

ARM ASSET BACKED SECURITIES SA

SECTIONS 168 / 234 INSOLVENCY ACT 1986 APPLICATION DATED 20 NOVEMBER 2015

SETTLEMENT UPDATE AND SUMMARY OF TERMS FOR BONDHOLDERS / CREDITORS

Background to the Application

As you are aware, on 20 November 2015, the Provisional Liquidators (the "PLs") issued an application to Court to determine (amongst other things) the ownership of the Pending Monies held in the accounts of three UK receiving agents (the "Application").

Dr Walter Pisarski (advised by Irwin Mitchell LLP and Mark Arnold QC) agreed to represent the interests of the Pending Bondholders in the Application. Mr Gordon Pullan (advised by Proskauer Rose (UK) LLP and Marcia Shekerdemian QC) agreed to represent the interests of the Non-Pending Bondholders. The costs of both representatives are payable from the assets of the estate.

Save in respect of one very limited issue for which they were appointed as representative (and which is now a moot point, given the settlement described below), the PLs' role in the Application was limited to providing the documentation and information which was necessary for the representatives and their advisers to be able to consider the legal arguments: the PLs themselves took a broadly neutral position.

We refer to the PLs' update for the period 6 June 2015 to 30 November 2015 (available [here](#)) for further detail on the background to, and the contents of, the Application.

On 25 January 2016, we updated creditors on the order made by Mr Justice Snowden setting out the directions which would apply to the application (available [here](#)). As set out in that update, the hearing of the application was due to take place on the first available date after 1 December 2016. In the event, the hearing was listed for March 2017 for 8 to 10 days. The estimated length of the hearing demonstrates the complexity of the issues at stake. The questions which the Court was being asked to determine are set out at Schedule 1 to this update.

As you may recall, it is unclear from the bond documentation, and as a matter of Luxembourg law, how the bonds are ranked as between themselves. Accordingly, the PLs had considered that it may be cost-efficient to seek clarification on this point from the Court at the hearing of the application. However, once the legal budgets had been received from the parties setting out their estimate of the costs associated with the determination of this issue, it became clear that the appropriate way forward was for the issue of ranking to be dealt with in the CVA (described below).

Put simply, the PLs undertook a balancing exercise between (a) the certainty which would come from the Court determining the issue, (b) the costs associated with that Court determination, and (c) the risk of a challenge following a compromise of the ranking issue in a CVA. The PLs ultimately took the view that the costs / benefit and risk analysis had tipped in favour of dealing with the ranking issue in a CVA and, in the circumstances, the proposed amended application was not pursued further.

Settlement discussions

The PLs have, throughout the course of the Application, actively encouraged the representative parties and their respective legal advisers to explore settlement as an alternative to the Court determining the issues. Active settlement discussions commenced in March 2016. The PLs have facilitated those discussions where possible (for example, by agreeing stays to the proceedings, and other amendments to the directions set out in the order made by Mr Justice Snowden).

The process of negotiating the settlement has been protracted for a number of reasons, including: the complicated nature of certain of the legal issues (several of which raise questions of Luxembourg law, as well as English law); the need for detailed modelling to be done of the financial outcome of different settlement structures; information on ARM's financial position and its creditor base becoming available as time has progressed; and the need to agree with the FSCS its intended approach to passing over amounts received by it to those creditors whose claims had been assigned to it. The support of the FSCS has been critical to the process because, as a result of the compensation process, they now represent approximately 70% (by value) of the claims and will also be responsible for paying over to individual creditors their share of any distribution payments received by the FSCS as part of the CVA described below.

The PLs are pleased to confirm that agreement on the key commercial terms of settlement was reached in February 2017. The formal settlement agreement was executed yesterday, 7 March 2017.

Terms of settlement

The key commercial terms of the settlement are set out below. Please note that this is necessarily a high level summary. A copy of the settlement agreement itself accompanies this update.

