



Africa Action Campaign Resource

Understanding Vulture Funds: Key Terms to Know

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Attachment – the court-ordered seizure of assets belonging to a debtor by a creditor in the event of legal default on a debt owed to the creditor. This practice is very unusual for mainstream sovereign debt arrangements, largely because of the practical problems and limitations of the mechanism. However, vulture funds have had some success in using attachment actions against sovereign debtor governments to their advantage, typically pressuring poor countries to settle out of court before actually forcing the seizure.

Bilateral Debt – debt owed by one government to another.

Commercial creditors – companies or financial institutions in the private sector that lend money to governments. Most commercial creditors are large banks.

Commercial sovereign debt (or simply **commercial debt**) – debt owed by national governments to private sector creditors such as commercial banks. This should not be confused with **private debt**, which is simply the debt owed by private sector borrowers to private lenders.

Creditor Friendly Courts – a term referring to the overall legal systems of the U.S., the U.K., France and Caribbean tax havens, where the laws in general favor creditors over debtors more than those of other wealthy countries. Vulture funds tend to bring their lawsuits to courts in one or more of these countries. For example, between 1998 and 2003, the vulture fund Red Mountain Finance sued the Democratic Republic of Congo (DRC) in a U.K. High Court and received \$40 million in judgments. It then took legal action to enforce these judgments in a U.S. District Court in California as well as courts in France and Bermuda. Ultimately, Red Mountain settled for a large undisclosed sum out of court, at great expense to the DRC's efforts to reconstruct its social and economic infrastructure amid years of conflict.

Distressed Sovereign Debt – the term vulture funds and other commercial creditors use to describe the debt contracts owed by the governments of poor countries that they purchase from mainstream creditors like commercial banks or middle income countries on the “secondary debt market.” The trading price of the debts (what the vultures pay) of the most impoverished countries is generally pennies to the dollar of the face value of the original loan. When a creditor purchases distressed sovereign debt, it buys the right to collect the face value, but it is only recently that vulture funds have begun to apply that right literally by rejecting international debt reduction agreements and instead demanding, through lawsuits against the debtor governments, 100% repayment.

Emerging Market Economies – the term investors often use to describe poor to middle income countries that are beginning to open their financial institutions to the global economy. Emerging markets can refer to countries with large economies, like China, or small economies, like Tunisia, both of which have low to middle range per capita incomes. Private investment in these countries, whether through budding national stock markets or other means, is seen as risky but potentially rewarding because of how much room emerging economies have to grow.

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Hedge Fund – a very specialized investment company, open only to wealthy individuals or institutional investors, that allows the fund manager to use a variety of complex investment techniques prohibited for mutual funds, pension funds, and other traditional types of financial companies. Hedge funds can offer investors the possibility of very high gains but carry above average to high risk. The vulture fund business model of investing in distressed sovereign debt at a discount and then suing for the debt's original value is pursued by companies that would be classified as hedge funds, although since hedge fund is not a legal term, the phrase is subject to some degree of interpretation. Hedge funds are not registered or regulated by U.S. Securities and Exchange Commission (SEC) as are most other investment funds. Since they do not have to regularly disclose their business information, they usually guard it very secretively. Hedge funds invest in all types of assets, public and private, and vulture fund activity targeting poor countries makes up only a tiny portion of the complete portfolios of even those rogue investors engaged in such practices.

The London Club – a very informal forum of commercial creditors (mostly large banks) that meets occasionally to negotiate rescheduling or restructuring sovereign debt. Also known as the “Creditors’ Committee.” The term “London Club” originated in the 1970s by analogy with the Paris Club. Unlike the Paris Club, the London Club has no fixed membership, no permanent secretariat, and meets only on a case by case basis. While the unofficial nature of the London Club means that participants do not issue unified statements on their policy toward issues like vulture funds, the organized collective negotiating structure of the London Club discourages participants from on-selling their debt to rogue creditors who may engage in vulture activity.

On-selling claims – when a creditor sells its rights to a given amount of debt to another party. Vulture funds acquire poor country debt when a creditor (such as a middle-income country like Romania, or a large commercial bank) agrees to on-sell the assets it holds to the vulture. The debt is sold at a deeply discounted price because the original lender considers the poor country unable to pay in full and in danger of default.

The Paris Club – the forum in which creditor governments meet to negotiate the rescheduling, restructuring, reduction or cancellation of the debts owed to them by other countries. The Paris Club originated in 1956 as an ad hoc group and remained a very informal arrangement until the late 1970s. Today, the Paris Club's meetings have become regular and its procedures and terms more standardized. Officials from some of the world's 19 richest countries currently meet for Paris Club discussions every six weeks at France's Ministry of the Economy, Finance, and Industry. The Paris Club agrees to the basic terms of rescheduling or reduction, but its consensus has no official legal status, and any debt cancellation or restructuring is actually put into effect by a series of bilateral agreements negotiated separately by each individual creditor later on. Paris Club creditors have publicly stated their commitment not to sell their claims on Heavily Indebted Poor Countries (HIPC) to creditors that might not be willing to implement the HIPC initiative – such as vulture funds.

Vulture Fund – a fund or investment company that seeks to profit by buying distressed investments, seeking a high return in the future on a bargain priced purchase. In the private sector, vulture funds buy assets such as bonds near or in default or equities near or in bankruptcy. Debt cancellation advocates are focused on a particular subgroup of vulture funds – those that target distressed sovereign debt. These companies buy up the debt of poor countries at a big discount from the original owner (either a government or a commercial creditor) with the purpose of suing the indebted country in court once the poor country has some money (often after debt cancellation) to recover the original face value of the debt, or close to it.