



Annuity & Life Re

2007

ANNUAL REPORT

TO

SHAREHOLDERS

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

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2007 Annual Report to Shareholders

General

Annuity and Life Re (Holdings), Ltd. (“Holdings”) was incorporated on December 2, 1997 under the laws of Bermuda. The Company has historically provided annuity and life reinsurance to select insurers and reinsurers through our wholly-owned subsidiaries: Annuity and Life Reassurance, Ltd., which is licensed under the insurance laws of Bermuda as a long term insurer; and Annuity and Life Re America, Inc., an insurance holding company based in the United States, and its subsidiary, Annuity and Life Reassurance America, Inc., a life insurance company authorized to conduct business in over 40 states of the United States and the District of Columbia. We acquired Annuity and Life Reassurance America on June 1, 2000. On February 29, 2008 we closed on the sale of Annuity and Life Reassurance America, Inc. Shortly thereafter we dissolved Annuity and Life Re America, Inc. For more detailed information about the Company and its subsidiaries, please see our Audited GAAP Financial Statements for the year ended December 31, 2007 which are included here beginning on page 9 and our quarterly Unaudited Financial Statements for 2008 which are available on our web site, www.alre.bm. References in this Annual Report to “Company”, “We”, “Us” or similar terms refer to Holdings and its direct and indirect subsidiaries.

As a result of significant operating losses, the Company became unable to meet its monetary obligations under certain reinsurance treaties in 2002. Since that time, the Company has negotiated termination, recapture, and novation or coinsurance agreements for all reinsurance treaties with the applicable counterparties or independent third parties. Since December 31, 2006, there were no reinsurance agreements in force that would generate operating revenue for the Company. The Company’s only source of revenue is investment income.

Due to the absence of ongoing insurance operations, the Company has significantly reduced its operations, including reduced the number of its employees, reduced the size of the Board of Directors, and moved to smaller office space. Because the Company continues to have residual commitments and contingencies as described in Note 12 of our Audited GAAP Financial Statements, it does not expect to immediately wind-down or liquidate. The Company intends to continue to explore strategic alternatives to attempt to maximize its economic value for shareholders, including a merger of Holdings into another entity, the sale of its operating subsidiary or other comparable transactions. In addition, the Company may consider cash distributions to shareholders, stock buybacks or similar transactions, to the extent its financial condition allows it to do so and it is not constrained by insurance regulatory or other laws.

The Reinsurance Business

The business of reinsurance generally consists of reinsurers, such as our company, entering into contractual arrangements (known as treaties) with primary insurers (known as ceding companies) whereby the reinsurer agrees to indemnify the ceding company for all or a portion of the risks associated with an underlying insurance policy in exchange for a reinsurance premium payable to the reinsurer. Reinsurers also may enter into retrocessional reinsurance arrangements with other reinsurers, which operate in a manner similar to the underlying reinsurance arrangement described above. Under retrocessional reinsurance arrangements, the reinsurer cedes a portion of the risk associated with an underlying reinsurance contract to other reinsurers (known as retrocessionaires).

Risks Reinsured

We had historically written reinsurance predominantly on a direct basis with primary life insurance companies and other reinsurers, but are currently not pursuing any new reinsurance agreements. The treaties we wrote were generally for traditional life reinsurance and annuity reinsurance, which exposed us to the following categories of risks: (i) mortality, (ii) investment, (iii) persistency (or lapse) and (iv) expense.

As mentioned earlier, all reinsurance treaties have been terminated. We remain subject to claims associated with a small number of treaties that were recaptured to the extent that the claims have not yet been reported but had occurred prior to the effective date of the recapture.

We continue to be subject to investment risk with respect to our own investments. Our investments primarily consist of money market funds and a small number of investment grade fixed income securities. The fixed income securities are subject to interest rate and credit risk. Significant changes in interest rates expose us to the risk of earning less income during periods when interest rates are falling, or realizing losses if we are forced to sell securities during periods when interest rates are rising.

Although we have historically had the ability to use interest rate swaps and other financial instruments as tools to mitigate the effects of asset/liability mismatches or the effect of interest rate changes on our balance sheet, we have not, in general, hedged our investment risk.

Business Written

The Company has no reinsurance business in force and is no longer receiving any policy revenue. Its only insurance transactions involve death claims that occurred while a reinsurance treaty was in effect but were reported after the termination of that treaty. The Company maintains a reserve for such claims. While the Company believes its reserve is adequate, there is can be no guarantee that this is the case.

Significant Events

Transamerica Transaction

In February 2008, the Company resolved its disputes with Transamerica regarding the December 31, 2004 novation of several reinsurance contracts. These disputes had been the subject of arbitration proceedings. The Company agreed to pay a total of \$16.567 million to settle all liabilities related to the novations: Transamerica received \$3 million and \$2.5 million, respectively, in settlement of the F&G and Scottish Re matters and Scottish Re received \$11.067 million. The settlement agreement discharges the Company from any future liabilities from Transamerica and Scottish Re. The Company continues to be liable for any pre-novation issues related to the F&G contract.

Repurchase of Common Shares

On November 21, 2007 Company agreed to purchase 275,000 shares from an unrelated shareholder. The purchase price of the share was \$0.52 per common share, a discount of 15% below the then current market price. There were no other rights associated with the repurchased shares.

Sale of U.S Based Subsidiary

On February 29, 2008, the Company, together with its wholly owned subsidiary, Annuity & Life Re America, Inc., sold its United States based insurance subsidiary, Annuity and Life Reassurance America, Inc. to an unrelated third party for \$11,058,717 in cash. Accordingly, the Company has recorded the financial statement effects of its entire U.S. based operations on its consolidated financial statements as Discontinued Operations- Held for Sale. In April 2008, Annuity and Life Re America, Inc. was dissolved.

Engagement of Financial Advisor

On February 9, 2006, the Company retained UBS Securities LLC for financial and market related advice and assistance in exploring strategic alternatives, including a merger of Holdings into another entity, the sale of its operating subsidiaries or other comparable transactions. In addition, the Company may consider cash distributions to stockholders, stock buybacks or similar transactions, to the extent its financial

condition allows it to do so. The Company has agreed to pay UBS a monthly retainer fee of \$10,000 which would be offset against a transaction fee of \$500,000 payable upon the closing of a potential transaction. The initial contract term was for a period of one year. The parties had verbally agreed to extend the contract on a month to month basis. The Company closed on the sale of its U.S. operating subsidiary on February 29, 2008. UBS was paid \$391,826 in 2008 and the engagement terminated.

Suspension of Reporting Requirements under the Securities Exchange Act of 1934

On February 2, 2006, the Company filed Form 15 with the Securities and Exchange Commission (“SEC”) which terminated the Company’s reporting obligations under the Securities Exchange Act of 1934 and terminated the registration of its common stock. Since February 2, 2006, the Company’s stock has been listed in the over-the-counter market under the trading symbol ANNRF.

Investments

Our investments are governed by investment guidelines established and approved by our Board of Directors. Our investment objectives are to achieve above average risk-adjusted total returns, maintain a high quality portfolio, maximize current income, maintain an adequate level of liquidity in our portfolio and match the cash flows of our investments to our operating expenses and remaining insurance liabilities. Our investment guidelines require our overall fixed income portfolio to maintain a minimum weighted average credit quality of “A” and limit investment in fixed income securities that are non-rated or below investment grade at the time of purchase to an aggregate of \$3,000,000. A fixed income security rated “A” by Standard & Poor’s is considered to be somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than higher rated issuers; however, the issuer’s capacity to meet its financial commitment on the security is still considered to be strong. We currently do not invest in any fixed income securities in emerging markets.

