



Kaupthing Singer & Friedlander Isle of Man
KSFIOM Depositors Action Group

**Memorandum submitted to the Tynwald Select Committee
in relation to events following the collapse of
Kaupthing Singer & Friedlander (IOM) Ltd (KSFIOM)**

**on behalf of
Kaupthing Singer & Friedlander Isle of Man
Depositors Action Group**

September 2010

The First (Interim) Report of the Tynwald Select Committee on KSFIOM concerning the first part of the Committee's remit was published in June 2010 and may be consulted at www.tynwald.org.im or via the KSFIOMDAG website at:

http://www.ksfiomdag.com/index.php?option=com_kb&task=article&article=147&Itemid=106

The Joint Response of the KSFIOM Depositors Action Group (KSFIOMDAG) and the Partially Protected Depositors Group (PPDG) to the Interim Report may be viewed and consulted at:

http://www.ksfiomdag.com/index.php?option=com_kb&task=article&article=151&Itemid=106

Contents

Remit of the Select Committee Inquiry	3
Introduction	3
Section 1: Efforts made in relation to keeping KSFIOM as a going concern	4
Section 2: The proposed Scheme of Arrangement	4
Section 3: The Depositors' Compensation Scheme	8
Section 4: Communication with depositors by the IOM authorities	10
Section 5: Efforts made to ensure 100% return of depositors' funds... ..	12
Appendix 1: Background relating to depositor protection in the IOM prior to 9th October 2008	13
Appendix 2: Key events following 8 th October 2008	15
Appendix 3: The Informal IOMT/DAG Committee set up in December 2008 to consider alternative proposals to liquidation: a statement by four DAG participants.	21
References	24

Remit of the Select Committee Inquiry

The remit of the Select Committee, set up by Tynwald on 16th July 2009, was to investigate and report on:

- (1) the cause of the collapse of Kaupthing Singer & Friedlander (IOM) Ltd*
- (2) the role of the Financial Supervision Commission in ensuring the proper management of Kaupthing Singer & Friedlander (IOM) Ltd to protect depositors' funds*
- (3) the credibility of the Depositors' Compensation Scheme; and*
- (4) any other relevant matter*

The first two items were addressed in the first part of the inquiry and form the subject of the Interim Report.

Introduction

The present submission relates to items 3 and 4, including our views on the proposed Scheme of Arrangement and the communication between the Isle of Man (**IOM**) authorities and the depositors.

KSFIOMDAG's submission for the first part of the inquiry, available from our website, contains much background information which we will not repeat here.[1] Although essentially concerned with the period leading up to the collapse of the bank, section 6 of that submission deals briefly with events subsequent to 9th October 2008 and should be read in conjunction with the present memorandum.

For this second part of the inquiry, our submission is intended to provide our views on the specific issues identified for investigation by the Select Committee (Sections 1 - 4), together with additional points we would wish to see addressed (Section 5).

Relevant background material relating to depositor protection in the IOM and a chronological account of the key events since the collapse of the bank as we experienced them is provided in Appendices 1 and 2.

Appendix 3 is a statement by four members of the then DAG steering committee who, in December 2008 and January 2009, took part in an informal committee set up by IOM Treasury to seek indicative support to alternative proposals to the liquidation of KSFIOM and makes reference to e-mail correspondence from the discussion of those proposals that has been redacted to protect the identities of depositors who wish to remain anonymous. As these members have had to step back from the DAG Steering Group for personal reasons, they have preferred to provide their evidence covering this period in time separately rather than commit to reviewing the whole of DAG's submission and, without taking away from that, we include it here at their request as their submission for ease of reference. The supporting evidence (Ev 1-16) is submitted in 3 separate files.

Separate files forming part of this Submission:

KSFIOMDAG Qualitative analysis of SoA.pdf

DAG Evidence 1-14.pdf

DAG Evidence 15.pdf

DAG Evidence 16.pdf

1. Efforts made in relation to keeping KSFION as a going concern

References to efforts being made were made by IOM government (IOMG) officials in discussions with DAG representatives in the early months following the bank's collapse, as can be seen from the evidence supplied¹. [Ev 6]

However, as far as we are aware, no concrete or detailed information was ever made available on this subject beyond these vague references, making it difficult to comment on the efforts made, if any, to keep KSFION as a going concern. In this context, it is notable that, in marked contrast to the UK authorities, who rapidly found a buyer for KSFUK's Edge business (in the form of ING), the IOM authorities never appeared to have a plan such as this ready to implement and nor did they deliver any update on developments on this front to retail creditors or explain why they were not being pursued with IOMG support as necessary to make such an outcome viable.

We also note that it is our understanding that the advisers to IOM Treasury (IOMT), Alix Partners, were appointed on terms that did not incentivise a speedy or simple solution, which – if this information is correct - we consider to be a fundamental and naïve error of judgment or oversight on the part of IOMT. Terms that reward a lengthy engagement, whether directly or indirectly, would not align the interests of IOMT, their advisers and the retail creditors of KSFION.

Whilst this issue may also be relevant in the following section, we mention it at this point in case the Committee is able to ascertain whether our understanding is correct in this context also.

2. The proposed Scheme of Arrangement

A Scheme of Arrangement (SoA) was first mooted by the IOMT on 27th November 2008, at the second court hearing of the petition to wind up the bank. The stated objective was to explore the possibilities of restructuring with a view to achieving “*more for depositors than [through liquidation and the Depositors' Compensation Scheme]*”.[13] An adjournment of 60 days was requested and granted in order to “*develop a plan that will meet with approval ...*”. Two further adjournments were necessary before – over 4 months later, on 9th April 2009 - the proposed SoA was judged by the Court to be “*not a model of clarity*” but not so defective as not to be put to a vote of creditors.[34] Throughout the long process of delaying liquidation and triggering the DCS, it was clearly understood by DAG from statements made by the IOMT that if the proposed compromise scheme was eventually rejected by depositors then DAG's legal costs of and occasioned by opposing the scheme and the associated delays would be borne by Treasury.

Early optimism that the IOMT was genuinely working to find a full and satisfactory resolution for depositors persuaded the then-members of the DAG Steering Committee to accept an invitation from John Spellman, former Finance Manager to the IOMT, in December 2008, to take part in an informal committee to consider and, it was hoped, to

¹ e-mail from J Spellman, 2 Jan 2009: “*JS: A SoA is simply a tool so I assume you mean types of approach. Examples are mergers with local entities (limited interest), asset swaps with london (not interested at this stage), debt sale to Iceland in exchange for assets (extremely complex and uncertain outcome - limited progress), early settlement at a discount by London (E&Y not in a position to consider at present), quasi nationalised entity (uncertain asset recovery position), securitisation (extremely expensive and unattractive to sub 50k), third party deal with IOMG involvement (on hold pending title clarity).*”

support alternative proposals to liquidation. Disillusionment soon set in however as the DAG representatives were unable to obtain any concrete details of the SoA under discussion. By late January, they had reluctantly concluded that the dialogue was not progressing as had been hoped for, leaving them unable to provide any opinion on the merits or otherwise of supporting a SoA. (see Appendix 3)

As it became increasingly clear that the SoA being developed would offer little if any monetary advantage to depositors, and seemingly more and more desperate for it nevertheless to be approved by creditors, the IOMT began its attempts to sell the SoA to depositors by casting grave doubts on the credibility of its previously much vaunted Depositors' Compensation Scheme (**DCS**). By the time of the fourth Court hearing on 19th February, uncertainty over the ability of the DCS to pay out compensation in a timely fashion had become the principal advantage put forward in favour of the SoA over liquidation.[27, 28] At the next hearing, on 9th April, arguments were again made that the DCS could not be relied upon and that the SoA was therefore the only option to guarantee 'fully protected depositors' (i.e. those with claims less than the DCS compensation limit) any certainty in the amount or timing of repayments. At this time, counsel for DAG argued that he could not imagine a situation in which it would be politically or economically acceptable for the IOMG to allow the DCS to default (which indeed proved to be the case when, following eventual liquidation, the DCS – with the help of £73m IOMT funding and an interest-free IOMT loan of a further £120m – paid out in one fell swoop, far sooner than would have been guaranteed by the SoA).[32-34] In the context of statements such as these, it is important to note the anger and frustration that retail creditors felt at this point, where – having been deprived of their savings and, in many cases, security - they could clearly see they were being manipulated and their worst fears were being played upon by those in power who had a responsibility to act in their best interests.

