

Enstar Group LTD
Form 10-K
February 24, 2012
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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

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2011

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, 18 Queen Street

Hamilton HM JX

Bermuda

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For the fiscal year ended December 31, 2011

(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 30, 2011, was approximately \$762,470,217.

As of February 22, 2012, the registrant had outstanding 13,854,447 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 2012 annual general meeting of shareholders are incorporated by reference in Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Company 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 17 portfolios of insurance and reinsurance business and are now administering those businesses in run-off. Of the 17 portfolios of insurance and reinsurance business, 10 were 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. 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.

Our primary corporate objective is to grow our net book value per share. We believe growth in our net book value is driven primarily by growth in our net earnings, which is in turn partially driven by successfully completing new acquisitions.

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 commuting the liabilities that we have assumed, we also try to maximize reinsurance recoveries on the assumed portfolio of business.

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. Such risks may relate to property, casualty, life, accident, health, financial or other perils that may arise from an insurable event. 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.

In recent years, the insurance industry has experienced 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. 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

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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, such as us, that specializes in run-off management to purchase the company or portfolio, or to manage the company or portfolio in run-off.

In the sale of a run-off company, 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 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 and so cannot sell the non-core business. In such instances we are able to provide economic finality for the insurer or reinsurer by providing a retroactive loss portfolio reinsurance contract to protect the insurer or reinsurer against deterioration of the subject 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. Our preferred approach to managing run-off business is to align our interests with the interests of the owners through both fixed management fees and certain incentive payments. Under certain management arrangements to which we are a party, however, we receive only a fixed management fee and do not receive any incentive payments.

Following the purchase of a run-off company, or acquisition of a portfolio of business in run-off, or a new consulting engagement to manage a run-off company or portfolio of business, it is incumbent on the new owner or manager 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 in run-off, as well as run-off companies or portfolios of businesses on behalf of third-party clients, includes 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.

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. This analysis enables us to identify those policyholders and reinsurers we wish to approach to discuss commutation or policy buy-back. Furthermore, following the acquisition of a company or portfolio of business in run-off, or new consulting engagement, we will often be approached by policyholders or reinsurers requesting commutation or policy buy-back. In these instances we will also 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

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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.

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, all of our insurance and reinsurance liabilities and reinsurance receivables are able to be either commuted or settled by way of policy buy-back over time. Many sellers of companies that we acquire have secure claims paying ratings and ongoing underwriting relationships with insureds and reinsureds, which often hinders their ability to commute the underlying insurance or reinsurance policies. Our lack of claims paying rating and our lack of potential conflicts with insureds and reinsureds of companies we acquire provides a greater ability to commute the newly acquired policies than that of the sellers.

We also attempt, where appropriate, to negotiate favorable commutations with reinsurers by securing the receipt of a lump-sum settlement from the reinsurer in complete satisfaction of the reinsurer's liability in respect of any future claims under a particular reinsurance contract. We, or the third-party client, are then fully responsible for any claims in the future. We typically invest proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

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 leader in the run-off segment of the insurance and reinsurance market. The experience and reputation of our management team is expected to generate opportunities for us to acquire or manage companies and portfolios in run-off, and to price effectively the acquisition or management of such businesses. Most importantly, we believe the experience of our management team will continue to allow us to manage the run-off of such businesses efficiently and profitably.

Professionally Manage Claims. We are professional and disciplined in managing claims against companies and portfolios we own or manage. Our management understands the need to dispose of certain risks expeditiously and cost-effectively by constantly analyzing changes in the market and efficiently settling claims with the assistance of our experienced claims adjusters and in-house and external legal counsel. When we acquire or begin managing a company or portfolio, we initially determine which claims are valid through the use of experienced in-house adjusters and claims experts. 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 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. Such commutations can take the form of policy buy-backs and structured settlements over fixed periods of time. By acquiring companies that are direct insurers, reinsurers or both, we are able to negotiate favorable entity-wide commutations with reinsurers that would not be possible if our subsidiaries had remained independent entities. We also negotiate with reinsurers to commute their reinsurance agreements providing coverage to our subsidiaries on terms that we believe to be favorable based on then-current market knowledge. We invest the proceeds from

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reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

Continue to Commit to Highly Disciplined Acquisition, Management and Reinsurance Practices. We utilize a disciplined approach to minimize risk and increase the probability of positive operating results from companies and portfolios we acquire or manage. We carefully review potential acquisition targets and management engagements for consistency with accomplishing our long-term objective of producing positive operating results. We focus our investigation on risk exposures, claims practices and reserve requirements. In particular, we carefully review all outstanding claims and case reserves, and follow a highly disciplined approach to managing allocated loss adjustment expenses, such as the cost of defense counsel, expert witnesses and related fees and expenses.

