491           | 35.2%                    |
| BBB or lower                           | 49,183            | 48,927            | 6.8%                     |
| Not Rated                              | 390               | 473               | 0.1%                     |
|  | <b>\$ 702,842</b> | <b>\$ 716,656</b> | <b>100.00%</b>           |

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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVESTMENTS (cont d)**

|                                | Amortized<br>Cost   | Fair<br>Value       | % of Total<br>Fair<br>Value |
|--------------------------------|---------------------|---------------------|-----------------------------|
| <b>As at December 31, 2010</b> |                     |                     |                             |
| AAA                            | \$ 405,682          | \$ 416,526          | 37.8%                       |
| AA                             | 267,917             | 273,500             | 24.8%                       |
| A                              | 332,401             | 341,447             | 31.0%                       |
| BBB or lower                   | 69,359              | 70,274              | 6.4%                        |
| Not Rated                      | 390                 | 463                 | 0.0%                        |
|                                | <b>\$ 1,075,749</b> | <b>\$ 1,102,210</b> | <b>100.0%</b>               |

**Trading**

The estimated fair values of the Company's investments in fixed maturity securities, short-term investments and equities classified as trading securities were as follows:

|                             | September 30,<br>2011 | December 31,<br>2010 |
|-----------------------------|-----------------------|----------------------|
| U.S. government and agency  | \$ 417,934            | \$ 162,014           |
| Non-U.S. government         | 178,955               | 129,861              |
| Corporate                   | 1,471,869             | 637,114              |
| Municipal                   | 31,528                | 2,297                |
| Residential mortgage-backed | 108,453               | 82,399               |
| Commercial mortgage-backed  | 54,819                | 17,102               |
| Asset backed                | 34,693                | 1,313                |
| Equities                    | 81,535                | 60,082               |
|                             | <b>\$ 2,379,786</b>   | <b>\$ 1,092,182</b>  |

The following tables set forth certain information regarding the credit ratings (provided by major rating agencies) of the Company's fixed maturity securities and short-term investments classified as trading:

|                                 | Fair<br>Value | % of Total<br>Fair Value |
|---------------------------------|---------------|--------------------------|
| <b>As at September 30, 2011</b> |               |                          |
| AAA                             | \$ 325,661    | 14.2%                    |
| AA                              | 1,018,740     | 44.3%                    |
| A                               | 787,579       | 34.3%                    |
| BBB or lower                    | 147,648       | 6.4%                     |
| Not Rated                       | 18,623        | 0.8%                     |

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|                                       |                   |                              |
|---------------------------------------|-------------------|------------------------------|
|                                       | \$ 2,298,251      | 100.0%                       |
|                                       |                   |                              |
|                                       | <b>Fair Value</b> | <b>% of Total Fair Value</b> |
| <b><u>As at December 31, 2010</u></b> |                   |                              |
| AAA                                   | \$ 395,881        | 38.4%                        |
| AA                                    | 177,302           | 17.2%                        |
| A                                     | 400,314           | 38.8%                        |
| BBB or lower                          | 51,983            | 5.0%                         |
| Not Rated                             | 6,620             | 0.6%                         |
|                                       | \$ 1,032,100      | 100.0%                       |



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**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVESTMENTS (cont d)***Other Investments*

The estimated fair values of the Company's other investments were as follows:

|                  | September 30,<br>2011 | December 31,<br>2010 |
|------------------|-----------------------|----------------------|
| Private equities | \$ 120,138            | \$ 104,109           |
| Bond funds       | 50,926                | 102,279              |
| Hedge fund       | 23,624                | 22,037               |
| Other            | 5,711                 | 6,289                |
|                  | \$ 200,399            | \$ 234,714           |

At September 30, 2011 and December 31, 2010, the Company had \$120.1 million and \$104.1 million, respectively, of other investments recorded in private equities, which represented 2.7% and 2.4% of total investments and cash and cash equivalents at September 30, 2011 and December 31, 2010, respectively. All of the Company's investments in private equities are subject to restrictions on redemptions and sales that are determined by the governing documents and limit the Company's ability to liquidate these investments in the short term. Due to a lag in the valuations reported by the managers, the Company records changes in the investment value with up to a three-month lag. These investments are accounted for at estimated fair value determined by the Company's proportionate share of the net asset value of the investee reduced by any impairment charges. As at September 30, 2011 and December 31, 2010, the Company had unfunded capital commitments relating to its other investments of \$73.3 million and \$84.7 million, respectively. See Note 12 for details of other investments with related parties.

The Company's bond fund holdings comprise a number of positions in diversified bond mutual funds managed by third-party managers.

*Other-Than-Temporary Impairment Process*

The Company assesses whether declines in the fair value of its fixed maturity investments classified as available-for-sale represent impairments that are other-than-temporary by reviewing each fixed maturity investment that is impaired and: (1) determining if the Company has the intent to sell the fixed maturity investment or (2) determining if it is more likely than not that the Company will be required to sell the fixed maturity investment before its anticipated recovery; and (3) assessing whether a credit loss exists, that is, where the Company expects that the present value of the cash flows expected to be collected from the fixed maturity investment is less than the amortized cost basis of the investment.

The Company had no planned sales of its fixed maturity investments classified as available-for-sale as at September 30, 2011. In assessing whether it is more likely than not that the Company will be required to sell a fixed maturity investment before its anticipated recovery, the Company considers various factors including its future cash flow requirements, legal and regulatory requirements, the level of its cash, cash equivalents, short-term investments and fixed maturity investments classified as available-for-sale in an unrealized gain position, and other relevant factors. For the nine months ended September 30, 2011, the Company did not recognize any other-than-temporary impairments due to required sales.

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In evaluating credit losses, the Company considers a variety of factors in the assessment of a fixed maturity investment including: (1) the time period during which there has been a significant decline below cost; (2) the extent of the decline below cost and par; (3) the potential for the fixed maturity investment to recover in value; (4) an analysis of the financial condition of the issuer; (5) the rating of the issuer; and (6) failure of the issuer of the fixed maturity investment to make scheduled interest or principal payments.

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**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVESTMENTS (cont d)**

Based on the factors described above, the Company determined that, as at September 30, 2011, no credit losses existed.

***Fair Value of Financial Instruments***

Fair value is defined as the price at which to sell an asset or transfer a liability (i.e. the exit price) in an orderly transaction between market participants. The Company uses a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. The hierarchy is broken down into three levels as follows:

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 instruments.

Level 2 Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect the Company's own assumptions about assumptions that market participants might use.

The following is a summary of valuation techniques or models the Company uses to measure fair value by asset and liability classes.

**Fixed Maturity Investments**

The Company's fixed maturity portfolio is managed by the Company's Chief Investment Officer and outside investment advisors. The Company uses inputs from nationally recognized pricing services, including pricing vendors, index providers and broker-dealers to estimate fair value measurements for all of its fixed maturity investments. These pricing services include FT Interactive Data, Barclays Capital Aggregate Index (formerly Lehman Index), Reuters Pricing Service and others.

In general, the pricing services use observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmark curves, benchmarking of like securities, non-binding broker-dealer quotes, reported trades and sector groupings to determine the fair value. In addition, pricing services use valuation models, such as an Option Adjusted Spread model, to develop prepayment and interest rate scenarios. The Option Adjusted Spread model is commonly used to estimate fair value for securities such as mortgage-backed and asset backed securities.

The following describes the techniques generally used to determine the fair value of the Company's fixed maturities by asset class.

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U.S. government and agency securities consist of securities issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other agencies. The significant inputs include the spread above the risk-free yield curve, reported trades and broker-dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

Non-U.S. government securities consist of bonds issued by non-U.S. governments and agencies along with supranational organizations. The significant inputs include the spread above the risk-free yield

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**NOTES TO THE UNAUDITED CONDENSED**

**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVESTMENTS (cont d)**

curve, reported trades and broker-dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

Corporate securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker-dealer quotes, benchmark yields, and industry and market indicators. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2. Where pricing is unavailable from pricing services, the Company obtains non-binding quotes from broker-dealers. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. In this event, securities are classified within Level 3. As at September 30, 2011, the Company had one corporate security classified as Level 3.

Municipal securities consist primarily of bonds issued by U.S.-domiciled state and municipal entities. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker-dealer quotes and benchmark yields. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

Asset backed securities consist primarily of investment-grade bonds backed by pools of loans with a variety of underlying collateral. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades, benchmark yields, broker-dealer quotes, prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

Residential and commercial mortgage-backed securities include both agency and non-agency originated securities. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades, benchmark yields, broker-dealer quotes, prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2. Where pricing is unavailable from pricing services, the Company obtains non-binding quotes from broker-dealers. This is generally the case when there is a low volume of trading activity and current transactions are not orderly. In this event, securities are classified within Level 3. As at September 30, 2011, the Company had one commercial mortgage-backed security classified as Level 3.

To validate the techniques or models used by the pricing services, the Company compares the fair value estimates to its knowledge of the current market and challenges any prices deemed not to be representative of fair value.

As of September 30, 2011, there were no material differences between the prices obtained from the pricing services and the fair value estimates developed by the Company.

**Equity Securities**

The Company's equity securities are managed by two external advisors. The Company uses nationally recognized pricing services, including pricing vendors, index providers and broker-dealers to estimate fair value measurements for all of its equity securities. These pricing services include FT Interactive Data and others.

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The Company has categorized all of its investments in common stock as Level 1 investments because the fair values of these securities are based on quoted prices in active markets for identical assets or liabilities. The Company has categorized all of its investments in preferred stock as Level 2 (except one which was categorized as Level 3) because their fair value estimates are based on observable market data.

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**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INVESTMENTS (cont d)**

**Other Investments**

For its investments in private equities, the Company measures fair value by obtaining the most recently published net asset value as advised by the external fund manager or third-party administrator. The use of net asset value as an estimate of the fair value for investments in certain entities that calculate net asset value is a permitted practical expedient. The Company's private equity investments are mainly in the financial services industry. The fund advisors continue to evaluate the overall market environment, as well as specific areas in the financial services sector, in order to identify segments they believe will offer the most attractive investment opportunities. The financial statements of each fund generally are audited annually under U.S. GAAP, using fair value measurement for the underlying investments. For all publicly-traded companies within the funds, the Company has valued those investments based on the latest share price. The value of Affirmative Investment LLC (in which the Company owns a non-voting 7% membership interest) is based on the market value of the shares of Affirmative Insurance Holdings, Inc., a publicly-traded company.

All of the Company's investments in private equities are subject to restrictions on redemptions and sales that are determined by the governing documents and limit the Company's ability to liquidate those investments in the short term. These restrictions have been in place since the initial investments. The capital commitments are discussed in detail in Note 12 to the unaudited condensed consolidated financial statements. The Company has classified private equities as Level 3 investments because they reflect the Company's own judgment about the assumptions that market participants might use.

For its investment in the hedge fund, the Company measures fair value by obtaining the most recently published net asset value as advised by the external fund manager or third-party administrator. The use of net asset value as an estimate of the fair value for investments in certain entities that calculate net asset value is a permitted practical expedient. The adviser of the fund intends to seek attractive risk-adjusted total returns for the fund's investors by acquiring, originating, and actively managing a diversified portfolio of debt securities, with a focus on various forms of asset backed securities and loans. The fund will focus on investments that the adviser believes to be fundamentally undervalued with current market prices that are believed to be compelling relative to intrinsic value. The units of account that are valued by the Company are its interests in the fund and not the underlying holdings of such fund. Thus, the inputs used by the Company to value its investment in the fund may differ from the inputs used to value the underlying holdings of such fund. The hedge fund is not currently eligible for redemption due to imposed lock-up periods of three years from the time of the initial investment. Once eligible, redemptions will be permitted quarterly with 90 days notice. There are no unfunded capital commitments in relation to the hedge fund. The investment in the hedge fund is classified as Level 3 in the fair value hierarchy.

The bond funds in which the Company invests have been classified as Level 2 investments because their fair value is estimated using the net asset value reported by Bloomberg and they have daily liquidity.

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**5. INVESTMENTS (cont d)***Fair Value Measurements*

In accordance with the provisions of the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification, the Company has categorized its investments that are recorded at fair value among levels as follows:

|                             | September 30, 2011   |   |   | Total Fair Value    |
|-----------------------------|--|---|---|---------------------|
|                             | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |                     |
| U.S. government and agency  | \$   | \$ 446,063                                    | \$  | \$ 446,063          |
| Non-U.S. government         |  | 362,229                                       |   | 362,229             |
| Corporate                   |  | 1,924,238                                     | 501                                       | 1,924,739           |
| Municipal                   |  | 31,528  |   | 31,528              |
| Residential mortgage-backed |  | 123,955                                       |   | 123,955             |
| Commercial mortgage-backed  |  | 70,576  | 9   | 70,585              |
| Asset backed                |  | 55,808  |   | 55,808              |
| Equities                    | 73,029   | 4,806   | 3,700                                     | 81,535              |
| Other investments           |  | 50,926  | 149,473                                   | 200,399             |
| <b>Total investments</b>    | <b>\$ 73,029</b>   | <b>\$ 3,070,129</b>                           | <b>\$ 153,683</b>                         | <b>\$ 3,296,841</b> |

|                             | December 31, 2010  |   |   | Total Fair Value |
|-----------------------------|--|---|---|------------------|
|                             | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |                  |
| U.S. government and agency  | \$   | \$ 227,803                                    | \$  | \$ 227,803       |
| Non-U.S. government         |  | 386,866                                       |   | 386,866          |
| Corporate                   |  | 1,346,854                                     | 530                                       | 1,347,384        |
| Municipal                   |  | 2,297   |   | 2,297            |
| Residential mortgage-backed |  | 102,506                                       |   | 102,506          |
| Commercial mortgage-backed  |  | 37,927  | 914                                       | 38,841           |
| Asset backed                |  | 28,613  |   | 28,613           |
| Equities                    | 56,369   | 138   | 3,575                                     | 60,082           |
| Other investments           |  | 102,279                                       | 132,435                                   | 234,714          |



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|                   |           |              |            |              |
|-------------------|-----------|--------------|------------|--------------|
| Total investments | \$ 56,369 | \$ 2,235,283 | \$ 137,454 | \$ 2,429,106 |
|-------------------|-----------|--------------|------------|--------------|

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**ENSTAR GROUP LIMITED**  
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**5. INVESTMENTS (cont d)**

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three months ended September 30, 2011:

|   | <b>Fixed<br/>Maturity<br/>Investments</b> | <b>Other<br/>Investments</b> | <b>Equity<br/>Securities</b> | <b>Total</b> |
|---|---|------------------------------|------------------------------|--------------|
| Level 3 investments as of July 1, 2011                | \$ 552                                    | \$ 148,840                   | \$ 4,431                     | \$ 153,823   |
| Purchases   |   | 2,196                        |                              | 2,196        |
| Sales   |   | (62)                         |                              | (62)         |
| Total realized and unrealized losses through earnings | (42)                                      | (1,501)                      | (731)                        | (2,274)      |
| Net transfers into and/or (out of) Level 3            |   |                              |                              |              |
| Level 3 investments as of September 30, 2011          | \$ 510                                    | \$ 149,473                   | \$ 3,700                     | \$ 153,683   |

The amount of net gains/(losses) for the three months ended September 30, 2011 included in earnings attributable to the fair value of changes in assets still held at September 30, 2011 was \$(0.3) million. Of this amount, \$(0.8) million was included in net realized and unrealized gains/(losses) and \$0.5 million was included in net investment income.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the three months ended September 30, 2010:

|   | <b>Fixed<br/>Maturity<br/>Investments</b> | <b>Other<br/>Investments</b> | <b>Equity<br/>Securities</b> | <b>Total</b> |
|---|---|------------------------------|------------------------------|--------------|
| Level 3 investments as of July 1, 2010                        | \$ 1,394                                  | \$ 104,079                   | \$ 3,238                     | \$ 108,711   |
| Net purchases (sales and distributions)                       |   | 7,832                        |                              | 7,832        |
| Total realized and unrealized (losses) gains through earnings | (18)                                      | 1,960                        | 237                          | 2,179        |
| Net transfers into and/or (out of) Level 3                    |   |                              |                              |              |
| Level 3 investments as of September 30, 2010                  | \$ 1,376                                  | \$ 113,871                   | \$ 3,475                     | \$ 118,722   |

The amount of net gains/(losses) for the three months ended September 30, 2010 included in earnings attributable to the fair value of changes in assets still held at September 30, 2010 was \$(0.3) million. Of this amount, \$0.2 million was included in net realized and unrealized gains and \$(0.5) million was included in net investment income.

