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Dear Mr Spellman

**Kaupthing Singer & Friedlander Isle of Man (KSFIOM)**

We write further to our meeting last week. You are aware that our clients remain of the view that the Isle of Man Treasury (IoMT) should make good the losses of depositors in their entirety and following the resultant assignment seek recovery through the Bank. Without prejudice to that view we submit comments in relation to the Scheme of Arrangement (SoA) as explained to our clients the other day.

We note the following verbal reassurances we received from yourself and Alix Partners during the meeting:-

1. The SoA is in effect "Liquidation Plus". It is a Funds Distribution Scheme alongside the Provisional Liquidation process. It will have all the benefits of liquidation and indeed, if deemed appropriate, could be followed by a formal liquidation or a sale of the Bank to a third party.
2. Under the SoA, creditors will enjoy all the legal rights that they would enjoy if KSFIOM was in liquidation, in particular rights to take action against parties related or affiliated to the company.
3. Under the SoA all depositors will be better off than in a liquidation plus DCS scenario. After two years from Scheme implementation 70%+ of depositors will be fully compensated
4. The SoA will be administered by an independent officer – either the Provisional Liquidator (PL) or an independent individual under the PL's authority, in either case appointed by creditors.
5. IOMT will be waiving any voting rights gained as a result of depositor take up under the Early Payment Scheme.
6. Exchange rates will be dated some time in April 2009, not October 2008 as originally proposed.

All these points should be fully disclosed and clarified specifically in the SoA contractual document. It is particularly important that third party legal rights are carved out so as to avoid any confusion with a moratorium on action against the Bank. We believe that legal action will be inevitable if 100p recovery upfront by depositors cannot be secured. The manner in which the Bank was operated by its directors under the supervision of the FSC gives rise to considerable question as to conduct and liability of the directors and the FSC. We will be writing to the Provisional Liquidator this week to put him on notice that our clients will be submitting documents and other materials in due course with the expectation that he takes appropriate action on behalf of all depositors.

Beyond the above, we believe that there is still scope to make the SoA more convincingly advantageous to the alternative of liquidation:

1. The SoA must contain powers to enable KSFIOM to assume debt and repay depositors on an accelerated timetable. We remain steadfast in our view that discussions on SoA content should not be viewed as unqualified acceptance of the SoA or liquidation as the depositors' preferred options. Any provision in the SoA that prevents a faster, more comprehensive and hence more just resolution of this unfortunate situation could easily result in depositors voting to reject the SoA.
2. The threshold at which the IoMT starts to recoup funds should be 100p, not 60p. While true best practice would yield 100% recovery to depositors upfront, the SoA should seek to mirror best practice too, albeit over the asset realisation time period

The 60p/£ threshold represents a repayment of £510m to depositors (60% of £850m), which is your stated "risk appetite". Up to this threshold IoMT has committed £175m to the SoA, (approximately 34% of £510m) so in effect only £337m will have been realised from the Bank's assets. Our view is that this represents an unjustifiably low assessment of asset realisation rates, as the following table illustrates;

#### KSFIOM

	Book Value £m	Adjusted for £175m from IOMT			
		Estimated Recovery %	Estimated Recovery £m	Estimated Recovery %	Estimated Recovery £m
<b>Bank Assets</b>					
Cash	140	100%	140	100%	140
CDs	36	100%	36	100%	36
Loan book	427	20%	85	45%	192
KSFIOM	390	20%	78	37%	144
	993	34%	339	52%	512

Given the IOMT's stated appetite for risk and the quality of KSFIOM assets, we consider 100p/£ to be the appropriate level at which the IOMT should be seeking to recover its commitment of £175m, as the following table illustrates:

	<b>Adjusted for £175m from IOMT</b>				
	<b>Book Value £m</b>	<b>Full Recovery %</b>	<b>Full Recovery £m</b>	<b>Full Recovery %</b>	<b>Full Recovery £m</b>
<b>Bank Assets</b>					
Cash	140	100%	140	100%	140
CDs	36	100%	36	100%	36
Loan book	427	72.0%	307	82.5%	352
KSFUK	390	50.0%	195	82.5%	322
	<u>993</u>	68%	<u>678</u>	86%	<u>850</u>

3. The SoA needs to make clear that the upfront bank financing is fully underwritten. We appreciate that you feel this is not our clients' problem, but we cannot ignore the need for this guarantee. In assessing the attractiveness of the SoA to our clients we have to be in a position to reassure them that the Scheme can work in practice not just in theory.
4. The SoA should specify all planned co-signatories to the document. In addition, all co-signatories should provide full representations and warranties that there is no information which may in any way effect the minds of depositors when voting and which is undisclosed.
5. There are three classes of depositor who should vote on the SoA, namely
  - unprotected at all by DCS
  - balances above £50,000/£20,000 DCS limits
  - balances less than 50,000/£20,000 DCS limits

These meet the tests set out in the affidavit of Gabriel Moss.

6. The Provisional Liquidator costs associated with the preparation of the SoA should be borne by IoMT whether or not the SoA proceeds.
7. You have recognised that exchange rates on October 8 are not relevant today. It would make sense to eliminate the currency debate altogether and repay depositors in their deposited currency. This is best practice in other jurisdictions.

In summary, our clients continue to believe that IoMT should be seeking to ensure that all depositors are refunded 100% upfront and should be working with UK Government and Life Companies to resolve this unfortunate situation. This alternative has a number of advantages to IoM, not least the avoidance of five years continual dialogue between ourselves/our clients and the Provisional Liquidator/yourselves.

In the event of the SoA proceeding, the opportunity for 100% recovery should remain available to depositors through provisions in the SoA, namely powers to assume debt, guarantee of protected legal rights and a threshold of 100p/£ before IOMT receives any dividends.

Yours faithfully

**Edwin Coe LLP**

**Cc Alan Bell**