Prudent Management of Investments and Capital. We strive to structure our investments in a manner that recognizes our liquidity needs for future liabilities. In that regard, we attempt to correlate the maturity and duration of our investment portfolio to our general liability profile. If our liquidity needs or general liability profile unexpectedly change, we may not continue to structure our investment portfolio in its current manner and would adjust as necessary to meet new business needs. We pursue prudent capital management relative to our risk exposure and liquidity requirements to maximize profitability and long-term growth in shareholder value. Our capital management strategy is to deploy capital efficiently to acquisitions and to establish, and re-establish when necessary, adequate loss reserves to protect against future adverse developments.

Recent Transactions

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 Limited via an Australian Federal Court approved scheme. Gordian received total assets and assumed total net reinsurance liabilities of approximately \$9.7 million Australian dollars (approximately \$10.0 million).

Claremont Novation Agreement

On September 1, 2011, we, through our wholly-owned subsidiary, Fitzwilliam Insurance Limited, or 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.

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, 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.

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Laguna

On March 25, 2011, we, through our wholly-owned subsidiary, Kenmare Holdings Ltd., or Kenmare, 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.

Claremont Acquisition

On December 31, 2010, we, through our wholly-owned subsidiary, CLIC Holdings, Inc., completed the acquisition of Claremont for an aggregate purchase price of \$13.9 million. Claremont is a California-domiciled insurer that is in run-off. The acquisition was funded from available cash on hand.

CIGNA Reinsurance

On December 31, 2010, we, through our wholly-owned subsidiary Fitzwilliam, entered into a 100% reinsurance agreement, administrative services agreement, and related transaction documents with three affiliates of CIGNA Corporation, or CIGNA affiliates, pursuant to which Fitzwilliam reinsured all of the run-off workers compensation and personal accident reinsurance business of those CIGNA affiliates. Pursuant to the transaction documents, the CIGNA affiliates have transferred assets into three reinsurance collateral trusts securing the obligations of Fitzwilliam under the reinsurance agreement and administrative services agreement. Fitzwilliam received total assets and assumed total net reinsurance reserves of approximately \$190.5 million. Fitzwilliam transferred approximately \$50 million of additional funds to the trusts to further support these obligations. We funded the contribution to the trusts through a draw on a \$115.0 million credit facility entered into with Barclays Bank PLC on December 29, 2010, which was fully repaid on June 30, 2011.

In addition to the trusts, we have provided a limited parental guarantee supporting certain obligations of Fitzwilliam in the amount of \$79.7 million. The amount of the guarantee will increase or decrease over time under certain circumstances, but will always be subject to an overall maximum cap with respect to reinsurance liabilities. As of December 31, 2011 the amount of the parental guarantee was \$79.7 million.

Inter-Hannover

On October 1, 2011, we, through our wholly-owned subsidiary, Brampton Insurance Company Limited, or Brampton, completed the portfolio transfer of certain run-off agency business from International Insurance Company of Hannover, or IICH, under part VII of the Financial Services and Markets Act 2000. The transferring business was previously reinsured by our wholly-owned subsidiary, Fitzwilliam, pursuant to a 100% quota share reinsurance agreement with IICH entered into on December 3, 2010. Fitzwilliam had received total assets and assumed total net reinsurance reserves of approximately \$137.1 million from IICH. In addition, we provided a parental guarantee supporting Fitzwilliam's obligations in the amount of approximately £76.0 million (approximately \$118.7 million). The amount of the guarantee will decrease over time in line with relevant independent actuarial assessments. This 100% quota share reinsurance, along with the associated guarantee, was novated in favor of Brampton as part of the portfolio transfer from IICH. As of December 31, 2011, the total amount of the parental guarantee was approximately £31.2 million (approximately \$48.5 million).

