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Monthly Market Update

July 2023

Judge for Yourself

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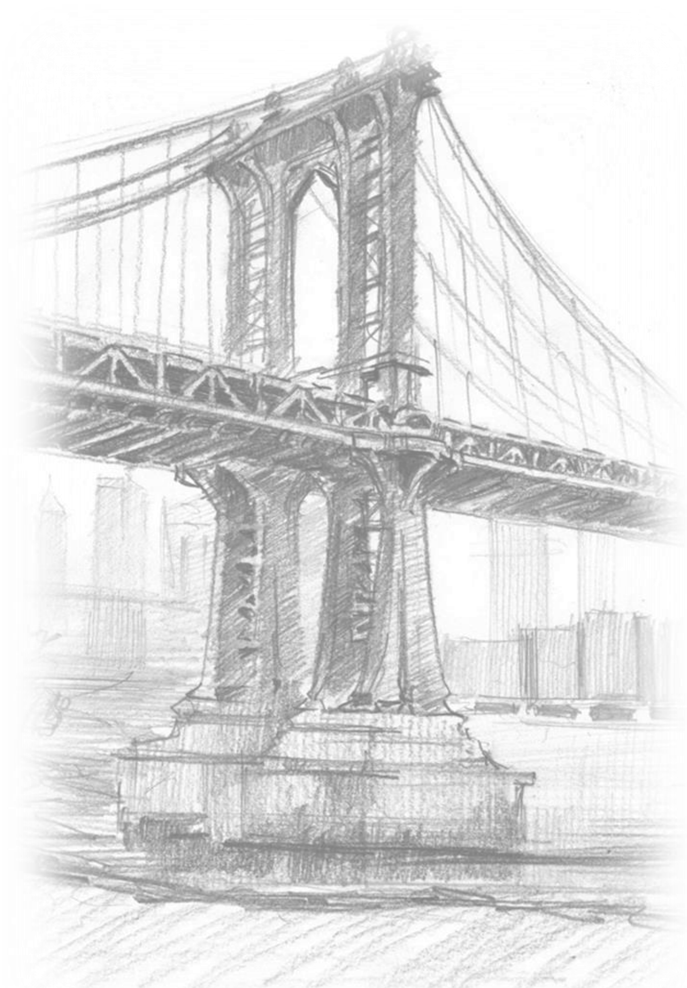

Regular readers of PPB's monthly insights know that we are big fans of Charles Dickens, as clearly illustrated in the title of our February market update. Dickens always had something clever to say about everything (which is only part of what made him so great), and legal proceedings are no different.

In *The Curiosity Shop*, Dickens writes:

"If there were no bad people, there would be no good lawyers."

If we may paraphrase a quote so authentic to tee up a conversation about the fascinating and impactful asset class of litigation finance:

"If there were no good financiers, there would be less opportunities for justice."

A true *alternative* investment even by today's standard, litigation finance can aid legal proceedings that require significant capital and resources while offering investors high yield income and uncorrelated returns. While sometimes an expensive form of financing, these private investments allow cases to proceed when they otherwise might run out of steam.

Facts of the Case

Opportunities in litigation finance (or "LitFin" for short) are typically categorized by the type of litigation (e.g., commercial, mass tort, international arbitration, etc.) and how the financing is structured, which typically is in the form of a loan directly to a law firm, or by lending against a specific case or docket.

For many years, regulations have placed restrictions on the types of financing available to law firms. These were enacted to prevent what would become an abject perversion of the legal system, which lies at the core of a functioning liberal democracy.

Throughout the life of a case, however, firms will incur considerable expenses which are expected to be fully recovered by the damages awarded through a favorable verdict. This is commonly known as "No Win No Fee." Law firms do not have access to funding from traditional capital markets like many businesses. When combining that with the apprehension of banks to take on case/docket-backed loans, there is a dearth of capital-infusion opportunities in capital intensive cases.

While still a heavily regulated industry, restrictions on financing for law firms have loosened in recent years. Limited access to capital combined with this decreased regulation has led to an explosion of private market litigation financing, with a +10x expansion in the market from 2012 to 2021 (see Chart 1)[1]. Despite this growth, LitFin is still an incredibly small market—relative to other alternative strategies. Considering the nuances of this niche market, LitFin investments have a certain level of inherent risk that requires expert hands to navigate.

While some pundits may question whether it is a societal positive to further integrate private investing with our courts, many see this free flow of capital having the same effect as efficient capital markets. Without funding, victims of wrongdoing may have difficulty seeking justice or bad actors may not face the appropriate repercussions of their actions.

