Litigation funding and AML obligations

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Between the increased regulatory scrutiny over anti-money laundering efforts and the growth in the use of third-party litigation funding, *CDR* takes a look at where the compliance obligation lies when law firms source finance for cases.

Readers need search no further than recent news events for evidence of the proliferation in the use of third-party litigation funding in commercial cases globally; equally as prominent is the appetite of regulators, including heightened efforts by the **Financial Conduct Authority**, to clamp down on anti-money laundering (AML) compliance failings by companies.

With whom, then, does the onus fall to ensure that capital used to fund litigation and arbitrations has gone through the appropriate AML checks – the provider of that capital or the recipient?

While the Law Society of England and Wales produces a range of resources and guidance for its members, including a dedicated AML webpage, a practical advice helpline, training events, webinars and – along with other legal sector AML supervisors – HM Treasury-approved AML guidance for the legal sector, there are no specific plans to produce guidance on litigation funding and AML. However, a spokesperson told *CDR* that "we will keep this under review".

This will be welcome to one lawyer *CDR* spoke with who suggested the Law Society could incorporate some guidance on this particular issue under its AML guidance, "as could the Association of Litigation Funders" – the funding industry's self-regulating body.

They added: "The latter's code of conduct focuses more on the funding of the litigation itself (such as capital requirements) rather than the fundraising side of things. We suspect that as an association, stakeholders focus most of their questions on whether funders have sufficient capital, interference with litigation strategy, control and unwarranted litigation."

For **Luke Harrison**, a partner and head of litigation at **Debenhams Ottaway**, "the law firm is not absolved from its obligations to satisfy itself as to the source of funds just because the funds are coming from a funder”.

It is a question of risk, he continues, explaining that some funders have known sources of funds, for example those who are publically listed companies like **Burford Capital, LCM Finance** and **Manolete Partners**. “There are, however, a growing number of new entrants to the market in respect of which the due diligence obligations are going to be more difficult to discharge,” he notes, adding that this is why it is important that users are provided with “appropriate verifiable due diligence information at the point an offer of funding is made” to keep the process moving efficiently.

Steven Friel, chief executive officer at **Woodsford Litigation Funding**, highlights the necessity for users of funding to understand the corporate and financial status of the funder.

“Some litigation funders use complex offshore structures, which may not be straightforward to understand, not least because of the difficulty in accessing independent corporate and financial information,” he adds, saying that as an onshore, English company, Woodsford’s financial and corporate information, including audited financial statements and details of directors and officers, are readily available at Companies House.

IT’S GOOD TO TALK

Anthony Maton, managing partner of **Hausfeld** in London, stresses that some funders are clear in their conversations where their capital originates from, and for others it is a matter of public record. “Although the funder is not a ‘client’ of a law firm as such, it is clear a law firm needs to be aware of the AML risks associated with funding they receive nonetheless, and to take appropriate steps including taking into account the Law Society’s AML guidance and the risk-based approach. Especially, if dealing with less established funders or funders for the first time.”

Harrison goes further in saying that users of funding can add an additional layer of protection by including clauses in their funding agreements that include a contractual obligation that requires funders to satisfy users of the source of the capital at each draw down date, not just at the start of the agreement.

He says that the due diligence requirement will be different in each case, “but a funder should be prepared to provide adequate due diligence to demonstrate, by creditable documentary evidence, the ultimate source of their funds”, whereas if the capital comes from a high-net-worth individual or family office, then due diligence would need to be carried out on them, while if it is from a regulated hedge fund then “that may very well be sufficient in itself”.

Users of funding ought also be aware of the potential risk of organised crime using litigation funding as a means of laundering the proceeds of crime, the Debenhams Ottaway partner emphasises, advising that lawyers should be very careful to look for the signs of sham litigation or arbitration in cases that are going to be funded.

“Warning signs would include cases where the client proposes the funder and the funder is not already established in the market. They could also include dispute that appear remarkable straightforward with limited issues and documentary evidence,” he says.

Ultimately, it is a matter of business common sense, Friel states: “In any significant financial transaction, the recipient of money should know the source of the money… not only relating to AML, and certainly not unique to litigation and litigation funding.”

On their part, “litigation funders need to understand the source of payments from which we benefit, including following settlements of litigations that we fund. In this regard, we are wholly aligned with the claimant’s law firm, not least because the proceeds of the litigation will usually flow through the law firm’s client account. It is good practice for the law firm and the funder to share their respective AML and KYC (know your customer) materials”, Friel concludes.