

## Newsflash

# Belgium adopts law against vulture funds



The Belgian Law tackling vulture funds activities<sup>1</sup> (the “**Vulture Funds Act**”) was published in the Belgian Official Journal on 11 September 2015.

The aim of the Vulture Funds Act, which is a pioneering initiative, is to prevent investment funds that qualify as “vulture funds” from using Belgian courts to obtain illegitimate benefits to the detriment of countries recovering from severe financial difficulties.

Below is a short summary of the background surrounding the so-called vulture funds (1), the tools developed by the Vulture Funds Act to identify vulture funds and to counter their action (2), an analysis of the Vulture Funds Act’s impact on the regime related to the third-party attachment of securities accounts (3) as well as a first, high level, critical approach on this legal initiative (4).

### 1. Background

Vulture funds, often located in tax havens, are investment funds that acquire sovereign debt (either in the form of government bonds or loans owned by sovereign states) at a discount price, specifically when these states are in a position of financial distress. These funds speculate on the improvement of the troubled state’s financial situation, based on the existence of sizeable assets, or on the fact that external financial aid would be granted. When circumstances become favourable, they start judicial proceedings in front of the most receptive courts, demanding immediate payment of the face value of the debt or loan with interests.

Once a court judgement is obtained, it is executed to seize assets and claims owned by the State, forcing its debtors to pay in the hands of the vulture funds. By making use of this practice, which leads to the depletion of the countries’ assets and impedes effective

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<sup>1</sup> Wet 12 juli 2015 teneinde de activiteiten van de aasgierfondsen aan te pakken, *B.S.*, 11 september 2015/ Loi du 12 juillet 2015 relative à la lutte contre les activités des fonds vautours, *M.B.*, 11 septembre 2015.

restructurings, vulture funds have played a notorious role in several high profile debt crises, notably Argentina's default. Even though vulture funds often target poor countries, they pose a threat to any other country facing debt distress.

The international community, including the International Monetary Fund and the International Capital Market Association, has become aware of the negative effects vulture funds have on debt restructuring. Legislative responses nevertheless remain scarce, with local legal initiatives having solely emerged in Belgium<sup>2</sup> and the United Kingdom<sup>3</sup>, the two European leading countries in this matter.

## 2. Illegitimate benefits

The Vulture Funds Act aims to protect all debt facing states. However, only those creditors intentionally seeking to exploit states by acquiring sovereign debt in order to pursue a benefit deemed illegitimate will be targeted.

The main criterion used to identify vulture funds is therefore the "pursuit of an illegitimate benefit".

Rather than defining these terms, the Vulture Funds Act states that a creditor is deemed to pursue an illegitimate benefit when two elements are present. The first and primary element is a manifest disproportion between the amount claimed by the creditor and the acquisition value of the debt. The second element consists in the presence of at least one of the following additional criteria:

- the State was in a proven or imminent state of insolvency at the moment the debt was acquired by the creditor; or
- the creditor has its registered office located in one of the following states or territories:
  - o tax havens as determined by Royal Decree;
  - o non-cooperative states or territories as determined by the Financial Action Task Force; or
  - o the states, determined by Royal Decree, that refuse to negotiate or sign an agreement which would, as from 2015, provide for the exchange of information related to fiscal and banking matters with Belgium, in accordance with OECD standards.
- the creditor's systemic use of judicial procedures to obtain repayment of previously acquired debt;

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<sup>2</sup> Wet 8 april 2008 die ertoe strekt de inbeslagneming of de overdracht te verhinderen van overheidsgeld bestemd voor de internationale samenwerking, met name via de techniek van de aasgierfondsen, *B.S.*, 16 mei 2008/ Loi du 8 avril 2008 visant à empêcher la saisie ou la cession des fonds publics destinés à la coopération internationale, notamment par la technique des fonds vautours, *M.B.*, 16 mai 2008.

<sup>3</sup> Debt Relief (Developing Countries) Act 2010.

- the State has taken restructuring measures, to which the creditor refused to participate;
- the creditor abused the State's weakened position in order to negotiate a clearly disproportionate repayment agreement in its favour; or
- the full repayment of the sums claimed by the creditor would have an adverse effect on the State's public finances and could endanger the social economic development of its population.

When a creditor is deemed to pursue an illegitimate benefit, under the Vulture Funds Act, his rights against the State will be limited to the amount that was paid when acquiring the loan or receivable.

### 3. Third-party attachment regime

In order to safeguard their claims, vulture funds often invoke conservatory measures to freeze assets. Given the fact that Belgium is the host of several central securities depositories, specific concerns arose with respect to the third-party attachment of securities accounts regime.

Article 11 of the coordinated Royal Decree no. 62 relating to the custody of fungible financial instruments and the settlement of transactions in those instruments of 11 November 1967<sup>4</sup> (**Royal Decree no. 62**) excludes the possibility of third-party attachments of securities accounts held in the books of a central securities depository, whether Euroclear Bank, Euroclear Belgium, the National bank of Belgium or the Bank of New York Mellon. Securities not held in a central securities depository system, on the other hand, remain susceptible to third-party attachments. Therefore, creditors remain free to invoke a third-party attachment procedure to target securities held by an investor in the books of a recognised account holder (*erkende rekeninghouder/teneur de comptes agréé*).

The Vulture Funds Act now addresses any remaining concerns with regard to attachments outside central securities depositories by introducing an absolute prohibition for vulture funds to obtain an enforcement or protective order in Belgium (at the request of the creditor in order to obtain payment in Belgium), to the extent that this would result in an illegitimate benefit.

### 4. First critical approach

The National Bank of Belgium and the Institute of International Finance have raised some concerns with regard to the non-quantifiable and subjective standards contained in the new act. Specific concerns relate to the potential negative effect of this legal intervention on the primary and secondary sovereign debt market which could have a counterproductive impact on the financial recovery of troubled states.

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<sup>4</sup> Gecoördineerd koninklijk besluit nr. 62 10 november 1967 betreffende de bewaargeving van vervangbare financiële instrumenten en de vereffening van transacties op deze instrumenten, *B.S.*, 23 februari 2004/ Arrêté royal n° 62 coordonné du 10 novembre 1967 relatif au dépôt d'instruments financiers fongibles et à la liquidation d'opérations sur ces instruments, *M.B.*, 23 février 2004.

This initiative aims to protect debtor-states by allowing them to rely on a principle of civil law anchored in the Belgian legal system according to which the creditor's claims are limited under certain circumstances. Considering that the appreciation of these circumstances is partially left to the courts' discretion under the Vulture Funds Act (the courts will have to determine whether there is a manifest disproportion between the amount claimed by the creditor and the debt's acquisition value), the success of this Act will very much depend on its implementation in practice. In addition, even, though the Vulture Funds Act's reach is limited to the Belgian territory, its impact on financial markets and sovereign debts held by intermediaries established in Belgium will need to be carefully analysed.

It remains to be seen whether the implementation of the Vulture Funds Act will respect the delicate balance between the protection of debtor-states on one hand, and the preservation of financial markets' stability on the other hand.

Even though an effective European or international legal framework strongly remains desirable, Belgium's initiative could serve as an example for other countries.

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