



Quixote Center

United Church of Christ,
Justice and Witness Ministries

Missionary Oblates

Vulture Funds: A Threat to the Poorest Countries and U.S. Foreign Assistance

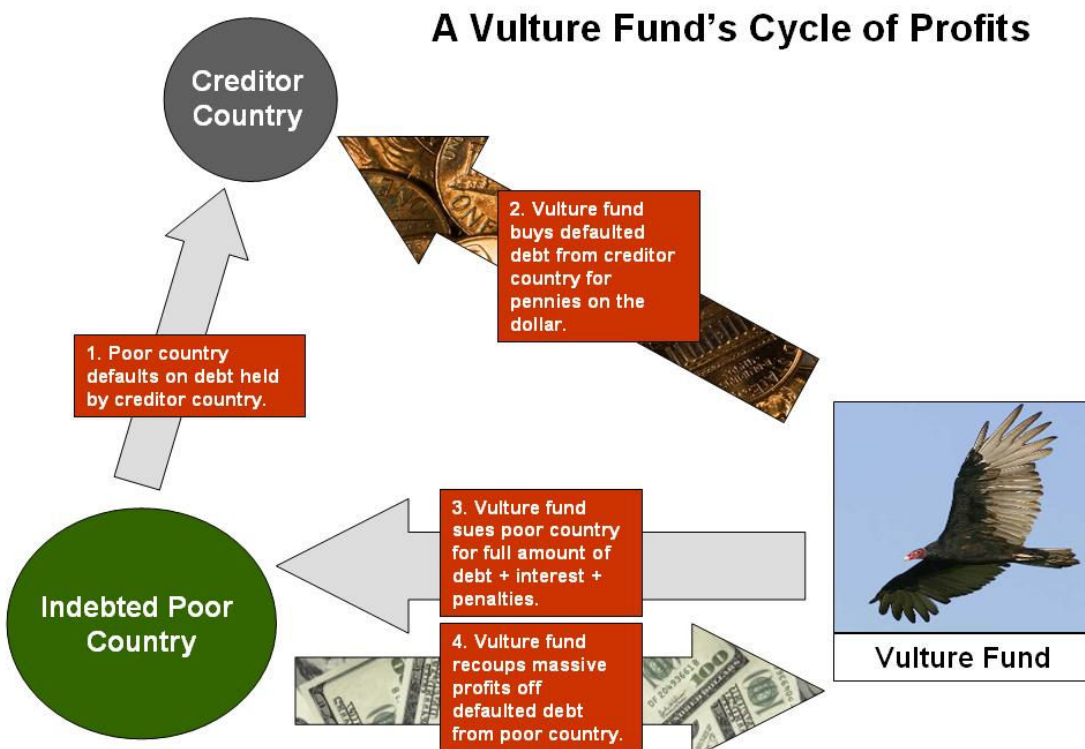
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Since the Heavily Indebted Poor Countries (HIPC) Initiative was created in 1996, donor countries have committed over \$90 billion in bilateral and multilateral debt cancellation to promote economic development and poverty reduction in the developing world. This vital progress has been threatened by the activity of Vulture Funds that exploit the most impoverished countries at the expense of both their citizens and of countries like the United States that support international debt cancellation. Vulture Funds acquire the defaulted sovereign debt of poor countries, and then refuse to participate alongside responsible creditors in international debt relief initiatives.

Two pieces of legislation currently before Congress impact the practices of Vulture Funds in impoverished countries. The **Stop VULTURE Funds Act (H.R. 2932)**, introduced on June 18, 2009, would outlaw profiteering by Vulture Funds on debts held by countries eligible for debt relief. However, the **Judgment Evading Foreign States Accountability Act (H.R. 2493)**, which is supported by vulture funds, would promote the rights of vulture funds and could affect countries eligible for expanded debt relief under the Jubilee Act.

What are Vulture Funds?

Vulture Funds are specialized types of private investment and hedge funds that seek to profit by acquiring the defaulted debt of the world's poorest countries on the secondary market and then suing the government for multiples of the price they paid for the debt. These funds are often based



in offshore tax havens, such as the Cayman Islands. Frequently using courts in the U.S. and the UK, Vulture Funds attempt to seize the debtor country's assets worldwide, interfere with and threaten established trade relationships between the sovereign debtor nation and private companies, and attempt to seize interests in debtor nations' natural resources. These tactics lead to judgments and awards against poor country governments that make it more difficult for impoverished country governments to meet the basic daily needs of their citizens.

