FOR PROFESSIONAL INVESTORS ONLY. NOT FOR RETAIL INVESTORS

UK FUNDS STATEMENT

Summary update for Investor Committee, Professional Investors and Advisers

Since the suspension of the CF Arch cru Funds (the "OEICs"), Arch Financial Products ("ARCH") has made the best interests of investors its absolute priority. In doing so we have worked tirelessly to preserve value in the portfolios and to restructure Guernsey cell underlying positions wherever necessary. We have also fielded many enquiries from the various Fund stakeholders, including the Authorised Corporate Director ("ACD"), the IFA community, regulators, and press. Despite the uncertainties and additional burdens, we are pleased to say that the underlying holdings of the Funds, although significantly affected by global events (especially lack of liquidity) are now in reasonable shape for the wind-down of positions over the medium-term.

We understand the frustrations that many of you have had regarding lack of communication around the suspension of the Funds. Given the need for certainty and to avoid unnecessary speculation, the various parties involved have been constrained in what they have been able to communicate to you. The information herein provides further information to supplement the letter sent to investors by Capita Financial Managers Limited ("CFML") in its capacity as ACD to the OEICs.

The key announcements made by either CFML or the Guernsey cells this week, were as follows :

1. The suspension of dealings in the OEICs will not be lifted and the OEICs will instead be wound down. It is expected that this wind down will take 3-5 years to complete (the "wind-down period")

2. The Year-End accounts for the underlying Guernsey cell companies have been finalised and are expected to be released in mid-December once the final audit sign-off is completed

3. Estimated valuations for the period March 2009 to September 2009 have been released by the Guernsey cell directors via the Channel Islands Stock Exchange. http://www.cisx.com/listedsecuritynews.php?offset=40. The impact on the OEIC valuations has been calculated by CFML in their letter to investors.

4. Given the wind-down of the OEICs, ARCH has resigned the management of the OEICs with effect from 4 December 2009. CFML has assumed investment management responsibility for the OEICs during the wind down period (principally the return of proceeds to investors)

5. With the consent of the Guernsey cell directors, ARCH have also transferred the management of the underlying Guernsey cell companies to Spearpoint Limited, a Channel Islands-based investment manager. The appointment of Spearpoint was effective from 30 November 2009.

In arriving at these decisions CFML and ARCH have necessarily weighed up the legal, accounting, regulatory and product structuring options around a restructure of these Funds. Also taken into account was the likelihood of further injections of new capital, as well as potential redemptions in the event that suspension of redemptions was lifted. In our view the Spearpoint deal represents the best outcome for investors in the Guernsey cells, to achieve continuity of investment management and expertise. We, CFML and Spearpoint estimate that the wind-down of the OEICs will necessarily take 3-5 years to complete, in order to maximise the value of the underlying investments over the medium-term, rather than conduct any type of "fire sale", which would be highly prejudicial to investors' best interests.

Frequently Asked Questions

In the section below we have provided answers to the likely questions resulting from the announcements made.

1. Why have CFML chosen to wind down the OEICs?

CFML commissioned a study into all alternative options for the future of the OEICs, including advice on the legal, tax and regulatory implications of each. The conclusion CFML reached was that winding down the OEICs in an orderly manner was the only viable option that was in the best interests of shareholders as a whole. Please refer to CFML's letter to shareholders which explains this process in significant detail.
http://www.capitafinancial.co.uk/reference/arch-20091207-1.asp

2. When will I receive the cash back for my investment, and how much?

Investors will receive back part payments over time, as underlying holdings are sold during the wind-down period and distributions are made from the OEICs. As mentioned above, the wind-down of the OEICs will take place over a number of years. This is in order to maximise the value of the underlying assets over the medium-term, rather than conduct any type of "fire sale", which would destroy value and lock into distressed prices, without due regard for investors' best interests.

As and when sufficient cash becomes available in the OEICs from the sale of the underlying assets, investors in the OEICs will receive a pro-rata partial return of capital on their investment. We understand that CFML will write to investors each time a distribution takes place. For investors who have invested via a platform or tax wrapper such as a SIPP or ISA, CFML will contact the provider to make arrangements regarding the way in which distributions will be handled, and investors should contact their provider to determine how this is to be treated.

3. Why are CFML managing the OEICs?

This is a unique situation. A number of proposals were received by CFML from various fund management companies for the future running of the OEICs. However, as the decision has been taken to wind up the OEICs in an orderly manner there will be no active investment management as such. Rather OEIC management going forwards is a cash management and registrar role. The decision has therefore been taken by CFML to take on this role using its own regulatory permissions, at the same time minimising the running costs in the best interests of investors. The FSA has been consulted on this approach.

