

Enstar Group LTD
Form 10-K
March 03, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

or

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

For the transition period from to

Commission File Number 001-33289

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, 22 Queen Street

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Hamilton HM JX

Bermuda

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (441) 292-3645

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary shares, par value \$1.00 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, June 28, 2013, was approximately \$1.17 billion.

As of March 2, 2014, the registrant had outstanding 13,903,380 voting ordinary shares and 2,725,637 non-voting convertible ordinary shares, each par value \$1.00 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to its 2014 annual general meeting of shareholders are incorporated by reference in Part III of this Form 10-K.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report and the documents incorporated by reference contain statements that constitute forward-looking statements within the meaning of Section 21E of 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, may and similar statements of a future or forward-looking nature identify forward-looking statements within the 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 annual report and the documents incorporated by reference.

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;

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

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;

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;

losses due to foreign currency exchange rate fluctuations;

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

emerging claim and coverage issues;

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

continued availability of exit and finality opportunities provided by solvent schemes of arrangement;

loss of key personnel;

the ability of our subsidiaries to distribute funds to us and the resulting impact on our liquidity;

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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 and external hazards;

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;

risks relating to our acquisitions, including our ability to successfully price acquisitions, evaluate opportunities, address operational challenges and support our planned growth;

risks relating to our ability to obtain regulatory approvals, including the timing, terms and conditions of any such approvals, and to satisfy other closing conditions in connection with our acquisition agreements, which could affect our ability to complete acquisitions;

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risks relating to our life and annuities business, including mortality and morbidity rates, lapse rates, the performance of assets to support the insured liabilities, and the risk of catastrophic events;

risks relating to the active underwriting businesses we have recently acquired or agreed to acquire, including unpredictability and severity of catastrophic events, failure of risk management and loss limitation methods, the risk of a ratings downgrade, cyclicity of demand and pricing in the insurance and reinsurance markets;

our ability to implement our strategies relating to the active underwriting market;

risks relating to our ability to structure our investments in a manner that recognizes our liquidity needs;

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

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;

changes in Bermuda law or regulation or the political stability of Bermuda; 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 Risk Factors that are included in Item 1A below. We undertake no obligation to publicly update or review any forward looking statement, whether to reflect any change in our expectations with regard thereto, or as a result of new information, future developments or otherwise, except as required by law.

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PART I

ITEM 1. BUSINESS

Company Overview

Enstar Group Limited, or Enstar, is a Bermuda-based holding company that was formed in 2001 and became publicly traded in 2007. We are listed on the NASDAQ Global Select Market under the ticker symbol ESGR. Our primary operating subsidiaries are located in Bermuda, the United Kingdom, the United States, Australia, and western Europe.

Our primary corporate objective is growing our net book value per share. We believe this is driven primarily by growth in our net earnings, which is in turn driven in large part by successfully completing new acquisitions, effectively managing companies and portfolios of business that we have acquired, and executing on our active underwriting strategies.

Our core focus is acquiring and managing insurance and reinsurance companies in run-off and portfolios of insurance and reinsurance business in run-off, and providing management, consulting and other services to the insurance and reinsurance industry. Since our formation, we have completed the acquisition of over 60 insurance and reinsurance companies and portfolios of insurance and reinsurance business and are now administering those businesses in run-off. This includes 13 Reinsurance to Close, or RITC transactions, with Lloyd's of London insurance and reinsurance syndicates in run-off, whereby the portfolio of run-off liabilities is transferred from one Lloyd's syndicate to another. In February 2013, we completed the acquisition of SeaBright Holdings, Inc., demonstrating our ability to acquire an underperforming live publicly quoted insurance company and place it into run-off. Until 2013, all but one of our acquisitions had been in the non-life run-off business, which for us generally includes property and casualty, workers' compensation, asbestos and environmental, construction defect, marine, aviation and transit, and other closed business.

While our core focus remains the acquisition and management of non-life run-off business, we have recently diversified our business profile in two distinct ways: first, by significantly increasing our closed life and annuities business, and second, by entering into the active underwriting business.

