



The slide features a blue background with the title 'Vulture Fund Overview' in white. To the right, there is a collage of images: two vultures pecking at a globe, a solid red square, a solid orange square, and a vulture in flight against a blue sky. In the bottom left corner, there is the ALSF logo, which consists of a stylized figure holding scales of justice. In the bottom right corner, the text reads: 'African Legal Support Facility PALU/ALSF Seminar Tunis, Tunisia 26 January 2012' and 'Amir Shaikh, Esq. a.shaikh@afdb.org'.

Vulture Fund Overview

African Legal Support Facility
PALU/ALSF Seminar
Tunis, Tunisia
26 January 2012

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ALSF
African Legal Support Facility
Facilité africaine de soutien juridique



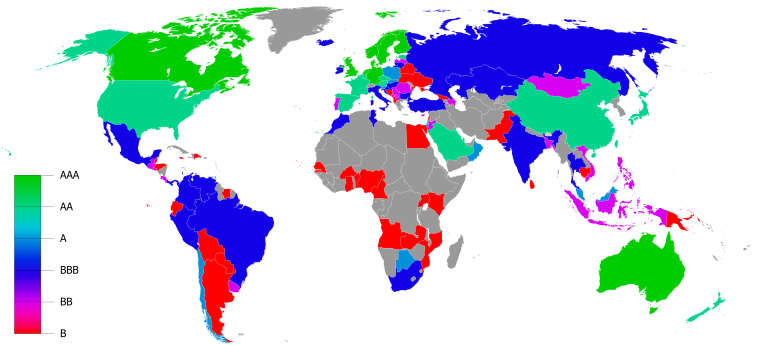
The slide has a blue background with a white plus sign and the title 'What is a Vulture Fund?'. Below the title, there is a definition of a vulture fund. A vertical red bar is on the left side of the slide.

What is a Vulture Fund?

A vulture fund is a fund or investment company that purchases debt of distressed nations on the secondary market when it is about to be written off and attempts to make large profits through the threat of litigation.

+ How a Vulture Fund Operates

Look for distressed debt purchasing opportunities



Source: World Countries by Standard and Poors Foreign Rating as of January 2012 created using <http://gunn.co.za/map>

+ How a Vulture Fund Operates

Purchase debt on secondary market at substantial discount

$$\Delta \log s_{it} = \phi_i \left[\log s_{it-1} - \alpha_i - \sum_{j=1}^J \beta_j x_{jit} \right] - \sum_{j=1}^J \gamma_{2ji} \Delta x_{jit} + u_{it}$$

- Distressed debt value varies depending on a variety of factors including:
 - Spreads, GDP, External Debt Levels, Public Debt, Short-Term Debt, Interest, Reserves, Amortization, Fiscal Balance, Current Account, Openness, Political Risk Index, Financial Stress Index, VIX, U.S. Treasury Yields
- Each fund most likely uses proprietary formula when assessing the price and expected returns.
- Purchase may be bonds, loans, arbitration awards etc.

Source: IMF Working Paper 10/281, Determinants of Emerging Market Sovereign Bond Spreads: Fundamentals vs. Financial Stress by Dimitri Bellas, Michael C. Papaioannou, and Iva Petrova.

+ How a Vulture Fund Operates

Attempt to negotiate a favorable resolution

- Greece debt deal currently under negotiation:
 - Debt holders:
 - Multi-lateral (Public, e.g. EBRD),
 - Bilateral (Public, e.g. Germany),
 - Private Creditors
 - Commercial Banks
 - Distressed Debt Funds / Vulture Funds
 - Other parties with an interest:
 - Credit Default Swap counter-parties
 - Politicians, Central Banks, Other distressed countries
 - ISDA (International Swaps and Derivatives Association)
 - Insurance Companies
- Offer to settle for 75% of original value of debt
 - Exchange of old debt for new debt with a reduction of principle and a new interest rate
 - Cash payout
- Voluntary settlement
 - Greece can opt to default
 - Parties not required to settle
 - Collective Action Clauses?