4. Why were the March 2009 reports for the Guersney cell companies filed late, and is this an ongoing issue?

Moore Stephens audit the underlying cell companies on an annual basis. Given the various additional requirements and assurances required by the stakeholders, this has resulted in considerable delay in both the preparation for, commencement of and duration of the audit. Further to this, there is usually a significant delay or lag experienced in the process of assessing the value of underling investments in private equity and other investments into private markets. Any valuation exercise needs to recognise this constraint.

The above factors, plus the requirement for all information to be released at the same time, hasled to a delay in the finalisation and publication of the audited accounts of the Guernsey cell companies. Accordingly, an announcement on the Exchange has been made by the Guernsey cell directors for a time extension. The audited accounts will be lodged with the Channel Islands Stock Exchange during December 2009. It should be recognised that the preparation and audit of the accounts is the responsibility of the directors of the cells, the administrators and auditors and not that of the investment manager.

5. How will Fund valuation and reporting be achieved going forwards?

In respect of the valuation process the position remains broadly unchanged. The OEICs are independently valued by CFML. The underlying Guernsey cell companies are independently valued by Bordeaux Services (Guernsey) Limited, the administrator to the Guernsey cell companies.

6. Can you please address earlier speculation in the media about the safety of our assets?

CFML confirmed in their letter of 9 October 2009 that their review of the existence and ownership of assets had been completed and raised no concerns. This independently confirms what we stated in our update of 5 May 2009. We believe investors may derive comfort from this, and from the involvement of several different firms in the operation of the OEICs. Each of the parties has specific responsibilities which help protect investors' interests. The OEICs and Guernsey cell companies each have independent administrators, custodians and auditors. The details for these and any other counterparties are listed in the relevant OEIC Prospectus or Scheme Particulars for each Guernsey cell. Where Guernsey cell companies invest into other funds, suitable precaution has been taken to ensure those funds also have appropriate independent custodial and administrative processes in place.

7. How much have the Funds fallen since suspension? What is their current value?

With all traditional and non-traditional asset classes under assault, valuations have been under downward pressure. As CFML highlighted in their letter of 9 October 2009, the assessment of the value of the underlying assets proved to be extremely complex, particularly in the current unprecedented market conditions. The nature of the assets, many of which are not listed on public markets and therefore have no readily available 'market price', makes this particularly difficult.

From the Capita letter to shareholders dated 7 December 2009, the estimated performances of the various OEIC sub-funds over the period are between -20% and -40% as follows :

	Fund	NAV 13 March 2009 (1)	Estimated NAV* 30 September 2009 (2)	%age change (1) to (2)
Investment Funds	Investment Portfolio	£242,840,283	£144,055,230	-40.68%
	Specialist Portfolio	£12,627,838	£8,666,125	-31.37%
Diversified Funds	Finance Fund	£56,825,709	£37,744,794	-33.58%
	Income Fund	£27,107,160	£16,504,063	-39.12%
	Balanced Fund	£21,151,186	£14,228,417	-32.73%
	Global Growth Fund	£2,679,402	£2,117,843	-20.96%

Source : CFML

(1) The NAV dated 13 March 22009 is based on the quoted CISX share prices for the underlying Guernsey cells.

** These figures are necessarily only estimated net asset values (NAVs) for the funds, as they are based on estimated, rather than finalised, NAVs for the cells. For example, the estimated NAVs for the funds do not take account of adjustments that will be made in light of the decision by various parties to waive their entitlement to certain fees from the funds. Updated NAVs for the funds will be prepared upon finalised NAVs being published by the cells. It is also important to note that the percentage decline in the price of any particular share class will not be the same as the overall estimated percentage decline in the NAV of the funds as a whole. This is principally because the charges applied to the funds vary across share classes, and because the value of non-sterling share classes may also be impacted by currency fluctuations.*

8. Who are Spearpoint? Why were they selected?

Spearpoint Limited is a Channel Islands based investment manager, authorised and regulated by both the Jersey and Guernsey Financial Services Commissions. Please refer to their website www.spearpoint.com for more information. Spearpoint were selected by the Guernsey cell directors from a shortlist of interested parties, as the most suitable replacement. Relevant selection criteria included financial resources, asset management experience, staffing and relevant expertise. The Financial Services Authority (FSA) and Guernsey Financial Services Commission (GFSC) have been kept informed of material developments and are aware of Spearpoint's appointment as investment manager to the Guernsey cells.

The Spearpoint team comprises many experienced investment professionals and as part of the transfer to Spearpoint, a core team of ARCH staff will continue to be involved in the management of the underlying Guernsey cell companies. This is considered essential, given the nature and relative complexity of the investment arrangements. We expect that the involvement of Spearpoint will also improve the liquidity position of the underlying assets within the Guernsey cell companies. For the above reasons and by achieving continuity of investment management and in-house expertise, we believe that Spearpoint's appointment represents the best outcome for all Guernsey cell investors.