New Castle

On December 3, 2010, we, through our wholly-owned subsidiary Kenmare, completed the acquisition of New Castle Reinsurance Company Ltd., or New Castle, for an aggregate purchase price of \$22.0 million. New Castle is a Bermuda-domiciled insurer that is in run-off. The acquisition was funded from available cash on hand.

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Brampton

On November 2, 2010, we acquired the 49.9% of the shares of Hillcot Holdings Ltd., or Hillcot, from Shinsei Bank Ltd., or Shinsei, that we did not previously own for a purchase price of \$38.0 million, resulting in us owning 100% of Hillcot. At the time of acquisition, Hillcot owned 100% of the shares of Brampton, a London-domiciled insurer that is in run-off. The fair value of the assets acquired that we did not previously own was \$34.9 million. The excess of the purchase price over the fair value of assets acquired in the amount of \$3.1 million was recorded as a charge to additional paid-in capital in accordance with the applicable guidance of accounting principles generally accepted in the United States of America, or U.S. GAAP. J. Christopher Flowers, a former member of our board of directors and one of our largest shareholders, is a director and the largest shareholder of Shinsei.

Seaton

On August 3, 2010, we, through our wholly-owned subsidiary, Virginia Holdings Ltd., or Virginia, acquired 55.6% of the shares of Seaton Insurance Company, or Seaton, for a \$nil purchase price. Seaton is a Rhode Island-domiciled insurer that is in run-off and, at that time, was the subsidiary of Stonewall Acquisition Corporation, or Stonewall. At that time, Virginia held 44.4% of the outstanding capital stock of Stonewall and, therefore, indirectly owned 44.4% of Seaton through its holdings. The acquisition of the 55.6% of the Seaton shares that it previously did not own was a result of the distribution by Stonewall to Virginia of proceeds and certain other assets following its sale of another subsidiary, Stonewall Insurance Company, to Columbia Insurance Company, an affiliate of National Indemnity Company (an indirect subsidiary of Berkshire Hathaway, Inc.). The distribution resulted in Virginia owning 100% of Seaton following the distribution.

Providence Washington

On July 20, 2010, we, through our wholly-owned subsidiary PWAC Holdings, Inc., completed the acquisition of PW Acquisition Company, or PWAC, for a purchase price of \$25.0 million. PWAC owns the entire share capital of Providence Washington Insurance Company. Providence Washington Insurance Company and its two subsidiaries are Rhode Island-domiciled insurers that are in run-off. The purchase price was financed by a term facility provided by a London-based bank, or the EGL Facility, which was fully repaid on September 13, 2010.

Torus Reinsurance

In July 2010, following the acquisition of the entire issued share capital of Glacier Insurance AG by Torus Insurance (Bermuda) Limited, or Torus, Fitzwilliam entered into two quota share reinsurance agreements with Torus protecting the prior year reserve development of two portfolios of business reinsured by them: a 79% quota share of Torus 95% quota share reinsurance of Glacier Insurance AG, and a 75% quota share of Torus 100% quota share reinsurance of Glacier Reinsurance AG. Fitzwilliam received total assets and assumed total gross reinsurance reserves of approximately \$105.0 million.

Bosworth

In May 2010, a specific portfolio of business in run-off underwritten by Mitsui Sumitomo Insurance Co., Ltd. of Japan, or Mitsui, was transferred to our 50.1% owned subsidiary, Bosworth Run-off Limited, or Bosworth. This transfer, which occurred under Part VII of the U.K. Financial Services and Markets Act 2000, was approved by the U.K. Court and took effect on May 31, 2010. As a result of the transfer, Bosworth received total assets and assumed net reinsurance reserves of approximately \$117.5 million. Shinsei owns the remaining 49.9% of Bosworth.

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Assuransinvest

On March 30, 2010, we, through our wholly-owned subsidiary, Nordic Run-Off Limited, completed the acquisition of Forsakringsaktiebolaget Assuransinvest MF, or Assuransinvest, for a purchase price of SEK 78.8 million (approximately \$11.0 million). Assuransinvest is a Swedish-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

Knapton Insurance

On March 2, 2010, we, through our wholly-owned subsidiary, Knapton Holdings Limited, or Knapton Holdings, completed the acquisition of Knapton Insurance Limited, formerly British Engine Insurance Limited, or Knapton, from RSA Insurance Group plc for a total purchase price of £28.8 million (approximately \$44.0 million). Knapton is a U.K.-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

In April 2010, Knapton Holdings entered into a term facility agreement with a London-based bank, or the Knapton Facility. On April 20, 2010, Knapton Holdings drew down \$21.4 million from the Knapton Facility. On June 30, 2011, the Knapton Facility was fully repaid.

