

An Analysis of Allianz' decision to discontinue its litigation funding business

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It has recently been announced that one of the oldest, and most reputable litigation funders in Europe, the subsidiary of the Allianz group, will discontinue its business in Europe and the UK. Existing cases will be funded to conclusion, but no new cases will be taken on. This is a relevant development for the industry of litigation funding as a whole, and we will try to analyse and assess the decision in this article. Calunius' Christian Stuerwald worked for Allianz from 2005 to 2009 in Munich and then London, and is therefore in a position to offer in depth analysis of the decision.

The most important thing to say about the decision is that it does not in any way indicate that litigation funding is not a profitable business, or that there is anything wrong with the business model. The reasons behind the group's decision are driven by the thoughts and processes of one of the largest insurance companies worldwide (the group's annual gross written premium is close to €100bn), with business interests reaching into every corner of the globe.

It is useful to explain the history of litigation funding within Allianz. It was an early but not the earliest mover in Germany, when it started its subsidiary in 2002. Even back then the group took a conservative approach and waited for several years after the industry had begun in the late 1990s before setting up its own business. At that time at least two sizable funders existed, who are still in the business in Germany and continue to provide funding.

Allianz set up the litigation funding subsidiary as an annex to its large legal expense insurance unit, which is roughly the equivalent of BTE insurance in the UK. In Germany millions of people have legal expense cover, and Allianz is a very important provider of this particular type of insurance. The thinking was simple: in cases where the policy does not provide cover due to exclusion clauses, the company wanted to create value for itself and its customers by pointing the insured towards another subsidiary that could assist with cases that were not covered. The reality is that this approach, as plausible as it may sound, never worked, and most cases have always been generated via law firms and independent of an existing relationship with insurance customers.

The business grew, quickly became profitable and expanded into other jurisdictions, mainly Switzerland, Austria and the UK. While the cases that were originally funded were small claims worth maybe a couple of hundred thousand euros, with time and growing market penetration and acceptance the cases became bigger; as claim values grew, so did the size of the defendants, as it plainly does not make sense to pursue a large case against an impecunious client; that meant that more and more often cases would be directed against large corporate entities. This is really where the problems began, because most corporate entities, certainly the ones that are domiciled in Germany, are customers of Allianz, typically of course in the insurance sector. Like in a big law firm conflict checks needed to be run, and they typically covered not only direct conflicts of interest but

also business embarrassment risks where the group was unwilling to endanger a sustainable income flow from renewable insurance policies in favour of one off revenues from a funded piece of litigation. For example antitrust matters were completely off mandate because large corporate cartelists were typically good customers, and Allianz had even found itself on the receiving end of cartel investigations and therefore had no interest to encourage private enforcement of follow on damage claims.

Because of the nature and sheer size of the organisation it was not always easy to detect potential business embarrassment risks in time, as the checks needed to be done on a global basis. This led to some instances where a litigation funding agreement was entered into when it was discovered that the case was directed against a long standing corporate client, who declared himself not amused when the fact of funding was disclosed. With time the litigation business, even though it was a neat, profitable unit, became a liability and a perceived embarrassment for the group. While the turnover was by no means negligible, it was, and was always going to be, dwarfed by the insurance revenues of the group. After some time of deliberating whether to take a more robust approach to business conflicts, to sell the company or at least the book of business, it was decided to keep the business and place it into run off, which is probably by far the most lucrative thing to do, because the portfolio will provide handsome returns without the same cost of running an expanding business, which should help to maximize the revenue.

What are the lessons to be learnt from this? The German litigation funding landscape remains intact, the remaining handful providers have confirmed that they will continue the business and are unaffected by Allianz' problems. It shows that as a business it is important to deal with conflict of interest issues upfront. While it is impossible to have investors that are completely independent and free from conflict, it is possible to greatly reduce the potential for conflict by pointing out the risks and realities of the business before inviting potential investors to make a commitment. One way of dealing with this is to concentrate one's funding activities on geographical areas away from the usual business activities of the investors; another is to agree a short list of targets that are 'off limits', or at least put in place quick and clear rules for checking conflicts. Arguably the worst set up for a funder of large scale commercial disputes is – with hindsight – to be part of a huge global corporate entity with business interests literally everywhere. From this angle it is fair to say that the Allianz litigation funding business has become a victim of its own success, and it is for the industry as a whole to learn from this experience and as tends to be the case in these circumstances, the market has already found a way of solving the problem and moving on; specialized funders like Calunius and others concentrate exclusively on the litigation funding business and only need to account to agree a conflict policy with their investors.

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