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**5. INVESTMENTS (cont d)**

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the nine months ended September 30, 2011:

|  | <b>Fixed<br/>Maturity<br/>Investments</b> | <b>Other<br/>Investments</b> | <b>Equity<br/>Securities</b> | <b>Total</b> |
|--|---|------------------------------|------------------------------|--------------|
| Level 3 investments as of January 1, 2011            | \$ 1,444                                  | \$ 132,435                   | \$ 3,575                     | \$ 137,454   |
| Purchases  |   | 12,760                       |                              | 12,760       |
| Sales  | (1,043)                                   | (1,728)                      |                              | (2,771)      |
| Total realized and unrealized gains through earnings | 109                                       | 6,006                        | 125                          | 6,240        |
| Net transfers into and/or (out of) Level 3           |   |                              |                              |              |
| Level 3 investments as of September 30, 2011         | \$ 510                                    | \$ 149,473                   | \$ 3,700                     | \$ 153,683   |

The amount of net gains/(losses) for the nine months ended September 30, 2011 included in earnings attributable to the fair value of changes in assets still held at September 30, 2011 was \$6.1 million. Of this amount, \$0.2 million was included in net realized and unrealized gains and \$5.9 million was included in net investment income.

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the nine months ended September 30, 2010:

|   | <b>Fixed<br/>Maturity<br/>Investments</b> | <b>Other<br/>Investments</b> | <b>Equity<br/>Securities</b> | <b>Total</b> |
|---|---|------------------------------|------------------------------|--------------|
| Level 3 investments as of January 1, 2010                     | \$ 641                                    | \$ 81,801                    | \$ 3,300                     | \$ 85,742    |
| Net purchase (sales and distributions)                        | 579                                       | 24,078                       |                              | 24,657       |
| Total realized and unrealized gains (losses) through earnings | 156                                       | 7,992                        | 175                          | 8,323        |
| Net transfers into and/or (out of) Level 3                    |   |                              |                              |              |
| Level 3 investments as of September 30, 2010                  | \$ 1,376                                  | \$ 113,871                   | \$ 3,475                     | \$ 118,722   |

The amount of net gains/(losses) for the nine months ended September 30, 2010 included in earnings attributable to the fair value of changes in assets still held at September 30, 2010 was \$9.1 million. Of this amount, \$0.3 million was included in net realized and unrealized gains and \$8.8 million was included in net investment income.

During the nine months ended September 30, 2011 and 2010, proceeds from the sales and maturities of available-for-sale securities were \$332.6 million and \$57.3 million, respectively. Gross realized gains on the sale of available-for-sale securities were, for the nine months ended September 30, 2011 and 2010, \$0.8 million and \$0.1 million, respectively, and gross realized losses on the sale of available-for-sale securities,

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were \$0.3 million and \$nil, respectively. Net unrealized (losses)/gains on trading securities were \$(5.2) million and \$3.9 million for the nine months ended September 30, 2011 and 2010, respectively.

### ***Restricted Investments***

The Company is required to maintain investments on deposit with various regulatory authorities to support its insurance and reinsurance operations. The investments on deposit are available to settle insurance and

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**5. INVESTMENTS (cont d)**

reinsurance liabilities. The Company also utilizes trust accounts to collateralize business with its insurance and reinsurance counterparties. These trust accounts generally take the place of letter of credit requirements. The investments held in trust as collateral are primarily highly rated fixed maturity securities. The carrying value of the Company's restricted investments as of September 30, 2011 and December 31, 2010 was as follows:

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| Assets used for collateral in trust for third-party agreements | \$ 535,098            | \$ 371,834           |
| Deposits with regulatory authorities                           | 207,425               | 33,970               |
| Others   | 63,561                | 62,437               |
|  | \$ 806,084            | \$ 468,241           |

**6. DERIVATIVE INSTRUMENTS**

In October 2010, the Company entered into a foreign currency forward exchange contract as part of its overall foreign currency risk management strategy. On the value date, June 30, 2011, the Company sold Australian dollars ( AU\$ ) 45.0 million for \$42.5 million. The contract exchange rate was AU\$1 for \$0.9439. On June 15, 2011, the Company effectively closed out the contract by entering into a forward exchange contract, with a value date of June 30, 2011, where it bought AU\$45.0 million for \$48.0 million. For the three and nine months ended September 30, 2011, the change in the fair value of the contract was \$nil and \$(1.9) million, respectively, the effect of which the Company has recognized as a foreign exchange loss included as part of its net earnings.

On August 23, 2011, the Company entered into a foreign currency forward exchange contract where it sold AU\$35.0 million for \$37.0 million. On September 22, 2011, the Company effectively closed out the contract by entering into a forward contract, with the same settlement date of December 2, 2011, where it bought AU\$35.0 million for \$34.0 million. The net gain on the contracts was \$3.0 million and has been included in net foreign exchange gains/(losses) as part of the Company's net earnings.

**7. REINSURANCE BALANCES RECEIVABLE**

|                                  | September 30,<br>2011 | December 31,<br>2010 |
|----------------------------------|-----------------------|----------------------|
| Recoverable from reinsurers on:  |                       |                      |
| Outstanding losses               | \$ 908,487            | \$ 425,336           |
| Losses incurred but not reported | 786,179               | 141,118              |
| Fair value adjustments           | (143,403)             | (41,014)             |

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|  |              |            |
|--|--------------|------------|
| Total reinsurance reserves recoverable | 1,551,263    | 525,440    |
| Paid losses                            | 388,037      | 436,002    |
|  | \$ 1,939,300 | \$ 961,442 |

The fair value adjustment, determined on acquisition of reinsurance subsidiaries, was based on the estimated timing of loss and loss adjustment expense recoveries and an assumed interest rate equivalent to a risk free rate for securities with similar duration to the reinsurance receivables acquired plus a spread to reflect credit risk, and is amortized over the estimated recovery period, as adjusted for accelerations on commutation settlements, using the constant yield method.

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**7. REINSURANCE BALANCES RECEIVABLE (cont d)**

The Company's acquired reinsurance subsidiaries, prior to acquisition, used retrocessional agreements to reduce their exposure to the risk of reinsurance assumed. The Company remains liable to the extent that retrocessionaires do not meet their obligations under these agreements, and therefore, the Company evaluates and monitors concentration of credit risk among its reinsurers. Provisions are made for amounts considered potentially uncollectible.

At September 30, 2011, the Company's top 10 reinsurers accounted for \$1,344.6 million or 69.3% (December 31, 2010: \$726.2 million or 75.5%) of reinsurance recoverables (which includes loss reserves recoverable and recoverables on paid losses) and included \$531.0 million of incurred but not reported (IBNR) recoverable (December 31, 2010: \$99.6 million). With the exception of \$50.8 million, which is recoverable from a BBB+ rated reinsurer, the remaining top 10 reinsurers, as at September 30, 2011, are all rated A+ or better. As at December 31, 2010, with the exception of \$17.6 million which was recoverable from a non-rated reinsurer, the remaining top 10 reinsurers were all rated A- or better. Reinsurance recoverables by reinsurer were as follows:

|   | September 30, 2011         |               | December 31, 2010          |               |
|---|----------------------------|---------------|----------------------------|---------------|
|   | Reinsurance<br>Recoverable | % of<br>Total | Reinsurance<br>Recoverable | % of<br>Total |
| Top 10 reinsurers                       | \$ 1,344,599               | 69.3%         | \$ 726,201                 | 75.5%         |
| Other reinsurers balances > \$1 million | 577,528                    | 29.8%         | 198,737                    | 20.7%         |
| Other reinsurers balances < \$1 million | 17,173                     | 0.9%          | 36,504                     | 3.8%          |
| Total                                   | \$ 1,939,300               | 100.0%        | \$ 961,442                 | 100.0%        |

At September 30, 2011 and December 31, 2010, the provision for uncollectible reinsurance relating to losses recoverable was \$431.4 million and \$381.4 million, respectively. To estimate the provision for uncollectible reinsurance recoverables, the reinsurance recoverables are first allocated to applicable reinsurers. This determination is based on a detailed process rather than an estimate, although an element of judgment is applied. As part of this process, ceded IBNR is allocated by reinsurer.

The Company uses a detailed analysis to estimate uncollectible reinsurance. The primary components of the analysis are reinsurance recoverable balances by reinsurer and bad debt provisions applied to these balances to determine the portion of a reinsurer's balance deemed to be uncollectible. These provisions require considerable judgment and are determined using the current rating, or rating equivalent, of each reinsurer (in order to determine their ability to settle the reinsurance balances), as well as other key considerations and assumptions, such as claims and coverage issues.

As at September 30, 2011 and December 31, 2010, reinsurance receivables with a carrying value of \$447.1 million and \$398.8 million, respectively, were each associated with two reinsurers which represented 10% or more of total reinsurance balances receivable. As at September 30, 2011, the two reinsurers had credit ratings of A+ or higher. In the event that all or any of the reinsuring companies are unable to meet their obligations under existing reinsurance agreements, the Company will be liable for such defaulted amounts.

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**8. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the three months ended September 30, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Three Months Ended</b> |              |
|--|---------------------------|--------------|
|  | <b>September 30,</b>      |              |
|  | <b>2011</b>               | <b>2010</b>  |
| Balance as at July 1   | \$ 3,267,341              | \$ 2,894,353 |
| Less: total reinsurance reserves recoverable                           | 556,374                   | 421,864      |
|  | 2,710,967                 | 2,472,489    |
| Effect of exchange rate movement                                       | (39,038)                  | 80,839       |
| Net reduction in ultimate loss and loss adjustment expense liabilities | (50,114)                  | (26,115)     |
| Net losses paid  | (73,941)                  | (80,501)     |
| Acquired on purchase of subsidiaries                                   | 600,045                   | 198,498      |
| Retroactive reinsurance contracts assumed                              | 40,660                    | 100,136      |
| Net balance as at September 30   | 3,188,579                 | 2,745,346    |
| Plus: total reinsurance reserves recoverable                           | 1,551,262                 | 488,353      |
| Balance as at September 30   | \$ 4,739,841              | \$ 3,233,699 |

The following table shows the components of the movement in the net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2011 and 2010:

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>September 30,</b>      |             |
|   | <b>2011</b>               | <b>2010</b> |
| Net losses paid   | \$ (73,941)               | \$ (80,501) |
| Net reduction in case and loss adjustment expense reserves                  | 99,447                    | 101,542     |
| Net reduction in IBNR reserves  | 16,961                    | (151)       |
| Reduction in estimates of net ultimate losses                               | 42,467                    | 20,890      |
| Reduction in provisions for bad debt  | 2,399                     | 1,304       |
| Reduction in provisions for unallocated loss adjustment expense liabilities | 14,113                    | 10,171      |
| Amortization of fair value adjustments                                      | (8,865)                   | (6,250)     |
| Net reduction in ultimate loss and loss adjustment expense liabilities      | \$ 50,114                 | \$ 26,115   |

Net reduction in case and loss adjustment expense reserves ( LAE reserves ) comprises the movement during the quarter in specific case reserve liabilities as a result of claims settlements or changes advised to the Company by its policyholders and attorneys, less changes in case reserves recoverable advised by the Company to its reinsurers as a result of the settlement or movement of assumed claims. Net reduction in IBNR reserves represents the change in the Company's actuarial estimates of losses incurred but not reported.



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The net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2011 of \$50.1 million was attributable to a reduction in estimates of net ultimate losses of \$42.5 million, a reduction in provisions for bad debt of \$2.4 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$14.1 million, relating to 2011 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$8.9 million.

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**NOTES TO THE UNAUDITED CONDENSED**

**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. LOSSES AND LOSS ADJUSTMENT EXPENSES (cont d)**

The reduction in estimates of net ultimate losses of \$42.5 million, comprised of net favorable incurred loss development of \$25.5 million and reductions in IBNR reserves of \$17.0 million, related primarily to:

- (i) the conclusion of the Company's review of historic case reserves for eleven of its insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 7,400 advised case reserves with an aggregate value of \$30.5 million; and
- (ii) an aggregate reduction in IBNR reserves of \$10.7 million as a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to revised historical loss development data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses relating to non-commuted exposures in eleven of the Company's insurance and reinsurance subsidiaries. The prior period estimate of aggregate net IBNR liabilities for these subsidiaries was reduced as a result of the combined impact on all classes of business of loss development activity during 2011, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. The Company in conjunction with its independent actuaries completed an actuarial review of the loss reserves for eleven of its most seasoned insurance and reinsurance subsidiaries as at September 30, 2011.

The reduction in provisions for bad debt of \$2.4 million resulted from the collection of receivables against which bad debt provisions had been provided for in earlier periods.

The net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2010 of \$26.1 million was attributable to a reduction in estimates of net ultimate losses of \$20.9 million, a reduction in provisions for bad debt of \$1.3 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$10.2 million, relating to 2010 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$6.3 million.

The reduction in estimates of net ultimate losses of \$20.9 million for the three months ended September 30, 2010 comprised net favorable incurred loss development of \$21.1 million and a modest increase in IBNR reserves of \$0.2 million, primarily related to the following:

- (i) a reduction in estimates of net ultimate losses of \$10.8 million in one of the Company's insurance entities following the commutations and policy buy-backs of five of its largest insurance and reinsurance exposures; and
- (ii) the conclusion of the Company's review of historic case reserves for two of its insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 1,750 advised case reserves with an aggregate value of \$11.8 million.