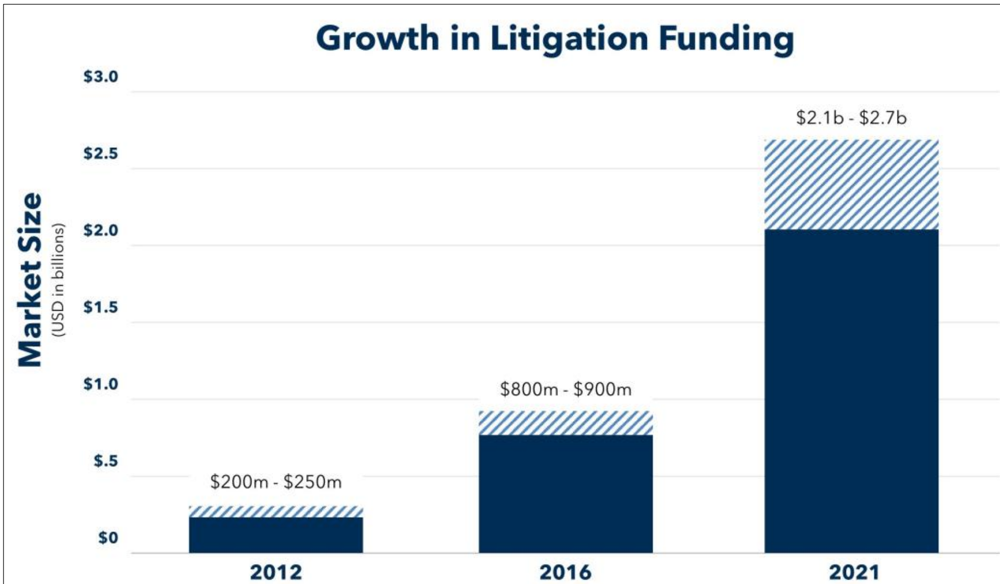

Chart 1: Potentially fundable litigation in the U.S., U.K., and Australia climbed significantly from 2012 to 2021.

Source: Vannin Capital as shown in "The 'Case' for Litigation Finance," Aon, 2022

Admissible Evidence

Now that we have completed our LitFin 101 course, it will pay to recall some fundamentals from Econ 101: supply and demand.

Looking at LitFin in a vacuum, the number of law firms seeking financing (demand) is disproportionate to the number of institutions willing to underwrite loans (supply). As we learned in our university lecture halls, low supply and high demand result in higher prices for that service. Considering the current dynamics of this niche market, the cost of receiving litigation financing is typically much higher than other industries. Such a dynamic will likely exist for years to come as regulations are still tight, potentially creating opportunities for investors.

The terms of litigation financing can depend on many factors, one of the most important of which is the stage of the case's lifecycle. Much like traditional fixed income offerings (in a healthy market), longer-dated loans typically have higher interest rates. Rates associated with LitFin, regardless of duration, are likely to be higher than traditional counterparts. Even as the Fed continues monetary tightening making some alternative income sources less attractive, litigation financing terms have benefited with yields that maintain investor appeal.

Apart from interest rates, investments in the LitFin space have little correlation to public markets and offer diversification in the truest sense. Bull market or bear, boom or bust, the courts will remain open, and firms will continue to require capital as they seek justice for their clients.

Despite the relatively small market for litigation finance, there remains a wide variety of strategies that may complement either portfolio's risk-on and growth investments or diversify an income-focused allocation. Funds focused on the early stages of cases—where the outcome is unknown—may have risk profiles similar to those often found in venture capital. Other strategies can take a more risk-adjusted approach by refinancing

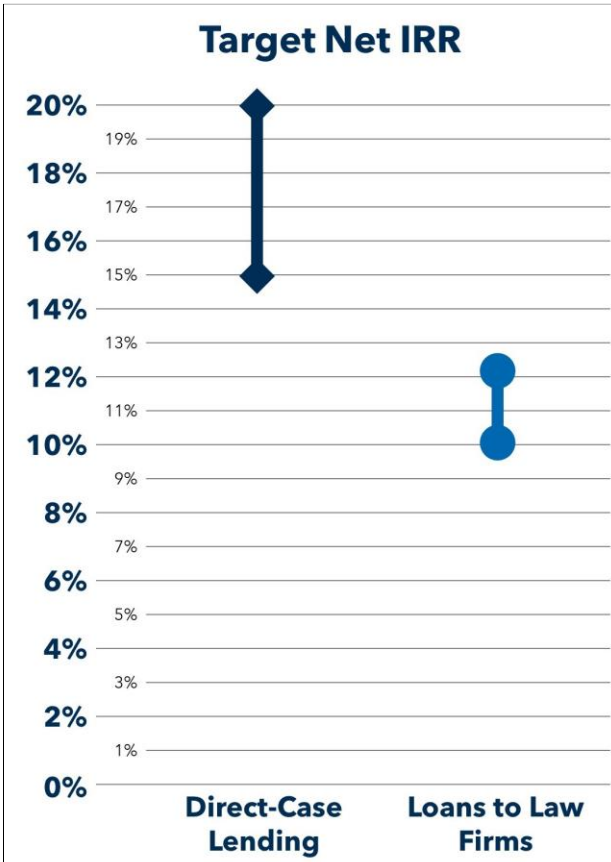

Chart 2: Target net IRRs for direct-case lending and loans to law firms.

Source: "The 'Case' for Litigation Finance," Aon, 2022 late-lifecycle cases where outcomes are known or when settlements are in process. As with all investments, the tradeoff for lower risk opportunities is the potential for lower returns. While performance data is relatively scarce, research from Aon indicates target net IRRs for direct case lending and loans to law firms range from 15-20% and 10-12%, respectively (Chart 2).

Despite all of this, no matter the stage of investment, litigation finance may be a valued component in an allocator's private market sleeve. In the truest sense, litigation finance may provide investors with diversification and uncorrelated returns.

About PPB Capital Partners

Launched in 2008, PPB Capital Partners brings premier alternative investment solutions and streamlined processing to the wealth advisor community. PPB builds and operates customized private fund solutions for wealth advisory firms nationwide. In addition, PPB provides wealth advisors entry points to a roster of best-in-class institutional alternative investment managers in strategies ranging from private equity, private credit, hedge funds, real estate, venture capital and alternative income.

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Footnotes and Important Disclosures

[1] "The 'Case' for Litigation Finance," Aon, 2022 (https://insights-north-america.aon.com/investment/aon-thecaseforlitigationfinance-whitepaper)

Additional sources:

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3751369

https://www.law.com/americanlawyer/2023/02/03/with-law-firms-under-profit-pressure-litigation-funders-have-bullish-outlook-for-2023/?slreturn=20230516111222

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