At December 31, 2007, our invested assets, including cash and cash equivalents, had an aggregate fair value of \$4,028,124, including gross unrealized gains of \$67,931. Our fixed-income portfolio was comprised of fixed income securities with a weighted average credit quality rating of “AA” and a weighted average duration of approximately 4 years. The effective yield rate earned on our total invested assets was approximately 5.0%. Approximately 87% of our total invested assets were held in cash and cash equivalents as of the end of the year.

Our results of operations and our financial condition are significantly affected by the performance of our investments and by changes in interest rates. During a period of declining interest rates, if our investments are prematurely sold, called, prepaid or redeemed, we may be unable to reinvest the proceeds in securities of equivalent risk with comparable rates of return. During a period of rising interest rates, the fair value of our invested assets could decline. In addition, rising interest rates could also cause disintermediation, which in turn could cause us to sell investments at prices and times when the fair values of such investments are less than their amortized cost.

Regulation

Bermuda

As a holding company, Holdings is not subject to Bermuda insurance regulations. Annuity and Life Reassurance, Ltd., our Bermuda operating subsidiary, is licensed as a long-term insurer under the Bermuda Insurance Act of 1978, as amended, and related regulations (collectively, the “Insurance Act”). The Insurance Act, which regulates the insurance business of Annuity and Life Reassurance, Ltd., provides that no person shall carry on an insurance business in Bermuda unless registered as an insurer under the Insurance Act by the Bermuda Monetary Authority (the “Authority”). The registration of an applicant as an insurer is subject to its complying with the terms of its registration and such other conditions as the Authority may impose at any time.

The Insurance Act imposes on Bermuda insurance companies solvency and liquidity standards and auditing and reporting requirements and grants to the Authority powers to supervise, investigate and intervene in the affairs of insurance companies. Any significant deterioration of our financial condition will likely expose our operations in Bermuda to an increased level of regulatory scrutiny and could possibly lead to the Authority petitioning for the winding up of our company.

We have been designated as non-resident for exchange control purposes by the Authority whose permission for the issue and transfer of our common shares has been obtained, as discussed below. This designation allows us to engage in transactions, or to pay dividends to non-residents of Bermuda who are holders of our common shares, in currencies other than the Bermuda Dollar.

We have the consent from the Authority under the Exchange Control Act 1972 and regulations thereunder allowing for the transfer of our common shares between persons regarded as non-resident in Bermuda for exchange control purposes and our issuance of common shares to such persons, provided that the shares remain listed on an appointed stock exchange or are trading on the OTC Bulletin Board or in the Pink Sheets.

In addition, issues and transfers of the common shares to any person regarded as resident in Bermuda for exchange control purposes require specific prior approval under the Exchange Control Act 1972. The common shares of Annuity and Life Reassurance, Ltd. cannot be transferred without the consent of the Authority.

As “exempted companies,” Holdings and Annuity and Life Reassurance, Ltd. are exempt from Bermuda laws restricting the percentage of share capital that may be held by non-Bermudians, but as exempted companies they may not participate in certain business transactions, including (i) the acquisition or holding of land in Bermuda (except that required for our business and held by way of lease or tenancy for terms of not more than 21 years) without the express authorization of the Bermuda legislature, (ii) the taking of mortgages on land in Bermuda to secure an amount in excess of \$50,000 without the consent of the Bermuda Minister of Finance, (iii) the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government securities, or (iv) the carrying on of business of any kind in Bermuda, including insuring domestic risks, except in furtherance of their business carried on outside Bermuda, and, in the case of Annuity and Life Reassurance, Ltd., reinsuring any long-term business risks undertaken by any company incorporated in Bermuda and permitted to engage in the insurance and reinsurance business, or under a license granted by the Bermuda Minister of Finance.

Annuity and Life Reassurance, Ltd. is prohibited from declaring or paying any dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. Additionally, under the Bermuda Companies Act 1981 (the “Companies Act”), neither Holdings nor Annuity and Life Reassurance, Ltd. may declare or pay a dividend, or make a distribution from contributed surplus, if there are reasonable grounds for believing that it is, or would after the payment be, unable to pay its liabilities as they become due, or the realizable value of its assets would be less than the aggregate of its liabilities and its unused share capital and share premium accounts.

United States

General. Our Bermuda operating subsidiary, Annuity and Life Reassurance, Ltd. is not licensed or admitted as an insurer in any state of the United States and is not directly subject to regulation in any state of the United States. The insurance laws of each state in the United States regulate the sale of insurance and reinsurance within their jurisdiction by reinsurers, such as Annuity and Life Reassurance, Ltd. which are not licensed or admitted to do business within such jurisdiction. Annuity and Life Reassurance, Ltd. conducts its business through its Bermuda office. Annuity and Life Reassurance, Ltd. does not maintain an office, and its personnel do not solicit, advertise, settle claims or conduct other activities that may constitute the transaction of the business of insurance, in any jurisdiction in which it is not licensed or otherwise authorized to engage in such activities.

Our former United States operating subsidiary, Annuity and Life Reassurance America, Inc. is licensed and authorized to conduct life insurance business in over 40 states of the United States and the District of Columbia. The insurance laws and regulations, as well as the supervisory authority that may be exercised by the various insurance departments in the United States, vary by jurisdiction, but generally grant broad powers to supervisory agencies or regulators to examine and supervise insurance companies and insurance holding companies with respect to the conduct of their insurance business. These laws and regulations generally require insurance companies to meet certain solvency standards, asset tests, standards of business conduct, guarantee fund assessments and to file certain reports with regulatory authorities, including information concerning their capital structure, ownership and financial condition. The insurance laws of Connecticut have the most significant impact on Annuity and Life Reassurance America, Inc. because that is its state of domicile.

Annuity and Life Re America, Inc. (our wholly-owned U.S. holding company – dissolved in April 2008) is domiciled in Delaware and regulated as a Delaware corporation. The Delaware insurance holding company system laws and regulations generally do not apply to Annuity and Life Re America, Inc. because it is not an insurer and because Annuity and Life Reassurance America, Inc. is not required to file registration statements with the Delaware Insurance Commissioner under applicable provisions of such laws and regulations. The books and records of Annuity and Life Re America, Inc. may be subject to inspection by the Connecticut insurance regulators because Annuity and Life Re America, Inc. is an affiliate of Annuity and Life Reassurance America, Inc. which is subject to Connecticut's laws governing insurance company systems.

The Connecticut insurance laws (applicable to Annuity and Life Reassurance America, Inc.) require that transactions between or among Annuity and Life Reassurance America, Inc. and any of its affiliates, including the payment of ordinary dividends to shareholders, shall be subject to the following requirements: (i) the terms shall be fair and reasonable; (ii) charges or fees for services performed shall be reasonable; (iii) expenses incurred and payment received shall be allocated to Annuity and Life Reassurance America, Inc. in conformity with customary insurance accounting practices consistently applied; (iv) the books, accounts and records of each party shall be so maintained as to clearly and accurately disclose the precise nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties; and (v) Annuity and Life Reassurance America, Inc.'s surplus with respect to policyholders shall be reasonable in relation to its outstanding liabilities and adequate to meet its financial needs. In addition, certain transactions, such as the payment of dividends, between or among Annuity and Life Reassurance America, Inc. and affiliates may not be entered into until notice of such transactions has been provided to the Connecticut Insurance Commissioner, and the Commissioner either approves the transaction or a thirty-day waiting period has passed during which the Commissioner has not disapproved the transaction.