The reduction in provisions for bad debt of \$1.3 million resulted from the collection of receivables against which bad debt provisions had been provided in earlier periods.



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**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. LOSSES AND LOSS ADJUSTMENT EXPENSES (cont d)**

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the nine months ended September 30, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|--|--------------|
|  | <b>2011</b>                                | <b>2010</b>  |
| Balance as at January 1  | \$ 3,291,275                               | \$ 2,479,136 |
| Less: total reinsurance reserves recoverable                           | 525,440                                    | 347,728      |
|  | 2,765,835                                  | 2,131,408    |
| Effect of exchange rate movement                                       | (5,686)                                    | 18,410       |
| Net reduction in ultimate loss and loss adjustment expense liabilities | (88,501)                                   | (78,077)     |
| Net losses paid  | (227,280)                                  | (211,589)    |
| Acquired on purchase of subsidiaries                                   | 610,484                                    | 420,540      |
| Retroactive reinsurance contracts assumed                              | 133,727                                    | 464,654      |
| Net balance as at September 30   | 3,188,579                                  | 2,745,346    |
| Plus: total reinsurance reserves recoverable                           | 1,551,262                                  | 488,353      |
| Balance as at September 30   | \$ 4,739,841                               | \$ 3,233,699 |

The following table shows the components of the movement in the net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2011 and 2010:

|   | <b>Nine Months Ended<br/>September 30,</b> |              |
|---|--|--------------|
|   | <b>2011</b>                                | <b>2010</b>  |
| Net losses paid   | \$ (227,280)                               | \$ (211,589) |
| Net reduction in case and LAE reserves                                      | 247,951                                    | 234,114      |
| Net reduction in IBNR reserves  | 52,237                                     | 35,411       |
| Reduction in estimates of net ultimate losses                               | 72,908                                     | 57,936       |
| Reduction in provisions for bad debt  | 4,071                                      | 14,411       |
| Reduction in provisions for unallocated loss adjustment expense liabilities | 37,433                                     | 30,832       |
| Amortization of fair value adjustments                                      | (25,911)                                   | (25,102)     |
| Net reduction in ultimate loss and loss adjustment expense liabilities      | \$ 88,501                                  | \$ 78,077    |



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**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. LOSSES AND LOSS ADJUSTMENT EXPENSES (cont d)**

The net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2011 of \$88.5 million was attributable to a reduction in estimates of net ultimate losses of \$72.9 million, a reduction in provisions for bad debt of \$4.1 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$37.4 million, relating to 2011 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$25.9 million. The reduction in estimates of net ultimate losses of \$72.9 million, comprised of net favorable incurred loss development of \$20.7 million and reductions in IBNR reserves of \$52.2 million, related primarily to:

- (i) the conclusion of the Company's review of historic case reserves for eleven of its insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 7,400 advised case reserves with an aggregate value of \$30.5 million; and
- (ii) an aggregate reduction in IBNR reserves of \$38.7 million as a result of the completion of two commutations of the Company's largest ten exposures and the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to revised historical loss development data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses relating to non-commuted exposures in eleven of the Company's insurance and reinsurance subsidiaries. The prior period estimate of aggregate net IBNR liabilities for these subsidiaries was reduced as a result of the combined impact on all classes of business of loss development activity during 2011, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. The Company in conjunction with its independent actuaries completed an actuarial review of the loss reserves for eleven of its most seasoned insurance and reinsurance subsidiaries as at September 30, 2011.

The reduction in provisions for bad debt of \$4.1 million resulted from the collection of receivables against which bad debt provisions had been provided for in earlier periods.

The net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2010 of \$78.1 million was attributable to a reduction in estimates of net ultimate losses of \$57.9 million, a reduction in provisions for bad debt of \$14.4 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$30.8 million, relating to 2010 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$25.1 million.

The reduction in estimates of net ultimate losses of \$57.9 million for the nine months ended September 30, 2010 comprised net favorable incurred loss development of \$22.5 million along with reductions in IBNR reserves of \$35.4 million. The net favorable incurred loss development of \$22.5 million, whereby net advised case and LAE reserves of \$234.1 million were settled for net losses paid of \$211.6 million, related to the settlement of non-commuted and commuted losses during the nine months ended September 30, 2010 including commutations and policy buy-backs of seven of the largest insured and/or reinsured exposures in three of the Company's insurance and reinsurance subsidiaries. These commutations and policy buy-backs were primarily responsible for the reduction in IBNR reserves of \$35.4 million following the application of the Company's reserving methodologies in determining the IBNR reserves related to the commuted exposures. The settlement of advised case and LAE reserves of \$234.1 million included the redundancy of approximately 1,750 advised case



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**8. LOSSES AND LOSS ADJUSTMENT EXPENSES (cont d)**

reserves with an aggregate value of \$11.8 million, which resulted from the Company's review of historic case reserves for two of its insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years.

The reduction in provisions for bad debt of \$14.4 million resulted from the collection of receivables against which bad debt provisions had been provided in earlier periods.

**9. LOANS PAYABLE**

The Company's long-term debt consists of loan facilities used to partially finance certain of the Company's acquisitions or significant new business transactions along with a loan outstanding in relation to the share repurchase agreements (the Repurchase Agreements) entered into with three of its executives and certain trusts and a corporation affiliated with the executives. The Unionamerica, Knapton and Enstar Group Facilities and the Repurchase Agreements are described in Note 11 to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Total amounts of loans payable outstanding, including accrued interest, as of September 30, 2011 and December 31, 2010 totaled \$314.6 million and \$245.3 million, respectively, and were comprised as follows:

| Facility                      | Date of Facility  | September 30,<br>2011 | December 31,<br>2010 |
|-------------------------------|-------------------|-----------------------|----------------------|
| EGL Revolving Credit Facility | June 30, 2011     | \$ 169,000            | \$                   |
| Clarendon Facility            | July 12, 2011     | 107,256               |                      |
| Unionamerica Facility A       | December 30, 2008 |                       | 71,259               |
| Unionamerica Facility B       | December 30, 2008 |                       | 154                  |
| Knapton                       | April 20, 2010    |                       | 21,532               |
| Enstar Group Facility A       | December 29, 2010 |                       | 52,100               |
| Enstar Group Facility B       | December 29, 2010 |                       | 62,900               |
| Total long-term bank debt     |                   | 276,256               | 207,945              |
| Repurchase agreements         | October 1, 2010   | 38,313                | 37,333               |
| Total loans payable           |                   | \$ 314,569            | \$ 245,278           |

*EGL Revolving Credit Facility; Prepayment of Certain Subsidiary Debt Facilities*

On June 13, 2011, the Company, as borrower, and certain of its subsidiaries, as guarantors, entered into a Revolving Credit Facility Agreement with NAB and Barclays Corporate, the corporate banking division of Barclays Bank PLC, as bookrunners and mandated lead arrangers, certain financial institutions, as lenders, and NAB as agent (the EGL Credit Agreement). The EGL Credit Agreement provides for a three-year revolving credit facility pursuant to which the Company is permitted to borrow up to an aggregate of \$250.0 million (the EGL Revolving Credit Facility), which will be available to prepay certain existing credit facilities of the Company and certain of its subsidiaries, to fund permitted



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acquisitions and for general corporate purposes. The Company's ability to draw on the EGL Revolving Credit Facility is subject to customary conditions.

On June 30, 2011, the Company borrowed \$167.7 million under the EGL Revolving Credit Facility, which was used to prepay \$167.7 million representing the total amounts owing by the Company under the Knapton, Unionamerica and Enstar Group facilities. The prepayment of these existing credit facilities was a condition to the Company's initial borrowing under the EGL Revolving Credit Facility. As of September 30, 2011, the outstanding EGL Revolving Credit Facility loan balance was \$169.0 million.

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**ENSTAR GROUP LIMITED**  
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**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. LOANS PAYABLE (cont d)**

The EGL Revolving Credit Facility is secured by a first priority lien on the stock of certain of the Company's subsidiaries and certain bank accounts held with Barclays Bank PLC in the name of the Company and into which amounts received in respect of any capital release from certain of the Company's subsidiaries are required to be paid. Interest is payable at the end of each interest period chosen by the Company or, at the latest, each six months. The interest rate is LIBOR plus 2.75%, plus an incremental amount tied to certain regulatory costs that may be incurred by the lenders, if any. The unused portion of the EGL Revolving Credit Facility will be subject to a commitment fee of 1.10%. The EGL Revolving Credit Facility is subject to various financial and business covenants applicable to the Company, the guarantors and certain other material subsidiaries, including limitations on mergers and consolidations, acquisitions, indebtedness and guarantees, restrictions as to dispositions of stock and dividends, and limitations on liens on stock. As of September 30, 2011, all of the covenants relating to the EGL Revolving Credit Facility were met.

During the existence of any payment default, the interest rate is increased by 1.0%. During the existence of any event of default as specified in the EGL Credit Agreement, the agent may cancel the commitments of the lenders, declare all or a portion of outstanding amounts immediately due and payable, declare all or a portion of outstanding amounts payable upon demand or proceed against the security. The EGL Credit Agreement terminates and all amounts borrowed must be repaid on June 13, 2014, the third anniversary of the date of the EGL Credit Agreement.

On October 21, 2011, the Company repaid \$25.0 million of the outstanding principal balance of the EGL Revolving Credit Facility, reducing the remaining outstanding loan balance, inclusive of accrued interest, to \$144.0 million.

The fair value of the Company's floating rate loan approximates its book value.

*Clarendon Facility*

On March 4, 2011, the Company, through Clarendon Holdings, Inc., entered into a \$106.5 million term facility agreement (the Clarendon Facility) with NAB. The Clarendon Facility provides for a four-year term loan facility available to be drawn to fund up to 50% of the purchase price of Clarendon. On July 12, 2011, the Company fully drew down the Clarendon Facility in connection with the acquisition of Clarendon. As of September 30, 2011, the outstanding Clarendon Facility balance was \$107.3 million.

The Clarendon Facility is secured by a security interest in all of the assets of Clarendon Holdings, Inc., as well as a first priority lien on the stock of both Clarendon Holdings, Inc. and Clarendon. Interest is payable at the end of each interest period chosen by Clarendon Holdings, Inc. or, at the latest, each six months. The interest rate is LIBOR plus 2.75%. The Clarendon Facility is subject to various financial and business covenants, including limitations on mergers and consolidations, restrictions as to disposition of stock and limitations on liens on the stock.

During the existence of any payment default, the interest rate is increased by 1.0%. During the existence of any event of default as specified in the term facility agreement, the lenders may declare all or a portion of outstanding amounts immediately due and payable, declare all or a portion of borrowed amounts payable upon demand, or proceed against the security. The Clarendon Facility terminates and all amounts borrowed must be repaid on July 12, 2015.

**10. EMPLOYEE BENEFITS**

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The Company's share-based compensation plans provide for the grant of various awards to its employees and to members of the board of directors. These are described in Note 14 to the consolidated financial statements

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**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. EMPLOYEE BENEFITS (cont d)**

contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The information below includes both the employee and director components of the Company's share-based compensation.

*(a) Employee share plans*

Employee stock awards for the nine months ended September 30, 2011 are summarized as follows:

|                              | <b>Number of<br/>Shares</b> | <b>Weighted<br/>Average<br/>Fair<br/>Value of<br/>the Awards</b> |
|------------------------------|-----------------------------|--|
| Nonvested January 1, 2011    | 153,930                     | \$ 13,019  |
| Granted                      | 70,305                      | 5,848  |
| Vested                       | (20,305)                    | (1,798)  |
| Nonvested September 30, 2011 | 203,930                     | \$ 19,439  |

*(i) 2006-2010 Annual Incentive Compensation Program, 2011-2015 Annual Incentive Compensation Program and 2006 Equity Incentive Plan*

For the nine months ended September 30, 2011 and 2010, 16,328 and 78,664 shares were awarded to directors, officers and employees under the 2006 Equity Incentive Plan. The total value of the awards for the nine months ended September 30, 2011 and 2010 was \$1.5 million and \$5.4 million, respectively, and was charged against the 2006-2010 Annual Incentive Compensation Program (the 2006 Program) accrual established for the years ended December 31, 2010 and 2009, respectively. The 2006 Program ended effective December 31, 2010. On February 23, 2011, the Company adopted the Enstar Group Limited 2011-2015 Annual Incentive Compensation Program (the 2011 Program).

In addition, for the nine months ended September 30, 2011 and 2010, 50,000 and 153,930 restricted shares were awarded to certain employees under the 2006 Equity Incentive Plan. The total unrecognized compensation cost related to the Company's non-vested share awards as at September 30, 2011 and 2010 was \$11.1 million and \$9.4 million, respectively. This cost is expected to be recognized over the next 4.0 years. Compensation costs of \$0.7 million and \$2.0 million relating to these share awards were recognized in the Company's statement of earnings for the three and nine months ended September 30, 2011, respectively, as compared to \$0.4 million and \$1.1 million, respectively, for the three and nine months ended September 30, 2010.

The accrued expense relating to the 2011 Program for the three and nine months ended September 30, 2011 was \$2.1 million and \$4.0 million, respectively, as compared to \$3.8 million and \$8.8 million, respectively, for three and nine months ended September 30, 2010 relating to the 2006 Program.

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### (ii) *Enstar Group Limited Employee Share Purchase Plan*

Compensation costs of less than \$0.1 million and \$0.2 million relating to the shares issued have been recognized in the Company's statement of earnings for both the three and nine months ended September 30, 2011 and 2010, respectively. As at September 30, 2011, 18,131 shares have, in total, been issued to employees under the Amended and Restated Enstar Group Limited Employee Share Purchase Plan.

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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. EMPLOYEE BENEFITS (cont d)***(b) Options*

|             |                    | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Intrinsic<br>Value of<br>Shares |
|-------------|--------------------|---------------------|--|---------------------------------|
| Outstanding | January 1, 2011    | 152,015             | \$ 34.55                                 | \$ 7,606                        |
| Exercised   |                    | (49,037)            | 19.63                                    | (3,709)                         |
| Outstanding | September 30, 2011 | 102,978             | \$ 41.65                                 | \$ 5,517                        |

Stock options outstanding and exercisable as of September 30, 2011 were as follows:

**Range of****Exercise**

| Prices      | Number of<br>Options | Weighted Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Life |
|-------------|----------------------|------------------------------------|---|
| \$40 - \$60 | 102,978              | \$ 41.65                           | 2.0 years   |

*(c) Deferred Compensation and Stock Plan for Non-Employee Directors*

For the nine months ended September 30, 2011 and 2010, 3,388 and 4,847 restricted share units, respectively, were credited to the accounts of Non-Employee Directors under the Enstar Group Limited Deferred Compensation and Ordinary Share Plan for Non-Employee Directors (the Deferred Compensation Plan).