+ How a Vulture Fund Operates

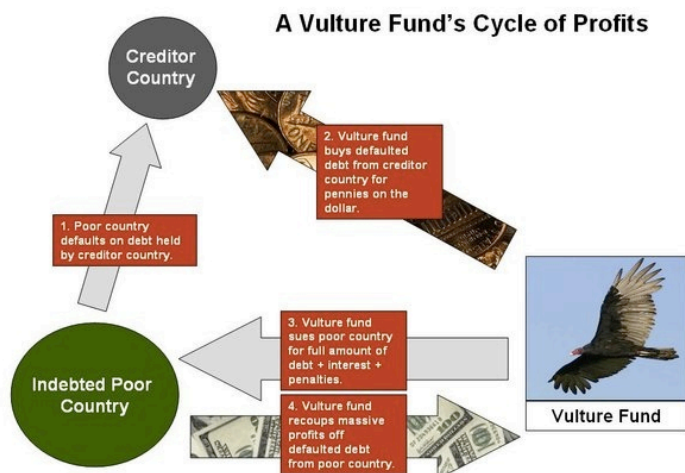
Aggressive Litigation

- Identify jurisdictions which will be most “friendly” to investor claims.
 - United States, Jersey (UK), others.
 - Defendant State’s national courts.
- Look for assets outside of the borders of the defendant.
- Look for business deals that state companies are engaging in overseas.
- Hire best lawyers and asset search firms.



+ How a Vulture Fund Operates

Summary

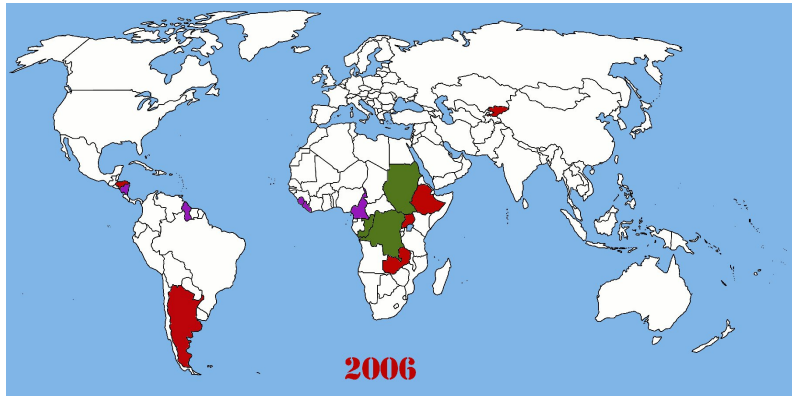


+ Who is affected?

The most vulnerable are nations nearing HIPC completion points.

Countries undergoing changes in government are also vulnerable due to previous regimes sovereign transactions.

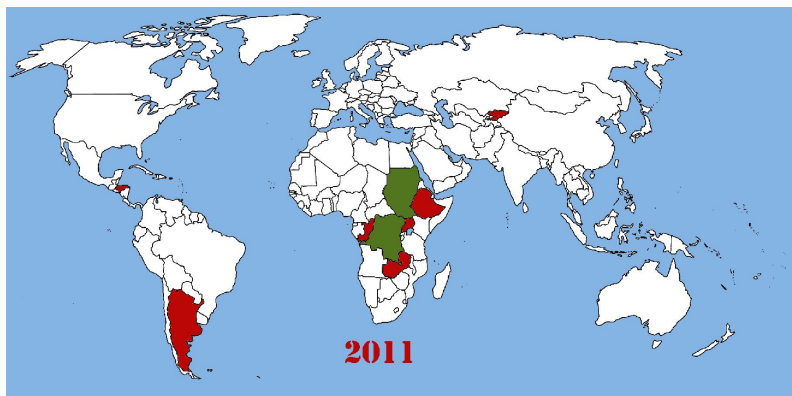
+ **Where Vultures Strike**
2006 v. 2011



Source: IMF World Bank HIPC Status Implementation Report 2006.



+ **Where Vultures Strike**
2006 v. 2011



Source: IMF World Bank HIPC Status Implementation Report 2011.





+ Why does it matter?

Money diverted from development projects in most vulnerable countries.