Under Connecticut insurance regulations, the Connecticut Insurance Commissioner is required to perform regular financial examinations of insurance companies under its jurisdiction at least every three to five years. In August 2005, the Commissioner completed an examination of Annuity and Life Reassurance America, Inc. that covered the three year period ending December 31, 2004.

In addition to the regulatory requirements imposed by the jurisdictions in which a reinsurer is licensed, a reinsurer's business operations are affected by regulatory requirements in other jurisdictions governing

“credit for reinsurance” which are imposed on its ceding companies. In general, a ceding company which obtains reinsurance from a reinsurer that is licensed, accredited or approved by the insurance regulator of the ceding company’s domiciliary jurisdiction is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the liability for policy reserves, claims and other amounts ceded to such reinsurer. Many jurisdictions permit ceding companies to take credit on their statutory financial statements for reinsurance obtained from unlicensed or non-admitted reinsurers only if adequate security is posted. Because our operating subsidiary Annuity and Life Reassurance, Ltd. is not licensed, accredited or approved in any jurisdiction except Bermuda, its reinsurance contracts typically required it to post a letter of credit or other security.

Properties

We conduct our operations from leased office space located at International Centre Suite 304, 26 Bermudiana Road, Hamilton, HM 11, Bermuda. Prior to its sale, Annuity and Life Re America, Inc. conducted its operations from leased space located at 124 Palisado Avenue, Windsor, Connecticut, USA. We believe our space is adequate to meet our current and future needs.

Legal Proceedings

There is no arbitration or other legal proceeding currently in process in which we are involved.

Dividends

Both Holdings and its Bermuda operating subsidiary, Annuity and Life Reassurance, Ltd. are required to comply with the provisions of the Bermuda Companies Act that regulate the payment of dividends and the making of distributions from contributed surplus. Neither Holdings nor Annuity and Life Reassurance, Ltd. may declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (i) the relevant company is, or would be after the payment be, unable to pay its liabilities as they become due; or (ii) the realizable value of the relevant company’s assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Since December 31, 2002, we have not declared a dividend to shareholders.

The Company declared a cash distribution (return of capital) of \$0.50 per common share to be made on May 15, 2008 to stockholders of record as of April 30, 2008. The total payout, \$12,266,905.50, has not been reflected in these financial statements since they are as of December 31, 2007.

We do not expect to declare or pay dividends or cash distributions to shareholders in the near future. The declaration and payment of future dividends to holders of our common shares will be at the discretion of our Board of Directors and will depend upon our results of operations and financial condition, capital requirements of our subsidiaries, the ability of our operating subsidiaries to pay dividends to us, regulatory considerations and other factors the Board of Directors deems relevant.

For a discussion of other factors affecting our ability to pay dividends, see “Regulation” above and Note 15 to our Audited GAAP Financial Statements for the year ended December 31, 2007. Currently, there is no Bermuda withholding tax on dividends paid by us to shareholders.

Forward-Looking Statements

This annual report, together with other statements and information we may provide, contains “forward-looking statements”. These statements may include, but are not limited to, projections of revenues, income

or loss, capital expenditures, plans for future operations and financing needs or plans, as well as assumptions relating to the foregoing. The words “expect,” “project,” “estimate,” “predict,” “anticipate,” “believe,” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements include these expressions. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results, performance and achievements could differ materially from those set forth in, contemplated by or underlying the forward-looking statements. We assume no obligation to update any forward-looking statement to reflect actual results or changes in or additions to the factors affecting such forward-looking statements.

Factors that could materially and adversely affect our operations and financial condition and/or cause our actual results of operations or financial condition to differ from those expressed or implied in our forward-looking statements include, but are not necessarily limited to, the following:

- While we believe we have sufficient operating liquidity to sustain our operations through at least the next twelve months, we continue to explore strategic alternatives to attempt to maximize shareholder value. These alternatives include, but are not limited to, a merger, sale, joint venture, or other comparable transaction. We do not know the terms upon which these transactions might be available, if at all.

Our continued operations are dependent on our ability to manage investment risks. Unexpected volatility or illiquidity in the markets in which we directly or indirectly hold positions could adversely affect our business. Our investments may include a limited amount of investments in below investment grade fixed income securities. While any investment carries some risk, the risks associated with lower-rated securities generally are greater than the risks associated with investment grade securities.

- Under Bermuda law, a single creditor could make a statutory demand upon us for satisfaction of obligations owed to that creditor. If the statutory demand is held to be valid, and we are unable to satisfy our obligations to that creditor, the creditor may institute proceedings seeking the liquidation of our business.
- We ceased to write new reinsurance agreements. We do not anticipate resuming writing new reinsurance agreements in the foreseeable future. As a result, our cash flow and results of operations in the near future will be based solely upon the performance of the returns generated from our invested assets.
- In preparing our financial statements, we used estimates and assumptions based upon the best information available and management’s best judgment at the time our financial statements are prepared. While we believe these estimates to be reasonable, we cannot assure you that they will be accurate. If these estimates prove to be inaccurate, they could have a significant adverse impact on our financial condition and results of operations.
- Significant changes in interest rates expose us to the risk of reduced investment income when interest rates are falling and to greater realized losses from the sale of securities when interest rates are rising.
- The loss of William H. Mawdsley, our Chief Executive Officer, could adversely affect our business.
- When we purchase reinsurance from another reinsurance company, known as a retrocessionaire, to cover certain risks that we have ourselves reinsured, we are subject to the risk that the retrocessionaire will be unable to pay amounts due to us because of its own financial troubles. The failure of a retrocessionaire to pay amounts due to us will not absolve us of our responsibility to pay our customers for risks that we have insured. Failure of our retrocessionaires to pay us could have a material adverse effect on our business, results of operations and financial condition.
- We are subject to the laws and regulations of the jurisdictions in which we conduct business. These laws and regulations cover many aspects of our business, including licensure, premium rates, marketing practices and capital adequacy. Recently, the insurance and reinsurance regulatory framework has

become subject to increased scrutiny in many jurisdictions and regulators have started to reexamine existing laws and regulations. Changes in these laws and regulations could have an adverse affect on our operations. Further deterioration in our financial condition could expose our operations to increased levels of regulatory scrutiny and possibly to the winding up of our operations.

- As a holding company, we have no significant operations or assets other than our ownership of the capital stock of our subsidiaries. Dividends and other permitted payments from our subsidiaries are our sole source of funds to pay expenses and dividends, and any limitations imposed on our subsidiaries to make such payments to us may cause us to have insufficient funds to operate our business and satisfy our obligations.
- Holdings and Annuity and Life Reassurance, Ltd. are Bermuda corporations that we believe are not subject to United States income tax because neither engages in business in the United States. However, because there is no definitive guidance as to what constitutes being engaged in trade or business in the United States, there can be no assurance that in the future the Internal Revenue Service may not contend that we are engaged in trade or business in the United States. The Internal Revenue Service has conducted an audit of our United States subsidiaries for 2000 and 2001. There are no adjustments pending to date. In addition, the IRS had requested certain information and documents related to the Company's Bermuda operations. While our United States subsidiaries have complied with the IRS' requests for information, both we and our Bermuda operating subsidiary declined to supply the IRS with certain information in response to its initial requests for information on May 7, 2002 and July 1, 2002. We did provide the IRS with certain publicly available information regarding us and our Bermuda operating subsidiary in addition to minutes of the Board of Directors meetings and committee meetings held from 1999 through to 2001. We have not received any additional requests for information since July 1, 2002. If we were considered to be engaged in business in the United States, we could be subject to United States tax at regular corporate rates on our taxable income that is effectively connected with their United States business plus an additional 30% "branch profits" tax on such income remaining after the regular tax. Such taxes would have a material adverse effect on our results of operations and financial condition.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES

FINANCIAL STATEMENTS

For the Years Ended December 31, 2007 and 2006

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

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Marcum & Kliegman LLP

Certified Public Accountants & Consultants

A Limited Liability Partnership Consisting of Professional Corporations

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of Annuity and Life Re (Holdings) Ltd. (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, comprehensive loss, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Annuity and Life Re (Holdings) Ltd. as of December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Note 2 to the consolidated financial statements, the Company has ceased all insurance operations effective on December 31, 2005. Although the Company is continuing to operate due to ongoing commitments, including regulatory requirements, the Company's Board of Directors may determine that it is in the Company's best interest to cease all operations and submit a plan of liquidation to the stockholders for approval.

