



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Litigation Funding Schemes) Instrument 2020/787

This is the Explanatory Statement for the *ASIC Corporations (Litigation Funding Schemes) Instrument 2020/787*.

The Explanatory Statement is approved by the Australian Securities and Investments Commission (*ASIC*).

Summary

1. ASIC is making this instrument to provide exemptions to responsible entities of litigation funding schemes from certain provisions in Chapter 7 and Chapter 5C of the *Corporations Act 2001* (the *Act*) to facilitate the implementation of the regulatory framework for litigation funding schemes commencing on 22 August 2020. Under the framework, litigation funding schemes will generally be regulated as managed investment schemes under Chapter 5C of the Act. This instrument addresses practical difficulties responsible entities of litigation funding schemes may encounter in transitioning to the new regime.

Purpose of the instrument

2. The purpose of this instrument is to support the transition to the new regulatory framework for litigation funding schemes commencing on 22 August 2020 and to give effect to Government policy on the regulation of litigation funding.
3. On 22 May 2020, the Government announced that from 22 August 2020, litigation funding schemes are to be regulated as managed investment schemes and operators of such schemes will be required to obtain an Australian Financial Services (AFS) licence in order to ensure greater regulatory oversight and accountability.
4. Following the Government's announcement, the *Corporations Amendment (Litigation Funding) Regulations 2020 (Amending Regulations)* were issued. The Amending Regulations remove the exemption from the managed investment scheme and AFS licensing regime that had applied to litigation funding schemes in relation to representative proceedings (more commonly known as class actions).

A 'litigation funding scheme', as defined in reg 7.1.04N(3) of the Regulations, includes what is commonly understood as a class action. In broad terms, a class

action typically involves a legal action brought by one or more persons on behalf of a wider group of persons against one or more defendants where the claims against the defendant(s) arise out of the same, similar or related circumstances and there is a common issue of law or fact. Class actions are governed by the rules of procedure for the particular state court or the Federal Court of Australia, as the case may be, in which the action is commenced. A class action may be closed or open. A class action is commonly described as ‘closed class’ if the ability to be a member of the class action is restricted to people who have retained a particular law firm and/or entered into an arrangement with a particular litigation funder. In contrast, an open class action is not limited in this way.

5. From 22 August 2020, litigation funding schemes and their operators will be required to comply with the managed investment scheme and AFS licencing regimes under the Act.
6. ASIC recognises that compliance with some obligations in Chapter 5C and Chapter 7 of the Act may be difficult for responsible entities of litigation funding schemes in some circumstances. As contemplated in the Explanatory Statement to the Amending Regulations, some exemptions and modifications to the legal requirements under the Corporations Act are required to address these practical difficulties.
7. The instrument provides relief to facilitate the implementation of the new regulatory framework for litigation funding schemes commencing on 22 August 2020.

Definitions

8. Terms used in this Explanatory Statement have the same meaning as those used in the instrument, and defined by section 4 of the instrument.

active general member means a person who is a general member of a litigation funding scheme and who:

- (a) is party to any of the following agreements in relation to the scheme:
 - (i) a funding agreement with the funder;
 - (ii) a retainer or costs agreement with the lawyer or legal practice providing services for the purposes of the scheme; or
- (b) has notified the funder, lawyer or legal practice that the person agrees to, or wishes to, participate in the scheme.

funder has the meaning given by subregulation 7.1.04N(3) of the Regulations.

funding agreement has the same meaning as in subregulation 7.1.04N(3) of the Regulations.

general member has the meaning given by subregulation 7.1.04N(4) of the Regulations.

litigation funding scheme has the meaning given by subregulation 7.1.04N(3) of the Regulations.

passive general member means a person who is a general member of a litigation funding scheme and who is not an active general member

Regulations means the *Corporations Regulations 2001*.

representative proceedings means, in relation to a litigation funding scheme, legal proceedings in relation to the litigation funding scheme that are referred to in paragraph 7.1.04N(3)(d)(iii) of the Regulations.

