

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.

The purpose of the *Corporations Amendment (Litigation Funding) Regulations 2021* (the Regulations) is to include new conditions on the Australian Financial Services License (AFSL) of a litigation funding entity 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 Regulations also include an obligation for persons providing an exempt financial service to maintain adequate practices for managing conflicts of interest and ensuring lawyers providing services in relation to the exempt scheme do not have or obtain a material financial interest in the scheme.

The *Corporations Amendment (Litigation Funding) Regulations 2020* (the amendment regulations) 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 amendment regulations require entities that deal in class action litigation funding schemes to hold an AFSL and to comply with the MIS regime, ensuring greater regulatory oversight and accountability.

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.

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.

The amendments impose additional conditions on the AFSL of licensees that deal in class action litigation funding schemes. These conditions further regulate class action litigation funders to ensure that lawyers providing services in relation to the scheme do not hold or obtain a material financial interest in the litigation funding entity funding the class action. These conditions ensure there are adequate practices in place to ensure that lawyers providing services in relation to the scheme do not hold a material financial interest in the licensee. The conditions also prescribe that if the licensee becomes aware of such an interest, that action is taken by the licensee to ensure that the lawyer stops providing services or relinquishes the interest. These

conditions protect the interests of the plaintiffs in proceedings to ensure they are not disadvantaged by lawyers providing services in relation to the scheme holding a financial interest in the funder. Failure to comply with these obligations may result in the suspension or cancellation of an AFSL.

Certain litigation funding schemes are exempt from the MIS requirements and requirement for the entity to hold an AFSL. These exempt schemes include litigation funding arrangements and insolvency litigation funding schemes. The amendments impose additional obligations consistent to the conditions. These obligations ensure that there are adequate practices in place for the management of conflicts of interest that may arise in relation to the scheme. The obligations also ensure that a lawyer providing services in relation to the scheme or arrangement does not have or obtain a material financial interest in the scheme. A contravention of this obligation can result in a penalty.

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

Details of the Regulations are set out in [Attachment A](#)

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

The Regulations commenced on the day after the instrument is registered.

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

Schedule 1 to the Regulations commence on the day after the instrument is registered on the Federal Register of Legislation.

Section 3 – Authority

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

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

Item 1 amends sub-regulation 7.6.01AB(2)(a) to ensure that financial services funding schemes exempt from the MIS and AFSL requirements have adequate practices for managing conflict of interests for activities undertaken in relation to the actions they fund. It also places an obligation on the lawyers providing services in relation to these schemes to ensure they do not have a material financial interest in the scheme and that they do not obtain one.

Items 2 and 3 (Amendments to subregulation 7.6.04(1) and (2) conditions on Australian financial services licence for litigation funding schemes to prevent conflict of interest)

Items 2 and 3 place a condition on an AFSL for licensees that deal in class action litigation funding schemes, to ensure that through the duration of the scheme, the legal service provider does not have a material financial interest in the litigation funder. It is a condition on the AFSL of such a funder that, if a lawyer providing services for the scheme does have 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 stops providing such services or relinquishes the interest. The lawyer's interest needs to be a material financial interest. It is intended that this term covers the lawyer's own interests, as well as any interests in the licensee that may be held by the lawyer's family members or close associates.

Subsection 914A(8) of the Corporations Act provides that an AFSL is subject to conditions prescribed by regulation. Failure to comply with the imposed obligations

may result in the suspension or cancellation of an AFSL by the Australian Securities and Investments Commission (ASIC).

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. 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 the funder's profit via its commission or fee. These conditions are being imposed to regulate litigation funders required to hold an AFSL in order to protect the interests of the plaintiffs in proceedings to ensure they are not disadvantaged by legal representatives holding a financial interest in the funder.