

# Toughening up

ALF chair **Leslie Perrin** reveals that the association has strengthened its capital adequacy measures



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**F**or the Association of Litigation Funders of England & Wales (the ALF), oversight of its members' capital adequacy is one of the most important tasks. The ALF's original tests of capital adequacy were the first such tests anywhere in the world, and it has continued to consider improvements to the all-important capital adequacy regime. Just as the availability of litigation funding is now widely accepted as important to improving access to justice, so too is ensuring that litigation funders have the capital needed to fulfil their commitments.

In October 2012, a working party of funder members of the ALF was established to discuss and propose:

- any desired improvements to the capital adequacy test; and
- an appropriate mechanism to verify compliance with that capital adequacy test.

The current capital adequacy provisions in the ALF Code of Conduct are as follows:

Article 2: A Funder has access to funds immediately within its control or acts as the exclusive investment adviser to an investment fund which has access to funds immediately within its control, such funds being invested pursuant to a Litigation Funding Agreement (LFA) to enable a litigant to meet the costs of resolving disputes by litigation or arbitration...

Article 7: A Funder will... (d) maintain at all times adequate financial resources to meet its obligations to fund all of the disputes that it has agreed to fund, and in particular will maintain the capacity: (i) to pay all debts when they become due and payable; and (ii) to cover aggregate funding liabilities under all of its LFAs for a minimum period of 36 months.

The recommendations of the working party, which are to apply to applications for funder membership and at all annual renewals thereafter, are that:

1. The required improvements should be achieved through changes to the ALF's articles and rules, building on article 26 which provides that membership of the ALF is open to persons who 'can demonstrate to the directors' satisfaction their compliance with the prevailing code', and further, that 'any question of eligibility for membership shall be determined by the directors'. The strong capital adequacy definitions in articles 2 and 7 of the code should remain unchanged.
2. The articles and rules should be amended to provide that all funder members have a minimum of £2m of capital, and that this minimum capital requirement be reviewed at least annually by the ALF, in the expectation that the amount of minimum capital required of funder members will be increased in the future.
3. The articles of the ALF should be amended to state explicitly that funder members are subject to a continuous disclosure obligation in respect of their capital adequacy, and have a specific obligation to promptly notify the ALF and all counterparties to their LFAs if they reasonably believe that their previous capital adequacy statements under article 2 or 7 of the code are no longer valid because of

changed circumstances.

4. The ALF should amend its articles and rules to include an undertaking by funder members that they will be audited annually by a recognised national or international audit firm, including a requirement that funder members must provide (i) a copy of a satisfactory audit opinion within one month of receipt of the opinion, and in any case within six months of financial year end and (ii) reasonable evidence from a qualified third party that the funder member satisfies the minimum capital requirement current at the time of annual subscription.

5. The ALF should amend its articles and rules to provide, in the event of failure by a funder member to produce the external verifications by the relevant deadline and in a form that is reasonably satisfactory to the board, for, (i) immediate suspension of the funder member's membership in the ALF and (ii) in the event the default has not been cured within three months of the relevant deadline, automatic expulsion of the funder member from the ALF.

6. The following factors should be considered by applicants and funder members when assessing whether they have 'adequate financial resources';

a. the need for funder members to be both conservative in assessing what is counted as capital and pessimistic about the timing and level of any expected returns under existing LFAs;

b. the quality, source and certainty of a funded member's capital, as well as the timing and extent of the aggregate financial commitments made by a funder member under LFAs and other commitments (actual or contingent);

c. the uncertain nature of litigation – in particular with respect to the merits, realistic claim value, budgeted costs (including overruns), enforcement and collection risks and timing of a case, and the professional experience of the litigation team and the funder member.

7. The ALF will publish guidance advising funder members to test their exposures whenever they make a new commitment under an LFA, and thereafter at least monthly with respect to ongoing commitments.

The working party comprised Brett Carron of Harbour Litigation Funding, who acted as chair, Jonathan Barnes of Woodsford Litigation Funding, Chris Bogart of Burford Capital, and Mark Wells of Calunius Capital. Their recommendations have been endorsed by the members of the ALF board and are likely to be adopted in full at their next meeting later this month.

I am grateful to members of the working party for their efforts, and I commend their proposals now to a wider audience. Litigation funding is an industry that is increasingly showing that it has the right to be taken seriously in its markets. That, together with the steep increase in interest in the industry's work that has been shown by lawyers and clients alike over the last year, demonstrates that it is here to stay.

*Leslie Perrin is chair of the Association of Litigation Funders of England & Wales*