Following J. Christopher Flowers' resignation from the Board of Directors, 3,610 restricted share units previously credited to his account under the Deferred Compensation Plan were converted into the same number of the Company's ordinary shares on May 24, 2011, with fractional shares paid in cash. Also on May 24, 2011, 4,515 restricted stock units previously credited to Mr. Flowers' account under a deferred compensation plan assumed in the Company's merger with Enstar USA, Inc., now a wholly-owned subsidiary of the Company, were converted into the same number of the Company's ordinary shares.

Following Paul J. Collins' resignation from the Board of Directors on September 30, 2011, 4,103 restricted share units previously credited to his account under the Deferred Compensation Plan were converted into the same number of the Company's ordinary shares on October 3, 2011, with fractional shares paid in cash. Also on October 3, 2011, 1,304 restricted stock units previously credited to Mr. Collins' account under a deferred compensation plan assumed in the Company's merger with Enstar USA, Inc., now a wholly-owned subsidiary of the Company, were converted into the same number of the Company's ordinary shares.

*(d) Pension plan*

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The Company provides pension benefits to eligible employees through various plans sponsored by the Company. All pension plans, except as disclosed below, are structured as defined contribution plans. Pension expense for the three and nine months ended September 30, 2011 was \$1.0 million and \$3.2 million, respectively, as compared to \$0.8 million and \$2.6 million, respectively, for three and nine months ended September 30, 2010.

The Company acquired, as part of the acquisition of PW Acquisition Company ( PWAC ) on July 20, 2010, a noncontributory defined benefit pension plan (the PWAC Plan ) that covers substantially all PWAC employees hired before April 1, 2003 and provides pension and certain death benefits. Effective April 1, 2004, PWAC froze the PWAC Plan. As at the date of acquisition of PWAC by the Company, the PWAC Plan had an unfunded liability of \$6.7 million that had been accrued by PWAC. Subsequent to acquisition, an actuarial review was performed of the PWAC Plan which determined that the PWAC Plan s unfunded liability was \$8.1 million. As at September 30, 2011, PWAC had an accrued liability of \$7.1 million for the unfunded PWAC Plan liability.

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**10. EMPLOYEE BENEFITS (cont d)**

The Company recorded pension expense relating to the PWAC Plan, for the three and nine months ended September 30, 2011, of \$0.2 million and \$0.5 million, respectively.

**11. EARNINGS PER SHARE**

The following table sets forth the comparison of basic and diluted earnings per share for the three and nine month periods ended September 30, 2011 and 2010:

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2011                             | 2010       | 2011                            | 2010       |
| <b>Basic earnings per share:</b>                                |                                  |            |                                 |            |
| Net earnings attributable to Enstar Group Limited               | \$ 12,064                        | \$ 21,443  | \$ 24,942                       | \$ 49,794  |
| Weighted average shares outstanding basic                       | 14,270,003                       | 13,704,832 | 13,743,191                      | 13,676,113 |
| Earnings per share attributable to Enstar Group Limited basic   | \$ 0.85                          | \$ 1.56    | \$ 1.81                         | \$ 3.64    |
| <b>Diluted earnings per share:</b>                              |                                  |            |                                 |            |
| Net earnings attributable to Enstar Group Limited               | \$ 12,064                        | \$ 21,443  | \$ 24,942                       | \$ 49,794  |
| Weighted average shares outstanding basic                       | 14,270,003                       | 13,704,832 | 13,743,191                      | 13,676,113 |
| <b>Share equivalents:</b>                                       |                                  |            |                                 |            |
| Unvested shares   | 203,930                          | 155,616    | 194,223                         | 116,214    |
| Restricted share units  | 19,594                           | 17,406     | 16,854                          | 15,965     |
| Options   | 65,637                           | 141,914    | 70,876                          | 148,656    |
| Weighted average shares outstanding diluted                     | 14,559,164                       | 14,019,768 | 14,025,144                      | 13,956,948 |
| Earnings per share attributable to Enstar Group Limited diluted | \$ 0.83                          | \$ 1.53    | \$ 1.78                         | \$ 3.57    |

**12. RELATED PARTY TRANSACTIONS**

The Company has entered into certain transactions with companies and partnerships that are affiliated with J. Christopher Flowers. Mr. Flowers is one of the largest shareholders of the Company and formerly was a member of the Company's board of directors.



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During the nine months ended September 30, 2011, the Company funded \$8.6 million of its remaining outstanding capital commitment to entities affiliated with Mr. Flowers. The Company had, as of September 30, 2011 and December 31, 2010, excluding its investment in Varadero International Ltd. (a hedge fund affiliated with the Company and Mr. Flowers with respect to which the Company has funded 100% of its capital commitment), investments in entities affiliated with Mr. Flowers with a total value of \$136.5 million and \$96.1 million, respectively, and outstanding commitments to entities managed by Mr. Flowers, as of those same dates, of \$72.2 million and \$84.6 million, respectively. The Company's outstanding commitments may be drawn down over approximately the next five years.

As at September 30, 2011, related party investments associated with Mr. Flowers accounted for 98.5% of the total unfunded capital commitments of the Company and 68.1% of the total amount of investments classified as other investments by the Company.

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**13. TAXATION**

Income tax expense for the three and nine months ended September 30, 2011 was \$4.4 million and \$6.0 million, respectively, as compared to \$1.0 million and \$23.0 million, respectively, for the three and nine months ended September 30, 2010.

Under current Bermuda law, the Company and its Bermuda subsidiaries are not required to pay any taxes in Bermuda on their income or capital gains. On March 25, 2011, the Company received confirmation from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, the period for which the Company and its Bermuda subsidiaries will be exempt from taxation in Bermuda would be extended until March 2035.

The Company has operating subsidiaries and branch operations in the United Kingdom, Australia, the United States and Europe and is subject to federal, foreign, state and local taxes in those jurisdictions. In addition, certain distributions from some foreign sources may be subject to withholding taxes.

The expected income tax provision for the foreign operations computed on pre-tax income at the weighted average tax rate has been calculated as the sum of the pre-tax income in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate.

The actual income tax rate for the three and nine months ended September 30, 2011 and 2010 differed from the amount computed by applying the effective rate of 0% under Bermuda law to earnings before income taxes as shown in the following reconciliation:

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2011                                | 2010      | 2011                               | 2010      |
| Earnings before income tax             | \$ 16,500                           | \$ 22,422 | \$ 30,970                          | \$ 72,810 |
| Expected tax rate                      | 0.0%                                | 0.0%      | 0.0%                               | 0.0%      |
| Foreign taxes at local expected rates  | 54.4%                               | 12.4%     | 59.5%                              | 40.6%     |
| Benefit of loss carryovers             | 0.0%                                | (4.3)%    | 0.0%                               | (5.4)%    |
| Change in uncertain tax positions      | 0.3%                                | 0.0%      | 0.5%                               | 0.2%      |
| Change in valuation allowance          | (29.1)%                             | (3.5)%    | (38.4)%                            | (3.9)%    |
| Impact of Australian tax consolidation | 0.0%                                | 0.0%      | (2.9)%                             | 0.0%      |
| Other                                  | 1.3%                                | (0.2)%    | 0.8%                               | 0.1%      |
| Effective tax rate                     | 26.9%                               | 4.4%      | 19.5%                              | 31.6%     |

The Company had net deferred tax assets of approximately \$10.6 million and \$3.2 million as of September 30, 2011 and December 31, 2010, respectively. Deferred income taxes arise from the recognition of temporary differences between income determined for financial reporting purposes and income tax purposes. The temporary differences that give rise to significant portions of the deferred tax assets and liabilities are net operating loss carryforwards, claims reserves due principally to the discounting for tax, and investments.

The Company has estimated future taxable income of its foreign subsidiaries and has provided a valuation allowance in respect of those loss carryforwards where it does not expect to realize a benefit. The Company has considered all available evidence using a more likely than not standard in determining the amount of the valuation allowance.

As of September 30, 2011 and December 31, 2010, the Company had unrecognized tax benefits of \$5.7 million and \$5.6 million, respectively, relating to uncertain tax positions.

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The Company's operating subsidiaries in specific countries may be subject to audit by various tax authorities and may have different statutes of limitations expiration dates. With limited exceptions, the

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**ENSTAR GROUP LIMITED**

**NOTES TO THE UNAUDITED CONDENSED**

**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. TAXATION (cont d)**

Company's major subsidiaries that operate in the United States, United Kingdom and Australia are no longer subject to tax examinations for years before 2005, 2008 and 2005, respectively.

Because the Company operates in many jurisdictions, its net earnings are subject to risk due to changing tax laws and tax rates around the world. The current, rapidly changing economic environment may increase the likelihood of substantial changes to tax laws in the jurisdictions in which it operates. The Company cannot predict what, if any, legislation will actually be proposed or enacted, or what the effect of any such legislation might be on the Company's financial condition and results of operations.

**14. SHARE CAPITAL**

On April 20, 2011, the Company entered into an Investment Agreement (the "Investment Agreement") with GSCP VI AIV Navi, Ltd., GSCP VI Offshore Navi, Ltd., GSCP VI Parallel AIV Navi, Ltd., GSCP VI Employee Navi, Ltd., and GSCP VI GmbH Navi, L.P. (collectively, the "Purchasers"), each of which is an affiliate of Goldman, Sachs & Co. Under the Investment Agreement, the Company agreed to issue and sell, and the Purchasers agreed to purchase, at several different closings described immediately below, securities representing 19.9% of the Company's outstanding share capital pro forma for all the issuances, with the right to acquire an additional 2.0% on a fully diluted basis pro forma for all the issuances through the exercise of warrants as described below, although the Purchasers' voting interest in the Company purchased pursuant to the Investment Agreement will be less than 4.9%. The securities that the Purchasers have acquired or, subject to certain conditions, will be acquiring at these closings can be further summarized as follows:

At the first closing, which occurred on April 20, 2011, 531,345 of the Company's voting ordinary shares, par value \$1.00 per share ("Voting Common Shares"), and 749,869 of the Company's newly created Series A convertible non-voting preference shares, par value \$1.00 per share (the "Non-Voting Preferred Shares"), at a purchase price of \$86.00 per share, or approximately \$110.2 million in the aggregate. Upon the receipt of shareholder approval to create three new classes of non-voting ordinary shares at the Company's Annual General Meeting on June 28, 2011 (the "Shareholder Approval"), the Non-Voting Preferred Shares automatically converted on a share-for-share basis into non-voting ordinary shares of the Company, par value \$1.00 (the "Non-Voting Common Shares"). At the first closing, the Company also issued to the Purchasers warrants to acquire 340,820 Non-Voting Preferred Shares (which converted to the right to acquire Non-Voting Common Shares upon receipt of the Shareholder Approval) for an exercise price of \$115.00 per share, subject to certain adjustments. The Purchasers may, at their election, satisfy the exercise price of the warrants on a cashless basis by surrender of shares otherwise issuable upon exercise of the warrants in accordance with a formula set forth in the warrants. The warrants expire on the ten year anniversary of the first closing.

At the second closing, which is expected to occur after receipt of applicable regulatory approvals and satisfaction of other closing conditions (but not before December 23, 2011), 134,184 Voting Common Shares and 827,504 Non-Voting Common Shares, at a purchase price of \$86.00 per share, or approximately \$82.7 million in the aggregate.

At the third closing, which was approved by the Company's shareholders at the Annual General Meeting of Shareholders on June 28, 2011 and which is expected to occur after receipt of applicable regulatory approvals and satisfaction of other closing conditions,

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1,148,264 Non-Voting Common Shares, at a purchase price of \$86.00 per share, or approximately \$98.7 million in the aggregate. If the third closing occurs, it is expected to occur simultaneously with the second closing.

The Purchasers may elect, at their option, to receive Series B Non-Voting Common Shares in lieu of Voting Common Shares that might otherwise be issuable to them at any of the closings discussed above. Any such

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**ENSTAR GROUP LIMITED**  
**NOTES TO THE UNAUDITED CONDENSED**  
**CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**14. SHARE CAPITAL (cont d)**

Series B Non-Voting Common Shares would be convertible on a share-for-share basis, subject to certain adjustments, into Voting Common Shares at the option of the Purchasers. All other Non-Voting Common Shares received by the Purchasers under the Investment Agreement, including those received upon conversion of the Non-Voting Preferred Shares received at the first closing, are Series C Non-Voting Common Shares. The Purchasers may also elect to receive Series B Non-Voting Common Shares, Series C Non-Voting Common Shares or Series D Non-Voting Common Shares upon conversion of Voting Common Shares held by them. In addition, the Purchasers may elect to receive Series D Non-Voting Common Shares upon conversion of Series B Non-Voting Common Shares or Series C Non-Voting Common Shares held by them. There is no economic difference in the sub-series of Non-Voting Common Shares, but there are slight differences in the limited voting rights of each sub-series that are designed to address certain regulatory matters affecting the Purchasers.

The total investment expected to be made by the Purchasers for the purchase of the Voting Common Shares, the Non-Voting Common Shares and the warrants is approximately \$291.6 million. The Company has accounted for the Purchaser's investment under the Investment Agreement as equity under the applicable U.S. GAAP.

On June 28, 2011 at the Company's Annual General Meeting, the Company's shareholders approved the reallocation of the Company's authorized share capital as follows:

|  | <b>June 28,<br/>2011</b>         | <b>Pre-June 28,<br/>2011</b> |
|--|----------------------------------|------------------------------|
|  | <b>(expressed in thousands )</b> |                              |
| Ordinary shares, par value \$1.00 per share                        | 90,000                           | 100,000                      |
| Non-voting convertible ordinary shares, par value \$1.00 per share | 21,000                           | 6,000                        |
| Preference shares, par value \$1.00 per share                      | 45,000                           | 50,000                       |
| <br>Total authorized share capital                                 | <br>156,000                      | <br>156,000                  |

**15. SEGMENT INFORMATION**

Due to the growing insignificance of the Company's consulting activities in relation to its core reinsurance operations, the Company has reevaluated its segment reporting and concluded that it has one reportable segment. As a result of the decreasing relative significance of consulting activities and the associated revenues and earnings, the Company no longer monitors the results of consulting activities separately for evaluating business performance and for making resource allocation decisions. Accordingly, effective January 1, 2011, the Company will no longer report separately the results of its consulting activities. Prior to 2011, the Company reported two segments: reinsurance and consulting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

of Enstar Group Limited

We have reviewed the accompanying condensed consolidated balance sheet of Enstar Group Limited and subsidiaries (the Company) as of September 30, 2011, and the related condensed consolidated statements of earnings and comprehensive income for the three-month and nine-month periods ended September 30, 2011 and 2010 and changes in shareholders' equity and cash flows for the nine-month periods ended September 30, 2011 and 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Enstar Group Limited and subsidiaries as of December 31, 2010 and the related consolidated statements of earnings, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended; and in our report dated March 4, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2010 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Deloitte & Touche Ltd.