Marcum & Kliegman LLP

April 2, 2008

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ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2007 and 2006

<u>ASSETS</u>		
	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$ 29,377,930	\$ 16,412,672
Fixed income investments at fair value (amortized cost of \$3,960,193 and \$16,978,478, at December 31, 2007 and 2006, respectively)	4,028,124	16,874,570
Accrued investment income	163,263	459,802
Assets of discontinued operations-held for sale including cash of \$4,746,777 and \$1,796,772 at December 31, 2007 and 2006, respectively	80,722,165	85,647,045
Prepaid insurance	<u>68,118</u>	<u>68,118</u>
TOTAL ASSETS	<u>\$114,359,600</u>	<u>\$119,462,207</u>
<u>LIABILITIES</u>		
Reserves for future policy benefits	\$ 441,420	\$ 515,200
Liabilities of discontinued operations-held for sale	70,142,730	73,381,492
Other reinsurance liabilities	16,825,788	184,800
Accounts payable and accrued expenses	<u>538,334</u>	<u>647,153</u>
TOTAL LIABILITIES	<u>87,948,272</u>	<u>74,728,645</u>
<u>STOCKHOLDERS' EQUITY</u>		
Preferred shares (par value \$1.00; 50,000,000 shares Authorized; no shares issued or outstanding)	--	--
Common shares (par value \$1.00; 100,000,000 shares authorized; 24,533,811 and 24,808,811 shares issued and outstanding at December 31, 2007 and 2006, respectively)	24,533,811	24,808,811
Additional paid-in capital	335,994,775	334,125,057
Stock warrants	1,350,000	1,350,000
Accumulated other comprehensive income (loss)	281,209	(188,372)
Accumulated deficit	<u>(335,748,467)</u>	<u>(315,361,934)</u>
TOTAL STOCKHOLDERS' EQUITY	<u>26,411,328</u>	<u>44,733,562</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 114,359,600</u>	<u>\$ 119,462,207</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2007 and 2006

	2007	2006
<u>REVENUES</u>		
Investment income, net of related expenses	\$ 1,670,288	\$ 1,883,909
Net realized investment gains (losses)	<u>94,780</u>	<u>(887,061)</u>
TOTAL REVENUES	<u>1,765,068</u>	<u>996,848</u>
<u>BENEFITS AND EXPENSES</u>		
Claims and policy benefits	16,655,432	(697,967)
Policy acquisition costs and other insurance expenses	340,001	(185,064)
Operating expenses	<u>1,689,331</u>	<u>3,086,939</u>
TOTAL BENEFITS AND EXPENSES	<u>18,684,764</u>	<u>2,203,908</u>
<u>NET LOSS FROM CONTINUING OPERATIONS</u>	(16,919,696)	(1,207,060)
DISCONTINUED OPERATIONS	<u>(1,729,119)</u>	<u>78,030</u>
NET LOSS	<u>\$(18,648,815)</u>	<u>\$(1,129,030)</u>
LOSS PER SHARE FROM CONTINUING OPERATIONS BASIC AND DILUTED	<u>\$(0.68)</u>	<u>\$(0.05)</u>
LOSS PER SHARE FROM DISCONTINUED OPERATIONS BASIC AND DILUTED	<u>\$(0.07)</u>	<u>\$(0.00)</u>
NET LOSS PER COMMON SHARE BASIC AND DILUTED	<u>\$(0.75)</u>	<u>\$(0.05)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	<u>24,785,894</u>	<u>24,801,311</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
<u>NET LOSS FOR THE PERIOD</u>	\$(18,648,815)	\$(1,129,030)
<u>OTHER COMPREHENSIVE LOSS</u>		
Unrealized holding gain (loss) on fixed income investments	564,361	(534,956)
Less reclassification adjustment for net realized investment losses in net loss	<u>(94,780)</u>	<u>(1,184,307)</u>
TOTAL COMPREHENSIVE LOSS	<u>\$(18,179,234)</u>	<u>\$ (479,679)</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN
STOCKHOLDERS' EQUITY

December 31, 2007 and 2006

	2007	2006
<u>Preferred shares par value \$1.00</u>		
Balance at beginning and end of period	\$ --	\$ --
<u>Common shares par value \$1.00</u>		
Balance at beginning of period	24,808,811	24,793,811
Issuance of shares		15,000
Cancellation of shares	<u>(275,000)</u>	<u>--</u>
Balance at End of Period	<u>24,533,811</u>	<u>24,808,811</u>
<u>Additional paid-in capital</u>		
Balance at beginning of period	334,125,057	334,123,757
Issuance of shares and stock options	--	1,300
Cancellation of shares	<u>1,869,718</u>	<u>--</u>
Balance at End of Period	<u>335,994,775</u>	<u>334,125,057</u>
<u>Stock warrants</u>		
Balance at beginning and end of period	<u>1,350,000</u>	<u>1,350,000</u>
<u>Unamortized stock-based compensation</u>		
Balance at beginning of period	--	(22,800)
Amortization of stock-based compensation	<u>--</u>	<u>22,800</u>
Balance at End of Period	<u>--</u>	<u>--</u>
<u>Accumulated other comprehensive income (loss)</u>		
Balance at beginning of period	(188,372)	(837,723)
Net unrealized loss on fixed income investments	<u>469,581</u>	<u>649,351</u>
Balance at End of Period	<u>281,209</u>	<u>(188,372)</u>
<u>Accumulated Deficit</u>		
Balance at beginning of period	(315,361,934)	(314,232,904)
Cancellation of shares	(1,737,718)	--
Net loss	<u>(18,648,815)</u>	<u>(1,129,030)</u>
Balance at End of Period	<u>(335,748,467)</u>	<u>(315,361,934)</u>
TOTAL STOCKHOLDERS' EQUITY	<u>\$ 26,411,328</u>	<u>\$ 44,733,562</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2007 and 2006

	2007	2006
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Net loss from continuing operations	\$ (16,919,696)	\$ (1,207,060)
Adjustments to reconcile net loss from continuing operations to cash used in operating activities:		
Net realized investment (gains) losses	(94,780)	887,061
Changes in:		
Accrued investment income	296,539	(284,547)
Other assets	--	168,775
Reserves for future policy benefits	(73,780)	(573,368)
Amounts due reinsurer	--	1,612,093
Other reinsurance liabilities	16,640,988	184,800
Accounts payable and accrued expenses	<u>(108,821)</u>	<u>(4,152,794)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(259,550)</u>	<u>(3,365,040)</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Proceeds from sales and maturities of fixed income investments	13,367,808	17,553,019
Purchases of fixed income investments	<u> --</u>	<u>(15,056,089)</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>13,367,808</u>	<u>2,496,930</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
Purchase and cancellation of Company stock	<u>(143,000)</u>	<u> --</u>
NET CASH USED IN FINANCING ACTIVITIES	<u>(143,000)</u>	<u> --</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS CONTINUING OPERATIONS	12,965,258	(868,110)
<u>CASH AND CASH EQUIVALENTS CONTINUING OPERATIONS – Beginning</u>	<u>16,412,672</u>	<u>17,280,782</u>
<u>CASH AND CASH EQUIVALENTS CONTINUING OPERATIONS – End</u>	<u>\$ 29,377,930</u>	<u>\$ 16,412,672</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