Consultation

9. Due to the relatively short period of time between the date of the Government's announcement on 22 May 2020 and the commencement on 22 August 2020 of the regulatory regime for litigation funding schemes, targeted consultation was undertaken with a number of industry participants including law firms, litigation funders and industry bodies. A consultation paper was not issued due to time constraints.
10. ASIC received written submissions from various industry participants. ASIC met with a number of interested parties as part of the consultation process.
11. On 4 August 2020 ASIC hosted an industry briefing in which ASIC foreshadowed the relief provided in the instrument. ASIC received and considered feedback from the industry briefing in the course of preparing the instrument.

Operation of the instrument

12. The instrument provides relief to the responsible entity of a registered litigation funding scheme from certain obligations arising under the Act in relation to:
 - the giving of Product Disclosure Statements to some members of a registered litigation funding scheme;
 - the use of application forms;
 - some content requirements of Product Disclosure Statements;
 - modification of the withdrawal procedures for scheme members;
 - obligations in relation to the valuation of scheme property; and

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- relief from the responsible entity's duty, as an AFS licensee, to comply with financial services laws to the extent that this duty requires the operator of a registered litigation funding scheme that has one or more passive members to maintain a register of members of the scheme.

Exemption from the obligation to give a Product Disclosure Statement in some circumstances

13. Section 5 of the instrument provides an exemption to the responsible entity of a litigation funding scheme from the requirement to give a Product Disclosure Statement. This exemption applies only in the circumstances described in paragraph 5(3) of the instrument and is available subject to the conditions in paragraph 6 of the instrument.
14. Under Part 7.9 of the Act, a Product Disclosure Statement must generally be given to a retail client before or at the time they are offered or issued an interest in a managed investment scheme.
15. Section 1012B of the Act sets out the situations in which a responsible entity or other regulated person is required to give a Product Disclosure Statement.
16. ASIC recognises that compliance with section 1012B of the Act may not be possible in relation to a member of a litigation funding scheme who is not known to the responsible entity. In light of the opt-out nature of representative proceedings, some general members may not be known to or reasonably identifiable by the responsible entity of a registered litigation funding scheme that has one or more passive members (an ***open litigation funding scheme***). On balance, ASIC has formed the view that a responsible entity should not be required to give a Product Disclosure Statement to a general member of an open litigation funding scheme, unless the general member has taken sufficient positive steps to participate in the representative proceeding. The instrument reflects this position by limiting the scope of the Product Disclosure Statement exemption to passive general members.
17. Under paragraph 5(3)(a) of the instrument, the exemption applies in relation to a responsible entity of the scheme where the responsible entity has made the Product Disclosure Statement publicly available on the responsible entity's website for the scheme. In relation to a regulated person that is not the responsible entity of the scheme, paragraph 5(3)(b) of the instrument requires the regulated person to have a reasonable belief that the responsible entity has made the Product Disclosure Statement publicly available on the responsible entity's website for the scheme. This requirement is to ensure transparency about the key features, benefits, risks, fees and costs of a litigation funding scheme for passive general members and the community generally.
18. Further, under section 6 of the instrument, a condition of the Product Disclosure Statement exemption is that the responsible entity of the scheme takes all reasonable steps to ensure that any notices to members or prospective members of the scheme and any advertising material in relation to the scheme contains a prominent reference to the Product Disclosure Statement and the website on which the Product Disclosure Statement may be accessed.

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19. Where a responsible entity relies on the Product Disclosure Statement exemption under subsection 5(1) of the instrument, under paragraph 6(a) of the instrument the responsible entity must give a Product Disclosure Statement to any person who is a passive general member and who subsequently becomes an active general member. The Product Disclosure Statement must be given to such a person before the time the person becomes an active general member.

Application forms

20. In circumstances where the exemption in subsection 5(1) of the instrument applies in respect of a passive general member, the responsible entity of a litigation funding scheme will be able to rely on section 11 of the *ASIC Corporations (Application Form Requirements) Instrument 2017/241* in respect to the application form requirements in section 1016A of the Act. This means an issue of an interest, or an offer to issue an interest, in the litigation funding schemes can be made to a passive general member other than in response to an eligible application where the exemption in subsection 5(1) of the instrument applies in respect of the passive general member.