- (a) The Pending Bondholders will give up their claim to the Pending Monies as trust assets, which monies will then form part of ARM's assets and be available for distribution to ARM's creditors generally;
- (b) As consideration for doing so, a top-up payment (known as the "Enhanced Dividend") will be made to those Pending Bondholders who, after taking into account any and all FSCS compensation which they may have received, and the dividends (other than the Enhanced Dividend) (the "Standard Dividends") from ARM payable to all Investors, still have uncompensated net losses;
- (c) The relevant net loss for these purposes will be the value of a Pending Bondholder's capital investment minus any payments received by him/her from ARM, in particular by way of interest payments;
- (d) The amount of the Enhanced Dividend (if any) payable to any individual Pending Bondholder will be calculated on the basis of a claims received within an initial 3 month period after the CVA has been approved;
- (e) Only creditors who file a proof of debt within three months of the CVA being approved by creditors will be entitled to an Enhanced Dividend;
- (f) The aggregate value of the Enhanced Dividend is capped at £950,000. It is currently anticipated that an Enhanced Dividend of approximately £740,000 will be paid out;
- (g) The Enhanced Dividend is to be paid at or around the same time as the first distribution in respect of the Standard Dividends is paid;
- (h) For the purposes of the CVA, the Standard Dividends will be calculated on a pro rata and *pari passu* basis (ie without applying any ranking between the Bonds); and
- (i) The settlement is in full and final settlement of all claims arising out of or connected with the Application.

The settlement is conditional on both the coming into effect of the CVA described below and the approval of the Court (which is being sought at a hearing presently expected to take place on 16 / 17 March 2017).

The CVA

If the settlement is approved by the Court, it is intended that a procedure known as a company voluntary arrangement (a "CVA") will be proposed in order to implement the agreed terms. A CVA is an arrangement between a company and its creditors under Part I of the Insolvency Act 1986. In this case, it is being used as a mechanism to distribute ARM's assets amongst its creditors with more flexibility and cost-effectiveness than would be the case in a liquidation.

The CVA will be voted on at a creditors' meeting. All creditors will be given at least 14 days' notice of the creditors meeting (including by way of notice published on this website). The notice will provide full details of the terms of the CVA, as well as, amongst other things, how the creditors' meeting will be run, how voting will work and how creditors may claim their share of dividends payable. The terms of the representative beneficiary agreement provide that the representative beneficiaries are appointed to represent the interests of their respective creditor populations only in respect of the Application and not in relation to voting on behalf of creditors in relation to the CVA.

A number of issues have arisen during the course of the negotiations in relation to the settlement of the application. The process and negotiations to resolve the Pending Monies issues have not only allowed these issues to be resolved, but have also resolved other issues to the satisfaction of the representative parties, and their legal advisers, which will assist in drafting the terms of the proposed CVA in a way which will be fair to all creditors. As a result, the settlement process has also allowed significant progress to be made in the wider objective of distributing ARM's assets to you.

As you will be aware, ARM's principal asset (other than the cash currently held at bank) is the right to receive future payments from the entity which acquired ARM's life policies (the "FCIL Receivable"). Instalments of approximately US\$7.2 million remain to be paid to ARM at the end of this year, and each following year up to and including 2021. The CVA will therefore remain in effect until after receipt of the final instalment.

The PLs' view is that the settlement is fair and reasonable

The PLs believe that the settlement which has been agreed between the representative parties is a fair and reasonable compromise of the issues in the Application and is in the interests of the creditors of ARM as a whole:

- (a) The ARM product was targeted at people reaching retirement age and was offered as an alternative to an annuity. The PLs are sensitive to the fact that a significant proportion of the creditors are relatively elderly individuals who have been suffering financial hardship, in some cases severe, and significant stress as result of ARM's demise. Some of these creditors will be in ill-health. The creditors have faced a period of uncertainty of over 6 years since ARM effectively ceased its business. The settlement brings finality to the Application and will result in earlier distributions than would otherwise have been the case had the matter needed to have been resolved by the Court. Although the timing of the Court process was uncertain, it could well have been many months after the end of the hearing before the Court delivered its judgment. In the event that either party sought to appeal the judgment, the process could have been extended by a further 1 to 2 years.
- (b) Whilst, because of, amongst other things, the complexities identified above, significant costs have been incurred in the process of reaching and documenting the settlement, the parties will make some cost savings as a result of a consensual resolution rather than Court determination.
- (c) Although it is a matter for the representative parties and their legal advisers, the PLs' understanding of each party's assessment of the merits and weaknesses of their claims and each party's motivation and reasoning for agreeing to the settlement leads us to believe the settlement is a fair outcome for all creditors, not least given the risks faced by them in the

valuation of their respective rights and entitlements depending on the outcome of a contested hearing of the Application. In particular, had the matter been resolved by the Court: (a) the Pending Bondholders faced a risk that the Court might have dismissed their trust claim over the Pending Monies in its entirety; and (b) the Non-Pending Bondholders faced a risk that, not only might the Court have upheld the trust claim, but it would also have granted the Pending Bondholders a "shortfall claim" into ARM's other assets.

- (d) Assuming the conditions to the settlement are satisfied, it will allow approx. £30 million to be distributed late this Summer / early this Autumn to creditors. The Pending Monies will be treated as general ARM assets, along with the FCIL Receivable, which means that the Non-Pending Bondholders will share in an early distribution from the approx. £18 million of Pending Monies, which would otherwise not have happened. Further, to the extent there exists any credit risk in relation to the FCIL Receivable, this risk will be shared across all creditors, rather than being largely borne by the Non-Pending Bondholders.
- (e) The terms of the settlement have been heavily negotiated by the representative parties (and their legal advisers) over a considerable period of time on behalf of their respective constituencies. Both Mark Arnold QC and Marcia Shekerdemian QC (the senior barristers representing the representative parties) will provide confidential opinions to the Court stating that, in their opinion, the settlement is fair and reasonable for the class of creditor which they represent. They have also received Luxembourg legal advice.
- (f) Further, the FSCS, which is now by far the largest creditor, representing approximately 70% by value of the claims in the estate, has confirmed it supports the settlement. Importantly, the settlement affects the returns to the FSCS in relation to all claims assigned to it.

The Ad-Hoc Committee

Since the date of the Application, to a large extent, the previous extensive engagement with the Ad-Hoc Committee has been replaced with significant amounts of time liaising with the representative parties and their legal advisers. The Ad-Hoc Committee was made aware of this approach at a committee meeting on 15 December 2015 and agreed to it.

On 6 March 2017, the PLs held a meeting of the Ad Hoc Committee in order to notify them of the terms of the settlement. The Ad-Hoc Committee has raised no objections to the settlement (and some members of the Ad-Hoc Committee were involved in the settlement discussions as, or working with, the representative beneficiaries).

Appointment as Liquidators

As a technical matter, before the CVA can be proposed, the PLs need to be appointed as liquidators of the Company. In order to achieve this, the PLs have been liaising with the Court, and have restored the hearing of the winding up petition which was first presented in 2013. The hearing of that winding up petition is due to take place on 10 March 2017. With the support of the FSCS as the significant majority creditor of ARM, it is expected that the PLs will be appointed as liquidators on or shortly after 10 March 2017 by the Secretary of State for Business, Energy and Industrial Strategy.