Following our March 2011 acquisition of a small Irish-based closed life company, which was our first life acquisition, we continued to review the closed life business, and during the second half of 2012, we determined we would expand our global run-off strategy to include considering acquisitions of other closed-life insurance companies. In September 2012, we agreed to acquire the closed U.S. life and annuities operations of HSBC Holdings plc (which we now refer to as Pavonia), a transaction we completed on March 31, 2013.

We view the acquisition of these closed-life and annuities businesses as a natural extension of our run-off business, which has the potential to provide us with a more regular earnings and cash flow stream, which may, to a degree, counter some of the volatility inherent in our core non-life run-off business over the long term. Given the different economic, operating and management dynamics of closed life business from our other businesses, our strategy is to consider future life run-off acquisition opportunities in conjunction with a strategic partner or partners on a joint venture basis.

During 2013, we also expanded Enstar's operations into the active underwriting business with the acquisition of Atrium Underwriting Group Limited (or Atrium) on November 25, 2013, and the acquisition of Arden Reinsurance Company Ltd (or Arden) on September 9, 2013. In July 2013, we announced the acquisition of Torus Insurance Holdings Limited (or Torus), which we expect to close during the first quarter of 2014.

Atrium's wholly-owned subsidiary, Atrium Underwriters Ltd, manages and underwrites specialist insurance and reinsurance business for Lloyd's Syndicate 609. Atrium's wholly-owned subsidiary, Atrium 5 Ltd, provides approximately 25% of the underwriting capacity and capital to Syndicate 609, with the balance provided by traditional Lloyd's Names. Arden provides reinsurance to Atrium 5 Ltd. through an approximately 65% quota share reinsurance arrangement, and is currently in the process of running off certain other discontinued businesses.

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Torus is an A- rated global specialty insurer with six wholly-owned insurance vehicles, including Lloyd's Syndicate 1301.

We have entered the active underwriting business not only to provide an additional earnings stream, but also to enhance our ability to compete for non-life run-off and other acquisition targets by providing opportunities for us to offer renewal rights or loss portfolio reinsurance transactions in connection with these transactions, which may be attractive to certain vendors or may present alternative ways in which proposed transactions can be structured. Atrium was an attractive opportunity to us primarily because of its skilled underwriting and management teams and strong historical performance at Lloyd's. Torus is a young company, formed in 2008, which has grown significantly but generally at the expense of its profitability. We believe Torus can be a successful global business following acquisition with a shift in its strategy to concentrate on profitable lines, reduce costs and enhance management.

While we believe the management of claims and control of expenses are Enstar's core competencies, active underwriting is a new exposure for us. Accordingly, we have partnered with the Trident V funds (managed by Stone Point Capital LLC) in the acquisitions of Atrium, Arden and Torus, with Enstar taking 60% equity interests and Trident V taking 40% equity interests in each transaction. Stone Point Capital is a financial services-focused private equity firm that has significant experience investing in insurance and reinsurance companies and other insurance-related businesses, which we believe will be valuable in these active underwriting joint ventures.

Following our expansion into closed life run-off and active underwriting, we now have the following three segments of business that are each managed, operated and reported on differently: (i) non-life run-off; (ii) life and annuities; and (iii) active underwriting.

Strategy

We aim to maximize our growth in net book value per share by using the following strategies:

Solidify Our Leadership Position in the Run-Off Market by Leveraging Management's Experience and Relationships. We continue to utilize the extensive experience and significant relationships of our senior management team to solidify our position as a leading run-off acquirer, which we expect will generate future growth opportunities for us.

Professionally Manage Claims. We manage claims made against companies and portfolios we own or manage in a professional and disciplined manner, relying on our in-house expertise as we seek to dispose of risks expeditiously and cost-effectively. We pay valid claims on a timely basis, while relying on well-documented policy terms and exclusions where applicable and litigation when necessary to defend against paying invalid claims under existing policies and reinsurance agreements.

