

EXPLANATORY STATEMENT

Issued by authority of the Treasurer

Corporation Act 2001

Corporations Amendment (Litigation Funding) Regulations 2021

Section 1364 of the *Corporations Act 2001* (the Corporations Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Part 1 of Schedule 1 to the *Corporations Amendment (Litigation Funding) Regulations 2021* (the Regulations) introduces further regulation for Australian financial services licensees dealing in litigation funding schemes which fund class actions. The amendments introduce an additional condition on the Australian Financial Services Licence (AFS Licence) of a litigation funding entity that deals in an interest in a litigation funding scheme that funds a class action (the licensee). The new condition prevents a legal representative of the plaintiff in a funded action from having or obtaining a material financial interest in the litigation funder for that action.

Entities that deal in an interest in a litigation funding scheme, and which are exempt from the Managed Investment Scheme (MIS) and financial product regimes, are required to maintain adequate practices in relation to managing conflicts of interest. The Regulations ensure that these entities must also maintain practices to prevent legal representatives of the funded side in a funded action from having or obtaining a material financial interest in the litigation funder for that action.

Part 2 of Schedule 1 to the Regulations makes technical amendments to Chapter 7 of the *Corporations Regulations 2001* (Corporations Regulations) to ensure consistency between the Corporations Act and Corporations Regulations when referring to litigation funding schemes that fund class actions following the commencement of the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Act 2021* (the Amendment Act). The Amendment Act establishes a new type of MIS, a ‘class action litigation funding scheme’, and unique regulatory requirements for such schemes. This definition in the primary law is intended to replace the schemes formerly defined by subregulation 7.1.04N(3) (litigation funding schemes). Part 2 removes the definition of litigation funding schemes in subregulation 7.1.04N(3), and replaces references to these schemes with references to class action litigation funding schemes where necessary. The amendments in Part 2 only commence when and if the Amendment Act commences.

Part 3 of Schedule 1 to the Regulations updates the AFS licence condition introduced in Part 1 to operate with respect to a class action litigation funding scheme rather than a litigation funding scheme. Following the commencement of the Amendment Act, licensees that deal in an interest in a class action litigation funding scheme must ensure the legal representative for the plaintiff in any action the entity funds does not hold a material financial interest in the licensee funder. The amendments in Part 3 only commence when and if the Amendment Act commences.

Sections 1 to 4, and Part 1 of Schedule 1 to the Regulations commence the day after the instrument is registered on the Federal Register of Legislation.

Parts 2 and 3 of Schedule 1 commence on either the day after the instrument is registered, or the day the Amendment Act commences. Parts 2 and 3 do not commence at all if the Amendment Act does not commence.

The Corporations Act does not specify any conditions that needs to be met before the power to make the Regulations may be exercised.

Treasury released an exposure draft of the proposed Regulations with respect to the new AFS licence condition for public consultation between 30 September 2021 and 6 October 2021. As a result of the consultation minor amendments were made to the proposed Regulations. The Amendment Act also underwent consultation at the same time, the need for the amendments in Part 2 arose as a result of submissions received during consultation.

The Office of Best Practice Regulation considers that the proposal is unlikely to have a more than minor regulatory impact. Therefore, a Regulatory Impact Statement (RIS) for these Regulations is not required. In relation to Part 2 of the Regulations, the supplementary RIS for the measures in the Amendment Act can be found in Attachment A to the Explanatory Memorandum to the Bill for the Amendment Act.¹

Details of the Regulations are set out in Attachment A

A statement of Compatibility with Human Rights is at Attachment B

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

¹ Available at https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6802_ems_79dbb4de-7531-403d-bc80-7fb484636ae4/upload_pdf/JC003896.pdf;fileType=application%2Fpdf

Details of the Corporations Amendment (Litigation Funding) Regulations 2021

Section 1 – Name of the Regulations

This section provides that the name of the Regulations is the *Corporations Amendment (Litigation Funding) Regulations 2021* (the Regulations).

Section 2 – Commencement

Sections 1 to 4 and Schedule 1 Part 1 to the Regulations commence on the day after the instrument is registered on the Federal Register of Legislation. Parts 2 and 3 of Schedule 1 commence on either the day after the instrument is registered, or the day the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Act 2021* (Amendment Act) commences, whichever is later. Parts 2 and 3 do not commence at all if the Amendment Act does not commence.

Section 3 – Authority

The Regulations are made under the *Corporations Act 2001* (the Corporations Act).

Section 4 – Schedule

This section provides that each instrument that is specified in the Schedules to this instrument will be amended or repealed as set out in the applicable items in the Schedules, and any other item in the Schedules to this instrument has effect according to its terms.

Schedule 1 – Amendments Corporations Amendments (Litigation Funding) Regulations 2021

Class action litigation funding schemes involve an entity that is not a party to the litigation (a third-party litigation funder) paying the costs of litigation and indemnifying parties from adverse costs orders in return for a share of the proceeds if the litigation is successful.

