

# FUNDED CLASS ACTIONS UNDER THE SPOTLIGHT: AUSTRALIAN FEDERAL GOVERNMENT INTRODUCES NEW REGULATIONS

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Legal Briefings - By **Jason Betts, Fiona Smedley, Christine Tran, Ruth Overington, Yorick Ng and Oliver Cook**

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On 24 July 2020, the Australian Federal Government introduced new regulations, removing the 'managed investment scheme' (**MIS**) and other financial services regulatory exemptions that apply for litigation funding schemes used in class actions.

Under these regulations, certain litigation funding schemes and arrangements entered into on or after 22 August 2020 will be subject to increased regulatory oversight and accountability.

It is anticipated that class actions supported by litigation funders would fall within this category, and therefore third party litigation funders will generally need to hold an Australian financial services licence (**AFSL**).

The regulations give effect to the [Government's recent announcement on 22 May 2020](#) that it intends to subject litigation funders *"to greater regulatory oversight by requiring them to hold an Australian Financial Services Licence (AFSL) and comply with the managed investment scheme regime."*

## BACKGROUND: THE PREVIOUS EXEMPTION FOR CLASS ACTION LITIGATION FUNDING ARRANGEMENTS

In 2009, a 2-1 majority in the Full Federal Court held that a third party litigation funding arrangement could (and in that specific case, did) meet the definition of a MIS and did not fall within any of the specific exemptions at the time: *Brookfield Multiplex v International Litigation Funding Partners Pte Ltd* (2009) 260 ALR 643.

The legislature promptly responded to this decision by introducing an express exemption for all litigation funding schemes and arrangements from the definition of a MIS and exemptions from AFSL and disclosure requirements (among other things).

The new regulations repeal and replace those exemptions in relation to class action litigation funding, resulting in more limited exemptions and greater regulation of class action litigation funding.

## **THE NEW, MORE LIMITED, EXEMPTIONS**

The amended and more limited exemptions are set out in [Corporations Amendment \(Litigation Funding\) Regulations 2020 \(Cth\)](#).

Under the new regulations, on the removal of a number of exemptions from financial product regulation that were previously available to class action litigation funding arrangements, those funding arrangements will become subject to a range of regulatory requirements applicable to financial products generally. These include:

- a. entities who deal in, or give advice in relation to, financial products must hold an AFSL for that type of product (or be exempt from holding an AFSL) and comply with their AFSL conditions and duties including to:
  1. have adequate arrangements to manage conflicts;
  2. report significant breaches of financial services laws to ASIC; and
  3. act fairly, efficiently and honestly;
- b. those entities must also comply with all the regulatory requirements applicable to their financial product activities, for example the best interests duty if they give personal advice; and

c. if the financial product is available to retail clients, the following obligations will also apply:

1. giving a product disclosure statement (**PDS**). The PDS must contain a range of prescribed disclosures including in relation to fees, risks and benefits, which will drive a greater transparency in relation to funding arrangements;
2. anti-hawking obligations;
3. from 5 October 2021, product design and distribution obligations;
4. intervention orders where litigation funding arrangements (or particular characteristics of an arrangement) result in or will likely result in significant detriment to retail clients; and
5. ongoing continuous disclosure and significant event disclosure obligations.

In addition to the above, litigation funding schemes and arrangements for class actions are removed from the MIS exemptions, but the MIS exemption for litigation funding for insolvency and individual claims remains.

'Managed investment scheme' is broadly defined under the *Corporations Act 2001* (Cth) as a scheme that has the following features:

- d. people contribute money or money's worth as consideration to acquire rights (**interests**) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
- e. any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the **members**) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);
- f. the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

The definition also sets out a number of carve-outs, to expressly exclude certain arrangements (such as a body corporate, a franchise, an unincorporated partnership of more than 20 partners) from being captured within its broad scope.

Whether or not a litigation funding arrangement in any given class action is a MIS (in addition to being categorised as a financial product) will need to be considered on the facts specific to that arrangement.

If the litigation funding arrangement meets the MIS definition and the proposed participants are retail clients, it will be subject to additional regulatory requirements. These include:

- a. registration requirements and ongoing compliance requirements for operating the MIS. This includes having a compliance plan, regulating members withdrawing from the MIS and having an enforceable constitution for the MIS with prescribed content requirements;
- b. having a responsible entity in place to operate the MIS;
- c. the responsible entity complying with a range of statutory duties including the duty to act in the best interests of MIS members and to treat MIS members of the same class equally;
- d. the responsible entity's remuneration and indemnification only being available in relation to the proper performance of its responsible entity duties; and
- e. the responsible entity holding an AFSL authorising it to operate registered MISs and meeting minimum regulatory capital requirements.

The amendments do not apply in relation to schemes or arrangements entered into before 22 August 2020. This is intended to minimise potential disruption to existing arrangements and proceedings.

## **IMPLICATIONS**

These changes are substantive and not merely procedural, and are likely to have a profound impact on the Australian litigation funding market.

How a litigation funding arrangement is regulated as a financial product and whether it is a MIS is a fact-specific inquiry. Class actions come in all shapes and sizes. Fitting class actions into the regulatory framework for financial products, PDSs and MISs gives rise to some difficult and interesting questions. It will take time to assess those questions and may require clarification from the courts, ASIC exemptions or modifications and regulatory guidance from ASIC.

We expect to see a short term spike in class action filings and funding arrangements that are currently the subject of a bookbuild, under investigation or otherwise in the pipeline, to ensure they are finalised between now and 22 August 2020 to enable commencement of the class action before the regulatory exemptions for funded class actions are removed.

We may also see a temporary disruption on class actions models funded by third party litigation funders as they obtain new AFSLs or vary existing AFSLs in order to operate funding arrangements after 22 August 2020.

The reforms may further the current trend towards 'closed' funded class actions which are limited to those prepared to sign specific funding agreements.

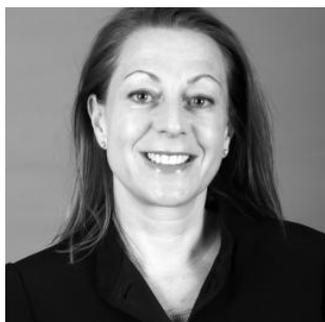
## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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