

Mr Michael Simpson
PricewaterhouseCoopers
Sixty Circular Road, 3rd Floor
Douglas IM1 1SA
Isle of Man

20 April 2009

Our Ref: DMG/DDB/KSF.1.1

Dear Mr Simpson

Kaupthing Singer and Friedlander Isle of Man (KSFiom)

We write in relation to Isle of Man Treasury's (IoMT) proposed Scheme of Arrangement (SoA).

We attach a copy of our letter to John Spellman of IoMT following our meeting with him, Alix Partners and Herbert Smith last week. The letter sets out our observations on and suggestions for improvements to the SoA. We wish to put on record that our clients are looking to the Provisional Liquidators to support their request for improved terms.

Our clients believe that the IoMT should make a non returnable payment to depositors to ensure that depositors are compensated in full. This is in line with what has occurred in all respectable jurisdictions in which major bank failures have occurred. They believe that the credibility of the Isle of Man as a banking jurisdiction can only be restored if this occurs. The comments on the SoA put forward in this letter are made subject to that demand. Our clients expect the Provisional Liquidators to seek to secure such a payment from the IoMT.

Our clients are particularly concerned about the 60p in the pound threshold at which the IoMT plans to receive a dividend. Can you please advise whether or not the Provisional Liquidators have pressed IoMT for a higher level? The 60p level is unfairly and arbitrarily low in the light of the quality of KSFiom assets, and your own personal comments about the absence of loan defaults.

In our letter to Mr Spellman we have stressed the importance our clients attach to the SoA preserving creditor rights for third party legal action to be taken on their behalf. It is important that the Provisional Liquidators understand how serious our clients are on this point. We have written to KSFiom directors putting them on notice of potential legal action against them. We believe there is a strong legal case against them for negligence and failure to perform their duties, particularly in relation to their disregard for banking guidelines against a background of known concerns about the frailty of Icelandic banks. You will be familiar with the regulations and best practice. These appear to have been flouted with the placing of assets firstly with the Kaupthing hf in Iceland and subsequently with KSF in London. The consequences are only too well known and have led to substantial losses.

We also believe a strong case may exist against both the FSA and FSC. There is resistance to full disclosure of correspondence between these two organisations. The documentation currently in the public domain suggests a substantial failure of communication between them. We expect the Provisional Liquidators to pursue proper disclosure of the communications between these bodies.

In the case of the FSC there is strong evidence of it acting in way which appears at the very least to have been negligent and may at worst have amounted to misfeasance. By way of example

- It was at the very least complicit in KSFIOM placing a very significant proportion of its assets in KSF UK, allowing these assets to fall victim to the UK treasury's interventions of 3 October and 8 October 2008. This was against all established rules of regulatory prudence.
- It is now apparent that the FSC allowed all IoM banks to make misleading claims as to the guarantees provided by the Depositors Compensation Scheme (DCS). These misleading claims about the solidity of the DCS continue to be tolerated by the FSC – there is no mention made on the bank websites or in their literature that the DCS is unfunded and that the legislation does not specify when compensation must be paid. Nor is there mention on the summary page of the FSC website that the DCS has the right to become a creditor of the DCS once the protected sums have been paid. Indeed the site specifically indicates that the scheme is funded by banks.
- In the case of KSFIOM the FSC also permitted a misleading claim as to the strength of the parent bank guarantee.

We are concerned that in response to depositor questions you have given the impression that there does not appear to be evidence for legal cases to be brought in the future. This is an unfortunate perception and we would like reassurances that you remain open minded at this stage and will press for the SoA to contain provisions that ensure our clients' rights are fully protected as if KSFIOM were in liquidation. This will include provision that none of the potential defendants to actions by KSFIOM or its creditors shall be able under the SoA to influence the decision of the Provisional Liquidator and/or Scheme Administrator as to the pursuit or conduct of any litigation.

In addition we will expect you to seek full disclosure from the FSA, the FSC, KSF UK and the United Kingdom Treasury so that the case for action against them can be examined.

Finally, we would ask that you keep detailed records of your costs incurred in supporting the development of the SoA and that you ensure these are met by IOMT, whether or not the SoA proceeds. We understand that this has in principle been agreed by the IoMT, but we would be grateful if you could confirm that this is the case.

Yours faithfully

Edwin Coe LLP