9. There has been a deterioration in liquidity and performance. What do you attribute this to?

Investors would be aware that the funds lost value during what was a tumultuous period in the first half of 2009. Despite the worst liquidity environment for decades, cash levels within the underlying Guernsey cell companies have been slowly improving, whilst at the same time capital commitments have been reduced. As with most investment exposures at this time, the preservation of liquidity is all important necessitating reduced exposure to, or restructuring of, those investments that require ongoing cash commitments or that are cash flow negative, so that they become self-funding.

The valuations are in essence "mark-to-market". However the applicability of mark-to-market methodologies to private market assets tends, in our view, to be overly conservative in the current economic environment, and is a subject of much debate within the industry.

In broad outline, we can attribute the reasons for the falls in net asset value as follows :

- The prices of virtually all assets (public or private) have fallen substantially since the advent of the financial crisis;
- Values of collateral assets backing many loans have thus also fallen substantially, particularly in shipping and real estate;
- Valuations for private market assets (and therefore the Guernsey cell companies) tend to lag those of public securities markets by 3 to 6 months, due to the valuation methodologies and time frames for the reporting of such assets;
- The global liquidity crisis has turned many formerly liquid types of asset and financing to illiquid, for the time being
- Extra conservatism being exercised by the parties responsible for the valuations, given the current environment and the impact of the application of "mark-to-market" methodologies at this time

That said, we are hopeful as to the long-term recovery prospects for the strategies pursued by the cell companies, for various reasons.

- there is room for valuation increases from here, as "mark-to-market" levels are expected to revert to more sensible levels. For example, the price of a ship currently valued at 1 times earnings is unlikely to stay there for very long
- changes in mark-to-market methodology are expected, which should be more consistent with the nature of and typical valuation standards applied, for such assets
- as liquidity improves, we would naturally expect valuations to recover ceteris paribus, as well as the ability to realise assets
- as the economic/trading environment improves, cashflows should naturally improve and therefore overall valuation levels as well

In late 2008 there was an unprecedented seizing up of the world financial system, in that banks stopped lending to customers and each other due to severe difficulties in continuing to fund themselves. Such unusually extreme market and asset/ liquidity conditions had several knock-on effects for the pricing of securities markets, asset markets and the provision of bank liquidity, which have all fallen in unison, allowing for the lagged valuation timescales mentioned earlier. International trade temporarily dried up at the same time, as letters of credit from banks were not forthcoming. Given the vicious cycle that has significantly weakened all balance sheets and cashflows, there is now a fundamental lack of capital available for investment or financing.

10. What are the prospects for recovery and when do you think this will happen?
The restoration of the natural liquidity of assets is dependent on the overall lending environment, itself determined by the availability of central bank liquidity and the general economic environment. The wind down of the funds is estimated to take between 3 to 5 years and will be optimised so that investors do not receive "fire sale" proceeds, but instead receive sensible values for the investments realised over time. Given the current state of the markets and the banking sector and in investors' best interests, this is not a process to be rushed.

Asset and securities markets are currently in a depressed state as a direct result of the financial crisis and associated events around the world. There are still many fundamental reasons as to why the current deflationary economic scenario may persist. As the banking industry restores itself, we would expect liquidity generation and asset recovery to re-establish themselves. A recovery in portfolio values should therefore be expected to occur over a few years, along with overall recovery from economic recession and more importantly, a recovery of the banking sector. In such a scenario we can progressively expect the following to occur :

- A recovery in asset values (and therefore collateral values)
- Assets may be sold to repay loans e.g. sale of properties, tankers, companies etc
- Loans may be repaid from trading profits or refinancing
- Holdings in funds that have suspended/restricted redemptions can be realised
- Private equity assets may be realised through trade sale, secondary market or public offering

11. Some critics have said the Investment Portfolio was not low to medium risk, despite being in the Cautious Managed Sector. Do you agree?
We categorically disagree with this on several fronts and expand on this below in some depth.

The qualification to be in the **Cautious Managed Sector** is that there is a minimum 30% of fund assets in cash/fixed interest, the rest can be in equities including emerging market equities, subject to a maximum of 60%. Assets must be denominated at least 50% in Sterling/Euro. A look-through basis is applied when assessing whether a fund qualifies for inclusion. The relevant funds have thus always met the test for inclusion in the IMA Cautious Managed Funds sector and have remained in the sector despite their current suspension status. It can also be seen from this definition and the allowable equity weightings, that Cautious Managed does not necessarily imply low risk.

