Securitized Products Special Topics

Litigation ABS: Tailwinds in Place for an Uncorrelated Segment

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Unique Collateral May Offer Value in Volatile Times

We see several tailwinds currently supporting the collateral performance of litigation ABS deals. Resolutions of pending cases, and the attendant plaintiff payments, should accelerate as court systems fully reopen after operating in limited capacity during the pandemic. Litigation receivables generate cashflows only following successful resolutions of the underlying claims.

In turn, rapid advancement of lawsuit outcome predictive models should inject more accuracy into cashflow projections in a sector where payments can be somewhat idiosyncratic. Some of the issuers in the fast-consolidating litigation funding industry are now employing aggregated court records and machine learning to better predict lawsuit case values. Lastly, litigation volume may rise in a recessionary or distressed economic environment, thereby expanding the collateral base for ABS transactions.[1]

Such trends could further spur investor interest in a sector that can be largely uncorrelated to other securitized segments, or to the underlying interest rate environment and key economic markets such as real estate and consumer debt. Rate-driven lending pullback or recession-driven rising delinquencies should not be key drivers of litigation ABS dynamics, echoing a view we discussed for other unique securitized segments, such as recovery bonds.[2] Rather, legislative and legal risks, as well as the specific composition of collateral pools by case type, play a bigger role in impacting the collateral performance outlook in the segment.

Issuance Volume Rises Post-Pandemic

Litigation ABS issuance picked up in 2023, with four deals pricing YTD, with a total $481 million issued volume (Figure 1). The most recent deal, the $119.3 million PEAR 2023-1, priced its benchmark single-A rated class at I+290bp last month.

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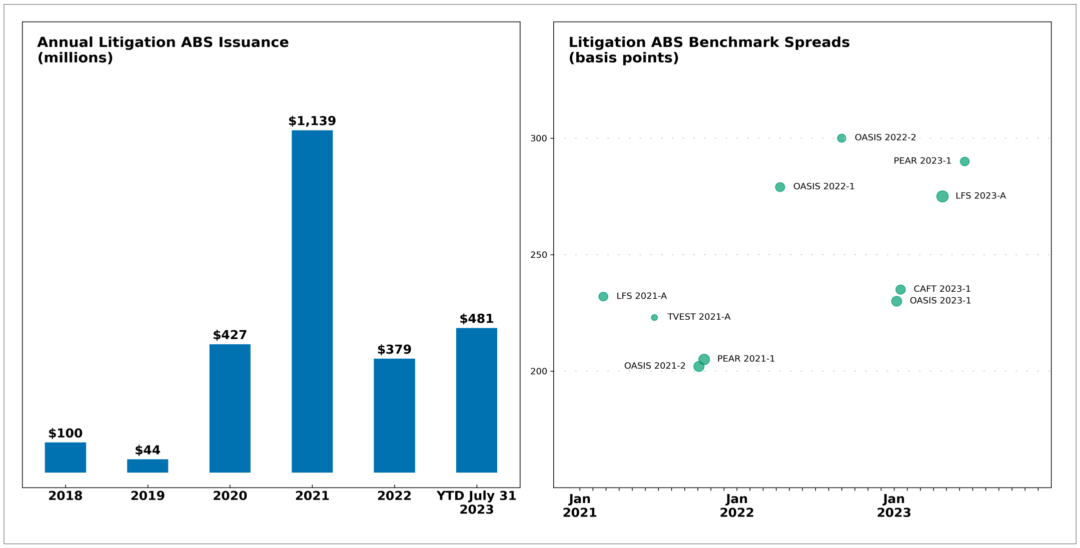
1 The last argument may be a bit more tenuous. While intuitively a distressed economic environment may generate more conflicts that end up in the court system, we cannot immediately tie some of the common case types backing litigation ABS deals, such as auto accidents or premises liability, purely to the economy backdrop.