Exemption from the obligation to value scheme property at regular intervals

21. Subsection 601FC(1)(j) of the Act imposes an obligation on responsible entities of registered schemes to ensure that scheme property is valued at regular intervals appropriate to the nature of the property. Subsection 601HA(1)(c) of the Act requires that the compliance plan of a registered scheme must set out adequate measures that the responsible entity is to apply including arrangements for ensuring that the scheme property is valued at regular intervals appropriate to the nature of the property.
22. Given the potential uncertainty as to the nature and characterisation of scheme property of a litigation funding scheme, and how it might best be valued, ASIC has formed the view that an exemption from the obligation to value scheme property at regular intervals is appropriate at this time.
23. Section 7 of the instrument exempts the responsible entity of a registered litigation funding scheme from paragraph 601FC(1)(j) of the Act.
24. Further, section 10 of the instrument makes a declaration that Chapter 5C of the Act applies to the responsible entity of a registered litigation funding scheme as if paragraph 601HA(1)(c) were omitted. This means that the compliance plan for a registered litigation funding scheme does not have to include adequate measures in relation to the regular valuation of scheme property.

Exemption from compliance with financial services laws in relation to register of members

25. ASIC has provided a no-action position to responsible entities of litigation funding schemes from the requirements under Chapter 2C of the Act in relation to member registers in particular circumstances. A copy of the no-action position is available on ASIC's website.

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26. To the extent that acting in reliance on the no-action position may cause a responsible entity to breach its obligations as a financial services licensee under section 912A of the Act, section 8 of the instrument provides an exemption to responsible entities of registered litigation funding schemes from the obligation to comply with paragraph 912A(1)(c) of the Act in relation to the requirements of section 168 and 169 of the Act for litigation funding schemes in which there are passive general members (i.e. open litigation funding schemes).

Declaration in regard to procedures for withdrawing from a litigation funding scheme

27. Part 5C.6 of the Act sets out how a member may withdraw from a managed investment scheme. The responsible entity of a registered scheme must not allow a member to withdraw from a scheme that is not liquid other than in accordance with the scheme's constitution and sections 601KB to 601KE of the Act.
28. ASIC recognises that the court rules for class actions specifically provide for how and when a general member may withdraw from a class action. ASIC recognises that these rules may not be consistent with member withdrawal provisions under Part 5C.6 of the Act. ASIC takes the view that requiring responsible entities of litigation funding schemes to comply with the withdrawal rules in sections 601KB to 601KE of the Act is not necessary in the light of the specific provision for withdrawals set out in the court rules.
29. To address this situation, section 9 of the instrument adds a new subsection 601KAA to Part 5C.6 of the Act. Under notional subsection 601KAA(2), sections 601KA to 601KE of the Act do not apply in relation to a general member of a registered litigation funding scheme. Under notional subsection 601KAA(3), the responsible entity must allow a general member to withdraw from the registered litigation funding scheme if and only if the general member opts out of the representative proceedings in relation to the scheme in accordance with the court rules or any order of the court, or the general member otherwise ceases to have an interest in the outcome of the representative proceedings.
30. Section 9 of the instrument also adds a notional subsection 601GA(4A), which provides that subsection 601GA(4) does not apply to a general member of a registered litigation funding scheme. Subsection 601GA(4) provides that, where a member has a right to withdraw from a scheme, the constitution of the scheme must set out the right to withdraw, there must be adequate procedures for making and dealing with withdrawal requests, the right to withdraw must comply with Part 5C.6 of the Act where the scheme is not liquid, and the withdrawal procedures must be fair to all members. The effect of section 9 of the instrument in respect of subsection 601GA(4) is that a general member of a registered litigation funding scheme will have a right to withdraw under notional section 601KAA.
31. Part 5C.6 does not deal with the compulsory redemption of interests in a registered scheme by the responsible entity: *MacarthurCook Fund Management*

Limited v TFML Limited [2014] HCA 17. The circumstances in which compulsory redemption will apply are able to be specified in the scheme constitution. Accordingly, no relief is required in order for a registered litigation funding scheme to make provision for the compulsory redemption of interests held by a general member upon the member ceasing to have an interest in the outcome of representative proceedings.