Estimated outcome for creditors

The following shows the estimated outcome for creditor classes, based on the information currently available to the PLs.¹

- Trial Scenario 1: All bondholders treated as pari passu and assets are available rateably to all classes of creditors.
- Trial Scenario 2: Pending Monies are held for the benefit of Pending Bondholders on trust with the shortfall being claimable against the other assets, with the costs being split 50:50 between the two pools of assets.
- Settlement: As described above, Pending Monies become assets of the estate and all bondholders are treated as pari passu, but with £950,000 held and made available for Pending Bondholders with an uncompensated net loss. With the application of the Enhanced Dividend, it is intended that all Pending Bondholders will be compensated in full in respect of their net loss (ie their capital investment less interest payments received from ARM, taking into of FSCS compensation). As stated above, importantly, beyond these Pending Bondholders, there is also an effect on the returns to the FSCS from all of the claims assigned to it.

	Notes	Scenario 1	Scenario 2	Settlement
Assets Available:				
-Estate Assets		57,401,163	45,952,375	56,661,070
-Trust Pending Assets		-	11,448,788	740,093
	1	57,401,163	57,401,163	57,401,163
Creditor Base:				
-NP Investors	2	175,208,906	175,208,906	175,208,906
-P Investors	2	41,501,907	41,501,907	41,501,907
-P Investors (shortfall)			30,053,119	
Standard Dividend:				
-NP Investors	3	26.49%	22.39%	26.15%
-P Investors	3	26.49%	43.80%	26.15%
Enhanced Dividend (max £950k):				
-P Investors	4			740,093

Notes:

1. This figure is estimated on the information presently available and has been used consistently across the scenarios to allow for comparative purposes, these are the assets net of costs.
2. The creditor base previously stated was £142m; this represented the actual amount of cash invested in the structure. As a result of the settlement negotiations, it has been determined that, allowing for accrued interest and growth up to the earlier of (i) the maturity of the bond or (ii) the date of liquidation, would be a fair approach for all creditors and in line with liquidation.

¹ This estimated outcome illustration (the "EoS") has been prepared for the sole purpose of illustrating the potential economic implications for creditors of the settlement. ARM's accounting and legal records are incomplete. This EoS is based on the information presently available to the PLs, and certain assumptions. It is therefore subject to potentially material change, depending on the outcome of certain events. FX rates are a particular risk in this regard. The ultimate outcome to creditors cannot therefore be guaranteed at any particular level.

3. This is the estimated return to creditors on their gross claim. This may be a lower value than previously reported which was based on net claims; however, this is a function of the larger claims base. For example, we had previously estimated a dividend of c.42%, ie if an investor had invested £10,000 they could expect a dividend of £4,200. The same investor would now be able to claim gross, and therefore would have an estimated claim of £16,500 (dependent on the terms of the bond) and receive a dividend of c26%, which is c£4,300. The actual returns to investors are also subject to any assignments to the FSCS.
4. The Enhanced Dividend will compensate those Pending Investors who are not already compensated up to their net loss through the FSCS compensation and the standard dividend. The cost of this is currently estimated to be £740,093; the Settlement Agreement places a maximum on the aggregate Enhanced Dividend of £950,000. As above, there is an effect on the FSCS beyond this.

Conclusion

The PLs are pleased to be able to report the conditional settlement of the Application. If any creditor has any questions or comments about the settlement, they are encouraged to email ARM.ABS.SA@bdo.co.uk by 14 March 2017.

We shall provide a further update after the settlement approval hearing presently expected to take place on 16 / 17 March 2017.

Schedule 1 - the Questions in the Application

(1) **CASS 7.7.2R Trust**

- (a) Do the client money rules in CASS 7 apply to Pending Monies received from Pending Bondholders (the "Jarvis Pending Monies") by Jarvis?
- (b) Are the Pending Monies received from Pending Bondholders and held by SLC and/or by Squaremile (the "SLC Pending Monies" and the "Squaremile Pending Monies" respectively) to be treated as having been received and/or held by CIGL and, if so, do the client money rules in CASS 7 apply to them?
- (c) If the client money rules in CASS 7 apply to the Jarvis Pending Monies and/or the Squaremile Pending Monies and/or the SLC Pending Monies, is there a statutory trust over those sums (or any of them) by virtue of CASS 7.7.2R?
- (d) If there is a statutory trust of those sums (or any of them), who is/are the beneficiary(y)(ies) of that trust or those trusts?