Commute Assumed Liabilities and Ceded Reinsurance Assets. Using detailed claims analysis and actuarial projections, we negotiate with the policyholders of the insurance and reinsurance companies or portfolios we own or manage with a goal of commuting insurance and reinsurance liabilities for one or more agreed upon payments at a discount to the ultimate liability.

Engage in Highly Disciplined Acquisition, Management and Reinsurance Practices across our Diverse Portfolio of Loss Reserves. We utilize a disciplined approach designed to minimize risk and increase the probability of positive operating results from companies and portfolios we acquire or manage, being highly selective in reviewing potential acquisition targets and management engagements and focusing our investigation on risk exposures, claims practices and reserve requirements.

Profitably Underwrite Selected Specialty Lines and Utilize our Active Underwriting Platforms to Enhance Future Opportunities. We selectively underwrite in chosen specialty lines where we believe we can operate with competitive advantages, focusing on balancing risk exposures and selectively growing organically. Where strategically beneficial, we will seek to utilize our active underwriting platforms in ways that will help us achieve future growth opportunities in our run-off business.

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Prudently Manage Investments and Capital. In managing our investments and deploying our capital, we strive to achieve superior risk-adjusted returns with the objective of maximizing profitability and long-term growth in shareholder value, while recognizing our liquidity needs for future liabilities. We manage our investments in a manner that attempts to correlate the maturity and duration of our investment portfolio to our general liability profile. We manage our capital by aiming to deploy capital efficiently to acquisitions and to establish adequate loss reserves that we believe will protect against future adverse developments.

Recent Transactions

Our transactions take the form of either acquisitions of companies or portfolio transfers, where a reinsurance contract transfers risk from the insurance or reinsurance company to one of our companies. Acquisitions and portfolio transfers (also referred to as significant new business) completed since the beginning of 2011 are outlined below.

Acquisitions

The table below sets forth a summary of acquisitions that we have completed in the last three years or are in the process of completing. For a more detailed explanation of these acquisitions, refer to Note 3 Acquisitions in the notes to our consolidated financial statements included within Item 8 of this Annual Report on Form 10-K.

Company Name	Date of Completion	Acquisitions (2011 - Present)			Segment	Primary Nature of Business
		Purchase Price	Fair Value of Net Assets Acquired	Goodwill/(Gain on Bargain Purchase)		
<i>Signed but not yet completed:</i> Torus Insurance Holdings Limited ⁽¹⁾	expected first quarter 2014	\$692.0 million ⁽²⁾	valuation pending	N/A	Active Underwriting	Global specialty insurer and Lloyd's Syndicate 1301
<i>Completed:</i> Atrium Underwriting Group Limited ⁽¹⁾	November 25, 2013	\$158.0 million	\$119.2 million	\$38.8 million	Active Underwriting	Managing agent for Lloyd's Syndicate 609, a global specialty insurer; provides 25% of syndicate's capital
Arden Reinsurance Company Limited ⁽¹⁾	September 9, 2013	\$79.6 million	\$79.6 million	Nil	Active Underwriting ⁽³⁾	U.S. casualty, credit and surety insurance; quota share provider to Atrium
The Pavonia Companies	March 31, 2013	\$155.6 million	\$155.6 million	Nil	Life and Annuities	U.S. and Canadian closed life insurance, reinsurance and annuities
SeaBright Holdings, Inc.	February 7, 2013	\$252.1 million	\$252.1 million	Nil	Non-life Run-off	U.S. workers compensation insurance
Clarendon Holdings, Inc.	July 12, 2011	\$219.1 million	\$219.1 million	Nil	Non-life Run-off	U.S. general liability and workers compensation insurance
Laguna Life Limited	March 25, 2011	\$21.2 million	\$34.3 million	\$(13.1) million	Life and Annuities	Irish closed life insurance

(1) Enstar has a 60% interest in the acquired companies, with the Trident V funds (or Trident) owning a 40% interest. Trident is a holder of approximately 9.7% of our voting ordinary shares outstanding. James D. Carey, a senior principal of Stone Point Capital LLC (the manager of Trident), serves as a member of our Board of Directors.