Declaration in regard to the content of Content of Product Disclosure Statements

32. Section 1013D of the Act sets out the prescribed information that a Product Disclosure Statement must contain and which a person would reasonably require for the purpose of making a decision as to whether to acquire a financial product.
33. ASIC considers that some of the content requirements under section 1013D of the Act should be modified to apply appropriately to litigation funding schemes to ensure that the overarching objective of clear, concise and effective disclosure is satisfied and that the information disclosed is not confusing or misleading.
34. Section 11 of the instrument provides a declaration that Part 7.9 of the Act applies in relation to an interest in a registered litigation funding scheme as if that Part were modified or varied by omitting subregulation 7.9.16N(2) of the Regulations and omitting paragraph 1013D(1)(l) of the Act.
35. The declaration that subregulation 7.9.16N(2) does not apply to litigation funding schemes removes the obligation that fees and costs disclosure in a Product Disclosure Statement must include:
 - a Fees and Costs Template and the additional explanation of fees and costs;
 - an example of annual fees and costs and associated notes; and
 - the boxed Consumer Advisory Warning Statement,

as set out in in Part 2 of Schedule 10 to the Regulations

36. The declaration that paragraph 1013D(1)(l) of the Act does not apply to litigation funding schemes removes the obligation that a Product Disclosure Statement for a litigation funding scheme must disclose the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention and realisation of the investment.

Commencement

37. The instrument commences on the later of the day after it is registered on the Federal Register of Legislation and 22 August 2020.

Legislative instrument and primary legislation

38. The Explanatory Statement to the Amending Regulations contemplated that ASIC may need to grant exemptions or modifications to facilitate the new regulatory framework for litigation funding schemes. The subject matter and policy implemented by this instrument is more appropriate for a legislative instrument rather than primary legislation because the instrument is providing minor and technical relief to litigation funding schemes and their operators in circumstances where strict compliance with the primary legislation produces an unintended or unforeseen result. On this basis, it is appropriate for ASIC to provide relief through its exemption and modification powers; the matters contained in this particular instrument are of a highly specific nature which are more appropriate for legislative instrument rather than primary legislation.

Legislative authority

39. This instrument is made under subsections 601QA(1), 926A(2) and 1020F(1) of the Act. Under subsection 601QA(1) of the Act, ASIC may exempt a person from a provision of Chapter 5C of the Act, or ASIC may declare that Chapter 5C applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration. Under subsection 926A(2), ASIC may grant an exemption from, or omit, modify or vary, a provision of Part 7.6 of the Act (other than Divisions 4 and 8). Under subsection 1020F(1), ASIC may grant an exemption from, or omit, modify or vary, a provision of Part 7.9 of the Act.
40. This instrument is a disallowable legislative instrument.

Regulatory Impact Statement

41. The relief contained in this instrument is expressly contemplated by the Explanatory Statement to the Amending Regulations. ASIC is making this instrument to facilitate and give effect to the amendments made by the Amending Regulations.
42. ASIC considers that the relief in this instrument is within the scope of the RIS prepared by Treasury for the Amending Regulations and is relying on that RIS for this instrument. Therefore, ASIC did not prepare a separate RIS for this instrument.

Statement of Compatibility with Human Rights

43. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is in the Attachment.

Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ASIC Corporations (Litigation Funding Schemes) Instrument 2020/787

Overview

1. The instrument provides relief to responsible entities of litigation funding schemes from certain provisions in Chapter 7 and Chapter 5C of the *Corporations Act 2001* to facilitate the implementation of the regulatory framework for litigation funding schemes commencing on 22 August 2020. In particular, the instrument provides relief from the obligation to give Product Disclosure Statements to some members of an open class action; limited exemptions from the content requirements of product disclosure statements; modifications to withdrawal procedures for illiquid schemes in relation to litigation funding scheme members; an exemption from the general licensee duty to maintain a register of members; and an exemption from the obligations in relation to the valuation of scheme property.

Assessment of human rights implications

2. This instrument does not engage any of the applicable rights or freedoms

Conclusion

3. This instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.