2 "Recovery Bonds: No Need to Closely Watch the Fed or the Economy Here," Securitized Products Special Topics, Academy Securities, November 30, 2022

Figure 1. Litigation ABS Issuance and Spreads



Source: Bloomberg and Academy Securities

Aspects to Track on Litigation ABS Deals

The elevated uncertainty around legal case outcomes puts a particular emphasis on the receivable pool diversification. Pools are diversified across many aspects, as recent deals demonstrate, including by case type, state, and payment sources (typically insurance firms). Deal documents also include long lists of so-called concentration limits, designed to ensure diverse exposures. We see concentration limits on aspects such as exposure to specific lawyer or law firm (for example, capped at 12.0% of the aggregate outstanding receivable principal balance), or to single payment source (example cap of 15.0%), among dozens other limits. Other aspects to note include:

- **Litigation vs. medical receivables.** The lion's share of receivables on litigation ABS deals comprises of advances to plaintiffs or lawyers in connection with potential future settlements. Some deals also include medical receivables – advances to medical providers in connection with medical services. The medical service providers (MSP) may later recover payments from case settlements. For example, in Libra 2023-1, 58.8% of the pool is litigation receivables and the remainder is medical receivables (Figure 2). Pear 2023-1 also contains a small sleeve of medical receivables. The presence of medical receivables may offer investors another diversification aspect. But deal documents and presale reports show that the underwriting and analysis approach to medical receivables is different from litigation receivables, adding a potential hurdle to investors not steeped in the sector.

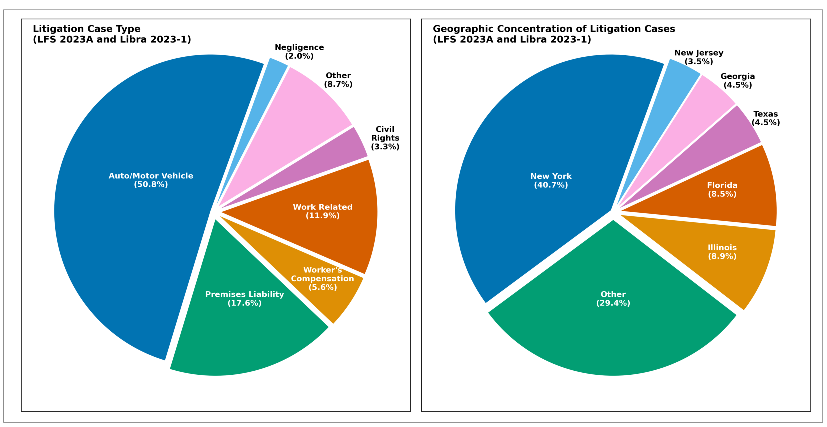
Figure 2. Litigation ABS Pool Characteristics

	Pear 2023-1	LFS 2023A	Cartiga 2023-1	Libra 2023-1	Libra 2022-2	LFS 2022A
Issuer	Golden Pear Funding	US Claims Holdings	Cartiga Asset Management	Libra Solutions	Libra Solutions	US Claims Holdings
Price Date	7/14/2023	5/22/2023	2/16/2023	2/8/2023	9/30/2022	5/11/2022
Pool Balance ($MM)	119.3	143.8	103.4	76.5	74.0	87.0
ADPB ($MM)	119.6	165.0	139.8			99.2
Overcollateralization (%)		12.9		10.3		
Number of Individual Advances		13,817		95,519	90,388	6,878
Number of Unique Plaintiff or Vendor Advances		6,462		16,445	16,488	4,263
Number of Unique Lawyer Advances		18				16
Litigation Receivables (%)	95.7	100.0		58.8	60.8	100.0
Medical Receivables (%)	4.3	0.0		41.2	39.2	0.0

Source: Deal Documents, Presales, and Academy Securities

- **Case type concentration.** Across litigation receivables, deals vary in their case types (Figure 3). For example, in Libra 2023-1 the dominant case type is auto-related, comprising over two-thirds of the litigation funding receivables. In LFS 2023-A motor vehicle accidents also comprise a significant share of the pool (34.2%), but two other case types - premises liability (25.3%) and work related (23.9%) – have a larger combined exposure. Presales suggest that the mix of case types in Libra and LFS is typical in the litigation finance sector. But such differences across deals in case type breakdowns do suggest some deals may be more sensitive to legal risks and uncertainty associated with specific case types.

Figure 3. Litigation ABS Case Type and State Exposure Breakdowns



Source: Deal Documents, Presales, and Academy Securities

- **State exposure.** Varying state concentrations across deals can elevate risks in particular deals, amid different local legal jurisdictions. One notable case study is a tort reform in Florida (HB 837) that became effective on March 24, 2023. The law's stated goal is to decrease frivolous lawsuits and limit personal injury cases, insurance litigation, and attorneys' fees. Underscoring the potential impact of the law on the litigation funding industry, on the eve of HB 837's enactment, plaintiffs' lawyers filed more than 280,000 new cases.

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