Hamilton, Bermuda

November 4, 2011

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**Item 2. *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

The following is a discussion and analysis of our results of operations for the three and nine months ended September 30, 2011 and 2010. This discussion and analysis should be read in conjunction with the attached unaudited condensed consolidated financial statements and notes thereto and the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

**Business Overview**

Enstar Group Limited, or Enstar, was formed in August 2001 under the laws of Bermuda to acquire and manage insurance and reinsurance companies in run-off and portfolios of insurance and reinsurance business in run-off, and to provide management, consulting and other services to the insurance and reinsurance industry.

Since our formation, we have acquired 35 insurance and reinsurance companies and 16 portfolios of insurance and reinsurance business and are now administering those businesses in run-off. Insurance and reinsurance companies and portfolios of insurance and reinsurance business we acquire that are in run-off no longer underwrite new policies. We derive our net earnings from the ownership and management of these companies and portfolios of business in run-off primarily by settling insurance and reinsurance claims below the acquired value of loss reserves and from returns on the portfolio of investments retained to pay future claims. In addition, we provide management and consultancy services, claims inspection services and reinsurance collection services to our affiliates and third-party clients for both fixed and success-based fees.

**Recent Transactions**

***Clarendon***

On July 12, 2011, we, through our wholly-owned subsidiary, Clarendon Holdings, Inc., completed the acquisition of 100% of the shares of Clarendon National Insurance Company, or Clarendon, from Clarendon Insurance Group, Inc., an affiliate of Hannover Re, or Hannover. Clarendon is a New Jersey-domiciled insurer that is in run-off. Clarendon owns three other insurers, two domiciled in New Jersey and one domiciled in Florida, that are also in run-off. The purchase price was \$219.1 million and was financed in part by borrowing \$106.5 million under a four-year term loan facility, or the Clarendon Facility, provided by National Australia Bank Limited, or NAB, and the remainder from available cash on hand.

In addition, on July 12, 2011, we, through our wholly-owned subsidiary, Fitzwilliam Insurance Limited, or Fitzwilliam, in connection with the acquisition of Clarendon, entered into a reinsurance agreement with Hannover, which provides adverse development cover, or ADC, to Clarendon to reinsure Hannover for the first \$80.0 million of the ADC. We provided a parental guarantee to Hannover in the amount of \$80.0 million supporting the obligations of Fitzwilliam.

***Laguna***

On March 25, 2011, we, through our wholly-owned subsidiary, Kenmare Holdings Ltd., completed the acquisition of Laguna Life Limited, formerly known as CitiLife Financial Limited, or Laguna, from Citigroup Insurance Holding Corporation, or Citigroup, an affiliate of Citigroup Inc. Laguna is an Ireland-based life insurer that is in run-off. The purchase price was \$15.0 million (approximately \$21.2 million) and was funded from available cash on hand. The previously disclosed purchase price of \$30.0 million (approximately \$42.4 million) was reduced, prior to completion of the acquisition, after Citigroup received approval from Laguna's regulator to distribute \$15.0 million (approximately \$21.2 million) to its shareholders.



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### **Significant New Business**

#### ***Insurance Australia Group***

On September 20, 2011, we, through our wholly-owned subsidiary, Gordian Run-off Limited, or Gordian, acquired an inwards reinsurance portfolio from Insurance Australia Group Ltd via an Australian Federal Court approved scheme. Gordian received total assets and assumed total net reinsurance liabilities of approximately \$8.6 million (approximately \$8.8 million Australian dollars).

#### ***Claremont***

On September 1, 2011, we, through our wholly-owned subsidiary, Fitzwilliam, entered into a novation agreement with another of our wholly-owned subsidiaries, Claremont Liability Insurance Company, or Claremont, and certain of its reinsurers with respect to three specific quota share contracts. Under the novation agreement, Fitzwilliam replaced those companies as reinsurer of Claremont on the quota share contracts in exchange for total assets and liabilities of approximately \$22.5 million.

#### ***Shelbourne RITC Transactions***

In December 2007, we, in conjunction with JCF FPK I L.P., or JCF FPK, and a newly-hired executive management team, formed U.K.-based Shelbourne Group Limited, or Shelbourne, to invest in Reinsurance to Close or RITC transactions (the transferring of liabilities from one Lloyd's syndicate to another) with Lloyd's of London insurance and reinsurance syndicates in run-off. We own approximately 56.8% of Shelbourne, which in turn owns 100% of Shelbourne Syndicate Services Limited, the Managing Agency for Lloyd's Syndicate 2008, a syndicate approved by Lloyd's of London on December 16, 2007 to undertake RITC transactions with Lloyd's syndicates in run-off.

JCF FPK is a joint investment program between Fox-Pitt, Kelton, Cochran, Caronia & Waller (USA) LLC, or FPK, and J.C. Flowers II, L.P., or the Flowers Fund. The Flowers Fund is a private investment fund advised by J.C. Flowers & Co. LLC. J. Christopher Flowers, one of our largest shareholders and formerly a member of our board of directors, is the Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC. In addition, an affiliate of the Flowers Fund controlled approximately 41% of FPK until its sale of FPK in December 2009.

In February 2011, Lloyd's Syndicate 2008 entered into RITC agreements with two Lloyd's syndicates with total gross insurance reserves of approximately \$129.6 million. The capital commitment to Lloyd's Syndicate 2008 with respect to these two RITC agreements amounted to £21.3 million (approximately \$34.1 million), which was fully funded from available cash on hand.

**Table of Contents****Results of Operations**

The following table sets forth our selected consolidated statement of operations data for each of the periods indicated.

|  | <b>Three Months Ended<br/>September 30,</b>     |                  | <b>Nine Months Ended<br/>September 30,</b> |                  |
|--|---|------------------|--|------------------|
|  | <b>2011</b>                                     | <b>2010</b>      | <b>2011</b>                                | <b>2010</b>      |
|  | <b>(expressed in thousands of U.S. dollars)</b> |                  |  |                  |
| <b>INCOME</b>  |   |                  |  |                  |
| Consulting fees  | \$ 1,623  | \$ 2,119         | \$ 7,704                                   | \$ 19,747        |
| Net investment income  | 18,966  | 20,165           | 60,436                                     | 69,284           |
| Net realized and unrealized (losses) gains                                     | (8,980)   | 10,635           | (348)                                      | 8,610            |
| Gain on bargain purchase   |   |                  | 13,105                                     |                  |
|  | 11,609  | 32,919           | 80,897                                     | 97,641           |
| <b>EXPENSES</b>  |   |                  |  |                  |
| Net reduction in ultimate loss and loss adjustment expense liabilities:        |   |                  |  |                  |
| Reduction in estimates of net ultimate losses                                  | (42,467)  | (20,890)         | (72,908)                                   | (57,936)         |
| Reduction in provisions for bad debt   | (2,399)   | (1,304)          | (4,071)                                    | (14,411)         |
| Reduction in provisions for unallocated loss adjustment expense liabilities    | (14,113)  | (10,171)         | (37,433)                                   | (30,832)         |
| Amortization of fair value adjustments   | 8,865   | 6,250            | 25,911                                     | 25,102           |
|  | (50,114)  | (26,115)         | (88,501)                                   | (78,077)         |
| Salaries and benefits  | 20,923  | 18,012           | 48,028                                     | 47,456           |
| General and administrative expenses  | 20,759  | 13,185           | 66,720                                     | 39,473           |
| Interest expense   | 2,435   | 2,961            | 6,098                                      | 8,160            |
| Net foreign exchange (gains) losses  | (8,878)   | (586)            | 388  | 1,387            |
|  | (14,875)  | 7,457            | 32,733                                     | 18,399           |
| Earnings before income taxes and share of net earnings of partly owned company | 26,484  | 25,462           | 48,164                                     | 79,242           |
| Income taxes   | (4,436)   | (979)            | (6,028)                                    | (23,016)         |
| Share of net earnings of partly owned company                                  |   | 1,351            |  | 10,704           |
| <b>NET EARNINGS</b>  | <b>22,048</b>                                   | <b>25,834</b>    | <b>42,136</b>                              | <b>66,930</b>    |
| Less: Net earnings attributable to noncontrolling interest                     | (9,984)   | (4,391)          | (17,194)                                   | (17,136)         |
| <b>NET EARNINGS ATTRIBUTABLE TO ENSTAR GROUP LIMITED</b>                       | <b>\$ 12,064</b>                                | <b>\$ 21,443</b> | <b>\$ 24,942</b>                           | <b>\$ 49,794</b> |

**Comparison of the Three Months Ended September 30, 2011 and 2010**

We reported consolidated net earnings, before net earnings attributable to noncontrolling interest, of approximately \$22.0 million and \$25.8 million for the three months ended September 30, 2011 and 2010, respectively. The decrease in earnings of approximately \$3.8 million was attributable primarily to the following:

- (i) net realized and unrealized losses on investments of \$9.0 million for the three months ended September 30, 2011 as compared to gains of \$10.6 million for the three months ended September 30, 2010;

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- (ii) an increase of \$7.6 million in general and administrative expenses due primarily to increased professional fees, arrangement and agency fees related to the Clarendon Facility and additional expenses arising out of new acquisitions;
  
- (iii) an increase of \$3.5 million in income tax expense due in large part to higher net earnings within our taxable subsidiaries;

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- (iv) an increase of \$2.9 million in salary and benefit costs due primarily to increased staff; and
- (v) a decrease of \$1.4 million in income earned from our investment in our partly owned company; partially offset by
- (vi) an increase of \$24.0 million in net reduction in ultimate loss and loss adjustment expense liabilities; and
- (vii) an increase of \$8.3 million in net foreign exchange gains.

We recorded noncontrolling interest in earnings of \$10.0 million and \$4.4 million for the three months ended September 30, 2011 and 2010, respectively. Net earnings attributable to Enstar Group Limited decreased from \$21.4 million for the three months ended September 30, 2010 to \$12.1 million for the three months ended September 30, 2011.

We no longer report our results of operations by segments. We previously reported our results of operations under the consulting and reinsurance business segments, but we believe the consulting business no longer meets the criteria of an operating segment, as more fully described in Note 15 to our unaudited condensed consolidated financial statements.

*Consulting Fees:*

|                                | Three Months Ended September 30, |          |          |
|--------------------------------|----------------------------------|----------|----------|
|                                | 2011                             | 2010     | Variance |
| (in thousands of U.S. dollars) |                                  |          |          |
| <b>Total</b>                   | \$ 1,623                         | \$ 2,119 | \$ (496) |

We earned consulting fees of approximately \$1.6 million and \$2.1 million for the three months ended September 30, 2011 and 2010, respectively. The decrease in consulting fees of \$0.5 million related primarily to the decrease in management fees earned from third-party agreements. Consulting fee income as a percentage of net earnings has declined in recent periods, and we would expect it to remain at or around current levels in future periods, excluding the impact of any one time incentive based fees that we might receive. While we intend to continue to provide management and consultancy services, claims inspection services and reinsurance collection services to third-party clients in limited circumstances, our core focus continues to be acquiring and managing insurance and reinsurance companies and portfolios of business in run-off.

*Net Investment Income and Net Realized and Unrealized (Losses) Gains:*

|                                | Three Months Ended September 30, |           |            |                             |           |             |
|--------------------------------|----------------------------------|-----------|------------|-----------------------------|-----------|-------------|
|                                | Net Investment Income            |           |            | Net Realized and Unrealized |           |             |
|                                | 2011                             | 2010      | Variance   | (Losses) Gains              |           |             |
| (in thousands of U.S. dollars) |                                  |           |            |                             |           |             |
| <b>Total</b>                   | \$ 18,966                        | \$ 20,165 | \$ (1,199) | \$ (8,980)                  | \$ 10,635 | \$ (19,615) |

Net investment income for the three months ended September 30, 2011 decreased by \$1.2 million to \$19.0 million, as compared to \$20.2 million for the same period in 2010. The decrease was attributable primarily to a reduction in income from fixed maturities and cash and cash equivalents due primarily to lower overall yields for the three months ended September 30, 2011 as compared to the same period for 2010, partially offset by the additional Clarendon cash and investments of \$834.6 million acquired on July 12, 2011.

The average annualized return on our investments for the three months ended September 30, 2011 was 0.64%, as compared to the average annualized return of 2.32% for the three months ended September 30, 2010. The average credit rating of our fixed maturity investments at September 30, 2011 was AA-. During the three months ended September 30, 2011, the rating agency Standard & Poors downgraded the U.S. sovereign debt from AAA to AA+. This, combined with the assets we acquired upon completion of the acquisition of Clarendon, which had a

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lower proportion of investments with AAA credit ratings, has resulted in us having a lower percentage of AAA rated investments than we had as at June 30, 2011. See Note 5 to our unaudited condensed consolidated financial statements for more information regarding the credit ratings of our investments.

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Net realized and unrealized (losses) gains for the three months ended September 30, 2011 and 2010 were (\$9.0) million and \$10.6 million, respectively. The net realized and unrealized (losses) gains relate predominantly to mark-to-market changes in the market value of our equity investments and fixed maturity trading securities.

**Fair Value Measurements**

In accordance with the provisions of the Fair Value Measurements and Disclosures topic of the U.S. Financial Accounting Standards Board (FASB) Codification, we have categorized our investments that are recorded at fair value among levels as follows:

|                             | September 30, 2011   |   |   | Total Fair Value |
|-----------------------------|--|---|---|------------------|
|                             | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |                  |
|                             | (in thousands of U.S. dollars)                                 |   |   |                  |
| U.S. government and agency  | \$   | \$ 446,063                                    | \$  | \$ 446,063       |
| Non-U.S. government         |  | 362,229                                       |   | 362,229          |
| Corporate                   |  | 1,924,238                                     | 501                                       | 1,924,739        |
| Municipal                   |  | 31,528  |   | 31,528           |
| Residential mortgage-backed |  | 123,955                                       |   | 123,955          |
| Commercial mortgage-backed  |  | 70,576  | 9   | 70,585           |
| Asset backed                |  | 55,808  |   | 55,808           |
| Equities                    | 73,029   | 4,806   | 3,700                                     | 81,535           |
| Other investments           |  | 50,926  | 149,473                                   | 200,399          |
| Total investments           | \$ 73,029  | \$ 3,070,129                                  | \$ 153,683                                | \$ 3,296,841     |

**Net Reduction in Ultimate Loss and Loss Adjustment Expense Liabilities:**

The following table shows the components of the movement in the net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2011 and 2010:

|   | Three Months Ended September 30, |             |
|---|----------------------------------|-------------|
|   | 2011                             | 2010        |
|   | (in thousands of U.S. dollars)   |             |
| Net losses paid   | \$ (73,941)                      | \$ (80,501) |
| Net reduction in case and loss adjustment expense reserves                  | 99,447                           | 101,542     |
| Net reduction in incurred but not reported reserves                         | 16,961                           | (151)       |
| Reduction in estimates of net ultimate losses                               | 42,467                           | 20,890      |
| Reduction in provisions for bad debt  | 2,399                            | 1,304       |
| Reduction in provisions for unallocated loss adjustment expense liabilities | 14,113                           | 10,171      |
| Amortization of fair value adjustments                                      | (8,865)                          | (6,250)     |
| Net reduction in ultimate loss and loss adjustment expense liabilities      | \$ 50,114                        | \$ 26,115   |

Net reduction in case and loss adjustment expense reserves, or LAE reserves, comprises the movement during the quarter in specific case reserve liabilities as a result of claims settlements or changes advised to us by our policyholders and attorneys, less changes in case reserves recoverable advised by us to our reinsurers as a result of the settlement or movement of assumed claims. Net reduction in incurred but not reported, or IBNR, reserves represents the change in our actuarial estimates of losses incurred but not reported.