What impact does Vulture Fund activity have on debt relief?

The World Bank, along with other multilateral and bilateral creditors, has already delivered more than \$90 billion in debt relief to 30 countries under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Thanks to this unprecedented cooperation, countries like Ghana are using the money formerly earmarked for debt repayment to provide micro-credit to farmers, build classrooms for their children, and fund clean water and sanitation projects. However, Vulture Funds have turned the MDRI into a map of which countries to target next.

In addition to World Bank and IMF initiatives, members of the Paris Club and London Club are also actively participating in debt relief and restructuring. However, Vulture Funds threaten to undermine these initiatives by forcing the debtor countries to ignore 'comparability of treatment' agreements with other creditors, thereby forcing the debtor country to give the Vulture Fund 'preferential treatment.' This can result in a reversal of negotiations between the debtor country and responsible creditors.

Which countries are affected?

Poor countries across the developing world are facing Vulture lawsuits. The Vulture Fund Donegal International claimed \$55 million from Zambia for a debt it purchased for \$3 million. Another Vulture Fund, FG Hemisphere, is currently pursuing litigation in Washington, DC against the Democratic Republic of Congo, a country plagued by civil war, demanding fines of up to \$80,000 a week because the country has not disclosed the location of all of its assets everywhere in the world. Other Vulture targets include Cameroon, Ethiopia, the Republic of Congo, Honduras, Nicaragua, Sierra Leone, and Uganda. A 2008 report by the IMF stated that Vulture Funds were engaged in claims seeking a total of \$1.47 billion from HIPCs.¹

How does Vulture Fund activity increase the cost of doing business with the U.S.?

Vulture Fund litigation adds an additional level of risk for any company doing business in or with a country that has become a target for the Vultures. Vulture Funds not only litigate against debtor countries, they also pursue solvent companies that have contracted to do business with the countries. In order to protect themselves from Vulture fund litigation, most trading partners of countries targeted by Vulture Funds adjust the price of their contracts to insure against expensive litigation, and the competing claims of Vulture Funds.² This places U.S. companies at a competitive disadvantage in the midst of an already difficult economic market. Some countries, such as China, provide complete protection against Vulture Fund litigation. For example, when a Vulture Fund attempted to seize a payment from a Chinese company to the Democratic Republic of Congo in 2008, the government of China intervened in the case and took the position that under Chinese law, the assets of a foreign sovereign are absolutely immune. A Hong Kong court thereafter dismissed

¹ International Development Association and International Monetary Fund, "Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) – Status of Implementation," September 12, 2008, p. 90-91.

² More information on the difficulties caused to companies doing business with poor countries being targeted by Vulture Funds is described in Andrew B. Derman & Andrew Melsheimer, Recent Developments in Foreign Sovereign Immunity and Texas Garnishment Law: A New Threat Facing U.S. Oil and Gas Companies, 29 Hous. J. Int'l L. 227 (2007).

the Vulture Fund's case.³ This protection against creditor litigation enables China to successfully compete for natural resources in countries around the world.

The Stop VULTURE Funds Act (H.R. 2932) – an Essential Reform of the International Financial System

What does the Stop VULTURE Funds Act do?

The Stop VULTURE Funds Act (H.R. 2932) aims to prevent Vulture Funds from profiteering on defaulted sovereign debt by capping the amount of profit that a secondary creditor can reap through litigation based on those debts. Before any such litigation can be pursued in the U.S. courts, the bill requires public disclosure of the names of any persons with an interest in the sovereign debt claim, how and where the claim was acquired and the purchase price. The bill also requires Vulture Funds to certify that they have not paid any bribes while pursuing collection of the defaulted debt claim.

Introduced by Judiciary and Financial Services Committee member Representative Maxine Waters (D-CA), the bill counts Financial Services Committee Ranking Member Spencer Bachus (R-AL), Judiciary Committee Chairman John Conyers (D-NJ), and 9 other Members as original co-sponsors. The Stop VULTURE Funds Act preserves the gains achieved through debt relief by preventing Vulture Funds from garnering excessive profits from extremely poor countries, many of which have received debt relief or will do so in the future.

Who supports the Stop VULTURE Funds Act?