The *Corporations Amendment (Litigation Funding) Regulations 2020* commenced on 22 August 2020. The amendment regulations removed the pre-existing exemption to the Managed Investment Scheme (MIS) regime that applied to class action litigation funding regimes but maintained the exemption for other types of litigation funding schemes and litigation funding arrangements. The amendments introduced in those regulations required entities that deal in an interest in a litigation funding scheme that fund class actions to hold an AFS licence and to comply with the MIS regime, ensuring greater regulatory oversight and accountability. Those amendments created a definition for litigation funding schemes that fund class actions in subregulation 7.1.04N(3) for the purposes of applying the AFS licensing regime to such schemes.

A MIS is a scheme that enables a group of investors to contribute consideration that is pooled for investment to produce a financial benefit. Chapter 5C of the Corporations Act contains provisions regulating MISs, which include providing for registration requirements for certain schemes. An interest in a MIS is a financial

product (see section 764A of the Corporations Act). Insolvency litigation funding schemes and litigation funding arrangements (defined in Chapter 5C of the Corporations Regulations) are exempt from the MIS requirements and the requirement for the entity to hold an AFS Licence.

The Amendment Act implements the Government response to certain recommendations of the Report of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Litigation funding and the regulation of the class action industry.² The Amendment Act establishes a new type of MIS called a ‘class action litigation funding scheme’.

Part 1 – Licence Condition

Item 1 (Amendment to subregulation 7.6.01AB(2) obligations on persons providing exempt financial services)

Section 911A(2)(k) of the Corporations Act provides that entities providing services in relation to certain financial products do not need to hold an AFS licence if the provision of services is covered by an exemption prescribed in the Corporations Regulations.

Subregulations 7.6.01(1)(x) and (y) exempt a service provider in relation to an insolvency litigation funding scheme and a litigation funding arrangement, as defined in Chapter 5C of the Corporations Regulations, from the requirement to hold an AFS Licence. Interests in these schemes are financial products (see regulation 7.1.04N). However, since these schemes pose a lesser regulatory risk due to their contained and specific functions, an entity that is the funder in these schemes does not need to hold an AFS Licence. The entity does however need to comply with specific requirements outlined in the Corporations Regulations concerning the management of conflicts of interest.

Subregulation 7.6.01AB(1) modifies the Corporations Act to insert subsection 911A(5C) into the Act to allow regulations to prescribe certain requirements relating to adequate practices and procedures for managing conflicts of interest in relation to entities that provide services for insolvency litigation funding schemes and litigation funding arrangements.

Item 1 amends subregulation 7.6.01AB(2)(a) of the Corporations Regulations to update these requirements. In addition to requiring entities to have adequate practices and procedures for managing conflicts of interest, subregulation 7.6.01AB(2)(a) now provides that entities that deal in such schemes must also have adequate practices for ensuring that a lawyer providing services in relation to the scheme, or the lawyers spouse or dependent children, does not have and does not obtain a material financial interest in the entity.

This additional requirement ensures consistency across how such interests are dealt with between entities that are not required to hold an AFS Licence, and entities that are required to hold an AFS Licence. These amendments align with the new

² See:

https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Litigationfunding/Report

condition placed on the AFS Licence of an entity that deals in an interest in a litigation funding scheme (see items 2 and 3 below). Adding this requirement to exempt litigation funders will help encourage consistent standards for managing such conflicts of interest across the industry.

Items 2 and 3 (Amendments to subregulation 7.6.04(1) and (2) to introduce an additional condition on Australian financial services licences for class action litigation funders)

Section 914A(8) of the Corporations Act allows regulations to prescribe the conditions of holding an AFS Licence.

Items 2 and 3 puts a condition on AFS Licences of licensees that deal in an interest in a litigation funding scheme, which funds a class action proceeding. The condition ensures that while the litigation funding scheme operates, the lawyer for the scheme does not hold a material financial interest, directly or indirectly, in the litigation funder (the licensee). It is a condition on the AFS licence of the funder that, if a lawyer providing services for the scheme has or obtains a financial interest in the scheme then the licensee must, as soon as they are made aware that the lawyer holds such an interest, ensure the lawyer ceases providing legal services for the scheme or relinquishes their interest.

The lawyer's interest needs to be a material financial interest. It is intended that this term covers interests that are more than incidental. The condition applies regardless of whether the lawyer holds the interest directly or indirectly, as a beneficial interest, through an arrangement with another party. The obligations on the licensee also apply in relation to the lawyer for the scheme if anyone in the lawyer's immediate family holds an interest in the licensee litigation funder. This includes the lawyer's spouse and any dependent children.

A failure by a licensee to comply with the obligations of an AFS licence may result in the suspension or cancellation of an AFS licence by the Australian Securities and Investments Commission.