The SoA which was finally put to the vote on 19th May 2009, over 7 months after the collapse of the bank, was fundamentally economically flawed, presenting no tangible financial advantage over liquidation beyond some cosmetic 'certainty' of payment dates (more certain but not necessarily faster – as events subsequently proved). Moreover, depositors would be giving up potentially significant rights by releasing all the parties involved in the SoA's preparation from any liability whatsoever arising in connection with it. The Scheme which eventually emerged appeared overly bureaucratic, unnecessarily complex and generally unintelligible to the average layman. The sheer volume of paper that creditors were confronted with to form a view on the SoA when it was finally presented to them underlines this fact.

After careful analysis in consultation with its lawyers, DAG concluded that “*the slim merits of the SoA are far outweighed by its disadvantages*” and that “*liquidation ... will almost inevitably be quicker, simpler, cheaper and conducted more openly than the proposed SoA*”.[38, 39] We continue to believe that this was – and remains - a valid analysis and that depositors would indeed have been financially disadvantaged by the proposed Scheme.

In a last ditch attempt to persuade (or perhaps rather to frighten?) depositors into voting for the Scheme, Mr Bell, speaking live in a Manx Radio programme on the eve of the vote (18th May), said that a failure to vote in favour would be “*damaging to the interests, certainly sections of the depositors, as they wouldn't get their money so quickly, ... there would be a 'fire sale' of assets, rather than the managed sale of assets which we think would give a higher return to the depositors; and one or two other things*”, a warning he repeated in another live broadcast early

the next morning, adding that liquidation could close the door to any possible sale of the business. It appears that these ill-conceived comments were not exactly appreciated by PWC (as Liquidators Provisionally), who hastened to reassure depositors that asset realisation was unlikely to be treated any differently under liquidation or the SoA.[40] Again, however, it is important to note the extreme anxiety, frustration and anger that comments such as these evoked among the retail creditors at this point in proceedings.

In the event, at the creditors' meeting on 19th May, the SoA was soundly defeated when it failed to gain the required majority, either by number or by value, in the class of partially protected depositors (those with deposits over the compensation limit). While it was approved by a clear majority of lower-value (fully protected) depositors – no doubt worried by the IOMT's dire predictions over the credibility of the DCS – it is worth noting that had these two classes of depositors been grouped together (as initially proposed by IOMT in the original court proceedings and resisted by counsel to DAG), the SoA would still have failed by value in the combined class. Somewhat embarrassingly for the IOMT, it also failed in the third (small) class of creditors not eligible for the DCS, where a single very high-value creditor was able to bring down the SoA single-handed, something which could perhaps have been foreseen by KSFIOM's joint liquidators (provisional, as the case may be, hereafter referred to as the "JLs"), the IOMT or even their advisers, and thus saved a great deal of wasted time and money. [41]

The time allowed by the Court, via successive adjournments, for unproductive negotiations and attempts to develop a SoA the Court felt could be put to creditors delayed the activation of the DCS and the liquidation distributions by at least 7 months. The first payments to creditors were made almost a year after the bank had collapsed.

Throughout this time, depositors saw nothing of their funds beyond the limited payments made under the two Early Payment Schemes (a mere £1000 in late January and up to a further £9000 in February), again causing much distress and suffering to many. For some, deprived of essential retirement income or suddenly finding themselves without access to funds from a recent house sale intended for the purchase of a new home (notably by expats in the course of returning to the UK to retire after long years of working abroad), the first distributions in September /October 2009 simply came too late. Again, throughout these discussions there was little or no information about likely recovery levels made available to creditors, and some were left with the impression that all their savings had disappeared for good.

We understand that the abortive SoA cost IOMT over £1,000,000 in fees paid to its external consultants (AlixPartners) and its legal advisers, as well as a great deal of its own management time. Having been treated so poorly throughout the discussions surrounding the SoA, creditors were further incensed when the IOMT declined to pay the costs incurred by the JLs in assisting them and AlixPartners in developing their proposal for the SoA, thereby reducing the amount available for distribution to creditors as a function of engaging in a process that had failed to meet with creditors' approval – and which failed to meet the clear criteria laid down at the outset by DAG representatives to the IOMT. When it also became clear that the IOMT had declined to voluntarily pay DAG's own legal costs, amounting to several hundred thousand pounds, incurred in successfully opposing the SoA, most retail creditors were understandably furious.

Finally, DAG (which is funded by depositors' and bondholders' donations) had to apply to the Court for an order that its costs be paid. But rather than awarding DAG its costs

from the IOMT, which is what DAG rightly expected (costs normally following the event in Manx law and, in opposing the SoA, DAG was undoubtedly the successful party and the IOMT the unsuccessful party), the Court ordered that DAG's costs be borne by the bank. The JLs had not promoted the SoA, save (we understand) reluctantly in the later stages at the instigation of the Treasury, yet an order that DAG's costs be paid by the bank means that those costs have to be borne by its creditors. Oddly, submissions made in Court on behalf of the bank appeared to support the IOMT's position that DAG's costs should be borne by *itself* (the bank) rather than the IOMT. In handing down his judgment, the Deemster acknowledged that there was "*a strong argument that this Order, which is that sought by Treasury, runs counter to Treasury's avowed claim ... that their sole motivation is to assist the general body of creditors and ... will inevitably diminish the amount available to the general body of creditors*".[45]

Even more tellingly, the JLs declined the Deemster's invitation to make an application for their own costs in relation to the scheme to be paid by the Treasury. In these circumstances, the Deemster had little choice but to refuse an application in this sense by DAG, despite the fact that he had "*no doubt that the Liquidators Provisional have incurred very considerable costs which, if not reimbursed by the promoters of the unsuccessful Scheme, will inevitably lead to possibly a quite material diminution in the assets available for distribution*." In his judgment, the Deemster continued: "*The Liquidators Provisional were of course specifically empowered by Court Orders of 29th January 2009 and 19th February 2009 to conduct such work, but this would not prevent them from seeking an Order that their costs thereof be paid otherwise than out of KSFiom. Nevertheless, the Liquidators Provisional have made a firm decision that they will not seek an Order against Treasury for the reimbursement of those costs in whole or in part. In those circumstances I take the view that this must be a matter for the Liquidators Provisional and perhaps the creditors who may, as Mr. Chambers submitted, take the view that the Liquidators Provisional have acted in dereliction of duty in failing to pursue such an Order.*" [45]

As if all this were not remarkable enough, DAG's application that it be awarded its costs relating to the costs hearing itself was refused by the Court, so that DAG (and hence its depositor supporters) had to bear the considerable costs it had incurred in obtaining a costs order *in its favour*. [45]

The reasons why the SoA was regarded as disadvantageous to depositors from a legal perspective are discussed in some detail in a document produced by DAG, in consultation with its lawyers, in May 2009 to assist depositors in their analysis and vote [39]. It maintains, among other things, that the SoA contained numerous examples of situations where the IOMT would have obtained a better position for itself than under a conventional liquidation and that, given likely recovery levels, the risk it was taking (in refraining from claiming its share until the liquidation had paid out 70p/£ to all creditors) was exaggerated. [see KSFiomDAG Qualitative analysis of SoA.pdf]

We continue to believe that the IOMT promoted the SoA primarily as a means of avoiding the anticipated reputational damage to the IOM associated with a bank in liquidation and to avoid activating the unfunded and, as of October 2008, largely inadequate DCS and perhaps to avoid closer scrutiny of the events leading up to the collapse of KSFiom.

The primary importance attached to protecting the reputation of the IoM was stressed on numerous occasions, starting with Mr Bell's opening statement in the emergency Tynwald debate on 9th October 2008 for the approval of the new DCS regulations (as

KSFIOM and the Financial Supervision Commission (**FSC**) jointly petitioned the Court for a winding-up of the bank): *“we have been following developments very closely and assessing how best to respond for the good of the Island, its people, its reputation as a premier small international finance centre, and its banking and other businesses and the people who work for them.”* The IOM’s customers seem strangely missing from this list, which we see as the first of many signs that Mr Bell is in fact more concerned with the island’s reputation than with the protection of the luckless depositors who place their funds there. It has been reported that, at the February court hearing, the Attorney General expressed his belief that a divergence from the well-trodden path of liquidation was justified in this case *“particularly as there are other clear reputation issues for the Island involved”*. [28]

We also firmly believe that this process caused retail creditors nothing but unwarranted delay in the distribution of funds to creditors and created additional anxiety, hardship and stress at a time when they had enough to consider following the collapse of the bank with their life’s savings in it, and that there was no consideration paid by any of the authorities to the interests of the customers that had relied on the IOM authorities’ regulation and governance of KSFIOM. The misconceived terms of the SoA and the time taken to seek to implement it are further evidence of this neglect.

