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‘Vulture’ hedge funds set to target unprotected government debt

By Elaine Moore **November 26, 2014**

“Vulture” hedge funds, which typically target distressed sovereign bonds, are set to turn their attention to other forms of public borrowing, in an attempt to keep forcing payouts from indebted governments.

Major changes to government bond contracts in the wake of Argentina’s default this year are making it harder for hedge funds to buy the bonds of indebted countries cheaply, resist their debt restructuring proposals, and then sue for full repayment.

But while these changes should act as a “shark repellent” that deters hedge funds from buying distressed sovereign bonds, Lee Buchheit – the lawyer who was lead adviser to Greece in the biggest debt restructuring in history – has warned that other types of government debt still lack protection. This unprotected debt can include loans, trade finance papers and bilateral credits.

In the past, some vulture hedge funds have bought up this debt and successfully sued governments for repayment – and lawyers now believe the practice will become more common.

For example, in July, Themis Capital and Des Moines Investments Ltd won a case concerning $18m of debt from the Democratic Republic of Congo, in which they had invested. US Southern District of New York Judge Paul A. Engelmayer ordered the country to repay the investors the full amount borrowed plus interest – which came to $70m, as the debt originated from the early 1980s under the regime of dictator Mobutu Sese Seko.

Eric LeCompte, executive director of Jubilee USA, which campaigns for debt relief in emerging market economies, said that aggressive hedge funds were likely to seek out this sort of debt more in future. “Funds tend to buy distressed sovereign bonds because they are more liquid than other forms of government debt,” he said. “But they can simply switch targets.”

Until now, most vulture hedge funds have focused on sovereign bonds. When Greece restructured almost €200bn of bonds in 2012, funds holding €6bn worth held out against the deal, and were repaid by Greece in full.

According to research by German academics Julian Schumacher, Christoph Trebesch and Henrik Enderlein, the likelihood of a country’s debt crisis being accompanied by creditor litigation has increased dramatically in recent years, from less than 10 per cent in the 1980s to 50 per cent now.

However, campaigners including Jubilee USA have argued that litigious hedge funds have set back economic development plans in emerging market economies and threatened the stability of debt markets.

To limit the scope for lengthy creditor battles, governments are starting to change bond contracts in ways that make it more difficult for investors to hold out against a restructuring deal and sue for full repayment. Mexico and Kazakhstan have already implemented the changes, which have the backing of the International Monetary Fund, International Capital Market Association and leaders of G20 nations.