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Vulture Funds – Not all bad?

In this article, Tom Murray, partner in Friel Stafford, considers the impact of "vulture funds" on individuals and businesses and the tendency to paint all as negative.

The issue of third party loan buyers of non-performing loans, colloquially known as "vulture funds" and the possible negative impact their purchase of loan books from "traditional" banks and finance houses has been the subject of many negative commentary and articles in the business press and the wider media.

The impact on individuals and businesses when a loan they took out for commercial or personal reasons fails to perform, can be significant in financial and emotional terms. It cannot be dismissed lightly and the effect should not be underestimated. However, the tendency to paint "vulture funds" as bad and the debtors as "good" is an overtly simplistic way of looking at complex and difficult circumstances.

The first thing that should be considered and evaluated in any conversation regarding the existence of these funds in Ireland (or any jurisdiction – the role they have played in Porto Rica recently is a case in point) is the context in which they entered this country.

In the eye of the financial storm / crisis in 2009 to 2014, there was a need for the established banks and financial institutions operating in the market and in particular, those with a long history here, to address the crippling and overbearing (from their balance sheets perspective) number of underperforming loans, as a large number of underperforming loans are a drain on the capacity of individuals, financial institutions and an economy. Stimulus is required.

Given that "limbo" is or was not an option for commercial banking institutions and is not an option for an economy trying to develop traction in a recovery, Ireland Inc. and its financial institutions needed to move these loans to owners who could repossess, manage and move property in the short term. Thus generating commercial activity and traction in the economy. Hence by selling to the "vulture funds", who by their nature are not here for the long term, and look to churn and realise their investments in relatively short periods, has resulted in property transactions happening. It has contributed to the stimulation of a moribund economy and critically seen debt being compromised with pragmatic deals being done.

So, the sale of underperforming loans to "vulture funds" has been good for those established institutions and also for the Irish economy as a whole. But what about the individuals who are still dealing with funds? Is dealing with them all bad. In my view it is not.

The first thing to note is that if a fund has purchased a loan, the terms and conditions of the contract in itself do not change because the loan is sold. Furthermore, under The Consumer Protection (Regulation of Credit Servicing Firms) Act 2015, homeowners whose loans have been sold to Vulture Funds, have been given the same protection regardless of whether their loan is owned by a licenced entity (bank) or unlicensed entity (vulture funds). How this works in practical terms, is that the Vulture Fund is obliged to appoint a credit servicing firm ("CSF") which is regulated by the Central Bank (although the vulture fund is not) to deal with mortgagors.

In this regard, if the loan is performing, then there should be no impact in the operation of the loan and the CSF will ensure complete transparency in the management of the loan in line with Central Bank regulations.

If the loan is not performing, Vulture Funds tend to adopt a commercial pragmatic approach to debt settlement. They have shown where commercial reality is brought to negotiations by the debtor that they are willing and quick to come to a deal. Generally speaking, this is done through informal negotiations and without the need or threat of litigation or repossession. They have also in certain circumstances shown commercial reality where tracker mortgages (a very hot topic at the moment) are involved.

If the loan is underperforming, an Irish debtor has recourse to what is arguably the most sophisticated personal insolvency regime globally (particularly in the context of dealing with the family home), where if it is necessary and appropriate to enforce a write down on a home loan to enable the saving of such family home, a court can direct the same.

Lastly, it has been our experience that their ability to move quickly to make commercially sensible decisions can also help a debtor get successfully approved for a personal insolvency arrangement where a vulture fund has a sizeable vote.

Our firm recently oversaw a successful debt settlement arrangement implemented by a debtor who was facing having a judgement registered against his interest in the family home. In this case, the debtor owed €443,000 to a bank and €8.3 million to the fund. Both debts were unsecured, meaning that the debtor was eligible to do a Debt Settlement Agreement ("DSA"). The debtor's only substantive asset was a 50% share in the unencumbered family home with a value of €900,000. However, the debtor had monthly income of €3,111 over and above his Reasonable Living Expenses.

A key fact was that the bank was just about to obtain judgment in the High Court and proceed to register a judgment mortgage against the debtor's interest in the family home. Whilst the fund had served legal demands on the debtor in respect of the debt of €8.3 million, it had not yet issued proceedings. We called the vulture fund and made the following case:

- If the bank registered their judgment of €443,000 on the debtor's interest in the family home, there would be no equity remaining for the vulture fund.
- The debtor's spouse had limited savings of her own, but she was prepared to use up to €80,000 of those savings to try and do a deal.
- Doing a deal now would save the fund substantial legal fees in obtaining judgment etc.

We said that if the vulture fund agreed to vote in favour of a DSA, that the DSA would pay a dividend of €54,500 to them. Within 2 days the agents and solicitors for the vulture fund evaluated the proposal and agreed to support it.

We then prepared a DSA. The key objective, given that the fund had committed to accepting a dividend of €54,500, in the DSA, was to ensure that the bank was not "unfairly prejudiced" by the DSA. If the bank could demonstrate to the High Court that they were unfairly prejudiced, then the DSA would not be approved. We prepared a "Statement of Estimated Outcome" comparing the proposed DSA with the expected outcome in a bankruptcy and could show that this was a better deal than bankruptcy for the bank and in this context the Court approved it.

In this scenario, the vulture fund worked with, rather than against the debtor in restoring their finances to a solvency.