3. The Depositors’ Compensation Scheme

On 9th October 2008, the day KSFIOM collapsed, an emergency sitting of Tynwald unanimously approved new DCS regulations, hastily drafted to replace those in place and unchanged since the first DCS was set up, equally hastily, in the wake of the collapse of another bank, BCCI, in 1991, at which time it took ten years to pay out the full compensation it guaranteed to depositors. While the new regulations included some significant improvements for which the depositors of KSFIOM have cause to be thankful (notably a belated increase in the maximum guaranteed compensation from 75% of £20,000 to 100% of £50,000 for individual retail depositors), it remained far inferior to depositor compensation schemes in place elsewhere, notably in the UK.

Specifically, the DCS remained unfunded, with levies to be collected from participating banks only after a bank default and then to a limited amount per participating bank per year, although the possibility, not previously included, for the DCS Scheme Manager to raise additional funds by borrowing was added. Depending on the amount of any such loan, it could still therefore take many years to pay out, leaving the severe criticisms levelled against the old scheme by the FSC in April 2008 largely unanswered. At a meeting on 24th April 2008, the FSC Board had noted: *“The Isle of Man has no central bank. The Government has no power to lend to banks and cannot offer emergency liquidity facilities to the banking sector. The Depositors’ Compensation Scheme, currently under review, could only provide limited protection over a protracted period.”* [5] On 29th April 2008, at a meeting with the directors of KSFIOM to discuss FSC concerns over the situation in Iceland, the FSC CEO confirmed: *“The IOM Depositors’ Compensation Scheme is a serious IOM political problem. In a worst case scenario, it would take years to pay the compensation due to depositors.”* [6] (see Appendix 1 for a more complete review of the background of the DCS prior to 9th October 2008)

On 24th October 2008, Tynwald approved an amended and further improved version of the DCS, extending the eligibility criteria to classes not previously covered and providing, for the first time, the possibility of Treasury funding of up to £150m in respect of

defaults in any one financial year in order “*to share the burden with the banks*”. Mr Bell pointed out that the whole foundation of the island's financial sector was at stake (again, the principal reason evoked was not the better protection of depositors). Nevertheless, the DCS remained – and remains- unfunded in advance of any default.

It is our belief that this basic deficiency in the DCS as formulated was one of the driving forces behind the desire of the IOMG to find any way to avoid triggering it, either at all or at least for as long as possible, in order to allow time to patch up its short-comings and thus avoid the shame and disastrous public image which would result if it failed to deliver (as would surely have been the case had it been triggered immediately). Indeed, the inadequacy of the DCS was cited more than once in Court by the IOMT and its counsel as an argument for supporting the SoA. We have seen no evidence that there was ever any real intention of achieving a better monetary outcome for depositors by means of a SoA. In the following months, it was frequently stated, in support of the SoA, that the SoA would “*assure DCS equivalent payments*”, or again that it would ensure that depositors with entitlement under the DCS would receive “*no less than that to which they would be entitled under the DCS*”. Such assurances were obviously a minimum requirement for any alternative to liquidation and the DCS to be even considered, but it soon became clear that there would be nothing more to be gained and a possible price to pay in other respects (see Section 2).

In the event, by the time the DCS was eventually activated following liquidation on 27th May 2009, Treasury funding of up to £150m (finally £73m as direct funding for DCS compensation of KSFiom depositors) had been agreed by Tynwald and steps taken to provide for an interest-free government loan (£120m agreed by Tynwald on 17th July 2009), to be recovered over time from the bank levies and liquidation dividends. This government funding package of £193m in total enabled the DCS to pay out to all DCS claimants their full entitlement as up-front payments (to be recovered in large part over time from the liquidation) in a single payment in October 2009 – much sooner in fact than would have been guaranteed by the two payments planned under the SoA (the second being one year after the start of operation of the Scheme).

Once triggered, seemingly overwhelmed by the large (but surely predictable) number of over 6000 claims, it took a further 4 months before the first DCS payments were received by depositors, a month or more after the first distribution by the Liquidators of KSFiom. Since then however, it is our view that the DCS has operated reasonably efficiently and we have few complaints, other than related to a lack of clarity over the assignment of depositors’ rights to the DCS.

While it was understood that complete assignment was necessary in order to ensure the DCS could subsequently recover all the monies due to it, partially protected depositors were assured at the outset that if and when the DCS had recovered from the liquidation the full amount of the compensation payment paid to them, their rights could be reassigned to them. This has proved not to be possible to date, as the Liquidators now insist that, under the IOM insolvency legislation, each and every such reassignment request has to be approved by the Court, at the expense of the individual depositor concerned. While this issue is not of great practical significance at present (liquidation payments due to DCS claimants are forwarded to them by DCS with a delay of around two weeks), it may become important if and when the dividend ever reaches 100%, at which point interest may become payable in the liquidation (but would not it seems be claimable under the DCS).

The DCS would appear to have been – and to continue to be - missold to potential customers. Few are aware that it is fundamentally not of the same nature as the UK compensation scheme, being unfunded prior to a bank default. Counsel for the IOMT has reportedly admitted that, as formulated, it was (and therefore still is) inadequate in practice [28, 33]. We believe that this inadequacy played a significant role in the huge delay of roughly 12 months after the collapse of the bank before full compensation was finally received by those it claimed to protect.

4. Communication with depositors by the IOM authorities

Communication with creditors throughout has been generally poor and often non-existent, particularly in the early days.

On 8th or 9th October 2008, an impersonal press announcement was posted on the bank's website with the stark information that “*in order to protect the interests of depositors*” KSFiom and the FSC had resolved to issue a joint petition for the appointment of a liquidator provisionally and that the FSC had suspended KSFiom's banking licence with immediate effect. This same announcement, still present on the home page, concluded by saying that the Scheme Manager of the DCS would be meeting “*as soon as appropriate*” to consider the activation of the Scheme, after which depositors would be contacted and invited to make a claim. Subsequently, on 13th October 2008, the first information to customers, headed “*What has happened?*” was posted on the site by Mike Simpson as Liquidator Provisionally (**LP**). Three further updates were posted in October, but gave mostly soothing words and little hard information.

The first letter effectively ‘informing’ all depositors that their bank had collapsed was sent by Mike Simpson on 6th November 2008 and began “*As you may be aware I was appointed as Liquidator Provisionally of the company at the High Court of Justice of the Isle of Man on 9 October 2008. Prior to my appointment the Isle of Man Financial Supervision Commission suspended the company's banking licence.*” Thanks to the power of the Internet, many depositors were indeed aware that their bank had collapsed and were receiving immense support through the website set up by a handful of depositors in the days immediately following the collapse, from which the Depositors' Action Group sprang. But one can wonder how many depositors, not users of the Internet and/or not having had recent need to contact the bank, were not so aware, and may have discovered their plight only through this letter, one month after the collapse. **No letter was ever sent to depositors by the Directors of the bank and no words of sympathy were forthcoming.** Depositors had to wait until 16th December 2008 to receive, from the LP, final statements of their accounts as at 9th October 2008. Apart from the documents and voting papers for the SoA (not received by all depositors – see below) and, later, those for the election of the Committee of Inspection, the only other official communication to depositors (excluding via the website) was the Official Receivers & Joint LP Report on the bank period from 9th Oct 2008, sent on 17th July 2009.

During the first worrying weeks, while the LP understandably got on with his basic job, anxious depositors desperate for information and any signs of support from the IOM authorities, were left waiting every evening for reports from an expat depositor who had installed himself on the island. **No-one in authority stepped forward and took responsibility or was accountable.**

The attempts initiated by John Spellman in December 2008 to involve members of DAG productively in discussions re possible alternatives to liquidation foundered at an early stage through the with-holding or at best the late communication of the sort of detailed information needed to allow serious analysis (see Section 2 and Appendix 3).

On 23rd February 2009, following the latest adjournment of the winding-up petition, the Court accorded extended powers to the JJs to allow them to act in conjunction with the Treasury to “*consider, prepare and promote (including in consultation with creditors) a scheme of arrangement...*” and “*to nominate an informal creditors' committee ... to assist [them] ...*”.[29] It is not clear whether this was intended as a directive from the Court or simply a possibility. Whatever the case, and to the best of our knowledge, no such consultative committee was ever formed.

It was at the instigation of DAG that more informative communications with the JJs were opened via a weekly telephone call system, allowing depositors' questions to be collected together and submitted for answer where possible. DAG also pushed for, and eventually obtained, more frequent and informative updates on the KSFIOM website.