Allianz Reinsurance

In February 2010, we, through our wholly-owned subsidiary, Fitzwilliam, entered into a 100% quota share reinsurance agreement with Allianz Global Corporate & Specialty AG (UK) Branch, or Allianz, with respect to a specific portfolio of run-off business of Allianz. Fitzwilliam received total assets and assumed total gross reinsurance reserves of approximately \$112.6 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 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.

Lloyd's Syndicate 2008 has, to date, entered into 10 RITC agreements with Lloyd's syndicates. During 2009, Lloyd's Syndicate 2008 entered into a RITC agreement with a Lloyd's syndicate with total gross insurance reserves of approximately \$67.0 million. During 2010, Lloyd's Syndicate 2008 entered into RITC agreements with three Lloyd's syndicates with total gross insurance reserves of approximately \$192.6 million. 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, required to be in place by February 29, 2012, amounted to £62.9 million (approximately \$97.7 million) and will be financed from available cash on hand.

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Copenhagen Re

On October 15, 2009, we, through our wholly-owned subsidiary, Marlon Insurance Company Limited, completed the acquisition of Copenhagen Reinsurance Company Ltd., or Copenhagen Re, from Alm. Brand Forsikring A/S for a total purchase price, including acquisition costs, of DKK149.2 million (approximately \$29.9 million). Copenhagen Re is a Danish-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

Constellation

On January 31, 2009, we, through our wholly-owned subsidiary, Sun Gulf Holdings Inc., completed the acquisition of all of the outstanding capital stock of Constellation Reinsurance Company Limited, or Constellation, for a total purchase price of approximately \$2.5 million. Constellation is a New York-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

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 is less than 4.9%. The securities that the Purchasers have acquired 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 occurred on December 22, 2011, we issued 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 occurred simultaneously with the second closing on December 22, 2011, we issued 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.

The Purchasers may 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. Holders of the Series B Non-Voting Common Shares would have the right to convert such shares on a share-for-share basis, subject to certain adjustments, into Voting Common Shares, Series C Non-Voting Common Shares or Series D Non-Voting Common Shares at their option. All Non-Voting Common Shares received by the Purchasers under the Investment Agreement are Series C Non-Voting Common Shares. Holders of the Series C Non-Voting Common Shares have the right to convert such shares, on a share-for-share basis, subject to certain adjustments, into Series D Non-Voting Common Shares at their option. 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.

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

Share Repurchase

On October 1, 2010, we entered into share repurchase agreements, or the Repurchase Agreements, with three of our executives and certain trusts and a corporation affiliated with the executives to repurchase an aggregate of 800,000 of our ordinary shares at a price of \$70.00 per share. We repurchased an aggregate of 600,000 ordinary shares from Dominic F. Silvester (our Chief Executive Officer and member of our board of directors) and a trust of which he and his immediate family are the sole beneficiaries, 100,000 ordinary shares from a trust of which Paul J. O Shea (our Joint Chief Operating Officer, Executive Vice President and a member of our board of directors) and his immediate family are the sole beneficiaries and 100,000 ordinary shares from a corporation owned by a trust of which Nicholas A. Packer (our Joint Chief Operating Officer and Executive Vice President) and his immediate family are the sole beneficiaries. The repurchase transactions closed on October 14, 2010. The aggregate purchase price of \$56.0 million is payable by us through promissory notes to the selling shareholders. The annual interest rate for the notes is fixed at 3.5%, and the notes are repayable in three equal installments on December 31, 2010, December 1, 2011 and December 1, 2012. In connection with the Repurchase Agreements, we entered into lock-up agreements with each of Messrs. Silvester, O Shea and Packer, and their respective family trusts and corporation. The lock-up agreements prohibit future sales and transfers of shares now owned or subsequently acquired for two years from the date of the Repurchase Agreements.

