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The Impact of Inflation // What Could the Future Hold for Litigation Funding?

Tom Steindler · Friday, June 11th, 2021

Global inflation, the economic force that for many years has been banished to the back-pages, may finally get its time back in the limelight, and for good reason. A quick glance at recent statistics shows the combined US budget deficit, plus Fed quantitative easing, currently matches the stimulus we saw following the Second World War, and that lead to an inflation peak of 15% in 1947. That sum is also 150% higher than the 2008 policy response, where US M3 money supply has risen 24% and service wage inflation stands at 5.4%. Closer to home, the ECB has committed to USD 2.1 trillion of pandemic alleviation spending, running out to March 2022.

Of course, an inflation-spike is by no means a certainty. The velocity of money remains extremely low but it is the high-levels of pent-up consumer demand that need to be considered, which could easily drive a period of persistent inflation globally over the next few years. So, what does this mean for the litigation finance sector?

At some point global central banks will stop any further quantitative easing programmes and start raising interest rates to suck excess liquidity out of the system. The expectation of this would see a move out of "risky" asset classes, as holders of fixed coupon securities suffered losses, money moved into floating rate instruments and counter inflationary assets, and stock markets would come off, even as defensive sectors came back into favour. Put simply, a "risk off" situation could sweep global investing.

This shift in thinking could lead to a period where capital for all alternative asset classes, including litigation finance, is dramatically reduced. There has been an explosive growth of assets under management across alternatives as investors have chased yield, leading to a proliferation of private debt funds, many of of whom have never been exposed to challenging credit cycle of stress and defaults. Liquidity would disappear, as shell shocked investors try to assess how persistent inflation will be, whilst watching markets and asset values tank. This could mean a severe stab of pain for litigation funders who do not have locked-in committed capital, either via their balance sheets, permanent capital vehicles or discretionary funds under management.

During the 2008/2009 GFC, even discretionary funds with committed capital from limited partners could not access the money because those same partners refused to honour drawdown notices, such was the level of fear that gripped the market. If available capital across the sector shrinks for a persistent period, would it mean happy hunting for those funders who still have access to financial firepower? Post-C19, litigation activity looks set to increase due to a wave of business interuption cases, combined with widespread investment and asset financing deal conflicts. At the same time, legal costs will not be immune from the impact of inflation, as professional fees rise to match demand. The actual investment amount per case could rise significantly, therefore the overall number of pools of cases that can be invested in profitability may well shrink.

For the past decade, markets have been defined by stability and low rates, which meant that locking up your money for several years financing a dispute was the norm. Now we face a world where the cost of money (rates) and value of money (inflation) are both highly volatile. This should trigger a period of evolution in litigation funding, where ways to create liquidity and risk manage litigation financing to push down pricing and effectively reduce locked in capital periods will become increasingly important. Equally, financing terms could start to price-in an inflation metric to protect the financing from budget expansion over the period of the investment.

The question is, can litigation finance be positioned as counter-inflationary? Any such scenario will create a more nimble and innovative asset class and this is the challenge for all alternatives. But those accessing funding would do well to consider this challenge right now.