The package of SoA documents represented a poor presentation of highly complex arrangements and was likely to be largely unintelligible to the average (or even above average) layperson. The final version was produced only shortly before the creditors' meeting on 19th May 2009 and the whole package was sent by post as late as 27th April, with proxy votes to be received in Douglas (by post, fax or email) by 15th May. The formal Scheme regulations ran to 53 pages and the accompanying Explanatory Statement, including voting forms and instructions, to a massive 71 pages. Creditors were urged to read the documents in full and to take time to consider them. Given the size and complexity of the documents, the time allowed was almost impossibly short – just over two weeks at most, and less for many overseas residents with normal postal delay times from the UK of up to a week. It is difficult to imagine how anyone with no prior knowledge of the Scheme being developed and who had not followed the discussions on the DAG websites or received DAG's (necessarily) last minute advice and analysis based on consultation with its lawyers could come to an informed decision in such a short time and many must have simply followed the recommendation of the JJs who, despite their apparently rather weak support for the Scheme, concluded: “*On balance and based upon the information available to them, the Provisional Liquidators therefore recommend that creditors vote in favour of the Scheme.*”[37]

There was worse to come! For reasons never fully elucidated, but almost certainly due to mismanagement by the mailing firm used by PWC, many depositors outside the UK and IOM never received these documents at all, while others received them only with considerable delay – in some cases after the 15th May deadline for receipt of proxy votes. While many were able to assess the Scheme and vote by down-loading the documents from the website (not without difficulty for depositors, some in far-flung outposts, with limited computer and Internet facilities), it remains unknown how many others – lacking the benefit of Internet access - were simply unaware that a vote was taking place at all. Unbelievably, complaints lodged with PWC were dismissed by both the JJs and the Court on the grounds that those complaining had been able to vote by downloading from the Internet. Obviously those without Internet didn't even know there was a vote and were therefore hardly in a position to complain! We believe that PWC neglected their duty by failing to follow up with the mailing company the reason for the late or non-

delivery of so many of the packages to a whole range of overseas countries, including France, Spain, Australia, USA, Canada, Japan, Thailand and S. Africa (we are aware of at least 131 members of DAG living abroad who had received nothing by 15th May; 50 of these were in France, where there was definitely no postal disruption at that time). Not surprisingly, attempts to do this by DAG were thwarted because they were not the clients.

5. Efforts made to ensure 100% return of depositors' funds

Depositors in KSFIOM are the only retail creditors in the Kaupthing Group in Europe who have not have been fully recompensed through the actions of the governments where the group operated. In all European countries with the notable exceptions of the IOM and Guernsey, government stepped in promptly to rescue its hapless savers caught up in the wake of the global financial crisis. The responsibility of the IOM towards its depositors was clearly recognised by Chief Minister Tony Brown when he said, at the UK Treasury Committee inquiry in February 2009: "*The Isle of Man takes the stance that we are responsible for our affairs*".[20] We firmly believe it is high time that the IOM faced up fully to that responsibility.

It is our understanding, from confidential sources which we believe to be reliable, that in late November 2008 serious consideration was given to an IOMT plan to assure a 100% pay-out to depositors in collaboration with the banks on the island, most of whom, we are informed, expressed their support. However, for reasons which remain obscure, this plan never came to fruition. Instead the Treasury appointed AlixPartners to produce a scheme which would avoid liquidation and the triggering of the DCS.

It is our further understanding that consideration was initially given to borrowing by the IOMG in order to pay depositors in full, but that this was also rejected - it would appear by AlixPartners. It has been suggested to us that, having been appointed on a time cost basis, AlixPartners may have been reluctant to support an arrangement that would have put an early end to their lucrative contract.

In June 2009, the UK Treasury Committee Report on the Banking Crisis included recommendations that the UK and IOM Governments work together to resolve the KSFIOM issue.[44] To date nothing appears to have happened.

KSFIOMDAG continues to call on the IOM authorities to seek and implement an arrangement which restitutes KSFIOM's retail creditors' funds to them in the shortest possible time. Given the high eventual recovery now predicted from the assets of the bank, the amount needed for the IOM Treasury to bridge the gap is relatively small and most of the money needed to stand in our shoes now would be recovered over the next few years through the liquidation. Depositors, unlike governments, have finite lives. Many are elderly and may not live to see even the currently predicted 90% or so of their funds returned; funds which they need now and not in 5-7 years time. The reputation of the IOM has undoubtedly suffered through its insensitive handling to date of the KSFIOM affair. We believe that such a gesture, late as it would be, would not only bring to an end the continuing suffering of the retail creditors whose lives were shattered but would also go a long way towards restoring lost confidence in the Island as a world-class financial centre.

Appendix 1: Background relating to depositor protection in the IOM prior to 9th October 2008

The IOM Depositors Compensation Scheme (DCS) was established in 1991 in the wake of the collapse of BCCI and remained basically unchanged until 2008. During these 17 years, neither the level of compensation (a maximum of 75% of £20,000 per depositor) nor the maximum levies collectable from the participating banks in case of a default, were increased to keep pace with inflation or the changing global financial situation. The Scheme was unfunded; a fund was to be created as the need arose following a bank default through levies on the participating banks of up to fixed maximum amounts per bank per year. It could therefore take several years to collect sufficient funds to make the guaranteed compensation payments to creditors of a failed bank. There was no defined time limit for compensation payments and no possibility of either government funding or borrowing by the DCS Scheme Manager to speed up payments. The Scheme was largely untested; prior to the collapse of KSFIOM in October 2008, it had never been called upon since the collapse of BCCI in 1991 (for which it was hastily set up) - when it took almost 10 years to pay out.[2]

In October 2007, following widespread international disruption in financial markets and an increase in the UK's compensation limit to £35,000, a review of the IOM DCS was called for in Tynwald. In January 2008, the Financial Supervision Commission (FSC), charged by the Treasury to carry out a “*review of the DCS and other methods of depositor protection*”, met with the Isle of Man Bankers Association (**IoMBA**) and collected data from IOM banking licenceholders.

On 6th March 2008, the FSC issued a Consultation Document seeking the views of all banking licenceholders and other interested parties on three options for change identified after discussion with the IoMBA: (a) to remove the DCS altogether (option regarded by the FSC as “*untenable for reputational reasons*”), (b) to keep the DCS unchanged or (c) to revise the current DCS. In case of option (c), the highest maximum compensation proposed (among several options) was £25,000 (75% of £33,000).[3] In the first of two responses to the Consultation Document, the Positive Action Group (**PAG**) commented “*The FSC primary role in the DCS must be to ensure good protection for all Depositors. It is not to find a solution that protects Banks / Government from increased cost / contributions. The FSC Consultation paper does not come over as taking public protection as its overriding objective in reviewing the status quo.*” [4]

On 24th April 2008, in relation to their growing concerns over Icelandic risk, the FSC Board noted that “*The Isle of Man has no central bank. The Government has no power to lend to banks and cannot offer emergency liquidity facilities to the banking sector. The Depositors' Compensation Scheme, currently under review, could only provide limited protection over a protracted period.*”[5] On 29th April 2008, at a meeting with the directors of KSFIOM to discuss the FSC concerns, the FSC CEO confirmed: “*The IOM Depositors' Compensation Scheme is a serious IOM political problem. In a worst case scenario, it would take years to pay the compensation due to depositors.*” [6]

On 25th June 2008, despite the concerns expressed by the FSC, Treasury Minister Allan Bell informed Members of Tynwald that, having received and considered an initial report from the FSC, he had concluded that “*the most appropriate position at this time was to defer a decision on any change to the existing Scheme, but to keep the matter under constant review*”. [7]

Following this decision, PAG chairman Roger Tomlinson commented:

“The announcement by Treasury is a non decision. Minister Bell promises to keep the matter under constant review. That will be of no comfort to any Island savers if in the meantime there was a collapse of their licence holder.

The consultation exercise conducted by the FSC, failed to take into account the concerns of ordinary depositors. It was directed at the financial institutions taking deposits over a very short period. Consequently of the 19 responses 17 were from these deposit-takers. It is hardly surprising that most of them opted to retain the current scheme.

Inevitably the outcome of the exercise was skewed in favour of the licence holders, not savers. We felt that the PAG submissions represented the interests of the customer and also ultimately safeguarded the reputation of the Isle of Man as a responsible financial jurisdiction.