For the Years Ended December 31, 2007 and 2006

	2007	2006
<u>CASH FLOWS FROM DISCONTINUED OPERATIONS</u>		
Cash flows from operating activities	\$ (364,786)	\$ (36,487,701)
Cash flows from investment activities	<u>3,314,791</u>	<u>36,287,765</u>
NET CASH FROM DISCONTINUED OPERATIONS	2,950,005	(199,936)
<u>CASH AND CASH EQUIVALENTS DISCONTINUED OPERATIONS – Beginning</u>	<u>1,796,772</u>	<u>1,996,708</u>
<u>CASH AND CASH EQUIVALENTS DISCONTINUED OPERATIONS – Ending</u>	<u>\$ 4,746,777</u>	<u>\$ 1,796,772</u>

See accompanying notes to the consolidated financial statements.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Organization and Description of Business

Annuity and Life Re (Holdings), Ltd. (“Holdings”) was incorporated on December 2, 1997 under the laws of Bermuda. Prior to July 1, 2005, Holdings provided annuity and life reinsurance to insurers and reinsurers through its wholly-owned subsidiaries: Annuity and Life Reassurance, Ltd., which is licensed under the laws of Bermuda as a long term insurer, Annuity and Life Re America, Inc., an insurance holding company based in the United States of America, and Annuity and Life Reassurance America, Inc., a life insurance company domiciled in the United States of America. Holdings, Annuity and Life Reassurance, Ltd., Annuity and Life Re America, Inc. and Annuity and Life Reassurance America, Inc., collectively referred to herein as the “Company.”

NOTE 2 - Basis of Presentation and Management’s Plans

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As a result of significant operating losses, the Company became unable to meet its monetary obligations under certain reinsurance treaties in 2002. Since that time, the Company has negotiated termination, recapture, and novation or coinsurance agreements for all reinsurance treaties with the applicable counterparties or independent third parties. Since December 31, 2005, there have been no reinsurance agreements in force that generated operating revenue for the Company. The Company’s only source of revenue in 2006 and 2007 is investment income.

Due to the absence of ongoing insurance operations, the Company has significantly reduced its operations including terminating employees, reducing the size of the Board of Directors, and moving to smaller office space. Because of statutory requirements, the wind-down or dissolution of the Company is not imminent. The Company continues to explore strategic alternatives to attempt to maximize its economic value for stockholders. The Company has engaged UBS Securities LLC (“UBS”) (see Note 3) as an exclusive financial advisor. On February 29, 2008 the Company closed the sale of its U.S. domiciled insurance company.

In addition, the Company may consider cash distributions to stockholders, stock buybacks or similar transactions, to the extent its financial condition allows it to do so and it is not constrained by insurance regulatory or other laws.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - Significant Events

Transamerica Transaction

In February 2008, the Company resolved its disputes with Transamerica regarding the December 31, 2004 novation of several reinsurance contracts. These disputes had been the subject of arbitration proceedings. The Company agreed to pay a total of \$16.567 million to settle all liabilities related to the novations. Transamerica received \$3 million and \$2.5 million, respectively, in settlement of the F&G and Scottish Re matters. In addition, the Company paid approximately \$11.1 million to Scottish Re. The settlement agreement discharges the Company from any future liabilities from Transamerica and Scottish Re. The Company continues to be liable for any pre-novation issues related to the F&G contract.

Repurchase of Common Shares

On November 21, 2007 Company agreed to purchase 275,000 shares from an unrelated shareholder. The purchase price of the share was \$0.52 per common share, a discount of 15% below the then current market price. There were no other rights associated with the repurchased shares.

Sale of U.S Based Subsidiary

On February 29, 2008, the Company, together with its wholly owned subsidiary, Annuity & Life Re America, Inc., sold its United States based insurance subsidiary, Annuity and Life Reassurance America, Inc. to an unrelated third party for \$11,058,717 in cash. Accordingly, the Company has recorded the financial statement effects of its entire U.S. based operations on its consolidated financial statements as Discontinued Operations- Held for Sale. See Note 11.

Engagement of Financial Advisor

On February 9, 2006, the Company retained UBS for financial and market related advice and assistance in exploring strategic alternatives, including a merger of Holdings into another entity, the sale of its operating subsidiaries or other comparable transactions. In addition, the Company may consider cash distributions to stockholders, stock buybacks or similar transactions, to the extent its financial condition allows it to do so. The Company has agreed to pay UBS a monthly retainer fee of \$10,000 which would be offset against a transaction fee of \$500,000 payable upon the closing of a potential transaction. The initial contract term was for a period of one year. The parties have verbally agreed to extend the contract on a month to month basis.

Suspension of Reporting Requirements under the Securities Exchange Act of 1934

On February 2, 2006, the Company filed Form 15 with the Securities and Exchange Commission ("SEC") which terminated the Company's reporting obligations under the Securities Exchange Act of 1934 and terminated the registration of its common stock. Since February 2, 2006, the Company's stock has been listed in the over-the-counter market under the trading symbol ANNRF.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - Summary of Significant Accounting Policies

Use of Estimates

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Actual results could differ from those estimates.

Basis of consolidation

The consolidated financial statements include the accounts of Holdings and its subsidiaries, Annuity and Life Reassurance, Ltd., Annuity and Life Re America, Inc. and Annuity and Life Reassurance America, Inc. All significant inter-company accounts and transactions have been eliminated upon consolidation.

Reserves for future policy benefits

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

Investments

The Company classifies its investments in fixed income securities as available for sale and, accordingly, such securities are carried at fair value. The cost of fixed income securities is adjusted for amortization of premiums and discounts. The carrying value of fixed income securities is adjusted for declines in value that are considered other than temporary and any such adjustment is considered a realized loss.

Realized gains and losses on investments are recognized in the results of operations, using the specific identification method. Changes in fair values of securities classified as available for sale are reflected in accumulated other comprehensive income (loss).

Loss per common share

The Company calculates basic earnings per common share and earnings per common share assuming dilution. Basic earnings per common share is calculated by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding during the period.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - Summary of Significant Accounting Policies, continued

Loss per common share, continued

Diluted earnings per common share is calculated by dividing the net income attributable to common stockholders by the weighted average number of common shares outstanding during the period, plus potential dilutive common shares. Options and warrants issued by the Company are considered potential dilutive common shares and are included in the calculation using the treasury stock method, unless their inclusion would be considered anti-dilutive.

Cash and cash equivalents

For the purposes of the statements of cash flows, the Company considers all time deposits and short-term investments with original maturities of 90 days or less as equivalent to cash. At times, the Company maintains cash balances in excess of the maximum amount insured by the FDIC.

Stock plans

The Company applies fair value accounting to all grants of employee stock options subsequent to December 31, 2002. The following table provides the required disclosure for grants made prior to the Company's adoption of the prospective method described in SFAS No. 148.