(2) **Pending Monies Trust:**

- (a) What law governs the question of whether or not a non-statutory trust arises over the Pending Monies (the "Applicable Law")?
- (b) Under the Applicable Law, are the Pending Monies held on trust for the Pending Bondholders by ARM, and if so what are the terms, effect, and extent of that trust?
- (c) If the answer to question 2(b) is "yes":
 - (i) do the beneficiaries of that trust (the "Beneficiaries") have a claim for any shortfall from the trust assets against any general assets held by ARM?
 - (ii) should the Beneficiaries account for and/or net off any interest or other payments received from ARM prior to ARM's provisional liquidation?
- (d) If the answer to question 2(b) is "no" (and subject to the answers to questions 4(b), (c) and (d) below), do the Pending Monies form part of the ARM estate for the benefit of creditors generally?

(3) **Pending Bondholder Claims:**

- (a) If the answer to question 2(b) above is "no", do the Pending Bondholders have a claim against ARM in contract?
- (b) If the answer to question 3(a) is "yes", are the contractual claims of the Pending Bondholders affected by limited recourse provisions in the terms and conditions of the Bonds (the "LRP") and what is the effect of the LRP?
- (c) For any Pending Bondholders who have claims against ARM on the basis of misrepresentation, negligent misstatement or fraud (or their equivalent under foreign law) ("Alternative Claims"), will those Alternative Claims be affected by the LRP and if so how?

- (d) If any Pending Bondholders have contractual claims or Alternative Claims against ARM, on what basis (if any) should they account for and/or net off any interest or other payments received from ARM?

(4) ***Non-Pending Bondholder Claims:***

- (a) For any Non-Pending Bondholders who have contractual claims or Alternative Claims against ARM, will those claims be affected by the LRP and if so how?
- (b) Depending on the answers given to any part of question 4(a), are there any remedies available to the Non-Pending Bondholders (under English law or Luxembourg law) which would have the consequence or effect of setting aside or displacing the LRP?
- (c) Is there any principle of English law or Luxembourg law which might operate so as to displace the LRP or render them unenforceable, whether as a matter of public policy or otherwise?
- (d) What is the effect of the sale by ARM and ARM Trust to FCIL of ARM's portfolio of Life Policies on:
 - (i) the contracts between the Non-Pending Bondholders and ARM;
 - (ii) the LRP; and
 - (iii) any contractual claims or Alternative Claims the Non-Pending Bondholders have against ARM?

(5) ***Distributions:***

- (a) Depending on the answers to the questions set out in the Application, in particular (1), (2) and (4) above:
 - (i) should the beneficiaries' beneficial entitlements be identified on the basis of the rule in Clayton's Case or rateably by reference to their relative contributions?; and
 - (ii) should the PLs be permitted and directed to distribute any trust money, and if so how?

Schedule 2**Worked Example**

Example - Income Bond:		£ (Equivalent)
	Note	£ (Equivalent)
Original Amount Invested:		220,150
Estimated Net Claim:	1	191,255
Compensation Received:	2	77,633
Estimated Notional Standard Dividend		
- 26.15% of £273,812 (Gross Loss)	3	71,602
Enhanced Dividend Required	4	42,020
		191,256
Notes		
1. Original amount invested less estimated interest received		
2. Joint investment, therefore double compensation received		
3. Gross Loss:		
	Date of Maturity : 31 December 2015	
	Quarterly Interest Rate: 1.875%	
	Term: 5 years (20 quarters)	
	Quarters between July 2011 and Maturity: 13 quarters	
	Unpaid Interest to Maturity: £53,662	
	Gross Loss: £273,812	
4. Enhanced dividend required to compensate investor up to net loss		
(191,255 - 77,633 - 71,602 = 42,020)		