We sincerely hope that Treasury will immediately reconsider their decision.” [8]

It appears that PAG's hopes went unanswered. Questioned by the Manx Herald as late as 2nd October 2008, Allan Bell confirmed that *“the position of the DCS is under regular review, but to date no formal proposed amendment to the existing DCS has been made, given the fact that final decisions had not been taken in other relevant countries in relation to their schemes ...”* and that they would *“continue to monitor developments, including whatever proposals emerge in relation to the further coverage of deposits in relevant jurisdictions.” [9]*

Just five days later, on 7th October 2008, the IOMT issued a press release concerning *“proposed arrangements to revise the DCS”*. After giving assurances that *“The Island's many strengths as a jurisdiction make it well placed to weather the current financial storm”*, Mr Bell announced that the IOM's maximum deposit protection would be increased to 100% of £50,000 for both local and international individual depositors. He explained that he was *“aware that people both on and off the Island are looking to me for leadership and clarity ...”* and that he would be seeking Tynwald approval at the October Tynwald (programmed for 21st October). It was made clear that the new arrangements had not yet been agreed with the banks when he added that consultation with them would continue *“in the period up to the October Tynwald”*. [10]

However, as KSFIOM teetered on the brink, an emergency sitting of Tynwald was called for the 9th October 2008 to seek approval of the proposed new DCS regulations with immediate effect. Late on the 8th, the news broke that KSFIOM had applied to the Court for a winding-up order and Tynwald Members were well aware that the Court was in session as Tynwald met on the morning of 9th October. Many Members reported having received anxious late-night calls from panicking constituents. Introducing the debate, Mr Bell emphasised that *“we have been following developments very closely and assessing how best to respond for the good of the Island, its people, its reputation as a premier small international finance centre, and its banking and other businesses and the people who work for them.”* The Compensation of Depositors Regulations 2008 (SD No 826/08) were unanimously approved. The maximum compensation was thereby increased to (100% of) £50,000 per eligible depositor. The maximum levies to be required from the banks in case of a default were correspondingly increased (without prior agreement of the banks). There was however, at this stage, no fundamental change in the funding mechanism other than to allow the Scheme manager to raise additional funds by borrowing; there was still no standing fund and no provision for Treasury funding (this was added only in an amendment on 23rd October 2008).

Appendix 2: Key events following 8th October 2008

8/9 Oct 2008. At 21.43 on 8th October 2008, the KSFIOM Board resolves that KSFIOM is unable to pay its debts and should apply for a winding up order. On 9th October 2008, a joint petition for winding-up is presented to the Court by KSFIOM and the FSC. Michael Simpson of PwC is appointed Liquidator Provisionally. Hearing adjourned until 24th October.

9 Oct 2008. New DCS Regulations are hastily approved with immediate effect at an emergency meeting of Tynwald. Maximum compensation for individual depositors increased from £15,000 (75% of £20,000) per individual to (100% of) £50,000. (See Appendix 1 for more details.)

23 Oct 2008. Tynwald approves an amended version of the DCS. Compensation up to a maximum of £20,000 for charities and other classes not previously eligible and a provision for Treasury funding of up to £150m are included. Mr Bell points out that the whole foundation of the island's finance sector is at stake. He also points out that the bank (KSFIOM) has not yet failed and that representations to delay its winding up are to be made in Court the following day. [11]

24 Oct 2008. First Court hearing for petition to wind up KSFIOM. Requesting a delay to allow time for attempts to save the bank, the IOM Treasury (IOMT) says it expects the Icelandic government to honour the parental guarantee and that the UK has agreed to represent the interests of the IOM in negotiations. Stephen Harding, acting for the IOMT, refers to “*high level meetings*” taking place in London that day between the UK Treasury, the FSA, IOM Chief financial officer Mark Shimmin and FSC CEO John Aspden. Hearing adjourned to 27th Nov. [12]

27 Nov 2008. Second Court hearing for petition to wind up KSFIOM. Treasury requests a 60-day adjournment. Despite the absence of positive results from the “high level talks”, and denial from UK that KSFIOM funds were ring-fenced, IOMT has not given up on them; FSC now prepared to allow time to explore possible alternatives to liquidation. **AlixPartners has been appointed by IOMT** to explore possibilities of restructuring with a view to achieving “*more for depositors than [through liquidation and DCS]*”. **Treasury lawyers admit that preventing reputational damage to IOM is a consideration behind the decision to try to avoid liquidation.** Treasury requests a 60-day adjournment for AlixPartners to “*develop a plan that will meet with approval ...*”. KSFIOMDAG requests a much shorter adjournment of 14 days. Hearing adjourned until 29th Jan 2009. [13]

11 Jan 2009. A delegation from IOM government (IOMG) goes to Iceland to meet the Kaupthing Resolution Committee and concludes there is “*no realistic prospect in the short-term that funds can be recovered from it under its parental guarantee.*” [14]

15 Jan 2009. David Lovett, of AlixPartners, states in an affidavit that they have advised the IOMT that a Scheme of Arrangement (SoA) “*could be formulated and proposed to the creditors of KSFIOM*” and that such a proposal is “*now under construction*”. The stated aims of such a scheme would be to “*(i) assure DCS equivalent payments, (ii) provide a streamlined claims process, and (iii) accelerate payments to creditors in a scheduled and structured fashion.*” [15]

17 Jan 2009: DAG issues a Press Release which states, among other things: “*Despite goodwill, effort and confidentiality by those representing the KSFION Depositors Action Group, they have yet to see anything to convince them that the suggestion of an alternative to liquidation is little more than an attempt to prevent the Depositors Compensation Scheme (DCS) being triggered. The activation of the DCS would not only cost the IOM Government and local banks dearly but would expose the scheme for what it is; namely an inadequate and outdated guise of protection that contains so many provisos and matters open to legal interpretation that the Government is refusing to explain clearly how it would work if it were to be put into action.*” [16]

20 Jan 2009: Tynwald approves first Early Payment Scheme (EPS1) to provide a maximum payment of £1000 to eligible KSFION depositors. £11m made available from Reserve Fund to meet claims and administration.

29 Jan 2009. Third Court Hearing for petition to wind up KSFION. David Lovett of AlixPartners outlines details of a “*Potential Scheme of Arrangement*” which would ensure that depositors with entitlement under the DCS would receive “*no less than that to which they would be entitled under the DCS*”. It is anticipated that depositors can expect “*the same final recovery under either the liquidation/DCS or the proposed [SoA]*”, but that there would be “*various advantages*” to the benefit of depositors under the SoA. These potential advantages appear to be in terms of (i) possibly accelerated payments and (ii) a small financial advantage in the event that the overall dividend to creditors was less than 60p/£. Treasury requests a further 60-day adjournment. Concerned by the stress and anxiety increasingly expressed by depositors as this matter drags on and by unresolved questions over possible effects on depositors' rights of legal redress under a SoA as opposed to a liquidation, DAG requests a much shorter adjournment, with further clarification on this and other issues to be provided sufficiently in advance to allow proper analysis. The Court accedes to DAG's request. Hearing adjourned until 19th February, with affidavits to be filed by Treasury by 12th February. [17-19]

03 Feb 2009. UK Treasury Committee evidence session. In response to questions from Michael Fallon MP, IOM Chief Minister Tony Brown states firmly that the IOM has its own compensation scheme, accepts its responsibilities and is endeavouring to rectify the situation. He further asserts: “*I do not think the UK Government is responsible for the financial affairs of the IOM*”. He denies a suggestion that KSFION has not been put into liquidation because of concerns about the IOM's ability to resource the DCS, adding that the IOM government has made £150m available and the banks £200m and that he is satisfied that they have the resources to cover an estimated net cost of around £50m. There is no suggestion of a possible 100% rescue plan for depositors. [20]

05 Feb 2009. Second Early Payment Scheme (EPS2) to be approved by Tynwald. Provides for a second 'early payment' to 'defined account holders', subject to a maximum aggregate payment under EPS1 and EPS2 of £10,000. Claims to be made by 31st March. [21]

19 Feb 2009. Fourth IOM Court Hearing for petition to wind up KSFION. Treasury seeks a further adjournment. In an affidavit dated 12th Feb 2009, Mr Bell expressed his belief that the SoA “*would offer clear and tangible benefits to all types of creditors of KSFION*”. In contrast to the previously described 'advantages' of the SoA, it is now put forward that the great advantage of the SoA to depositors owed £50k (or less, presumably) is that they are guaranteed – by Treasury - to get that amount, now apparently uncertain under the DCS. The alleged deficiencies of the DCS seem now to

have become the main argument in favour of the SoA. The Attorney General believes a divergence from the well-trodden path of liquidation is justified in this case “*particularly as there are clear reputation issues for the Island involved*”. Treasury requests a further adjournment sufficient for the proposed Scheme to be put to creditors. DAG opposes any further adjournment on the grounds that, despite the time already allowed to develop a comprehensive plan, the proposals remain sketchy and incomplete, with no financial benefit over liquidation, and that their previously expressed concerns have not been satisfactorily addressed. DAG maintains that the Scheme promoters have failed to make out a case that their proposals present any significant advantage to creditors, while potentially compromising their rights. An independent group of higher-value depositors is also highly critical of the proposals presented, which they regard as “*deeply flawed*” and, while not ruling out possible future acceptance of a much-improved SoA, express a strong preference for liquidation rather than implementation of the current SoA. After much deliberation, and despite serious reservations, the Deputy Deemster rules that “*the Scheme should be allowed to develop further*”. Hearing adjourned until 9th April. [22-28]

