HFW LITIGATION

JUNE 2020

AUSTRALIAN PARLIAMENTARY INQUIRY INTO THE CLASS ACTION INDUSTRY

Class actions financed by litigation funders loom large in the Australian legal landscape. On 5 March 2020, the Morrison government announced a wide-ranging inquiry into the regulation of class actions and the litigation funding industry. The terms of reference were specifically expanded on 13 May 2020 to include *"the potential impact of Australia's current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic."*

Against this backdrop, greater regulation of litigation funders appears inevitable and, indeed, has already occurred. On 22 May 2020, the Federal Treasurer announced that litigation funders will be subject to greater regulatory oversight by requiring them to hold an Australian Financial Services License (AFSL) and to comply with the managed investment scheme regime in the Corporations Act 2001 (the Act). Litigation funders will have three months to obtain an AFSL.

So what will these changes mean for the litigation funding industry?

For the litigation funders who already hold an AFSL these changes will do no more than level the playing field. For other funders, the additional requirements are likely to have a significant impact and may even produce a consolidation of the litigation funding market in Australia. To the extent that the changes increase the transparency of litigation funding arrangements and ensure that funders are able to meet their funding commitments, they should be welcomed.

Parliamentary inquiry into class actions

The Parliamentary Joint Committee on Corporations and Financial Services has been given broad terms of reference to examine all aspects of the class action system, including whether further regulation of litigation funders is needed to improve justice outcomes. The terms of reference also include the consequences of allowing Australian lawyers to enter into contingency fee arrangements, on the back of a bill that has been introduced by the Victorian government which will allow contingency fees to be paid to plaintiff law firms in class action proceedings.

Submissions to the inquiry are due on 11 June 2020, hearings will be held in July, and the Committee is due to report on 7 December 2020.

Requirement to hold an AFSL and comply with the managed investment scheme regime

The regulatory changes will be achieved by amending the *Corporations Regulations 2001* (the Regulations). While little detail has been provided regarding the proposed amendments, it is likely that the existing exemption for litigation funding schemes from the definition of a managed investment scheme and from the requirement to hold an AFSL in certain circumstances in the Regulations will be removed. Those exemptions were inserted into the Regulations following the Full Federal Court decision in *Brookfield Multiplex Ltd v International Litigation funding Partners Pte Ltd* [2009] FCAFC 147 where the Court held that the litigation funding arrangements between the funder and group members constituted a managed investment scheme and the scheme was not registered but should have been.

As a holder of an AFSL, litigation funders will be subject to such requirements as:

- Ensuring that the financial services covered by their licenses are provided efficiently, honestly and fairly;
- Having available adequate resources to provide the services covered by their license; and
- Maintaining an appropriate level of competence to provide financial services.

Litigation funders are already required to have in place adequate arrangements for the management of conflicts of interest.

Further, where interests in litigation funding schemes are offered to retail clients, it will generally be the case that managed investment schemes will need to be registered under Chapter 5C of the Act. Operators of a registered managed investment scheme in Australia as holders of an AFSL are subject to various solvency requirements and must audit compliance with these requirements annually or when ASIC requests. They must also be operated by a responsible entity which is an Australian public company registered with ASIC.

Finally, offshore funders (of which there are many operating in Australia) will need to consider the foreign financial services licensing regime.

Take-aways

It's too soon to tell what broader measures will emerge from the parliamentary inquiry on class actions and litigation funding. However, the related announcement that litigation funders will be required to hold an AFSL and be subject to the managed investment scheme regime in the Corporations may prove to be a positive development. There is a level of distrust of litigation funders by corporates and insurers in Australia as a result of years of escalating numbers of class actions and rising directors' and officers' insurance premiums. Greater regulation of litigation funders has the potential to go some way towards remedying this distrust. At the very least, it will increase the transparency of litigation funding arrangements and will also ensure that unscrupulous operators are not allowed to muddy the waters for those litigation funders who are doing the right thing.

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HFW will be hosting a webinar on *'A comprehensive guide to litigation funding: what clients need to know'* on 25 June 2020. To register, please click **here**.

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