	Year Ended December 31,	
	2007	2006
Net loss - as reported	\$(18,648,815)	\$(1,129,030)
Stock based compensation expense recognized	--	22,800
Pro forma effect on net loss of applying fair value Accounting to all stock based compensation grants	--	(22,800)
Net Loss - pro forma	<u>\$(18,648,815)</u>	<u>\$(1,129,030)</u>
Net loss per common share - as reported:		
Basic and diluted	<u>\$ (0.75)</u>	<u>\$ (0.05)</u>
Net loss per common share - pro forma:		
Basic and diluted	<u>\$ (0.75)</u>	<u>\$ (0.05)</u>

The Company also granted restricted shares to employees in 2003 and 2002 included in above table. The stock based compensation expense for these grants amounted to \$0 and \$22,800 in 2007 and 2006, respectively.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 - Summary of Significant Accounting Policies, continued

Stock plans, continued

The fair value of the options is estimated on the date of grant using the Black-Scholes option-pricing model. The following table details the assumptions and fair values for options issued in the past five years:

Year of Grant	Dividend Yield	Expected Volatility	Weighted Average Risk Free Rate	Weighted Average Fair Value
2003	0.00%	241.10%	3.68%	\$ 1.03
2004	0.00%	50.00%	4.46%	\$ 0.30
2005	0.00%	15.50%	4.45%	\$ 0.46

NOTE 5 - Investments

The amortized cost and fair values of investments in fixed income securities classified as available for sale at December 31, 2007 and 2006 are as follows:

2007	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U.S. Government Securities	\$2,276,779	\$80,874	\$ --	\$2,357,653
U.S. Corporate Securities	1,102,248	843	(7,201)	1,095,890
Non U.S. Corporate Securities	<u>581,166</u>	<u>487</u>	<u>(7,072)</u>	<u>574,581</u>
	<u>\$3,960,193</u>	<u>\$82,204</u>	<u>\$(14,273)</u>	<u>\$4,028,124</u>
2006	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U.S. Government Securities	\$12,273,455	\$1,500	\$ (56,944)	\$12,218,011
U.S. Corporate Securities	4,107,397	--	(33,241)	4,074,156
Non U.S. Corporate Securities	<u>597,626</u>	<u>--</u>	<u>(15,223)</u>	<u>582,403</u>
	<u>\$16,978,478</u>	<u>\$1,500</u>	<u>\$(105,408)</u>	<u>\$16,874,570</u>

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - Investments, continued

The following table sets forth certain information regarding the investment ratings of the Company's fixed income securities portfolio at December 31, 2007 and 2006.

Ratings (1)	2007		2006	
	Amortized Cost	%	Amortized Cost	%
AAA	\$2,276,779	57.5%	\$12,273,455	72.3%
AA	--	--	200,865	1.2%
A	887,544	22.4%	2,076,757	12.2%
BAA	795,870	20.1%	1,380,133	8.1%
B	--	--	500,223	2.9%
Non Rated	<u>--</u>	<u>--</u>	<u>547,045</u>	<u>3.2%</u>
	<u>\$3,960,193</u>	<u>100.0%</u>	<u>\$16,978,478</u>	<u>100.0%</u>

(1) Ratings as assigned by Moody's.

The maturity distribution of fixed income securities held as of December 31, 2007 and 2006 is shown below. Actual maturity dates may differ from contractual maturity dates because certain borrowers have the ability to prepay their obligations without penalty.

	2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ --	\$ --	\$ 7,434,551	\$ 7,426,491
From one year to five years	3,960,193	4,028,124	6,723,427	6,684,523
From six to ten years	--	--	2,273,455	2,216,511
More than ten years	<u>--</u>	<u>--</u>	<u>547,045</u>	<u>547,045</u>
	<u>\$3,960,193</u>	<u>\$4,028,124</u>	<u>\$16,978,478</u>	<u>\$16,874,570</u>

Investment income, net of related expenses, earned during the years ended December 31, 2007 and 2006 was as follows:

	2007	2006
Interest income	\$1,739,071	\$2,086,738
Amortization of premiums (discount) on fixed income investments	(56,241)	(107,776)
Investment expenses	<u>(12,542)</u>	<u>(95,053)</u>
	<u>\$1,670,288</u>	<u>\$1,883,909</u>

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - Stockholders' Equity

Preferred Stock

The Company is authorized to issue 50,000,000 preferred shares of par value \$1.00 each. Currently, there are no preferred shares issued or outstanding.

Common Stock

The Company is authorized to issue 100,000,000 common shares of par value \$1.00 each. The common stockholders have no pre-emptive, redemption, conversion or sinking fund rights. Subject to certain voting restrictions, which limit the voting power of United States persons to less than 10%, and non-United States persons to less than 17%, of the combined voting power of the issued voting shares of the Company, each holder is entitled to one vote per share.

In the event of a liquidation, dissolution or winding up of the Company, the holders of the common shares are able to share equally in the assets of the Company, if any remain after payment of all liabilities and the liquidation preference of any outstanding preferred shares. Certain restrictions exist with respect to the transfer of shares, should such a transfer cause the number of shares held by one United States person to be 10% or more, or a non-United States person to be 17% or more, of the Company's outstanding common shares.

Class A Warrants

In connection with the initial capitalization of the Company, the Company issued Class A Warrants that initially entitled the holders to purchase up to 3,059,990 common shares of the Company. The initial exercise price of the Class A Warrants was \$15.00, which was equal to the price of the Company's common shares in the initial public offering. As the result of the issuance of warrants to Hartford Life Insurance Co. and CIGNA, discussed below, the effect of anti-dilution adjustment provisions in the Class A Warrants has increased the number of shares issuable upon exercise of the Class A Warrants to 3,265,515 common shares and the exercise price of the Class A Warrants has been adjusted to \$14.06. The Class A Warrants are all currently exercisable and expired on January 15, 2008. No Class A Warrants had been exercised at December 31, 2007.

Class B Warrants

In connection with the direct sales of equity securities to certain "Strategic Investors" in connection with the Company's initial public offering, the Company issued Class B Warrants that initially enabled the holders to purchase an aggregate of 397,500 common shares of the Company. The initial exercise price of the Class B Warrants was \$15.00 per share, which was equal to the price of the common shares in the initial public offering. As the result of our issuance of warrants to Hartford Life and CIGNA, discussed below, the effect of anti-dilution adjustment provisions in the Class B Warrants has increased the number of shares issuable upon exercise of the Class B Warrants to 424,198 common shares and the exercise price of the Class B Warrants has been adjusted to \$14.06.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - Stockholders' Equity, continued

In 2005, the Company purchased from Overseas Partners 133,396 Class B warrants. Following the acquisition, the Warrants were cancelled by the Company. The remaining 290,802 Class B Warrants are all currently exercisable and expire on April 15, 2008. No Class B Warrants had been exercised at December 31, 2007.

Stock Warrants

In 2003, the Company issued warrants to purchase an aggregate one million common shares of the Company at an exercise price of \$1.25 per share to Hartford Life, the ceding company under the Company's then largest guaranteed minimum death benefit reinsurance agreement. The warrants were issued in connection with the recapture of that agreement and expire on June 30, 2013, and are currently exercisable. The fair value of these warrants at the date of issue, using a Black-Scholes pricing model, was estimated at \$1,250,000.

In connection with the recapture of the Company's GMDB/GMIB reinsurance agreement with CIGNA on October 26, 2004, the Company issued CIGNA a warrant dated as of September 30, 2004 to acquire one million common shares of the Company at an exercise price of \$1.00 per share. The warrant expires on September 30, 2014 and is currently exercisable. The fair value of this warrant at the date of issue, using a Black-Scholes pricing model, was estimated at \$100,000.

NOTE 7 - Loss Per Common Share

As of December 31, 2007 and 2006 the Company had 124,000 stock options outstanding, there were Class A and Class B warrants outstanding representing the right to acquire 3,556,317 shares as of December 31, 2007 and 2006.