Depositors are stunned by yet another adjournment of almost two months. In the opinion of the Manx Herald, reporting on the proceedings, the Deputy Deemster was persuaded to grant a further adjournment “*not so much on how good the alternative, and yet to be nailed down, SoA will be but by how poor a safety net the DCS is by comparison*”. [28]

The Court Order (dated 23 Feb 2009) grants extended powers to the Joint LPs of KSFIO to allow them (i) to act in conjunction with Treasury to “*consider, prepare and promote (including in consultation with creditors) a scheme of arrangement...*”, (ii) “*to nominate an informal creditors' committee ... to assist [them] ...*” and (iii) in conjunction with Treasury and its agents, “*to finalise the terms of a scheme of arrangement and explanatory statement ...*” and “*on being reasonably satisfied that such scheme has a reasonable prospect of being approved [by the creditors and the Court] ... to do all such things as may be necessary to secure the approval, sanctioning and implementation of such a scheme*”. [29]

24 Feb 2009: Mr Bell questioned in Tynwald over Court decision of 19th Feb.

Questioned in Tynwald over implications of the latest adjournment, Mr Bell says that Deemster Corlett has been persuaded the scheme of arrangement represents the best outcome for depositors as repayments would be at least as quick if not quicker. He admits that there is as yet no formal agreement with the banks but “*we are very close to it*”. Commenting in *iomtoday*, Lou Huckvale (depositor) points out that in a meeting with Mr Bell on 28th January he was assured, in company of others, that the banks were on board and all necessary documentation was already in their possession. [30]

19 March 2009: Tynwald agree to support SoA and to provide extra money to provide cash flow.[31]

Mid-March 2009: Representatives of DAG meet with IOM representatives in London. Present from IOM: Mr Spellman (IOMT), AlixPartners and Herbert Smith. DAG members and their UK legal advisers are presented with facts and figures intended to convince them that the SoA is advantageous to all depositors in comparison with liquidation and are assured that scheme documents (in preparation) will reflect this view.

3-8 April 2009: DAG is finally provided with a copy of the proposed SoA late on Friday 3rd April. The Explanatory Statement is received in its final form only on 8th April, the day before the Court hearing, and the worked examples of how it might

operate around 7 pm that same evening, clearly putting DAG (and indeed the Court) under considerable pressure. Having considered these documents, DAG concludes that the SoA is only of (possible) advantage (in terms of guaranteed timing) to depositors with lower-value deposits and of disadvantage to the remainder. DAG instructs its lawyers to oppose the Scheme.

09 April 2009. Fifth IOM Court Hearing for petition to wind up KSFION.

Despite opposition from a broad band of depositors, but with some minor concessions on behalf of IOMT, the Court gives permission for the SoA to proceed to a vote of creditors, to be held on 19th May. Mr Hacker, for Treasury, apologises for the short delay given to depositors to consider the latest proposals, but adds that in any case he doesn't think, strictly speaking, they have a right to it anyway! Arguments are again made that the DCS cannot be relied upon and that the SoA is the only option that guarantees fully protected depositors (those under the DCS compensation limit) certainty in repayments. Counsel for DAG counters that he cannot imagine a situation where politically or economically it would be acceptable for the IOMG to allow the DCS to default. Notwithstanding that it finds the Scheme “*not a model of clarity*”, the Court agrees that it can be put to a vote of creditors, for them to decide. Following representations by DAG, the Court rules that the vote should be conducted among 3 classes of creditors: (i) those with rights under the DCS whose claims fall within the DCS limit (fully protected), (ii) those with rights under the DCS whose claims exceed the DCS limit (partly protected) and (iii) creditors with no rights under the DCS (unprotected). To be accepted, the SoA would need to be approved by a majority by number and 75% by value in each class. [32-34]

9-22 April 2009. DAG opposes the Scheme in its present form, but continues to press for more favourable terms. It seems “*very clear to DAG that the IOM government wants the Scheme to go through and does not want liquidation*”. DAG proxies are appointed to enable depositors to vote according to the agreed DAG position at the time of the vote. [32, 35]

22 April 2009: Tynwald approves new regulations which, in the event the SoA is approved, will require IOM banks to contribute the same amount to the SoA as they would under the DCS. This seems to offer no additional benefit to KSFION depositors. [35]

23 April 2009: The IOM Court approves modifications to the SoA. Following news from the Administrators of KSFUK that the estimated total distributions from KSFUK should now be at least 50p/£, Treasury amends the proposed SoA. The guaranteed DCS-like top-up payments will now be paid in two tranches instead of three, with payments of £35,000 (or the full deposit if less) within the first 100 days and £50,000 (or the full deposit) within one year. In addition, Treasury will receive no payment under the Scheme until all creditors have received at least 70% of their claim (previously 60%). [36]

27 April 2009: A letter and full information package on the proposed SoA and voting procedures is sent by the JLS to all known creditors of the bank and also posted on the bank's website. [37] The vote is to be held on 19th May and proxy votes must be received in Douglas (by post, fax or email) by 15th May or handed in at the meeting. The formal Scheme regulations run to 53 pages and the accompanying Explanatory Statement, including voting forms and instructions, to a massive 71 pages. Creditors are urged to read the documents in full and to take time to consider them. Despite the apparent weakness of their support, the JLS recommend acceptance: “*On balance and based upon the*

information available to them, the Provisional Liquidators therefore recommend that creditors vote in favour of the Scheme.” [37]

In the event, for reasons never fully elucidated, but almost certainly due to mismanagement by the mailing firm used, many depositors outside the UK and IOM never received these documents at all, while others received them only with considerable delay – in some cases after the deadline for receipt of proxy votes. While many were able to assess the Scheme and vote by down-loading the documents from the website, it remains unknown how many – without the benefit of Internet access - were simply unaware that a vote was taking place.

1 May 2009: DAG makes available to depositors a document incorporating advice from its lawyers and observations from other lawyers and other depositors with the aim of explaining its opposition to the SoA. On the basis of its legal advice, DAG maintains that the SoA is disadvantageous to depositors from a legal perspective and concludes that: “*the slim merits of the SoA are far outweighed by its disadvantages*” and that “*liquidation ... will almost inevitably be quicker, simpler, cheaper and conducted more openly than the proposed SoA*”. [38, 39]

18/19 May 2009: Speaking live in a Manx Radio programme on 18th May, IOM Treasury Minister Allan Bell says that a failure to vote in favour of the SoA would be “*damaging to the interests, certainly sections of the depositors, as they wouldn't get their money so quickly, ... there would be a 'fire sale' of assets, rather than the managed sale of assets which we think would give a higher return to the depositors; and one or two other things*”. This warning is repeated in an early morning live interview on the 19th May (day of the vote), when it is asserted that liquidation could close the door to any possible sale of the business. Later that day, Mr Simpson (JL) reassures depositors that he doubts whether asset realisation would be treated any differently under liquidation than under the SoA. [40]

19 May 2009: KSFIOM Creditors' Meeting to vote on SoA

At the meeting of creditors held on 19th May 2009, although approved by class 1 (fully protected) depositors, the SoA fails to gain approval, either by number or by value, in class 2 (partially protected depositors) and is therefore soundly defeated. Interestingly, had classes 1 and 2 been grouped together (as originally proposed by Treasury), the SoA would still have failed by value in the combined class. Somewhat embarrassingly for the IOMT, it also failed in the third (small) class of creditors, not eligible for the DCS, where a single very high value creditor was effectively able to bring down the SoA single-handed, something which could perhaps have been foreseen by the JLS, the IOMT or even their advisers and thus saved a great deal of wasted time and money. [41]

Immediately after the vote, Treasury Minister Allan Bell announces: “*We will seek to achieve a similar outcome for creditors with claims under £50,000 as would have been achieved under the SoA ...*” and adds “*We continue to believe that developing the SoA provided the creditors with a viable alternative and was in the best interests of all of the depositors*”. [42]

27 May 2009. IOM Court Hearing. The Court accepts that the creditors have voted down the SoA and KSFIOM is finally placed into liquidation. [43]

19 June 2009. UK Treasury Committee Report on the Banking Crisis.

Conclusions include recommendations that the UK and IOM Governments work together to resolve the KSFIOM issue. [44] To date nothing appears to have happened.