(2) Enstar has agreed to fund its share of the purchase price through the issuance of 2,612,346 shares (which will consist of a combination of voting and non-voting shares) and the payment of \$69.2 million in cash.

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- (3) Arden is considered part of our active underwriting segment with respect to its quota share reinsurance provided to Atrium, and is considered part of our non-life run-off segment with respect to its discontinued insurance business.

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The table below sets forth a summary of significant new business transactions that we have signed or completed in the last three years. For a more detailed explanation of these transactions, refer to Note 4 Significant New Business in the notes to our consolidated financial statements included within Item 8 of this Annual Report on Form 10-K.

Portfolio Name	Date of Completion	Significant New Business (2011 - Present)		Segment	Primary Nature of Business
		Liabilities Assumed / Assets Acquired			
<i>Signed but not yet completed:</i>					
Reciprocal of America (in Receivership)	expected second quarter 2014	\$169.0 million		Non-life Run-off	U.S. workers compensation insurance
<i>Completed:</i>					
Lloyd s RITC Shelbourne	January 1, 2014	\$25.3 million		Non-life Run-off	Worldwide property and U.K. liability insurance
Lloyd s RITC Shelbourne	January 1, 2013	\$51.4 million		Non-life Run-off	U.K. motor insurance
American Physicians Assurance Corporation/APSpecialty Insurance Company	April 23, 2013	\$35.3 million		Non-life Run-off	U.S. workers compensation insurance
Claremont Liability Insurance Company	August 6, 2012 / December 17, 2012	\$38.0 million		Non-life Run-off	U.S. construction defect reinsurance
Zurich Insurance Company Danish Branch	June 30, 2012	\$60.0 million		Non-life Run-off	Danish disability insurance and commercial reinsurance
Lloyd s RITC Shelbourne	January 1, 2012	\$116.5 million		Non-life Run-off	Worldwide property and liability reinsurance
Lloyd s RITC Shelbourne	December 31, 2012	\$313.3 million		Non-life Run-off	U.K. property and liability insurance
Insurance Australia Group ⁽¹⁾	September 20, 2011	\$10.0 million		Non-life Run-off	International reinsurance
Claremont Liability Insurance Company	September 1, 2011	\$22.5 million		Non-life Run-off	U.S. construction defect reinsurance
Lloyd s RITC Shelbourne	February 28, 2011	\$129.6 million		Non-life Run-off	Worldwide marine and non-marine property and casualty insurance

(1) Enstar has a 70% economic interest in the acquired companies, with J.C. Flowers Fund II, L.P. owning a 30% non-voting economic interest.

Operating Segments

We have three business segments: (i) non-life run-off, (ii) life and annuities, and (iii) active underwriting. These segments are described below. For additional information and financial data relating to our segments, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Segment Reporting beginning on page 83 and Note 22 Segment Information in the notes to our consolidated financial statements included within Item 8 of this Annual Report on Form 10-K.

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The below chart highlights the percentage of the aggregate total of our gross losses and loss adjustment expense liabilities and policy benefits for life and annuity contracts accounted for by each of our segments:

* Enstar has a 60% interest in the companies within the active underwriting segment, with Trident owning the remaining 40%.

Non-life Run-off

Our non-life run-off segment comprises the operations of our subsidiaries that are running off their property and casualty and other non-life lines of business. It also includes our smaller management business, in which we manage the run-off portfolios of third parties through our service companies.

In the primary (or direct) insurance business, the insurer assumes risk of loss from persons or organizations that are directly subject to the given risks. In the reinsurance business, the reinsurer agrees to indemnify an insurance or reinsurance company, referred to as the ceding company, against all or a portion of the insurance risks arising under the policies the ceding company has written or reinsured. When an insurer or reinsurer stops writing new insurance business, either entirely or with respect to a particular line of business, the insurer, reinsurer, or the line of discontinued business is in run-off.