In terms of **asset allocation and diversification**, the OEICs were structured to deliver a dynamic strategic asset allocation, investing into both traditional and alternative asset classes which are, over time, both liquid and less liquid. In doing so, this in our opinion provides genuine diversification of risk and risk-adjusted return. The inclusion of less liquid investment holdings creates, in our view, a portfolio that is diversified with respect to not just securities / asset price risk, but also with respect to the holding period. This further supports the arguments as to prudent spread of risk, consistent with the Collective Investment Scheme rules.

With particular reference to those funds classified as in the Cautious Managed sector, we believe that :

- The Investment Portfolio and Income Fund were highly diversified, diversification being a core requirement to preserve capital during volatile periods
- There is a misconception that these funds were heavily invested in Private Equity. They actually had a very well diversified exposure to many asset and investment strategy types
- The more focused Finance Fund was also diversified across many asset types, with collateral and investments across sectors including real estate, shipping, alternative investment funds, equity and debt. Within each of these areas there was further underlying diversification. For example the shipping collateral comprised exposure to passenger ferries, newly built vessels, tankers, bulk carriers and conversions. All such sectors are non-homogeneous with varying asset and sector-specific risk and return characteristics over time.

Turning to the question of **investment risk**, in our opinion the portfolios were well diversified and exhibited low volatility and low correlation to other asset types. As with most assets, diversification has not been particularly effective due to the worldwide upheavals in the financial, corporate and other sectors. Simply put, no diversified fund was able to protect capital in the aftermath of the financial crisis. Money market funds were also having problems/losses, yet they were believed to be “ultra low risk” (for example many of the money market funds managed by household names all suffered substantial losses).

With particular reference to those funds classified as in the Cautious Managed sector :

- They exhibited low volatility in absolute terms and low correlation to other asset classes and were therefore by most industry measures of risk, low risk
- By avoiding the public markets in the main, they were much less subject to short-term public market sentiment and volatility – another low risk indicator
- It would be fair to say that most investments in the world became “high risk” on a short-term basis, following these extreme market and liquidity conditions. However, risk should not be measured over short time periods nor can risk be gauged in real-time with perfect hindsight.
- All funds might now be viewed as “higher risk” than before, on a short-term assessment or measurement basis. In general this is because the price of virtually any asset has followed equity markets down, and equally in the particular case of the Finance Fund, because the collateral /asset values backing many loans have fallen substantially.
- Risk gradings for all investments change with time. This is a point we have frequently made mention of. However the industry at large does not change its risk ratings over short time periods, as risk is not recognized as changing in this way. Rather risk is measured and ascertained by the industry as a medium-term concept and rated accordingly.

Lastly, in terms of **macroeconomic / cyclical risk** :

- By assiduously avoiding public securities market risk or “beta risk” in their allocations, these funds successfully avoided much of the volatility experienced by most mutual funds over the period since inception. The Funds (and underlying Guernsey cells) also held plenty of cash as standard practice, balancing the need to generate performance with the need to maintain liquidity to deal with cash flow uncertainty.
- What was unusual about the recent crisis period was that there was a financial markets crisis and a banking and liquidity crisis happening at the same time i.e. unusually extreme market and asset liquidity conditions , as well as a collapse in asset prices. This is very rare. The period also included a temporary seizure in international trade.
- It has taken a global liquidity / banking crisis to turn many asset types from liquid to illiquid, driving down asset values in the process. As the banking industry restores itself, liquidity generation and asset recovery should re-establish themselves.

12. What are the current allocations/weightings of the Funds?

	Private Finance	Private Equity	Real Assets (Real Estate, Sustainable, Energy etc)	Cash
Investment Portfolio	42%	32%	23%	3%
Specialist Portfolio	11%	43%	31%	15%
Income Fund	63%	6%	22%	9%
Balanced Fund	37%	27%	25%	11%
Global Growth Fund	8%	37%	27%	28%
Finance Fund	82%	0%	0%	18%

Source: Arch Financial Products, based on estimated net asset values as of September 2009

13. There is a concern that the Fund suspensions were caused by institutions having pulled out significant money. Is this accurate?
This is inaccurate. Investments from the "platforms"Fidelity Funds Network and Cofunds totalled around £4.4 mln at the time of the suspension in dealings in the OEICs. This represents around 1% of the OEICs' assets.

14. How long will this process take?
The wind down is dependent on the ability of the OEICs to realise their underlying holdings at sensible or fair value prices. While some assets are liquid, others such as private equity will take some time to realise or find suitable buyers. Investors should expect that this could take 3 to 5 years, with proceeds being returned through periodic distributions of capital.

Arch Financial Products
7 December 2009

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