23 June 2009: IOM Court hearing to consider award of costs incurred by the SoA. Judgement 30 June. DAG requests that its costs in respect of the SoA and the Winding-Up petition be paid by IOMT or, alternatively, jointly by the Treasury and KSFIOM. After a long deliberation, the Court finally rules that DAG's costs be paid out of the assets of KSFIOM (and thus be borne by the body of creditors). It is acknowledged that the scheme documentation was “*a fiendishly complex piece of work*” and that it was “*not surprising that much time, effort and costs were expended on trying to penetrate the fearsomely complex wording of the Scheme and its Explanatory Statement in respect of which it seems perfectly fair that legal advice should have been taken ...*”. DAG also applied for the costs of the JLs to be paid by Treasury, but in the absence of an application from the JLs themselves this was not surprisingly denied. [45]

17 July 2009: Tynwald approves a £193m Government funding package (£73m direct Treasury funding as per the DCS regulations and a further £120m interest-free loan, recoverable over time from the bank levies and liquidation dividends). This should enable all fully-protected depositors to receive their full DCS entitlement in a single payment in September this year. [46]

04 Sep 2009. First dividend payments of 24.8% received by depositors claiming directly in the liquidation.

Oct 2009. The DCS pays out! Roughly 12 months after the collapse of KSFIOM – and 4 months after liquidation - depositors claiming via the DCS finally start to receive payments. With the help of Treasury funding (now incorporated in the Regulations), the DCS finally paid out fully to all eligible claimants in a single payment (and thus much faster than would have been achieved under the SoA).

Appendix 3: The Informal IOMT/DAG Committee set up in December 2008 to consider alternative proposals to liquidation: a statement by four DAG participants.

In December 2008 members of the steering committee for the KSFIOM Depositors Action Group (DAG) were contacted directly by John Spellman the former Finance Manager to the Isle of Man Treasury (IoMT) initially via the DAG website and then directly by phone and email, for the purpose of establishing an informal committee (IC) and to seek indicative support to alternative proposals to the liquidation of KSFIOM and triggering of the Depositors Compensation Scheme (DCS).

During a series of telephone conversations and email exchanges, the members of the DAG steering committee asked Mr Spellman if all possible routes to repatriating depositors with an immediate 100% of their money had been explored. Mr Spellman verbally listed all routes of possible resolution that had been examined to date and told the DST that none of the options were feasible at that time due to unknown asset recovery from Kaupthing Singer & Friedlander (KSFUK) [Ev 6], however, Mr Spellman did say that should the asset recovery be better than anticipated the IoMT would consider working with a third party to 'bridge the gap'. At the time it was said that there were two potentially interested third parties. [Ev 1, 6, 10] This information created early misplaced optimism that the IoMT were working to find a full and satisfactory resolution and formed the basis of the decision for the members of the DAG steering committee to agree to work with Mr Spellman in finding a solution and alleviating the hardship being experienced by many caught up in this financial debacle. Therefore the IC was established to represent depositors with sub £50k, supra £50k, small business account, bondholder and money in transit.

The IC was asked to keep all correspondence and documentation confidential at the time. Members of the IC met with Mr Spellman and Alix Partners at IoM offices in London on 12th January 2009. Mr Spellman presented the IC with a suggested alternative to liquidation and DCS in the form of a Scheme of Arrangement (SoA) and sought to canvass the IC for their opinion on the value of moving forward with presenting this SoA to the creditors of the bank. The actual detail (proposed numbers) of the SoA was not produced. The IC requested first a full explanation of how the DCS would work in practice so that they were able to consider the relative merits of this option versus the proposed SoA. Mr Spellman was unable to provide this information in any adequate form as the machinations of the DCS were unknown having been untested to date, but there was weight and emphasis given to the fact that the DCS was at that time unfunded (and by implication unlikely to deliver). The IC in fact drafted its own understanding of the DCS and submitted this to Mr Spellman for his confirmation however despite canvassing IOMT legal opinion including the Attorney General, Mr Spellman was unable to confirm or deny whether the understanding of the scheme as outlined by the IC was correct or not. [Ev 16]

This was one of the first indications to DAG steering committee that despite the global banking meltdown the IOMT and the FSC were not prepared for the situation that had arisen nor, unlike all other European territories, were they working to put depositors' needs at the top of its agenda. IC stated that they expected any intervention on behalf of the IoMT to be as an attempt to find a full resolution for depositors as was happening around the world, especially in respect of other Kaupthing depositors.

The IC awaited information in relation to the quantitative and qualitative merits of both the SoA and the DCS, but again due to constraints from the IoM Attorney General (AG) this was consistently delayed. It was soon apparent that despite all the pleasant words and assurances, no one within the IoMT was prepared to put in writing anything concrete relating to the DCS or the SoA. The IC grew increasingly frustrated since long telephone exchanges and emails were resulting in no new information. [Ev 9] These delays meant the DAG would be unable to make a considered opinion and take legal advice in advance of the impending court hearing of 29th January 2009. After several delays, a basic and extremely inadequate paper was produced containing no substantial quantitative information on which the IC would be able to make any comparison or decision. Throughout the communication while awaiting the watered down document it should be noted that Mr Spellman stated more than once that if the IC felt unable to support the SoA it would not be taken forward. [Ev 1, 5]

Reluctantly the members of the DAG steering committee came to the conclusion that the dialogue between themselves and Mr Spellman was not progressing as they had hoped and were therefore unable to provide any opinion on the merits of supporting a SoA. The DAG instructed its lawyers Edwin Coe to conduct all future correspondence with Mr Spellman and IoMT legal advisors on their behalf. This move led to the DAG being defined as 'litigious'. [Ev 14]

With no information in respect of the SoA or the actual SoA being provided before the court case of 29th January 2009, DAG legal representatives found themselves with no alternative but to oppose the position being taken by IoMT Counsel. It should be noted however that nine identical letters were submitted at the last minute by individuals living or visiting the IoM at the time as a supporting appendix to the affidavit of the IoMT. [47] DAG steering committee and legal representatives were very disappointed that these individuals had seemingly been encouraged to openly support the SoA in this way despite having received no detailed information or legal advice. As a result it appeared that there was a conflict of views amongst depositors which was not the case at the time - it was a situation that nonetheless undermined the wishes of the majority and created a perception of disunity amongst the DAG and the misperception that the IoMT had considerable support for its position.

On 30th January 2009, following the court case, Edwin Coe wrote to John Spellman [Ev 15]. Mr Spellman and the IoMT legal representatives failed to respond to this request demonstrating a disappointing degree of contempt and by this time it had become the strong opinion of the DAG steering committee that there was actually no incentive or willingness on behalf of IoMT to find a solution to repatriate depositors with 100% of their deposits, but instead the motivation was to find a solution to avoid bank liquidation and triggering of the DCS and protect the reputation of the IoM first and foremost. In fact we had reason to believe that the IoMT were putting the views and requirements of depositors who were local IoM residents ahead of the rest. [Ev 14]

At the court hearing of 19th February 2009, the IoMT sought adjournment of liquidation for a further period of time, despite rejection of the proposals by the DAG steering committee and their legal team, the very panel the IoMT had canvassed for opinion on behalf of the broader creditor base. As a result, the DAG were forced to fight what turned into a lengthy and costly legal and political battle for over nine months in order to eventually ensure the SoA was quashed and the bank could go into liquidation and trigger the DCS. During this time many depositors struggled financially and the legal and consultancy costs to the IoMT were significant. To the horror of depositors and the

surprise of DAG legal advisers, the Deemster at a later date agreed that these costs should be covered by the liquidator thus paid for by depositors even though depositors' representatives had given the IoMT an early indication that the SoA proposals were inadequate and would likely be rejected.

The whole costly exercise was never going to succeed without providing adequate information to depositors. The IoMT was told this at an early stage and yet were determined to pursue a path retaining external consultants to 'advise' them in this process. At the end of the day the cost of proposing the SoA incurred by the IoMT served to exacerbate an already unacceptable position for depositors and compounded the general opinion that the IoMT was not operating on the basis of finding the best possible solution for depositors. It seemed that there were other powers at play and depositors still believe that the truth behind the failure of the bank, the actions of its directors' and the IOM regulator and their roles in its demise, and the subsequent actions of the IoMT and its advisers must be told.

Truth and clarity was all the DAG was seeking from the outset yet in contrast there was continual stonewalling and misinformation that appeared to have an objective beyond that of helping distressed depositors in their time of great financial stress and hardship. KSFiom depositors were given the impression that they were fighting much more than a situation resulting from the vagaries of global financial markets, instead there were deeper political and financial objectives at play.