The calculation of the diluted loss per common share does not include the incremental number of shares from the assumed exercise of options and warrants because their inclusion would be anti-dilutive.

NOTE 8 - Agreements with Related Parties

Michael P. Esposito, Jr., a director of the Company, served as the non-executive Chairman of the Board of XL Capital Ltd ("XL Capital") until December 28, 2007.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - Agreements with Related Parties, continued

In 2005, the Company entered into letter agreements with William H. Mawdsley and John W. Lockwood setting forth the terms of their continued employment by the Company. Pursuant to the letter agreement with Mr. Mawdsley, he is entitled to an annual salary of \$250,000 and an additional \$13,000 per month as a housing and travel allowance. Effective with the execution of the letter agreement, Mr. Mawdsley was named the Company's Chief Executive Officer and he was appointed to fill a vacancy on the Company's Board of Directors. Mr. Mawdsley had previously been a Vice President of the Company and the Chief Actuary of its Bermuda based operating subsidiary. Pursuant to the letter agreement with Mr. Lockwood, he is entitled to an annual salary of \$200,000 and an additional \$7,500 per month as a housing and travel allowance. Mr. Lockwood will continue to serve as the Company's Chief Financial Officer and President of the Company's United States based subsidiaries.

The Company agreed to continue to provide Messrs. Mawdsley and Lockwood with the same benefits, consisting primarily of housing allowances they are currently receiving, and they will be eligible for bonus compensation at the discretion of the Company's Board of Directors. Mr. Mawdsley and Mr. Lockwood may be terminated at any time for any reason, but if such termination is without "cause" (as defined in the letter agreements), Mr. Mawdsley would be entitled to receive a severance payment of \$620,000 plus reasonable relocation expenses from Bermuda to the United States, and Mr. Lockwood would be entitled to receive a severance payment of \$490,000. Both men would also receive the foregoing severance payments if they resign because of a reduction in their base salary or housing allowance to which they did not agree or if they resign for any other reason within the period commencing 90 days and ending 180 days following the effective time of (i) the acquisition of all of the outstanding equity securities of Holdings or (ii) the merger of Holdings with another entity, other than one of Holding's direct or indirect wholly owned subsidiaries. Effective on March 31, 2008, the Company terminated the employment agreement with Mr. Lockwood.

NOTE 9 - Compensation Plans

Stock Option Plan

In 1998, the Company adopted a Stock Option Plan (the "Plan") under which it may grant, subject to certain restrictions, Incentive Stock Options ("ISO's") and Non-Qualified Stock Options ("NQSO's"). The aggregate number of common shares for which options may be granted under the Plan was initially limited to 1,552,500 common shares. In 1999, the Plan was amended such that options may be granted in any fiscal year equal to not more than 2% of the adjusted average of the outstanding common shares of the Company, as that number is

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 - Compensation Plans, continued

Stock Option Plan, continued

determined by the Company to calculate diluted earnings per share. Only eligible employees of the Company are entitled to ISO's, while NQSO's may be granted to eligible employees, non-employee directors and consultants. The Board of Directors administers the Plan.

The term of the options granted under the Plan will not be more than ten years from the date of grant. Unless otherwise provided in the option agreement related to a specific grant, options granted under the Plan will be exercisable in three equal annual installments, commencing on the first anniversary of the grant date.

Each person who becomes an eligible non-employee director, as defined in the plan, is automatically granted an option to purchase 15,000 common shares on the date he or she becomes an eligible non-employee director. These options have an exercise price equal to the greater of par value per common share or the fair market value of the common shares on the date the options are granted and are exercisable in three equal annual installments commencing with the first anniversary of the grant date. In addition, prior to 2006 and subject to certain conditions, each non-employee director was automatically granted an option to purchase 5,000 common shares at each successive annual general meeting. These options had an exercise price equal to the greater of fair market value of the optioned common shares on the date the options were granted or par value and are immediately exercisable if granted after April 8, 1999.

	2007		2006	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at beginning of Year	124,000	\$7.98	407,702	\$14.08
Exercised	--	--	(15,000)	1.00
Forfeitures	--	--	<u>(268,702)</u>	<u>(17.62)</u>
Outstanding at end of year	<u>124,000</u>	<u>\$7.98</u>	<u>124,000</u>	<u>\$ 7.98</u>

At December 31, 2007, options to acquire 124,000 common shares were exercisable. The weighted average remaining contractual life of these exercisable options was approximately 5 years.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 - Compensation Plans, continued

The following table summarizes information about the Company's stock options for options outstanding and exercisable as of December 31, 2007:

Range of Exercise Prices		Options Outstanding			Options Exercisable	
		Number of options	Average Remaining Contractual Life	Average Exercise Price	Number of options	Average Exercise Price
\$ 1.00	\$ 1.17	82,500	6.20	\$ 1.11	82,500	\$ 1.10
<u>16.22</u>	<u>28.50</u>	<u>41,500</u>	<u>3.13</u>	<u>21.64</u>	<u>41,500</u>	<u>21.64</u>
<u>\$ 1.00</u>	<u>\$28.50</u>	<u>124,000</u>	<u>5.17</u>	<u>\$ 7.98</u>	<u>124,000</u>	<u>\$ 7.98</u>

The Company has adopted the fair value based method of accounting for stock-based employee compensation under the prospective method described in SFAS No. 148. Under this method, the Company applies fair value accounting to all grants of employee stock options subsequent to December 31, 2002. Based on the vesting of the options granted, and offset partially by cancellations of options, the Company recorded stock-based compensation expense of approximately \$22,800 in 2006. Unamortized stock-based compensation expense at December 31, 2007 amounted to \$0. The fair value of stock options awarded to employees and new directors will be amortized into income over the three-year vesting period. The fair value of stock options awarded to all other directors will be expensed immediately as their options are exercisable on the day of grant and vest upon their award.

Restricted Stock Plan

The Company adopted a Restricted Stock Plan (the "Restricted Stock Plan") under which it may grant common shares to key employees. The aggregate number of common shares that may be granted under the Restricted Stock Plan is 1,200,000, and the Board of Directors administers the Restricted Stock Plan. The Company issued 976,000 shares of restricted stock. As a result of certain employees terminating their employment with the Company and the closing of the Wilton Re transaction there are no outstanding restricted common shares remaining as of December 31, 2006 and 2007.

NOTE 10 - Retrocession Agreements

The Company's wholly owned subsidiary, Annuity & Life Reassurance America, Inc. is a party to a retrocession agreement with the prior owner related to business assumed prior to June 1, 2000, the date Annuity & Life Reassurance America, Inc. was acquired by the Company. Retrocession agreements do not relieve the Company from its obligations to the ceding companies and failure of the Company's reinsurers to honor obligations could result in losses to the Company. The amounts related to the reinsured business are included on the Company's consolidated balance sheet in assets of discontinued operations and with an offsetting liability recorded as liabilities of discontinued operations. At December 31, 2007 and 2006, these amounts were \$68.2 million and \$73.0 million, respectively. As described in Note 3, Annuity & Life Reassurance America, Inc. was sold on February 29, 2008.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - Discontinued Operations

As previously disclosed in Note 3, the Company sold its U.S. based insurance subsidiary on February 29, 2008.

The Company realized proceeds from the sale of \$11,058,717 and recorded a charge to loss from discontinued operations of approximately \$1.2 million which includes \$500,000 in transaction fees due UBS.

As a result of the closing of the sale transaction, the Company plans to dissolve Annuity & Life Re America, Inc. The Company has recorded \$590,000 in severance costs and other expenses to be paid as a result of the dissolution.