+ Legal Issues

- Impede Debt Re-structuring
 - *Pari Passu* – requires that all creditors be treated equally
 - Threat of litigation can impede a sovereign debt restructuring
- Collective Action Clauses
 - Clauses that permit debt restructuring as long as a majority or super majority of creditors approves the transaction.
- Legislation
 - UK – Debt Relief (Developing Countries) Act
 - Limits ability of vulture funds to recover in the UK.
 - Belgium – law limiting transferring of qualified debts
 - US – Foreign Sovereign Immunities Act – Commercial Activity Exception



+ Legal Issues

Key contract terms relating to creditor protections

- Terms that strengthen enforcement
 - Waiver of Immunity from suit; Waiver of Immunity from Execution; Agent for Service of Process; Grants of Security Interests; Negative Pledge; *Pari Passu*; Choice of Jurisdiction; Cross-Default and Acceleration; Arbitration; Tax Gross Up
- Terms that Structure Payments
 - Sinking Funds; GDP-Indexation
- Terms that Require Disclosure and Enable Monitoring
 - Exchange Listing; IMF Membership
- Terms Related to Restructuring
 - Non-Payment Modification; Payment Modification; Aggregation; Collective Acceleration and Reverse Acceleration; Disenfranchisement; Bondholder Committees and Trustee Provisions

Source: Stephen J. Choi, Mitu Gulati and Eric A. Posner, *Political Risk and Sovereign Debt Contracts*, John M. Olin Law and Econ. Working Paper No. 883 (Nov. 2011).



+ Development Impacts

- Resources diverted from domestic development priorities.
 - Currently USD 1.5 billion in private claims pending by vulture funds against African countries.
 - African Development Bank gave approximately USD 900 million in grants in 2010.
- Secondary market for debt is healthy and leads to efficient markets, however, vulture funds who purchase debt at deep discounts with the sole intention of profit work against the good intentions of the HIPC and MDRI programs.
- 21 African Countries currently involved in commercial creditor disputes.



+ How does it work?

Example of FG Hemisphere v. Democratic Republic of Congo

+ How a Vulture Fund Operates

Case Study: FG Hemisphere v. DRC

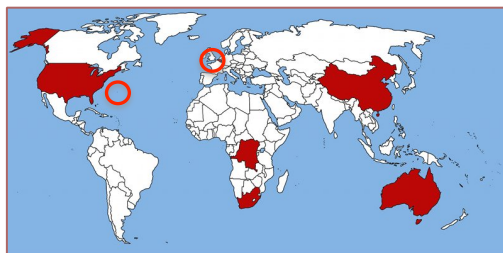
- Energoinvest (former Yugoslavian corporation) receives energy contract to be manufactured in what is now Bosnia.
- Payment was never made as both countries were in civil war.
- Energoinvest initiates arbitration at the ICC and wins a judgment of approximately USD 100 million (original debt valued at USD 28 million).
- Debt allegedly sold for USD 3.3 million by the Bosnian Prime Minister to FG Hemisphere.
- Allegations that FG Hemisphere paid for the lawyers of Energoinvest during the ICC Arbitration even though at that time FG Hemisphere had no official interest in case.



+ How a Vulture Fund Operates

Case Study: FG Hemisphere v. DRC

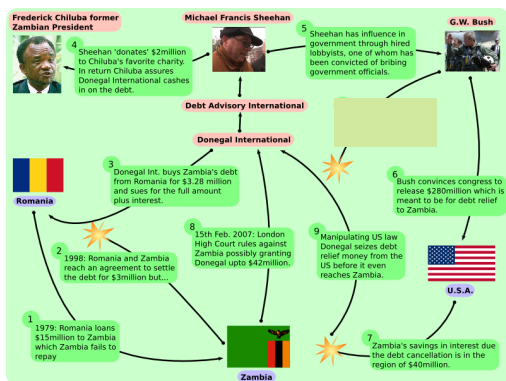
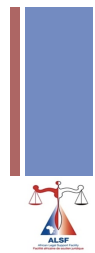
- ICC Arbitration award sold to FG Hemisphere, in the lawsuits, the plaintiff is suing to enforce an arbitration award rather than the underlying debt.
- Actions pending against:
 - Democratic Republic of Congo (DRC)
 - SNEL – national electricity company
 - Gecamines – national mining company



+ How a Vulture Fund Operates

Case Study: Donegal v. Zambia

- Many players, many interests, politics, and money



Questions?



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