Management of Run-Off Portfolios

We are a party to several management engagements pursuant to which we have agreed to manage the run-off portfolios of third parties with gross loss reserves, as of December 31, 2011 of approximately \$546.9 million. Such arrangements are advantageous for third-party insurers because they allow a third-party insurer to focus its management efforts on its core competency while allowing it to maintain the portfolio of business on its balance sheet. In addition, our expertise in managing portfolios in run-off allows the third-party insurer the opportunity to potentially realize positive operating results if we achieve our objectives in management of the run-off portfolio. We specialize in the collection of reinsurance receivables through our subsidiary Kinsale Brokers Limited. Through our subsidiaries, Enstar (US) Inc. and Cranmore Adjusters Limited, we also specialize in providing claims inspection services whereby we are engaged by third-party insurance and reinsurance providers to review certain of their existing insurance and reinsurance exposures, relationships, policies and/or claims history.

Our primary objective in structuring our management arrangements is to align the third-party insurer's interests with our interests. Consequently, management agreements typically are structured so that we receive fixed fees in connection with the management of the run-off portfolio and certain incentive payments based on a portfolio's positive operating results. These agreements do not include the recurring engagements managed by our claims inspection and reinsurance collection subsidiaries, Cranmore Adjusters Limited, Enstar (US), Inc. and Kinsale Brokers Limited, respectively.

Claims Management and Administration

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. To ensure that claims are appropriately handled and reported in accordance with these guidelines, all claims matters are reviewed regularly, with all material claims matters being circulated to and authorized by management prior to any action being taken.

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When we receive notice of a claim, regardless of size and regardless of whether it is a paid claim request or a reserve advice, it is reviewed and recorded within the claims system, reserving our rights where appropriate. Claims reserve movements and payments are reviewed daily, with any material movements being reported to management for review. This enables flash reporting of significant events and potential insurance or reinsurance losses to be communicated to senior management worldwide on a timely basis irrespective from which geographical location or business unit location the exposure arises.

We are also able to efficiently manage claims and obtain savings through our extensive relationships with defense counsel (both in-house and external), third-party claims administrators and other professional advisors and experts. We have developed relationships and protocols to reduce the number of outside counsel by consolidating claims of similar types and complexity with experienced law firms specializing in the particular type of claim. This approach has enabled us to more efficiently manage outside counsel and other third parties, thereby reducing expenses, and to establish closer relationships with ceding companies.

When appropriate, we negotiate with direct insureds to commute or buy back policies either on favorable terms or to mitigate against existing and/or potential future indemnity exposures and legal costs in an uncertain and constantly evolving legal environment. We also pursue commutations on favorable terms with ceding companies of reinsurance business in order to realize savings or to mitigate against potential future indemnity exposures and legal costs. Such buy-backs and commutations typically eliminate all past, present and future liability to direct insureds and reinsureds in return for a lump sum payment.

With regard to reinsurance receivables, 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 receivables (both of which may often involve extensive legal expense), realize savings, remove the potential future volatility of claims and reduce required regulatory capital.

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 are 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.

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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

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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 including latent exposures primarily relating to asbestos and environmental, or A&E, 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 in detail in Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies .

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 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 actuarial methods used to estimate ultimate loss and ALAE for our non-latent exposures are discussed in detail in Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies .

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 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 Loss and Loss
Adjustment Expense**

Years Ended December 31,

Reserves	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(in thousands of U.S. dollars)										
Reserves assumed	\$ 419,717	\$ 284,409	\$ 381,531	\$ 1,047,313	\$ 806,559	\$ 1,214,419	\$ 1,591,449	\$ 2,798,287	\$ 2,479,136	\$ 3,291,275	\$ 4,282,916
1 year later	348,279	302,986	365,913	900,274	909,984	1,227,427	1,436,051	2,661,011	2,237,124	3,057,032	
2 years later	360,558	299,281	284,583	1,002,773	916,480	1,084,852	1,358,900	2,422,291	2,039,141		
3 years later	359,771	278,020	272,537	1,012,483	853,139	1,020,755	1,284,304	2,245,557			
4 years later	332,904	264,040	243,692	953,834	778,216	949,595	1,235,982				
5 years later	316,257	242,278	216,875	879,504	733,151	905,043					
6 years later	294,945	238,315	204,875	835,488							