The insurance industry continues to experience significant consolidation. As a result of this consolidation and other factors, the remaining participants in the industry often have portfolios of business that are either inconsistent with their core competency or provide excessive exposure to a particular risk or segment of the market (i.e., workers compensation, property/casualty, asbestos, environmental, director and officer liability, etc.). These non-core and/or discontinued portfolios are often associated with potentially large exposures and lengthy time periods before resolution of the last remaining insured claims, resulting in significant uncertainty to the insurer or reinsurer covering those risks. These factors can distract management, drive up the cost of capital and surplus for the insurer or reinsurer, and negatively impact the insurer's or reinsurer's credit rating, which makes the disposal of the unwanted company or portfolio an attractive option. Alternatively, the insurer may wish to maintain the business on its balance sheet, yet not divert significant management attention to the run-off of the portfolio. The insurer or reinsurer, in either case, is likely to engage a third party that specializes in run-off management, such as us, to purchase or manage the company or portfolio in run-off.

In the sale of a company in run-off, a purchaser, such as us, may pay a discount to the book value of the company based on the risks assumed and the relative value to the seller of no longer having to manage the company in run-off. Such a transaction can be beneficial to the seller because it receives an up-front payment for the company, eliminates the need for its management to devote any attention to the disposed company and

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removes the risk that the established reserves related to the run-off business may prove to be inadequate. The seller is also able to redeploy its management and financial resources to its core businesses.

In some situations, an insurer or reinsurer may wish to divest itself of a portfolio of non-core legacy business that may have been underwritten alongside other ongoing core business that the insurer or reinsurer does not want to dispose of. In such instances, we are able to provide economic finality for the insurer or reinsurer by providing a loss portfolio reinsurance contract to protect the insurer or reinsurer against deterioration of the non-core portfolio of loss reserves.

Alternatively, if the insurer or reinsurer hires a third party, such as us, to manage its run-off business, the insurer or reinsurer will, unlike in a sale of the business, receive little or no cash up front. Instead, the management arrangement may provide that the insurer or reinsurer will retain the profits, if any, derived from the run-off with certain incentive payments allocated to the run-off manager. By hiring a run-off manager, the insurer or reinsurer can outsource the management of the run-off business to experienced and capable individuals, while allowing its own management team to focus on the insurer's or reinsurer's core businesses.

Overall, the focus of our non-life run-off segment is to acquire new companies or portfolios in run-off and to effectively manage the business previously acquired, in each case in ways that further our primary corporate objective.

Acquisition Process

We evaluate each acquisition opportunity presented by carefully reviewing the portfolio's risk exposures, claim practices, reserve requirements and outstanding claims, and may seek an appropriate discount and/or seller indemnification to reflect the uncertainty contained in the portfolio's reserves. Based on this initial analysis, we can determine if a company or portfolio of business would add value to our current portfolio of run-off business. If we determine to pursue the purchase of a company in run-off, we then proceed to price the acquisition in a manner we believe will result in positive operating results based on certain assumptions including, without limitation, our ability to favorably resolve claims, negotiate with direct insureds and reinsurers, and otherwise manage the nature of the risks posed by the business.

At the time we acquire a company in run-off, we estimate the fair value of liabilities acquired based on external actuarial advice, as well as our own views of the exposures assumed. While we earn a larger share of our total return on an acquisition from disciplined claims management and/or commuting the liabilities that we have assumed, we also try to maximize reinsurance recoveries on the assumed portfolio of business.

Run-off Management

Following the purchase of a company in run-off, or acquisition of a portfolio of business in run-off, or a new consulting engagement to manage a company in run-off or portfolio of business, we strive to conduct the run-off in a disciplined and professional manner in order to efficiently discharge the liabilities associated with the business while preserving and maximizing its assets. Our approach to managing our acquired companies and portfolios of business in run-off, as well as run-off companies or portfolios of businesses we manage on behalf of third-party clients, includes, where possible, negotiating with third-party insureds and reinsureds to commute their insurance or reinsurance agreement (sometimes called policy buy-backs) for an agreed upon up-front payment by us, or the third-party client, and to more efficiently manage payment of insurance and reinsurance claims. We attempt to commute policies with direct insureds or reinsureds in order to eliminate uncertainty over the amount of future claims. Commutations and policy buy-backs provide an opportunity for the company to exit exposures to certain policies and insureds generally at a discount to the ultimate liability and provide the ability to eliminate exposure to further losses. Such a strategy also contributes to the reduction in the length of time and future cost of the run-off.