The consolidated assets and liabilities of Annuity & Life Re America, Inc. and Annuity & Life Reassurance America, Inc. are comprised of the following at December 31, 2007 and 2006:

	2007	2006
<u>Assets</u>		
Cash and cash equivalents	\$ 4,746,777	\$ 1,796,772
Fixed income investments at fair value (amortized cost of \$7,359,427 and \$10,700,272 at December 31, 2007 and 2006, respectively)	7,574,149	10,617,254
Receivable for reinsurance ceded	68,183,753	72,972,368
Accrued investment income	162,259	226,592
Other assets	55,227	34,059
Total Assets	\$80,722,165	\$85,647,045
<u>Liabilities</u>		
Reserves for future policy benefits	\$68,198,203	\$72,977,368
Accrued loss on disposal	1,200,371	--
Other reinsurance liabilities	--	140,687
Accounts payable and accrued expenses	744,156	263,437
Total Liabilities	\$70,142,730	\$73,381,492

The consolidated statements of operations of Annuity & Life Re America, Inc. and Annuity & Life Reassurance America, Inc. are comprised of the following at December 31, 2007 and 2006:

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - Discontinued Operations, continued

	2007	2006
<u>REVENUES</u>		
Investment income, net of related expenses	\$ 520,291	\$ 540,299
Net realized investment gains (losses)	<u>27,589</u>	<u>(297,246)</u>
 TOTAL REVENUES	 <u>547,880</u>	 <u>243,053</u>
<u>BENEFITS AND EXPENSES</u>		
Claims and policy benefits	54,468	(56,503)
Operating expenses	1,022,160	221,526
Loss on disposal	<u>1,200,371</u>	<u>---</u>
 TOTAL BENEFITS AND EXPENSES	 <u>2,276,999</u>	 <u>165,023</u>
 <u>NET (LOSS) INCOME FROM OPERATIONS</u>	 <u>\$(1,729,119)</u>	 <u>\$ 78,030</u>

NOTE 12 - Contingencies

The Company may be subject to contingencies for amounts that may be due under previously terminated or recaptured reinsurance agreements relating to deaths that occurred prior to such terminations or recaptures. The Company is also liable for obligations that have been 100% reinsured with third parties in the event the reinsurer is unable or unwilling to pay its obligations.

The Company has continuing obligations under an employment agreement with its CEO, including obligations to make severance payments under certain circumstances. These amounts have not yet been reflected in the balance sheet.

NOTE 13 - Fair Value of Financial Instruments

The following discussion outlines the methodologies and assumptions used to determine the estimated fair value of the Company's financial instruments. Considerable judgment is required to develop these fair values. Accordingly, the estimates shown are not necessarily indicative of the amounts that would be realized in a one-time, current market exchange of all of the Company's financial instruments.

Fixed Income Securities

Fair values for fixed income securities are based on quoted market prices, where available. For fixed income securities not actively traded, fair values are estimated using values obtained from independent pricing services.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - Fair Value of Financial Instruments, continued

Cash and Cash Equivalents

The carrying value of assets classified as cash and cash equivalents approximates fair value.

Other Items

Fair value disclosures are not required for reinsurance balances recoverable, deferred policy acquisition costs, or liabilities arising from insurance and annuity contracts. As a result, the Company has not determined such disclosures. Fair values of other assets and liabilities approximate their carrying values due to their short-term nature.

NOTE 14 - Taxation

The effective tax rate provided for in the financial statements is computed at a rate of zero. A substantial portion of the Company's operations is based in Bermuda and as a result income is exempt from taxation. There is no income or capital gains tax payable by the Company or Annuity and Life Reassurance, Ltd.

Under current Bermuda law, the Company and Annuity and Life Reassurance have received from the Bermuda Minister of Finance, under The Exempted Undertakings Tax Protection Act 1966 of Bermuda, assurances to the effect that in the event of there being enacted by Bermuda any legislation imposing tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax shall not be applicable to them or to any of their respective operations or to their shares, debentures or other obligations until March 28, 2016. This is not to be construed so as to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda or to prevent the application of any tax payable in accordance with the provisions of The Land Tax Act 1967 of Bermuda or otherwise payable in relation to any property leased to the Company or its Bermuda subsidiary.

Annuity and Life Re America and Annuity and Life Reassurance America, Inc. (together "the Company's United States operating subsidiaries"), are subject to all applicable Federal and State taxes of the United States. U.S. income taxes applicable to the Company's U.S. operations are not material to the consolidated financial statements and, therefore, no separate item appears in the consolidated statement of operations or the consolidated balance sheet.

The Company's United States Operating Subsidiaries file stand-alone U.S. Federal Income Tax returns and are not party to any tax sharing arrangements between them that may be available under U.S. Federal Tax laws. There are no tax positions taken that meet the "more likely than not" threshold for recognition in the Company's financial statements. Our United States based operating subsidiaries remain subject to examination by the U.S. Internal Revenue Service (the "IRS") for the tax years 2004, 2005 and 2006.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 - Taxation, continued

No deferred tax asset or liability related to operations has been recognized. Stand alone net operating results for the Company's U.S. operations for the year ended 2007 and 2006 was a gain of \$1,252 and \$78,030, respectively. The tax basis net operating loss carry forward at December 31, 2007 was \$14,322,952 which begins expiring in 2015. The Company does not expect that its future taxable net income will be sufficient to offset its deferred tax asset within a reasonable time period. The Company's deferred tax asset is primarily the result of net operating loss carry forwards. Therefore, the Company has established valuation allowances of approximately \$5,013,000 and \$6,201,000 at December 31, 2007 and 2006, respectively, against its deferred tax asset. The aforementioned tax loss carry-forward will transfer to the purchasers of the Company's U.S based subsidiary upon closing of the sale transaction, subject to applicable limitations.

Tax Related Risks and Uncertainties

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

The Company has no reinsurance treaties in force that generate operating revenue. As a result, there may be tax consequences to stockholders that are US taxpayers. Those consequences include, but are not limited to, taxes, tax penalties, and certain elections required or imposed for an investment in a Passive Foreign Investment Company.

NOTE 15 - Statutory Requirements and Dividend Restrictions

The Company and Annuity and Life Reassurance are required to comply with the provisions of the Companies Act that regulate the payment of dividends and the making of distributions from contributed surplus. Neither the Company nor Annuity and Life Reassurance may declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (i) the relevant company is, or would be after the payment, unable to pay its liabilities as they become due; or (ii) the realizable value of the relevant company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. As of and since December 31, 2002, the Company has not declared a dividend. The Company's ability to pay dividends depends on the ability of its operating subsidiaries to pay dividends to the Company, which may be subject to regulatory constraints that affect their ability to pay dividends to the Company.

ANNUITY AND LIFE RE (HOLDINGS), LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 - Statutory Requirements and Dividend Restrictions, continued

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

In 2007, Annuity & Life Reassurance, Ltd. paid a dividend of \$593,000 to its parent Annuity & Life Re (Holdings), Ltd.

Annuity and Life Reassurance America, Inc. is subject to statutory regulations of the state of Connecticut in the United States that restrict the payment of dividends. It may not pay dividends in any 12-month period in excess of the greater of the statutory net gain from operations for the immediately preceding calendar year excluding pro rata distributions of any class of Annuity and Life Reassurance America's securities or 10% of Annuity and Life Reassurance America's statutory surplus as regards policyholders as of the immediately preceding December 31 at the end of the preceding year, without regulatory approval. Connecticut regulations also require that dividends be paid from earned surplus unless prior regulatory approval is granted. At December 31, 2007, the statutory capital and surplus of Annuity and Life Reassurance America was approximately \$11.7 million (unaudited).