References

1. KSFIOM/PPDG Joint Response to the First Interim Report of the Tynwald Select Committee on KSFIOM: http://www.ksfiomdag.com/index.php?option=com_kb&task=article&article=100&Itemid=106
2. Isle of Man repays 60% to BCCI depositors. Tax-news, 15 Aug 2001. <http://www.iomtoday.co.im/news/Two-decades-on-from-bank39s.6061089.jp>
3. Consultation with all banking licenceholders on options for change to the Isle of Man's Depositors' Compensation Scheme, FSC, 6 March 2008. <http://www.gov.im/lib/docs/fsc/Consultative/consultationtobanks6308final.pdf>
4. Positive Action Group submissions to FSC Consultation document on options for change to the DCS, 24 & 31 March 2008: http://www.positiveactiongroup.org/PAG_DCS_Submission_1.pdf
http://www.positiveactiongroup.org/PAG_DCS_Submission_2.pdf
5. Letter from FSC to KSFIOM MD 25 April 2008, evidence supplied to the Tynwald Select Committee: fscfile1.7.pdf, pp 89-90.
6. FSC notes on a Meeting with KSFIOM directors 29 April 2008, evidence supplied to the Tynwald Select Committee: fscfile1.7.pdf, pp 79-81.
7. Review of Depositors' Compensation Scheme, IOM Treasury News 25 June 2008: <http://www.gov.im/lib/news/treasury/reviewofdeposito.xml>
8. Positive Action Group Press Release 4 July 2008: http://positiveactiongroup.org/html/depositor_compensation.html
9. Treasury dithers over increase in investor compensation, Manx Herald 2 Oct 2008: <http://www.manxherald.com/index.php/news/319.html>
10. DCS limit increased to £50,000, IOM Treasury Press Release 7 Oct 2008: <http://www.gov.im/lib/docs/fsc/PressReleases/081007depcompscheme.pdf>
11. Tynwald votes to put £150m of taxpayers' money on the line. Manx Herald, 23 Oct 2008. <http://www.manxherald.com/index.php/business/328.html>
12. Petition to wind up Kaupthing Singer & Friedlander is adjourned, IOM Today, 24 Oct 2008. <http://www.iomtoday.co.im/news/Petition-to-wind-up-Kaupthing.4627802.jp>
13. KSF (IOM) continues to be the subject of a slow death, Manx Herald, 27 Nov 2008: <http://www.manxherald.com/index.php/business/349.html>
14. Chief Minister returns 'empty-handed' from Iceland, Manx Herald, 11 Jan 2009: <http://www.manxherald.com/index.php/business/370.html>
15. Second Affidavit of David C. Lovett, 15 Jan 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Signed%20Affidavit%20of%20David%20%20C%20Lovett%20-%20251108.pdf>

16. While Isle of Man is busy saving reputations, depositors are left to watch as other territories quickly enact rescue strategies. KSFIOM Press Release, 17 Jan 2009: <http://www.ksfiomdepositors.org/press-release/while-isle-man-busy-saving-reputations-depositors-are-left-watch-other-territories-qui>
17. Third affidavit of David Lovett, 28 Jan 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Third-Affidavit-of-David-C-Lovett-26.01.09.pdf>
18. Affidavit of John Wright (for DAG), 28 Jan 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/DAG-Affidavit-090128.pdf>
19. KSFIOM petition of 29 January 2009 – Isle of Man Court Judgment: <http://www.judgments.im/content/J910.htm>
20. Banking Crisis vol 1 - oral evidence, Treasury Committee, House of Commons, 1 April 2009, page 197, Qs 1447-1450: <http://www.publications.parliament.uk/pa/cm200809/cmsselect/cmtreasy/144/144i.pdf>
21. KSFIOM Early Payment (n° 2) Scheme, Government Circular 04/09, 5 Feb 2009: <http://www.gov.im/lib/docs/fsc/PressReleases/ksfeps2doc.pdf>
22. Third affidavit of Allan Bell, 12 Feb 2009: [http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Third%20Affidavit%20of%20Allan%20Robert%20Bell%20\(signed\)-1.pdf](http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Third%20Affidavit%20of%20Allan%20Robert%20Bell%20(signed)-1.pdf)
23. Affidavit of Gabriel Moss QC, 12 Feb 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Affidavit%20of%20Gabriel%20Moss%20QC-1.pdf>
24. Fourth affidavit of David Lovett, 13 Feb 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/Fourth%20Affidavit%20of%20David%20C%20Lovett-1.pdf>
25. Third affidavit of John Wright, 18 Feb 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/3rd-Aff-JW.pdf>
26. Letter from group of depositors to the IOM Court, 18 Feb 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/KSFIO-M-lett-from-large-depositors-to-HHDDCorlett-18022009.pdf>
27. KSFIOM petition of 19 Feb 2009 – Isle of Man Court Judgment: <http://www.judgments.im/content/J917.htm>
28. KSF IOM gets another reprieve but DCS exposed as a financial ‘fig leaf’, Manx Herald, 19 Feb 2009 <http://www.manxherald.com/index.php/business/403.html>
29. Isle of Man Court Order, 23 Feb 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/20090223161501648.pdf>

30. Bell hints at agreement with banks over KSF funds, iomtoday, 24 Feb 2009: <http://www.iomtoday.co.im/news/Bell-hints-at-agreement-with.5010514.jp>
31. Tynwald backs Treasury's SoA for KSF (IOM) to tune of £180million, Manx Herald, 19 March 2009: <http://www.manxherald.com/index.php/comment/429.html>
32. The legal position on the Scheme of Arrangement, KSFIOMDAG, 19 April 2009: <http://www.ksfiomdepositors.org/public-page/legal-position-scheme-arrangement-190409>
33. Deemster Corlett gives in to Treasury – KSF (IOM) SoA to be put to creditors' vote, Manx Herald, 9 April 2009: <http://www.manxherald.com/index.php/business/485.html>
34. KSFIOM petition of 9 April 2009 – Isle of Man Court Judgment: <http://www.judgments.im/content/J931.htm>
35. KSF (IOM) DAG unconvinced voting 'Yes' to SoA is best option, Manx Herald, 22 April 2009: <http://www.manxherald.com/index.php/business/494.html>
36. Affidavit of Kenneth McGreal 23 April 2009: <http://www.law-man.com/library/news-75.pdf>
37. Final details and documents relating to Scheme of Arrangement proposed to KSFIOM creditors and arrangements for voting on 19 May 2009: <http://www.kaupthingsingers.co.im/Pages/SchemeOfArrangement.asp>
38. Proposed Scheme of Arrangement, KSFIOMDAG, undated c. 19 May 2009: <http://www.ksfiomdepositors.org/public-page/proposed-scheme-arrangement>
39. KSFIOM Scheme of Arrangement ("SoA") Summary of Qualitative Issues, KSFIOMDAG, 1 May 2009: <http://www.ksfiomdepositors.org/sites/www.ksfiomdepositors.org/files/KSFIO%20SCHEME%20OF%20ARRANGEMENT%20SUMMARY%20OF%20QUALITATIVE%20ISSUES.pdf>
40. Did Bell deliberately give potentially misleading information to influence KSF (IOM) SoA vote?, Manx Herald, 20 May 2009: <http://www.manxherald.com/index.php/business/525.html>
41. Report to Court of meeting of creditors to vote on SoA, 22 May 2009: [http://www.kaupthingsingers.co.im/Files/IOM/SchemeOfArrangement/M%20Simpson%20Affidavit%2022%20May%202009%20\(2\).pdf](http://www.kaupthingsingers.co.im/Files/IOM/SchemeOfArrangement/M%20Simpson%20Affidavit%2022%20May%202009%20(2).pdf)
42. Treasury responds to KSF IoM depositors vote, 22 May 2009: <http://www.gov.im/lib/news/cso/treasuryresponds.xml>
43. IOM Court Order placing KSFIOM in liquidation, 27 May 2009: <http://www.law-man.com/library/news-77.pdf>
44. Banking Crisis: The impact of the failure of the Icelandic banks: Responses from the Government and the Financial Services Agency to the Committee's Fifth

Report of Session 2008-09:

<http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/656/656.pdf>

45. Isle of Man Court Judgment on DAG costs hearing of 23 June:

<http://www.judgments.im/content/J964.htm>

46. The Isle of Man's response to the global financial situation as of 17 July 2009:

http://www.gov.im/cso/faq_gfs.xml

47. Affidavit of Peter Clucas (Cains):

<http://www.gov.im/lib/docs/fsc/PressReleases/affidavitpclucas.pdf>