In certain lines of business, such as direct workers' compensation insurance, commutations and policy buy-back opportunities are not typically available and our strategy with respect to these businesses is to derive value through efficient and effective management of claims.

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An integral factor to our success is our ability to analyze, administer, manage and settle claims and related expenses, such as loss adjustment expenses. Our claims teams are located in different offices within our organization and provide global claims support. We have implemented effective claims handling guidelines along with claims reporting and control procedures in all of our claims units. All claims matters are reviewed regularly, with all material claims matters being circulated to and authorized by management prior to any action being taken in furtherance of our goal of appropriately handling claims and reporting them in accordance with our guidelines. Our claims management processes also include utilizing our extensive relationships and developed protocols to more efficiently manage outside counsel and other third parties, thereby reducing expenses. With respect to certain lines of business, we have arrangements with third-party administrators to manage and pay claims on our subsidiaries' behalf and advise with respect to case reserves. These agreements generally set forth the duties of the third party administrators, limits of authority, indemnification language designed for our protection and various procedures relating to compliance with laws and regulations. These arrangements are also subject to review by our relevant claims departments, and we monitor these administrators on an ongoing basis.

Following the acquisition of a company in run-off, or acquisition of a portfolio of business in run-off, or new consulting engagement, we will spend time analyzing the acquired exposures and reinsurance receivables on a policyholder-by-policyholder basis in order to identify those we wish to approach to discuss commutation or policy buy-back. In addition, we will often be approached by policyholders or reinsurers requesting commutation or policy buy-back. We then carry out a full analysis of the underlying exposures in order to determine the viability of a proposed commutation or policy buy-back. From the initial analysis of the underlying exposures it may take several months, or even years, before a commutation or policy buy-back is completed. In a number of cases, if we and the policyholder or reinsurer are unable to reach a commercially acceptable settlement, the commutation or policy buy-back may not be achievable, in which case we will continue to settle valid claims from the policyholder, or collect reinsurance receivables from the reinsurer, as they become due.

Certain insureds and reinsureds are often willing to commute with us, subject to receiving an acceptable settlement, as this provides certainty of recovery of what otherwise may be claims that are disputed in the future, and often provides a meaningful up-front cash receipt that, with the associated investment income, can provide funds to meet future claim payments or even commutation of their underlying exposure. Therefore, subject to negotiating an acceptable settlement, our insurance and reinsurance liabilities and reinsurance receivables are able to be either commuted or settled by way of policy buy-back over time.

With regard to reinsurance recoverables, we manage cash flow by working with reinsurers, brokers and professional advisors to achieve fair and prompt payment of reinsured claims, taking appropriate legal action to secure receivables where necessary. We also attempt where appropriate to negotiate favorable commutations with our reinsurers by securing a lump sum settlement from reinsurers in complete satisfaction of the reinsurer's past, present and future liability in respect of such claims. Properly priced commutations reduce the expense of adjusting direct claims and pursuing collection of reinsurance, realize savings, remove the potential future volatility of claims and reduce required regulatory capital.

Consulting Services

We provide consultancy services to third parties in the insurance and reinsurance industry primarily through our subsidiaries, the Cranmore companies, Enstar Limited, Enstar (US), Inc., Kinsale Brokers Limited and Shelbourne Syndicate Services Limited. The services we provide range from full-service incentive-based or fixed fee run-off management to bespoke solutions such as claims inspection, claims validation, reinsurance asset collection and IT consulting services. Paladin Managed Care Services, Inc., acquired in the SeaBright transaction, provides medical bill review, utilization review, physician case management and related services in the workers' compensation area. In addition to third-party engagements, our consultancy companies also perform these services in-house for our Enstar companies, using their expertise to assist in managing our run-off portfolios and performing certain due diligence matters relating to new acquisitions.