If these amendments are not made, there is a risk, in a proceeding funded by a litigation funder, that the lawyer for the funded plaintiff may hold a material financial interest in the litigation funder. In this situation, the lawyer would stand to gain from the fees charged in relation to the action, and from the profits made by the funder as a result of its commission or fee. This condition is being imposed to protect the interests of the plaintiffs in class action proceedings. The new licence condition ensures plaintiffs are not disadvantaged by legal representatives holding a material financial interest in the funder, and therefore possibly not acting in the best interests of the plaintiffs.

These additional obligations for licensees commence the day after the Regulations are registered on the Federal Register of Legislation.

Part 2 – Class action litigation funding schemes

Items 5, 6, 7 and 8 (Amendments to subregulations 5C.11.01(4) and (5), subregulations 7.1.04N(3) and (4) and subregulation 7.1.06(2A))

Part 2 of Schedule 1 to the Regulations amends certain provisions in Chapter 7 of the Corporations Regulations to omit the former definition of litigation funding scheme in subregulations 7.1.04N(3) and (4) and where appropriate, replace those references with a reference to a class action litigation funding scheme. These amendments are

largely technical changes to ensure the definition of class action litigation funding scheme is used consistently between the Corporations Act and the Corporations Regulations, once the Amendment Act commences.

Items 6 and 7 omit the definition of litigation funding scheme in subregulation 7.1.04N because the definition of such is superseded by the definition of class action litigation funding scheme as introduced by section 9AAA of the Amendment Act. An interest in a class action litigation funding scheme does not need to be declared to be a financial product in this regulation because a class action litigation funding scheme is a new type of MIS. An interest in a MIS is a financial product and any entity dealing in such products is required to hold an AFS licence that allows them to deal in the product.

Item 5 replaces references to schemes defined in 7.1.04N(3) with references to a class action litigation funding scheme, with the effect of clarifying that insolvency litigation funding schemes and litigation funding arrangements defined in Chapter 5C of the regulations are not class action litigation funding schemes.

Subregulation 7.1.06(2A) declares specific things that are not credit facilities. Item 8 of the Regulations removes the reference to litigation funding schemes defined in subregulation 7.1.04N(3) and declares that a class action litigation funding scheme is not a credit facility. Without this amendment, class action litigation funding schemes could be considered to be credit facilities and interests in these schemes therefore excluded from being treated as a financial product under the Corporations Act due to the decision of the High Court in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45.

Part 2 of Schedule 1 to the Regulations commences on the same day as the commencement of the provisions of the Amendment Act. Part 2 does not commence if the Amendment Act does not commence because there will not be a need to provide for class action litigation funding schemes if such schemes are not established by the Amendment Act.

Part 3 – Licence condition in relation to class action litigation funding schemes Items 9 and 10 (Amendments to subregulations 7.6.04(1) and (2A))

Part 3 of Schedule 1 to the Regulations applies the additional AFS licence condition introduced in Part 1 to entities that deal in an interest in a class action litigation funding scheme, as defined in the Amendment Act, once the Amendment Act commences, rather than to schemes defined in subregulation 7.1.04N(3). AFS licensees that deal in class action litigation funding schemes will need to ensure that lawyers acting for the plaintiffs in these schemes do not hold an interest in the licensee.

If the Amendment Act does commence, items 9 and 10 amend the provisions introduced in items 2 and 3 of Part 1 to apply the new condition to licensees that deal in class action litigation funding schemes.

Part 3 of Schedule 1 commences immediately after the Amendment Act commences. It does not commence at all if that Act does not commence.

**Application of Parts 1 and 3
Items 4 and 12 (Regulations 10.47.01 and 10.47.02)**

Item 4 provides that the new licence condition applies to licensees that deal in schemes that meet the definition of a litigation funding scheme defined in subregulation 7.1.04N(3) on and after the commencement of Part 1, whether or not the scheme existed before or after the commencement of Part 1. This means that a licensee must comply with the condition in relation to any scheme which currently operates, or begins operating, on and from the commencement of Part 1.

When the Amendment Act commences, Parts 2 and 3 of Schedule 1 also commence. Item 11 provides that the AFS licence condition introduced in items 2 and 3, apply to schemes that were litigation funding schemes defined by subregulation 7.1.04N(3), and after the commencement of the Amendment Act, are class action litigation funding schemes. This means if a scheme was a litigation funding scheme before commencement of the Amendment Act, and after commencement is now a class action litigation funding scheme, the licensee must comply with the licence condition regardless of when the scheme was set up. The condition also applies to class action litigation funding schemes that are entered into after the commencement of the Amendment Act.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment (Litigation Funding) Regulations 2021

This Legislative 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*.

Overview of the Legislative Instrument

The Legislative Instrument introduces further regulation for Australian financial services licensees dealing in litigation funding schemes which fund class actions. The amendments introduce an additional condition on the Australian Financial Services Licence (AFS Licence) of a litigation funding entity that deals in litigation funding schemes that fund class action (the licensee) to prevent legal representatives of the plaintiff in a funded action from having or obtaining a material financial interest in the litigation funder for that action.

The Legislative Instrument also makes technical changes to the *Corporations Regulations 2001* to take effect following the commencement of the *Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Act 2021*.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.