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What Mainstreaming Of Litigation Finance Means For Industry

By **William Weisman** (October 1, 2021, 4:48 PM EDT)

Commercial litigation finance has gone mainstream. We need only look at two prime indicators to reach that conclusion: the rush of new capital into the space, and the number of new funders.

According to the International Legal Finance Association, assets under management in litigation finance doubled from 2017 to 2020, reaching \$10 billion last year.[1] An analysis conducted by Bloomberg Law, meanwhile, found that despite the pandemic, funds dedicated to litigation finance raised more than \$1 billion in 2020 alone. In fact, they had already eclipsed that figure by mid-August.[2]



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And at least five different litigation financiers raised funds in the hundreds of millions of dollars last year,[3] which brings us to the second indicator. A good deal of that money is going to new market entrants, increasing not just the total amount of funding available but also the number of providers offering it up.

According to one analysis, the number of litigation funders rose from 41 to 46 in 2020.[4] But that figure includes only dedicated funders and not the many other players joining the game, such as more traditional investment firms. Although public data on this trend is sparse, hedge funds and family offices are increasingly funding litigation directly, as opposed to investing passively through established litigation funders.

The basic concept of litigation finance — in which a litigant receives funding in exchange for sharing the potential recovery from an underlying legal claim — was an esoteric one not too long ago. That's no longer the case. As recently as 2017, just 40% of lawyers surveyed by Research Nester were familiar with it. By early this year, that percentage had doubled to 80%.[5]

If you are a user of litigation funding, mainstreaming might sound like bad news. For savvy consumers, after all, the mainstreaming phenomenon has a way of spoiling their best finds.

It happens when their favorite restaurants get discovered, when their favorite getaway destinations get overrun by Instagramming tourists, or their favorite musicians aim for a broader audience and lose their edge. In these examples and others, a familiar pattern unfolds: Word gets out about something, the masses flock in, and the product becomes less special.

Here in this particular corner of the world, the question for customers (i.e., litigants and law firms), financiers and investors is this: How will the cash influx and growing number of funding providers affect litigation finance transactions and the industry at large? Before we address that query, let's look at the likely causes of this mainstreaming.

Why is it happening?

The answer, not surprisingly, is rooted in economics.

Financing a lawsuit is inherently a risky proposition; it can leave investment dollars tied up in litigation for years, with any return hinging on complex legal questions and disputed facts, often in circumstances where all parties are represented by world-class legal counsel.

But with that risk comes the possibility of significant reward; funds commonly target annual returns of 20%, a welcome return on investment in nearly any portfolio.[6]

Moreover, investments in lawsuits are not correlated to stock market returns. That's a desirable trait, especially when equities keep hitting new highs and company valuations are lofty.

On top of all that is the fact that the financial system is awash in liquidity. With only so many places to park money, and with bonds offering meager returns, institutional investors are looking to alternative asset classes.

What will the impact be?

As a general proposition, the mainstreaming of an entire industry can of course have negative impacts on both suppliers, which suddenly have more competition, and customers, who may get a watered down product, though that is, of course, not always what transpires.

Here, while there is additional competition in the marketplace to be sure, right now that doesn't appear to be such a bad thing for any constituency.

From the perspective of users of litigation finance, the introduction of new capital, through new providers, is resulting in heightened levels of competition on price and other key deal terms, including the ever important speed to close.

Hedge funds and institutional investors in the space are making greater use of quantitative analysis and advanced financial modeling to inform pricing, product offerings and portfolio composition. This results in a wider array of offerings in the marketplace and better structuring and pricing for the funding transaction at issue.

Moreover, if for no other reason than basic principles of supply and demand, counterparties should find it generally easier to procure funding. In short, there is more capital available in the market right now, and more funders means increased bandwidth to close more transactions.

This recalls though, the insight of famed investor Warren Buffett, who in discussing investment philosophy famously advised, "You don't have to swing at everything — you can wait for your pitch."

With the mainstreaming phenomenon at full bore, one might think some funders will find themselves a bit antsy in the batter's box. However, all shrewd money managers know that you cannot compromise underwriting standards to chase deployment, so increased competition notwithstanding, we aren't likely to see funders hacking away outside the strike zone.

Relatedly, mainstreaming should lead to increased specialization among financiers.

All funders have different preferences in terms of the type of matters they are most comfortable

financing (e.g., antitrust verses patent litigation), ideal bite size (i.e., capital commitment), and overall risk tolerance.

As the market goes mainstream, litigants and their counsel shopping for funding will learn which shops are best to call upon for a particular type of case and will become more in tune with individual funders' proclivities. This will better position counterparties to reach out to the right funder and avoid spinning their wheels with an outfit that ultimately isn't the proper fit.

What, though, should we project the mainstreaming phenomenon means to law firms?

With more players and more money in the space, law firms will increasingly develop institutionalized relationships with preferred funding partners, something already underway as funders fight for positioning on the law firm landscape. These relationships will mean that firms can incorporate greater risk-sharing into their business models, as they know they can call upon a long-standing financial partner to allocate risk when necessary.

So, what then does mainstreaming mean for capital providers? While conventional wisdom dictates that increased competition isn't good for suppliers, a more nuanced perspective seems apt.

For starters, mainstreaming makes users of litigation finance more knowledgeable about the entire process, which recalls an adage from the haberdasher Sy Syms: "An educated consumer is our best customer."

Simply put, informed counterparties make it far easier for litigation financiers to get deals closed. These counterparties do not overnegotiate insignificant deal terms, they more clearly articulate their end goals and other factors critical in designing a workable funding framework, and they anticipate and readily address the substantive considerations relevant to a funder's investment decision.

Plainly, they enable funders to get to "yes" or "no" on their funding decisions much more quickly.

Additionally, with the marketplace more mature, funders can afford to worry less than before about simply developing a market for their product. With the beachhead more or less secured, there is opportunity for funders to try to differentiate themselves as superior to the competition. Mr. Market can be fickle for sure, but even so, once set consumer preferences are difficult to dissuade.

Funders possessing the expertise to appropriately structure and efficiently underwrite transactions, the knowledge and experience to readily identify choice opportunities, and ample dry powder — i.e., deployment-ready capital — to call upon when needed, should in time find themselves positioned above the crowd. The furthering of stratification among different classes of funders seems a likely offshoot from the mainstreaming phenomenon.

All this is to say that, during these early days of mainstreaming, possibilities abound.

It was the poet Maya Angelou who observed: "You can't use up creativity. The more you use, the more you have."

This truism applies to all human endeavors, and litigation finance is no exception. At this stage of the game at least, mainstreaming seems to be spurring ingenuity and progressive evolution. Simply put, mainstreaming of litigation finance is not spoiling it; rather, right now things are still ripening.

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[1] <https://www.pionline.com/investing/litigation-finance-finds-its-feet-targeting-returns-20>.

[2] <https://news.bloomberglaw.com/business-and-practice/litigation-finance-has-surpassed-1-billion-raised-in-busy-2020?context=article-related>.

[3] <https://advantage.westfleetadvisors.com/the-westfleet-insider-2020-litigation-finance-market-report>.

[4] Id.

[5] <https://www.globenewswire.com/news-release/2021/02/04/2169925/0/en/Global-Litigation-Funding-Investment-Market-to-Cross-USD-13-Billion-in-2021-Rise-in-Pending-Claims-Insolvency-and-Bankruptcy-Due-to-COVID-19-and-Interest-in-ROI-Among-Investors-to-.html>.

[6] <https://www.pionline.com/investing/litigation-finance-finds-its-feet-targeting-returns-20>.

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