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The net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2011 of \$50.1 million was attributable to a reduction in estimates of net ultimate losses of

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\$42.5 million, a reduction in provisions for bad debt of \$2.4 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$14.1 million, relating to 2011 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$8.9 million.

The reduction in estimates of net ultimate losses of \$42.5 million, comprised of net favorable incurred loss development of \$25.5 million and reductions in IBNR reserves of \$17.0 million, related primarily to:

- (i) the conclusion of our review of historic case reserves for eleven of our insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 7,400 advised case reserves with an aggregate value of \$30.5 million; and
- (ii) an aggregate reduction in IBNR reserves of \$10.7 million as a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to revised historical loss development data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses relating to non-commuted exposures in eleven of our insurance and reinsurance subsidiaries. The prior period estimate of aggregate net IBNR liabilities for these subsidiaries was reduced as a result of the combined impact on all classes of business of loss development activity during 2011, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. We in conjunction with our independent actuaries completed an actuarial review of the loss reserves for eleven of our most seasoned insurance and reinsurance subsidiaries as at September 30, 2011.

The reduction in provisions for bad debt of \$2.4 million resulted from the collection of receivables against which bad debt provisions had been provided for in earlier periods.

The net reduction in ultimate loss and loss adjustment expense liabilities for the three months ended September 30, 2010 of \$26.1 million was attributable to a reduction in estimates of net ultimate losses of \$20.9 million, a reduction in provisions for bad debt of \$1.3 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$10.2 million, relating to 2010 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$6.3 million.

The reduction in estimates of net ultimate losses of \$20.9 million for the three months ended September 30, 2010 comprised net favorable incurred loss development of \$21.1 million and a modest increase in IBNR reserves of \$0.2 million, primarily related to the following:

- (i) a reduction in estimates of net ultimate losses of \$10.8 million in one of our insurance entities following the commutations and policy buy-backs of five of our largest insurance and reinsurance exposures; and
- (ii) the conclusion of our review of historic case reserves for two of our insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 1,750 advised case reserves with an aggregate value of \$11.8 million.

The reduction in provisions for bad debt of \$1.3 million resulted from the collection of receivables against which bad debt provisions had been provided in earlier periods.



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The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the three months ended September 30, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Three Months Ended<br/>September 30,</b> |              |
|--|---|--------------|
|  | <b>2011</b>                                 | <b>2010</b>  |
|  | <b>(in thousands of U.S. dollars)</b>       |              |
| Balance as at July 1   | \$ 3,267,341                                | \$ 2,894,353 |
| Less: total reinsurance reserves recoverable                           | 556,374                                     | 421,864      |
|  | 2,710,967                                   | 2,472,489    |
| Effect of exchange rate movement                                       | (39,038)                                    | 80,839       |
| Net reduction in ultimate loss and loss adjustment expense liabilities | (50,114)                                    | (26,115)     |
| Net losses paid  | (73,941)                                    | (80,501)     |
| Acquired on purchase of subsidiaries                                   | 600,045                                     | 198,498      |
| Retroactive reinsurance contracts assumed                              | 40,660                                      | 100,136      |
| Net balance as at September 30   | 3,188,579                                   | 2,745,346    |
| Plus: total reinsurance reserves recoverable                           | 1,551,262                                   | 488,353      |
| Balance as at September 30   | \$ 4,739,841                                | \$ 3,233,699 |

*Salaries and Benefits:*

|       | <b>Three Months Ended September 30,</b> |             |                 |
|-------|---|-------------|-----------------|
|       | <b>2011</b>                             | <b>2010</b> | <b>Variance</b> |
|       | <b>(in thousands of U.S. dollars)</b>   |             |                 |
| Total | \$ 20,923                               | \$ 18,012   | \$ (2,911)      |

Salaries and benefits, which include expenses relating to our discretionary bonus and employee share plans, were \$20.9 million and \$18.0 million for the three months ended September 30, 2011 and 2010, respectively. The increase in salaries and benefits was attributable primarily to:

- (i) increased staff costs due primarily to an increase in average staff numbers from 323 for the three months ended September 30, 2010 to 390 for the three months ended September 30, 2011; and
- (ii) increased U.S. dollar costs of our U.K.-based staff following an increase in the average British pound exchange rate from approximately 1.5512 for the three months ended September 30, 2010 to 1.6096 for the three months ended September 30, 2011. Of our total headcount as at September 30, 2011 and 2010, approximately 54% and 65%, respectively, had their salaries paid in British pounds. These increases were partially offset by
- (iii) a decrease in the discretionary bonus expense, for the three months ended September 30, 2011, as a result of lower earnings. Expenses relating to our discretionary bonus plan will be variable and are dependent on our overall profitability.

*General and Administrative Expenses:*

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|       | Three Months Ended September 30, |           |            |
|-------|----------------------------------|-----------|------------|
|       | 2011                             | 2010      | Variance   |
|       | (in thousands of U.S. dollars)   |           |            |
| Total | \$ 20,759                        | \$ 13,185 | \$ (7,574) |

General and administrative expenses increased by \$7.6 million during the three months ended September 30, 2011, as compared to the three months ended September 30, 2010. The increase was due principally to:

(i) increased bank costs of \$2.6 million mainly associated with the arrangement and agency fees paid in relation to the establishment of the Clarendon Facility;

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- (ii) additional general and administrative costs of \$3.2 million related to acquisitions completed subsequent to September 30, 2010; and
- (iii) increased professional fees of approximately \$1.3 million due to costs associated with ongoing and completed due diligence projects.

*Interest Expense:*

|              | 00000                            | 00000    | 00000    |
|--------------|----------------------------------|----------|----------|
|              | Three Months Ended September 30, |          |          |
|              | 2011                             | 2010     | Variance |
|              | (in thousands of U.S. dollars)   |          |          |
| <b>Total</b> | \$ 2,435                         | \$ 2,961 | \$ 526   |

Interest expense of \$2.4 million and \$3.0 million was recorded for the three months ended September 30, 2011 and 2010, respectively. The decrease in interest expense was attributable predominantly to the lower interest rates on the loan facilities outstanding during the three months ended September 30, 2011 as compared to the same period in 2010.

*Net Foreign Exchange Gains:*

|              | 00000                            | 00000  | 00000    |
|--------------|----------------------------------|--------|----------|
|              | Three Months Ended September 30, |        |          |
|              | 2011                             | 2010   | Variance |
|              | (in thousands of U.S. dollars)   |        |          |
| <b>Total</b> | \$ 8,878                         | \$ 586 | \$ 8,292 |

We recorded net foreign exchange gains of \$8.9 million and \$0.6 million for the three months ended September 30, 2011 and 2010, respectively. The net foreign exchange gains for the three months ended September 30, 2011 arose primarily as a result of the holding of surplus U.S. dollar assets in one of our subsidiaries whose functional currency is Australian dollars at a time when the U.S. dollar was appreciating against the Australian dollar and the foreign exchange gains of \$3.0 million realized on an Australian dollar forward exchange contract, which we entered into on August 23, 2011 and closed out on September 22, 2011.

The net foreign exchange gains for the three months ended September 30, 2010 arose primarily as a result of the holding of surplus U.S. dollar assets in one of our subsidiaries whose functional currency is Australian dollars at a time when the U.S. dollar was appreciating against the Australian dollar, partially offset by foreign exchange losses arising as a result of our holding surplus British pounds at a time when the British pound was depreciating against the U.S. dollar.

In addition to the net foreign exchange gains recorded in our consolidated statement of earnings for the three months ended September 30, 2011, we recorded in our condensed consolidated statement of comprehensive income currency translation adjustment losses, net of noncontrolling interest, of \$18.7 million as compared to gains, net of noncontrolling interest, of \$25.8 million for the same period in 2010. For the three months ended September 30, 2011 and 2010, the currency translation adjustments related primarily to our Australian based subsidiaries. As the functional currency of these subsidiaries is Australian dollars, we are required to record any U.S. dollar gains or losses on the translation of their net Australian dollar assets of approximately \$148.9 million at September 30, 2011 through accumulated other comprehensive income.

*Income Tax Expense:*

|              | 00000                            | 00000  | 00000      |
|--------------|----------------------------------|--------|------------|
|              | Three Months Ended September 30, |        |            |
|              | 2011                             | 2010   | Variance   |
|              | (in thousands of U.S. dollars)   |        |            |
| <b>Total</b> | \$ 4,436                         | \$ 979 | \$ (3,457) |

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We recorded income tax expense of \$4.4 million and \$1.0 million for the three months ended September 30, 2011 and 2010, respectively. The increase in taxes for the three months ended September 30, 2011 was due predominantly to higher overall net earnings in our tax paying subsidiaries as compared to those earned in the same period in 2010.

**Table of Contents***Share of Net Earnings of Partly Owned Company:*

|              | <b>Three Months Ended September 30,</b> |                 |                   |
|--------------|---|-----------------|-------------------|
|              | <b>2011</b>                             | <b>2010</b>     | <b>Variance</b>   |
|              | <b>(in thousands of U.S. dollars)</b>   |                 |                   |
| <b>Total</b> | <b>\$</b>                               | <b>\$ 1,351</b> | <b>\$ (1,351)</b> |

For the three months ended September 30, 2011, we recorded \$nil as our share of net earnings of partly owned company as compared to \$1.4 million for the three months ended September 30, 2010. The decrease was attributable to the fact that we no longer have an investment in a partly owned company; during 2010, we disposed of our 44.4% indirect interest in Stonewall Insurance Company and we acquired a 100% interest in Seaton Insurance Company.

*Noncontrolling Interest:*

|              | <b>Three Months Ended September 30,</b> |                 |                 |
|--------------|---|-----------------|-----------------|
|              | <b>2011</b>                             | <b>2010</b>     | <b>Variance</b> |
|              | <b>(in thousands of U.S. dollars)</b>   |                 |                 |
| <b>Total</b> | <b>\$ 9,984</b>                         | <b>\$ 4,391</b> | <b>\$ 5,593</b> |

We recorded a noncontrolling interest in earnings of \$10.0 million and \$4.4 million for the three months ended September 30, 2011 and 2010, respectively. The increase for the three months ended September 30, 2011 in noncontrolling interest was due primarily to an increase in earnings for those companies where there exists a noncontrolling interest.

**Comparison of the Nine Months Ended September 30, 2011 and 2010**

We reported consolidated net earnings, before net earnings attributable to noncontrolling interest, of approximately \$42.1 million and \$66.9 million for the nine months ended September 30, 2011 and 2010, respectively. The decrease in earnings of approximately \$24.8 million was attributable primarily to the following:

- (i) an increase of \$27.2 million in general and administrative expenses due primarily to an increase in professional fees, legal fees and settlement costs related to certain litigation, arrangement and agency fees associated with our loan facilities and additional expenses arising out of new acquisitions;
- (ii) a decrease of \$12.0 million in consulting fees mainly related to lower fees earned from incentive based engagements;
- (iii) a decrease of \$10.7 million in income earned from our investment in our partly owned company;
- (iv) net realized and unrealized losses on investments of \$0.3 million for the nine months ended September 30, 2011 as compared to gains of \$8.6 million for the nine months ended September 30, 2010; and
- (v) a decrease of \$8.8 million in net investment income; partially offset by
- (vi) a decrease of \$17.0 million in income tax expense due in large part to lower net earnings within our taxable subsidiaries;

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- (vii) the gain on bargain purchase of \$13.1 million in 2011, which arose in relation to our acquisition of Laguna;
- (viii) an increase of \$10.4 million in the net reduction in ultimate loss and loss adjustment expense liabilities; and
- (ix) a decrease of \$2.1 million in interest expense.

We recorded noncontrolling interest in earnings of \$17.2 million and \$17.1 million for the nine months ended September 30, 2011 and 2010, respectively. Net earnings attributable to Enstar Group Limited decreased from \$49.8 million for the nine months ended September 30, 2010 to \$24.9 million for the nine months ended September 30, 2011.

**Table of Contents***Consulting Fees:*

|              | Nine Months Ended September 30, |           |             |
|--------------|---------------------------------|-----------|-------------|
|              | 2011                            | 2010      | Variance    |
|              | (in thousands of U.S. dollars)  |           |             |
| <b>Total</b> | \$ 7,704                        | \$ 19,747 | \$ (12,043) |

We earned consulting fees of approximately \$7.7 million and \$19.7 million for the nine months ended September 30, 2011 and 2010, respectively. The decrease in consulting fees of \$12.0 million related primarily to the decrease in incentive fees earned from third-party agreements. Consulting fee income as a percentage of net earnings has declined in recent periods, and we would expect it to remain at or around current levels in future periods, excluding the impact of any one time incentive based fees that we might receive. While we intend to continue to provide management and consultancy services, claims inspection services and reinsurance collection services to third-party clients in limited circumstances, our core focus continues to be acquiring and managing insurance and reinsurance companies and portfolios of business in run-off.

*Net Investment Income and Net Realized and Unrealized (Losses) Gains:*

|              | Nine Months Ended September 30, |           |            |   |          |            |
|--------------|---------------------------------|-----------|------------|---|----------|------------|
|              | Net Investment Income           |           |            | Net Realized and Unrealized<br>(Losses) Gains |          |            |
|              | 2011                            | 2010      | Variance   | 2011  | 2010     | Variance   |
|              | (in thousands of U.S. dollars)  |           |            |   |          |            |
| <b>Total</b> | \$ 60,436                       | \$ 69,284 | \$ (8,848) | \$ (348)                                      | \$ 8,610 | \$ (8,958) |

Net investment income for the nine months ended September 30, 2011 decreased by \$8.9 million to \$60.4 million, as compared to \$69.3 million for the same period in 2010. The decrease related primarily to:

- (i) a reduction of approximately \$3.6 million in investment income attributable to our private equity and bond portfolios classified as other investments; and
- (ii) a reduction of approximately \$5.3 million in investment income attributable to lower yields for the nine months ended September 30, 2011 as compared to the same period in 2010.