The legislation is supported by numerous non-profit and faith-based organizations including Jubilee USA Network, TransAfrica Forum, Africa Action, the United Church of Christ, the Center for Economic and Policy Research and the Quixote Center, all of which are working for debt cancellation and a more just international financial system for the world's impoverished countries. World leaders and financial institutions also recognize the threat posed by Vulture Funds. In 2007, the G-7 Finance Ministers voiced their concerns about "the problem of aggressive litigation against HIPC countries." UK Prime Minister Gordon Brown has condemned "the perversity where Vulture Funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed - a morally outrageous outcome." The World Bank has called Vulture Funds "a threat to debt relief efforts."

What impact would the Stop VULTURE Funds Act have on secondary credit markets?

The Stop VULTURE Funds Act is carefully crafted to avoid any adverse impact on the established secondary markets for sovereign debt, and seeks only to prevent excessive profiteering on defaulted sovereign debt of countries eligible for or potentially eligible for international debt relief initiatives. The original creditors, or creditors who acquire the debt before default, face no restrictions from the legislation, and under its terms, even Vulture Funds are allowed to obtain a proposed six percent annual return on their investment, as opposed to the double and even triple digit interest rates currently being litigated. Vulture creditors often force indebted countries to grant them preferential treatment at the expense of responsible creditors who may also be renegotiating debt instruments with the countries. This Vulture activity discourages good faith negotiations with these responsible creditors, and impedes the countries' ability to operate autonomously in the secondary debt market.

³ *FG Hemisphere Associates, LLC v. Democratic Republic of Congo, et al.* HCMP 928/2008 (High Court of Hong Kong, Dec. 12, 2008).

The Judgment Evading Foreign States Accountability Act (H.R. 2493)

What does the Judgment Evading Foreign States Accountability Act do?

The Judgment Evading Foreign States Act (JEFSAA) was introduced into the House of Representatives on May 19, 2009 by Representative Eric Massa (D-NY). The objective of the bill is to punish countries that are in default of U.S. court judgments on debt claims. Specifically, the bill would deny foreign states that have been in default of U.S. court judgments exceeding \$100 million for more than two years access to U.S. capital markets; deny access to US capital markets for domestic corporations of a judgment evading foreign state that remains in default for more than three years; require the U.S. to consider the default status of such states before granting such countries aid; and require the Secretary of the Treasury to issue annual reports naming these states and analyzing the effect of their behavior on the U.S. economy. The bill has been promoted as a measure to prevent a repetition of the default on sovereign debts by Argentina in 2001 and Ecuador in 2008. However, our organizations are concerned about the bill because: (1) if enacted into law could have far-reaching negative effects for these countries *as well as a much broader set of poor nations* struggling under a burden of onerous debts; and (2) because the bill fails to address the underlying cause of sovereign debt defaults – the need for an international framework for sovereign debt restructuring.

Who are JEFSAA's main advocates?

Several of the entities actively promoting the Judgment Evading Foreign States Act are vulture funds themselves. Members of the American Task for Argentina, the main proponent of the legislation, include Elliott Associates, L.P. and FH International Asset Management, LLC.

Which countries could be affected?

JEFSAA provides an exemption to 40 countries that are eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative . But Jubilee USA and other leading anti-poverty organizations support the Jubilee Act for Expanded Debt Cancellation and Responsible Lending, which would extend bilateral and multilateral debt cancellation to all low-income countries eligible for “IDA (International Development Association)-only” support from the World Bank. This group includes 66 low-income countries, whereas JEFSAA only exempts up to 40 countries eligible for HIPC.

If not through JEFSAA, how should we address the problem of sovereign debt defaults?

The JEFSAA targets the symptoms rather than the real cause of the problem that developing countries face in addressing their debts. In the current international economic system, there is no recourse for a sovereign debtor in case of insolvency or of credible allegations of illegitimacy of its debt claims. Rather than seeking to harshly punish those who default, a better approach would be to support efforts to develop an international mechanism for sovereign debt restructuring that provides an independent forum for debtors and creditors to resolve disputes. Recent developments suggest both the increased need for and support the development of an international bankruptcy framework. The UN Commission chaired by former World Bank Chief Economist Joseph Stiglitz strongly urges the establishment such a framework.⁴

For more information about Vulture Funds, visit:

www.jubileeusa.org www.transafricaforum.org www.africaaction.org

⁴ Interim Report of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, May 2009, p. 103.