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Reserves for Unpaid Losses and Loss Adjustment Expense

Applicable insurance laws and regulations and generally accepted accounting practices require us to maintain reserves to cover our estimated losses under insurance policies that we have assumed and for loss adjustment expenses, or LAE, relating to the investigation, administration and settlement of policy claims. Our LAE reserves consist of both reserves for allocated loss adjustment expenses, or ALAE, and for unallocated loss adjustment expenses, or ULAE. ALAE are linked to the settlement of an individual claim or loss, whereas ULAE reserve is based on our estimates of future costs to administer the claims.

We and our subsidiaries establish losses and LAE reserves for individual claims by evaluating reported claims on the basis of:

our knowledge of the circumstances surrounding the claim;

the severity of the injury or damage;

the jurisdiction of the occurrence;

the potential for ultimate exposure;

the type of loss; and

our experience with the line of business and policy provisions relating to the particular type of claim.

Because a significant amount of time can lapse between the assumption of risk, the occurrence of a loss event, the reporting of the event to an insurance or reinsurance company and the ultimate payment of the claim on the loss event, the liability for unpaid losses and LAE is based largely upon estimates. Our management must use considerable judgment in the process of developing these estimates. The liability for unpaid losses and LAE for property and casualty business includes amounts determined from loss reports on individual cases and amounts for losses incurred but not reported, or IBNR. Such reserves, including IBNR reserves, are estimated by management based upon loss reports received from ceding companies, supplemented by our own estimates of losses for which no ceding company loss reports have yet been received.

In establishing reserves, management also considers actuarial estimates of ultimate losses. Our independent actuaries employ generally accepted actuarial methodologies and procedures to estimate ultimate losses and loss adjustment expenses. Our loss reserves are largely related to casualty exposures and include latent exposures primarily relating to asbestos and environmental, as discussed below. In establishing the reserves for unpaid claims, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy, and management can reasonably estimate its liability. In addition, reserves are established to cover loss development related to both known and unasserted claims.

The estimation of unpaid claim liabilities is subject to a high degree of uncertainty for a number of reasons. Unpaid claim liabilities for property and casualty exposures in general are impacted by changes in the legal environment, jury awards, medical cost trends and general inflation. Moreover, for latent exposures in particular, developed case law and adequate claims history do not exist. There is significant coverage litigation involved with these exposures which creates further uncertainty in the estimation of the liabilities. Therefore, for these types of exposures, it is especially unclear whether past claim experience will be representative of future claim experience. Ultimate values for such claims cannot be estimated using reserving techniques that extrapolate losses to an ultimate basis using loss development factors, and the uncertainties surrounding the estimation of unpaid claim liabilities are not likely to be resolved in the near future. There can be no assurance that the reserves established by us will be adequate or will not be adversely affected by the development of other latent exposures. The actuarial methods used to estimate ultimate loss and ALAE for our latent exposures are discussed below.

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For the non-latent loss exposures, a range of traditional loss development extrapolation techniques is applied. Incremental paid and incurred loss development methodologies are the most commonly used methods. Traditional

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cumulative paid and incurred loss development methods are used where inception-to-date, cumulative paid and reported incurred loss development history is available. These methods assume that groups of losses from similar exposures will increase over time in a predictable manner. Historical paid and incurred loss development experience is examined for earlier underwriting years to make inferences about how later underwriting years' losses will develop. Where company-specific loss information is not available or not reliable, industry loss development information published by reliable industry sources such as the Reinsurance Association of America is considered.

The reserving process is intended to reflect the impact of inflation and other factors affecting loss payments by taking into account changes in historical payment patterns and perceived trends. However, there is no precise method for the subsequent evaluation of the adequacy of the consideration given to inflation, or to any other specific factor, or to the way one factor may affect another.

The loss development tables below show changes, for our non-life run-off segment, in our gross and net loss reserves in subsequent years from the prior loss estimates based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher than the original estimate. The Reserve redundancy line represents, as of the date indicated, the difference between the latest re-estimated liability and the reserves as originally estimated.

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Gross Losses and Loss
Adjustment Expense

December 31,

Reserves	2003	2004
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