The average annualized return on our cash and fixed maturities for the nine months ended September 30, 2011 was 1.52%, as compared to the average annualized return of 1.98% for the nine months ended September 30, 2010. The average credit rating of our fixed maturity investments at September 30, 2011 was AA-. During the three months ended September 30, 2011, the rating agency Standard & Poors, downgraded the U.S. sovereign debt from AAA to AA+. This, combined with the assets we acquired upon completion of the acquisition of Clarendon, which had a lower proportion of investments with AAA credit ratings, has resulted in us having a lower percentage of AAA rated investments than we had as at December 31, 2010. See Note 5 to our unaudited condensed consolidated financial statements for more information regarding the credit ratings of our investments.

Net realized and unrealized (losses) gains for the nine months ended September 30, 2011 and 2010 were (\$0.3) million and \$8.6 million, respectively. The net realized and unrealized (losses) gains relate predominantly to mark-to-market changes in the market value of our equity investments and fixed maturity trading securities.

*Gain on Bargain Purchase:*

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|       | Nine Months Ended September 30, |      |           |
|-------|---------------------------------|------|-----------|
|       | 2011                            | 2010 | Variance  |
|       | (in thousands of U.S. dollars)  |      |           |
| Total | \$ 13,105                       | \$   | \$ 13,105 |

Gain on bargain purchase of \$13.1 million and \$nil was recorded for the nine months ended September 30, 2011 and 2010, respectively. The gain on bargain purchase was earned in connection with our acquisition of Laguna and represents the excess of the cumulative fair value of net assets acquired of \$34.3 million over the



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cost of \$21.2 million. This excess has, in accordance with the provisions of the Business Combinations topic of the FASB Codification, been recognized as income for the nine months ended September 30, 2011. The gain on bargain purchase arose mainly as a result of our reassessment, upon acquisition, of the total required estimated costs to manage the business to expiry. Our assessment of costs was lower than the acquired costs recorded by the vendor in the financial statements of Laguna.

*Net Reduction in Ultimate Loss and Loss Adjustment Expense Liabilities:*

The following table shows the components of the movement in the net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2011 and 2010:

|   | Nine Months Ended<br>September 30, |              |
|---|------------------------------------|--------------|
|   | 2011                               | 2010         |
|   | (in thousands of U.S. dollars)     |              |
| Net losses paid   | \$ (227,280)                       | \$ (211,589) |
| Net reduction in case and LAE reserves                                      | 247,951                            | 234,114      |
| Net reduction in IBNR reserves  | 52,237                             | 35,411       |
| Reduction in estimates of net ultimate losses                               | 72,908                             | 57,936       |
| Reduction in provisions for bad debt  | 4,071                              | 14,411       |
| Reduction in provisions for unallocated loss adjustment expense liabilities | 37,433                             | 30,832       |
| Amortization of fair value adjustments                                      | (25,911)                           | (25,102)     |
| Net reduction in ultimate loss and loss adjustment expense liabilities      | \$ 88,501                          | \$ 78,077    |

The net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2011 of \$88.5 million was attributable to a reduction in estimates of net ultimate losses of \$72.9 million, a reduction in provisions for bad debt of \$4.1 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$37.4 million, relating to 2011 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$25.9 million.

The reduction in estimates of net ultimate losses of \$72.9 million for the nine months ended September 30, 2011, comprised net favorable incurred loss development of \$20.7 million and reductions in IBNR reserves of \$52.2 million, related primarily to

- (i) the conclusion of our review of historic case reserves for eleven of our insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years. This review confirmed the redundancy of approximately 7,400 advised case reserves with an aggregate value of \$30.5 million; and
- (ii) an aggregate reduction in IBNR reserves of \$38.7 million as a result of the completion of two commutations of our largest ten exposures and the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to revised historical loss development data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses relating to non-commuted exposures in eleven of our insurance and reinsurance subsidiaries. The prior period estimate of aggregate net IBNR liabilities for these subsidiaries was reduced as a result of the combined impact on all classes of business of loss development activity during 2011, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. We in conjunction with our independent actuaries completed an actuarial review of the loss reserves for eleven of our most seasoned insurance and reinsurance subsidiaries as at September 30, 2011.

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The reduction in provisions for bad debt of \$4.1 million resulted from the collection of receivables against which bad debt provisions had been provided for in earlier periods.

The net reduction in ultimate loss and loss adjustment expense liabilities for the nine months ended September 30, 2010 of \$78.1 million was attributable to a reduction in estimates of net ultimate losses of \$57.9 million, a reduction in provisions for bad debt of \$14.4 million and a reduction in provisions for unallocated loss adjustment expense liabilities of \$30.8 million, relating to 2010 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$25.1 million.

The reduction in estimates of net ultimate losses of \$57.9 million for the nine months ended September 30, 2010 comprised net favorable incurred loss development of \$22.5 million along with reductions in IBNR reserves of \$35.4 million. The net favorable incurred loss development of \$22.5 million, whereby net advised case and LAE reserves of \$234.1 million were settled for net losses paid of \$211.6 million, related to the settlement of non-commuted and commuted losses during the nine months ended September 30, 2010 including commutations and policy buy-backs of seven of the largest insured and/or reinsured exposures in three of our insurance and reinsurance subsidiaries. These commutations and policy buy-backs were primarily responsible for the reduction in IBNR reserves of \$35.4 million following the application of our reserving methodologies in determining the IBNR reserves related to the commuted exposures. The settlement of advised case and LAE reserves of \$234.1 million included the redundancy of approximately 1,750 advised case reserves with an aggregate value of \$11.8 million, which resulted from our review of historic case reserves for two of our insurance and reinsurance subsidiaries for which no updated advices had been received for a number of years.

The reduction in provisions for bad debt of \$14.4 million resulted from the collection of receivables against which bad debt provisions had been provided in earlier periods.

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the nine months ended September 30, 2011 and 2010. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|--|--------------|
|  | <b>2011</b>                                | <b>2010</b>  |
|  | <b>(in thousands of U.S. dollars)</b>      |              |
| Balance as at January 1  | \$ 3,291,275                               | \$ 2,479,136 |
| Less: total reinsurance reserves recoverable                           | 525,440                                    | 347,728      |
|  | 2,765,835                                  | 2,131,408    |
| Effect of exchange rate movement                                       | (5,686)                                    | 18,410       |
| Net reduction in ultimate loss and loss adjustment expense liabilities | (88,501)                                   | (78,077)     |
| Net losses paid  | (227,280)                                  | (211,589)    |
| Acquired on purchase of subsidiaries                                   | 610,484                                    | 420,540      |
| Retroactive reinsurance contracts assumed                              | 133,727                                    | 464,654      |
| Net balance as at September 30   | 3,188,579                                  | 2,745,346    |
| Plus: total reinsurance reserves recoverable                           | 1,551,262                                  | 488,353      |
| Balance as at September 30   | \$ 4,739,841                               | \$ 3,233,699 |

*Salaries and Benefits:*

|       | <b>Nine Months Ended September 30,</b> |             |                 |
|-------|--|-------------|-----------------|
|       | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|       | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| Total | \$ 48,028                              | \$ 47,456   | \$ (572)        |

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Salaries and benefits, which include expenses relating to our discretionary bonus and employee share plans, were \$48.0 million and \$47.5 million for the nine months ended September 30, 2011 and 2010, respectively.

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The principal changes in salaries and benefits were:

- (i) increased staff costs due to an increase in the average staff numbers from 309 for the nine months ended September 30, 2010 to 360 for the nine months ended September 30, 2011; and
- (ii) increased U.S. dollar costs of our U.K.-based staff following an increase in the average British pound exchange rate from approximately 1.5350 for the nine months ended September 30, 2010 to 1.6146 for the nine months ended September 30, 2011. Of our total headcount as at September 30, 2011 and 2010, approximately 54% and 65%, respectively, had their salaries paid in British pounds. These increases were partially offset by
- (iii) the reduction in the discretionary bonus accrual of \$9.5 million due to the release back to earnings in 2011 of approximately \$4.0 million relating to the unallocated portion of the 2010 year end bonus accrual provision and the reduction in net earnings for the nine months ended September 30, 2011 as compared to 2010. Expenses relating to our discretionary bonus plan will be variable and are dependent on our overall profitability.

*General and Administrative Expenses:*

|              | <b>Nine Months Ended September 30,</b> |             |                 |
|--------------|--|-------------|-----------------|
|              | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|              | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| <b>Total</b> | \$ 66,720                              | \$ 39,473   | \$ (27,247)     |

General and administrative expenses increased by \$27.2 million during the nine months ended September 30, 2011, as compared to the nine months ended September 30, 2010. The increase was due principally to:

- (i) increased bank costs of \$7.2 million primarily associated with the costs of establishing and maintaining our letters of credit, along with the arrangement and agency fees paid in relation to the establishment of both our Clarendon Facility and EGL Revolving Credit Facility;
- (ii) additional general and administrative expenses of \$6.0 million incurred in relation to both new acquisitions and significant new business that we completed subsequent to September 30, 2010;
- (iii) increased legal expenses of approximately \$8.5 million due primarily to legal fees and settlement costs associated with certain litigation, along with legal fees associated with ongoing due diligence projects; and
- (iv) an increase in actuarial consulting fees of approximately \$2.0 million due to costs associated with ongoing and completed due diligence projects.

*Interest Expense:*

|  | <b>Nine Months Ended September 30,</b> |             |                 |
|--|--|-------------|-----------------|
|  | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|  | <b>(in thousands of U.S. dollars)</b>  |             |                 |

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|       |          |          |          |
|-------|----------|----------|----------|
| Total | \$ 6,098 | \$ 8,160 | \$ 2,062 |
|-------|----------|----------|----------|

Interest expense of \$6.1 million and \$8.2 million was recorded for the nine months ended September 30, 2011 and 2010, respectively. The decrease in interest expense was attributable predominantly to the lower interest rates on the loan facilities outstanding during the nine months ended September 30, 2011 as compared to the same period in 2010.

*Net Foreign Exchange Losses:*

|       | <b>Nine Months Ended September 30,</b> |             |                 |
|-------|--|-------------|-----------------|
|       | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|       | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| Total | \$ 388                                 | \$ 1,387    | \$ 999          |

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We recorded net foreign exchange losses of \$0.4 million and \$1.4 million for the nine months ended September 30, 2011 and 2010, respectively.

In addition to the net foreign exchange losses recorded in our consolidated statement of earnings for the nine months ended September 30, 2011, we recorded in our condensed consolidated statement of comprehensive income currency translation adjustment losses, net of noncontrolling interest, of \$9.5 million as compared to gains, net of noncontrolling interest, of \$13.8 million for the same period in 2010. For the nine months ended September 30, 2011 and 2010, the currency translation adjustments related primarily to our Australian based subsidiaries. As the functional currency of these subsidiaries is Australian dollars, we are required to record any U.S. dollar gains or losses on the translation of their net Australian dollar assets of approximately \$148.9 million as at September 30, 2011 through accumulated other comprehensive income.

*Income Tax Expense:*

|              | <b>Nine Months Ended September 30,</b> |             |                 |
|--------------|--|-------------|-----------------|
|              | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|              | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| <b>Total</b> | \$ 6,028                               | \$ 23,016   | \$ 16,988       |

We recorded income tax expense of \$6.0 million and \$23.0 million for the nine months ended September 30, 2011 and 2010, respectively. The decrease in taxes for the nine months ended September 30, 2011 was due predominantly to lower overall net earnings in our tax paying subsidiaries as compared to those earned in the same period in 2010.

*Share of Net Earnings of Partly Owned Company:*

|              | <b>Nine Months Ended September 30,</b> |             |                 |
|--------------|--|-------------|-----------------|
|              | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|              | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| <b>Total</b> | \$                                     | \$ 10,704   | \$ (10,704)     |

For the nine months ended September 30, 2011, we recorded \$nil as our share of net earnings of partly owned company as compared to \$10.7 million for the nine months ended September 30, 2010. The decrease was attributable to the fact that we no longer have an investment in a partly owned company; during 2010, we disposed of our 44.4% indirect interest in Stonewall Insurance Company and we acquired a 100% interest in Seaton Insurance Company.

*Noncontrolling Interest:*

|              | <b>Nine Months Ended September 30,</b> |             |                 |
|--------------|--|-------------|-----------------|
|              | <b>2011</b>                            | <b>2010</b> | <b>Variance</b> |
|              | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| <b>Total</b> | \$ 17,194                              | \$ 17,136   | \$ (58)         |

We recorded a noncontrolling interest in earnings of \$17.2 million and \$17.1 million for the nine months ended September 30, 2011 and 2010, respectively. The increase for the nine months ended September 30, 2011 in noncontrolling interest was due primarily to a decrease in earnings for those companies where there exists a noncontrolling interest.

**Liquidity and Capital Resources***Long-term Debt*

On June 13, 2011, we, as borrower, and certain of our subsidiaries, as guarantors, entered into a Revolving Credit Facility Agreement, or the EGL Credit Agreement, with NAB and Barclays Corporate, the corporate banking division of Barclays Bank PLC, as bookrunners and mandated

lead arrangers, certain financial

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institutions, as lenders, and NAB as agent. The EGL Credit Agreement provides for a three-year revolving credit facility, or the EGL Revolving Credit Facility, pursuant to which we are permitted to borrow up to an aggregate of \$250.0 million, which will be available to prepay certain existing credit facilities of ours and certain of our subsidiaries, to fund permitted acquisitions and for general corporate purposes. Our ability to draw on the EGL Revolving Credit Facility is subject to customary conditions.

On June 30, 2011, we borrowed \$167.7 million under the EGL Revolving Credit Facility, which was used to prepay \$167.7 million representing the total amounts owing by us under the Knapton, Unionamerica and Enstar Group facilities. The prepayment of these existing credit facilities was a condition to our initial borrowing under the EGL Revolving Credit Facility. As of September 30, 2011, the outstanding EGL Revolving Credit Facility loan balance was \$169.0 million.

The EGL Revolving Credit Facility is secured by a first priority lien on the stock of certain of our subsidiaries and certain bank accounts held with Barclays Bank PLC in our name and into which amounts received in respect of any capital release from certain of our subsidiaries are required to be paid. Interest is payable at the end of each interest period chosen by us or, at the latest, each six months. The interest rate is LIBOR plus 2.75%, plus an incremental amount tied to certain regulatory costs that may be incurred by the lenders, if any. The unused portion of the EGL Revolving Credit Facility will be subject to a commitment fee of 1.10%. The EGL Revolving Credit Facility is subject to various financial and business covenants applicable to us, the guarantors and certain other material subsidiaries, including limitations on mergers and consolidations, acquisitions, indebtedness and guarantees, restrictions as to dispositions of stock and dividends, and limitations on liens on stock. As of September 30, 2011, all of the covenants relating to the EGL Revolving Credit Facility were met.

