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UPDATE ON LITIGATION FUNDING REGULATION

In my article on 12 June 2020, I referred to the Government's plans to require litigation funders to obtain an Australian Financial Services License (AFSL) and to be subject to the managed investment scheme regulatory regime. I supported the reforms as a means of increasing the transparency of litigation funding arrangements, which could potentially alleviate the distrust of funders by corporates and insurers in Australia.

So what has happened since then? The short answer is "a lot".

The requirement for litigation funders to hold an AFSL and for litigation funding schemes to generally be subject to the managed investment scheme (**MIS**) regime under the *Corporations Act 2001* commenced on 22 August 2020.

At the time of writing this article, of the approximately 10 major funders in the Australian market, there were only 6 who to my knowledge had obtained an AFSL. This suggests that the market consolidation predicted in my previous article, with some funders exiting the Australian market, appears to have happened, at least in the short term.

There has not yet been a managed investment scheme commenced in Court, so these reforms have not yet been tested.

In the interim, ASIC has issued three separate relief instruments to assist with managing the litigation funding industry's transition to the new regulatory regime. This includes relief for responsible entities of litigation funding managed investment schemes from certain requirements (such as the requirement to give product disclosure statements to passive general members, the obligation to regularly value scheme property etc). ASIC has also issued a consultation paper regarding the workability of the MIS regime for litigation funding schemes, and has foreshadowed further relief.

The most significant impact of these developments has been a marked decrease in the number of class actions funded by litigation funders. In 2019 59% of class actions were known to have received third party funding. In 2020 the figure was approximately one third. And this is against the backdrop of 2020 seeing more class actions filed than any previous year. Tellingly, 11 class actions were filed in the 48 hours prior to the introduction of the funding regulatory reforms.

The decrease in class actions funded by litigation funders appears to have been offset by an increase in class actions funded by law firms in Victoria, where from August 2020 contingency fees have been permitted.

Further reform of the litigation funding industry, including reforms to make the MIS regime fit for purpose for litigation funding arrangements, appears likely.

The Parliamentary Joint Committee on Corporations and Financial Services report into 'Litigation funding and the regulation of the class action industry' was published in December 2020. The report made 31 recommendations which have not, to date, been adopted by the Government. A key focus of the report is increasing the transparency of litigation funders (a theme from my last article). For example the report notes that the litigation funding industry "*requires much higher degrees of transparency to assure Australians the legal system their taxes fund is not being hijacked for profit.*"

The recommendations include that the Government legislate a fit-for-purpose MIS regime tailored for litigation funders.

A related development which may ultimately reduce the number of shareholder class actions in Australia occurred on 13 August 2021, when the *Treasury Laws Amendment (2021 Measures No. 1) Bill 2021* received Royal Assent. The bill permanently amends continuous disclosure obligations so that companies and their officers will now only be liable in civil proceedings in respect of alleged breaches of continuous disclosure obligations where they have acted

with 'knowledge, recklessness or negligence'. Previously there was no element of fault required. Requiring a fault element brings Australia more into line with the US and the UK.

There are rapid changes occurring across the class action and litigation funding landscape in Australia. It remains to be seen whether, once the storm has passed, Australia will have a fit for purpose regime to regulate litigation funders which both facilitates access to justice and ensures litigation funders are held to high standards of conduct and transparency.

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