During the existence of any payment default, the interest rate is increased by 1.0%. During the existence of any event of default as specified in the EGL Credit Agreement, the agent may cancel the commitments of the lenders, declare all or a portion of outstanding amounts immediately due and payable, declare all or a portion of outstanding amounts payable upon demand or proceed against the security. The EGL Credit Agreement terminates and all amounts borrowed must be repaid on June 13, 2014, the third anniversary of the date of the EGL Credit Agreement.

On October 21, 2011, we repaid \$25.0 million of the outstanding principal balance of the EGL Revolving Credit Facility, reducing the remaining outstanding loan balance, inclusive of accrued interest, to \$144.0 million.

*Clarendon*

On March 4, 2011, we, through Clarendon Holdings, Inc., entered into a \$106.5 million term facility agreement, or the Clarendon Facility, with NAB. The Clarendon Facility provides for a four-year term loan facility available to be drawn to fund up to 50% of the purchase price of Clarendon. On July 12, 2011, we fully drew down the Clarendon Facility in connection with the acquisition of Clarendon. As of September 30, 2011, the outstanding Clarendon Facility balance was \$107.3 million.

The Clarendon Facility is secured by a security interest in all of the assets of Clarendon Holdings, Inc., as well as a first priority lien on the stock of both Clarendon Holdings, Inc. and Clarendon. Interest is payable at the end of each interest period chosen by Clarendon Holdings, Inc. or, at the latest, each six months. The interest rate is LIBOR plus 2.75%. The Clarendon Facility is subject to various financial and business covenants, including limitations on mergers and consolidations, restrictions as to disposition of stock and limitations on liens on the stock.

During the existence of any payment default, the interest rate is increased by 1.0%. During the existence of any event of default as specified in the term facility agreement, the lenders may declare all or a portion of outstanding amounts immediately due and payable, declare all or a portion of borrowed amounts payable upon demand, or proceed against the security. The Clarendon Facility terminates and all amounts borrowed must be repaid on July 12, 2015.



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*Private Placement*

On April 20, 2011, we entered into an Investment Agreement, or the Investment Agreement, with GSCP VI AIV Navi, Ltd., GSCP VI Offshore Navi, Ltd., GSCP VI Parallel AIV Navi, Ltd., GSCP VI Employee Navi, Ltd., and GSCP VI GmbH Navi, L.P., or, collectively, the Purchasers, each of which is an affiliate of Goldman, Sachs & Co. Under the Investment Agreement, we agreed to issue and sell, and the Purchasers agreed to purchase, at several different closings described below, securities representing 19.9% of our outstanding share capital pro forma for all the issuances, with the right to acquire an additional 2.0% on a fully diluted basis pro forma for all the issuances through the exercise of warrants as described below, although the Purchasers' voting interest in us purchased pursuant to the Investment Agreement will be less than 4.9%. The securities that the Purchasers have acquired or, subject to certain conditions, will be acquiring at these closings can be further summarized as follows:

At the first closing, which occurred on April 20, 2011, we issued to the Purchasers 531,345 of our voting ordinary shares, par value \$1.00 per share, or the Voting Common Shares, and 749,869 of our Series A convertible non-voting preference shares, par value \$1.00 per share, or the Non-Voting Preferred Shares, at a purchase price of \$86.00 per share, and warrants to acquire 340,820 Non-Voting Preferred Shares for an exercise price of \$115.00 per share, for aggregate proceeds of approximately \$110.2 million. Upon the receipt of shareholder approval to create three new classes of non-voting ordinary shares at our Annual General Meeting on June 28, 2011, or the Shareholder Approval, the Non-Voting Preferred Shares automatically converted on a share-for-share basis into our non-voting ordinary shares, par value \$1.00, or the Non-Voting Common Shares, and the warrants became exercisable for Non-Voting Common Shares rather than Non-Voting Preferred Shares.

At the second closing, which is expected to occur after receipt of applicable regulatory approvals and satisfaction of other closing conditions (but not before December 23, 2011), we will issue to the Purchasers 134,184 Voting Common Shares and 827,504 Non-Voting Common Shares, at a purchase price of \$86.00 per share, for aggregate proceeds of approximately \$82.7 million.

At the third closing, which was approved by our shareholders at the Annual General Meeting of Shareholders on June 28, 2011 and which is expected to occur after receipt of applicable regulatory approvals and satisfaction of other closing conditions, we will issue to the Purchasers 1,148,264 Non-Voting Common Shares, at a purchase price of \$86.00 per share, for aggregate proceeds of approximately \$98.7 million. If the third closing occurs, it is expected to occur simultaneously with the second closing.

The Purchasers may elect, at their option, to receive Series B Non-Voting Common Shares in lieu of Voting Common Shares that might otherwise be issuable to them at any of the closings discussed above. Any such Series B Non-Voting Common Shares would be convertible on a share-for-share basis, subject to certain adjustments, into Voting Common Shares at the option of the Purchasers. All other Non-Voting Common Shares received by the Purchasers under the Investment Agreement, including those received upon conversion of the Non-Voting Preferred Shares received at the first closing, are Series C Non-Voting Common Shares. The Purchasers may also elect to receive Series B Non-Voting Common Shares, Series C Non-Voting Common Shares or Series D Non-Voting Common Shares upon conversion of Voting Common Shares held by them. In addition, the Purchasers may elect to receive Series D Non-Voting Common Shares upon conversion of Series B Non-Voting Common Shares or Series C Non-Voting Common Shares held by them. There is no economic difference in the sub-series of Non-Voting Common Shares, but there are slight differences in the limited voting rights of each sub-series that are designed to address certain regulatory matters affecting the Purchasers.

The total investment expected to be made by the Purchasers for the purchase of the Voting Common Shares, the Non-Voting Common Shares and the warrants is approximately \$291.6 million.

We believe that the proceeds received and to be received in connection with the closings under the Investment Agreement will provide us with capital and financial flexibility to pursue desirable acquisitions of insurance and reinsurance companies in run-off and portfolios of insurance and reinsurance business in run-off.

Other than the above, there have been no material changes to our liquidity position or capital resource requirements since December 31, 2010. For more information refer to Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources included in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2010.

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### *Cash Flows*

With respect to the nine month periods ended September 30, 2011 and 2010, net cash used in our operating activities was \$683.5 million and \$630.2 million, respectively. The increase in cash used of \$53.3 million was attributable primarily to:

- (i) a decrease in the net changes in assets and liabilities of \$248.1 million; and
- (ii) an increase in purchases of trading securities of \$463.0 million. The increase in sales, maturities and purchases of trading securities reflects the decision of our investment committee, made during 2010, to increase the allocation of our investment portfolio to trading securities. These increases were partially offset by
- (iii) an increase in the sales and maturities of trading securities of \$679.5 million.

Net cash provided by investing activities for the nine month periods ended September 30, 2011 and 2010 was \$496.0 million and \$233.6 million, respectively. The increase in cash provided by investing activities of \$262.4 million was attributable primarily to:

- (i) an increase of \$275.2 million in the sales and maturities of available-for-sale securities due to the decision of our investment committee to increase the allocation of our investment portfolio to trading securities;
- (ii) a decrease in funding of other investments of \$63.7 million from \$89.4 million for the nine months ended September 30, 2010 to \$25.7 million for the nine months ended September 30, 2011;
- (iii) an increase of \$66.9 million in the redemption of bond funds; and
- (iv) an increase of \$137.6 million in transfers out of restricted cash and cash equivalents arising as a result of the purchase of restricted investments classified as trading securities; partially offset by
- (v) a net reduction in cash flows related to acquisitions of \$243.9 million.

Net cash provided by (used in) financing activities for the nine month periods ended September 30, 2011 and 2010 was \$156.9 million and (\$58.4) million, respectively. The increase of \$215.3 million in cash provided by financing activities was attributable primarily to the following:

- (i) net proceeds of \$105.7 million received from the completion of the private placement; and
- (ii) an increase in outstanding bank loans of \$227.8 million; partially offset by
- (iii) an increase in repayment of loans of \$113.5 million.

### **Commitments and Contingencies**

In February 2011, Lloyd's Syndicate 2008 entered into RITC agreements with two Lloyd's syndicates with total gross insurance reserves of approximately \$129.6 million. Our capital commitment to Lloyd's Syndicate 2008 with respect to these two RITC agreements amounted to £21.3 million (approximately \$34.1 million).

On July 12, 2011, we provided a parental guarantee in the amount of \$80.0 million to Hannover supporting the obligations of Fitzwilliam under a reinsurance agreement between Fitzwilliam and Hannover, under which Fitzwilliam provides adverse development cover, or ADC, to Clarendon to reinsure Hannover for the first \$80.0 million of the ADC.

There have been no other material changes in our commitments or contingencies since December 31, 2010. Refer to Item 7 included in our Annual Report on Form 10-K for the year ended December 31, 2010.

### **Critical Accounting Estimates**

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Our critical accounting estimates are discussed in Management's Discussion and Analysis of Results of Operations and Financial Condition contained in our Annual Report on Form 10-K for the year ended December 31, 2010.

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### **Off-Balance Sheet and Special Purpose Entity Arrangements**

At September 30, 2011, we did not have any off-balance sheet arrangements, as defined by Item 303(a)(4) of Regulation S-K.

### **Cautionary Statement Regarding Forward-Looking Statements**

This quarterly report contains statements that constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, with respect to our financial condition, results of operations, business strategies, operating efficiencies, competitive positions, growth opportunities, plans and objectives of our management, as well as the markets for our ordinary shares and the insurance and reinsurance sectors in general. Statements that include words such as estimate, project, plan, intend, expect, anticipate, believe, would, should, could, seek, and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements are necessarily estimates or expectations, and not statements of historical fact, reflecting the best judgment of our management and involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. These forward-looking statements should, therefore, be considered in light of various important factors, including those set forth in this quarterly report.

Factors that could cause actual results to differ materially from those suggested by the forward-looking statements include:

risks associated with implementing our business strategies and initiatives;

the adequacy of our loss reserves and the need to adjust such reserves as claims develop over time;

risks relating to the availability and collectability of our reinsurance;

risks that we may require additional capital in the future which may not be available or may be available only on unfavorable terms;

changes and uncertainty in economic conditions, including interest rates, inflation, currency exchange rates, equity markets and credit conditions, which could affect our investment portfolio, our ability to finance future acquisitions and our profitability;

operational risks as a result of our past and future acquisitions, such as cash flow shortages, personnel recruitment challenges, additional integration costs and excessive management time and effort;

losses due to foreign currency exchange rate fluctuations;

tax, regulatory or legal restrictions or limitations applicable to us or the insurance and reinsurance business generally;

increased competitive pressures, including the consolidation and increased globalization of reinsurance providers;

emerging claim and coverage issues;

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lengthy and unpredictable litigation affecting assessment of losses and/or coverage issues;

loss of key personnel;

changes in our plans, strategies, objectives, expectations or intentions, which may happen at any time at management's discretion;

operational risks, including system or human failures;

the risk that ongoing or future industry regulatory developments will disrupt our business, or mandate changes in industry practices in ways that increase our costs, decrease our revenues or require us to alter aspects of the way we do business;

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changes in Bermuda law or regulation or the political stability of Bermuda;

changes in tax laws or regulations applicable to us or our subsidiaries, or the risk that we or one of our non-U.S. subsidiaries become subject to significant, or significantly increased, income taxes in the United States or elsewhere; and

changes in accounting policies or practices.

*The factors listed above should be not construed as exhaustive and should be read in conjunction with the other cautionary statements and Risk Factors that are included in our Annual Report on Form 10-K for the year ended December 31, 2010, as well as in the other materials filed and to be filed with the U.S. Securities and Exchange Commission. We undertake no obligation to publicly update or review any forward looking statement, whether as a result of new information, future developments or otherwise.*

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**Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK***

In October 2010, we entered into a foreign currency forward exchange contract as part of our overall foreign currency risk management strategy. On the value date, June 30, 2011, we sold Australian dollars (AU\$) 45.0 million for \$42.5 million. The contract exchange rate was AU\$1 for \$0.9439. On June 15, 2011, we effectively closed out the contract by entering into a forward exchange contract, with a value date of June 30, 2011, where we bought AU\$45.0 million for \$48.0 million. On August 23, 2011, we entered into a foreign currency forward exchange contract in which we sold AU\$35.0 million for \$37.0 million. We closed out the contract on September 22, 2011 buying AU\$35.0 million for \$34.0 million. As at September 30, 2011, we did not have any foreign currency forward exchange contracts outstanding. Other than the foregoing, there have been no material changes in our market risk exposures since December 31, 2010. For more information refer to Quantitative and Qualitative Disclosures about Market Risk included in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 4. *CONTROLS AND PROCEDURES***

**Evaluation of Disclosure Controls and Procedures**

Our management performed an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of September 30, 2011. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission and is accumulated and communicated to management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Controls**

Our management has performed an evaluation, with the participation of our Chief Executive Officer and our Chief Financial Officer, of changes in our internal control over financial reporting that occurred during the three months ended September 30, 2011. Based upon that evaluation there were no changes in our internal control over financial reporting that occurred during the three months ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

We are, from time to time, involved in various legal proceedings in the ordinary course of business, including litigation regarding claims. We do not believe that the resolution of any currently pending legal proceedings, either individually or taken as a whole, will have a material adverse effect on our business, results of operations or financial condition. Nevertheless, we cannot assure you that lawsuits, arbitrations or other litigation will not have a material adverse effect on our business, financial condition or results of operations. We anticipate that, similar to the rest of the insurance and reinsurance industry, we will continue to be subject to litigation and arbitration proceedings in the ordinary course of business, including litigation generally related to the scope of coverage with respect to asbestos and environmental claims. There can be no assurance that any such future litigation will not have a material adverse effect on our business, financial condition or results of operations.

**Item 1A. RISK FACTORS**

Our results of operations and financial condition are subject to numerous risks and uncertainties described in Risk Factors included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010. The risk factors identified therein have not materially changed.

**Item 5. OTHER INFORMATION**

On November 2, 2011, upon the recommendation of the Company's Chairman and Chief Executive Officer, Dominic F. Silvester, the Board of Directors separated the positions of Chairman and Chief Executive Officer. The Board of Directors appointed current director Robert J. Campbell as the new Chairman of the Board of Directors, a non-executive position, effective immediately. Mr. Campbell, who the Board of Directors has determined is independent, has been a director of the Company since 2007. Mr. Silvester will continue to serve as Chief Executive Officer and as a director of the Company.



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**Item 6. EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Description</b>   |
|------------------------|--|
| 15.1*                  | Deloitte & Touche Ltd. Letter Regarding Unaudited Interim Financial Information.   |
| 31.1*                  | Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2*                  | Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1**                 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2**                 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101**                  | Interactive Data Files.  |

\* Filed herewith

\*\* Furnished herewith

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 4, 2011.

ENSTAR GROUP LIMITED

By: /s/ Richard J. Harris  
Richard J. Harris  
Chief Financial Officer, Authorized Signatory and  
Principal Accounting and Financial Officer

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