

EXPLANATORY STATEMENT

Select Legislative Instrument 2012 No. 172

Issued by the Minister for Financial Services and Superannuation

Subject - *Corporations Act 2001*

Corporations Amendment Regulation 2012 (No. 6)

The *Corporations Act 2001* (the Act) provides for the regulation of corporations, financial markets, products and services, including in relation to licensing, conduct, financial product advice and disclosure.

Subsection 1364(1) of the Act provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations, or necessary or convenient to be prescribed by such regulations for carrying out or giving effect to the Act.

The *Corporations Amendment Regulation 2012 (No. 6)* makes a number of amendments to the *Corporations Regulations 2001*. The amendments clarify that litigation funding schemes, as well as similar arrangements, are not managed investment schemes (MIS) under section 9 of the Act.

Litigation funding schemes are based on a person or entity that is not a party to the litigation and has no direct interest in its outcome paying the costs of litigation in return for a percentage share of the proceeds if the litigation is successful. Litigation funding schemes are used in both individual proceedings and in class actions (a form of lawsuit where a large group of people collectively bring a claim to court).

On 20 October 2009, the Federal Court decided in *Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (2009) 260 ALR 643 that funded class actions are managed investment schemes (MIS) as defined in the Act. Prior to the decision, funded litigation and class actions generally were not understood to be subject to regulation under the Act.

The Federal Court's decision would have imposed a wide range of requirements that apply to MIS, such as registration, licensing, conduct and disclosure requirements on litigation funders and their arrangements with their clients. The Government considers that these requirements are not appropriate for litigation funding schemes. The Government supports class actions and litigation funders as they can provide access to justice for a large number of consumers who may otherwise have difficulties in resolving disputes. The Government's main objective is therefore to ensure that consumers do not lose this important means of obtaining access to the justice system.

The Regulation therefore exempts litigation funding schemes from the definition of a MIS in the Act. In order to clarify that these arrangements are also not financial products as defined in Chapter 7 of the Act, the Regulation also provides exemptions from the licensing, conduct and disclosure requirements in that Chapter. The Regulation also addresses potential conflicts between the interests of litigation funders and their clients in certain situations, for example when assessing proposed awards or settlements.

The Commonwealth consulted publicly on drafts of the Regulation between late July and August 2011, and between December 2011 and January 2012.

Under the Corporations Agreement 2002 (the Corporations Agreement), the State and Territory Governments referred their constitutional powers with respect to corporate regulation to the Commonwealth. The Legislative and Governance Forum for Corporations (meeting as the Ministerial Council for Corporations) has been consulted about the Regulation as required by clause 506(1) of the Corporations Agreement. However, paragraph 507(1)(f) and subclause 511(2) of the Corporations Agreement provide that approval of the Council and the usual public exposure period are not required for amendments to regulations relating to financial products and services.

Details of the Regulation are set out in the Attachment.

The Act does not specify any conditions that need to be satisfied before the power to make the Regulation may be exercised.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

Details of the Corporations Amendment Regulation 2012 (No. 6)

Section 1 – Name of Regulation

This section specifies the name of the Regulation as the *Corporations Amendment Regulation 2012 (No. 6)*.

Section 2 – Commencement

This section provides for Schedule 1 to the Regulation to commence the day that is 6 months after registration.

Section 3 – Amendment of the Corporations Regulations 2001

This section provides that Schedule 1 amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1 – Amendments

Item 1, pursuant to paragraph (n) of the definition of managed investment scheme in section 9 of the *Corporations Act 2001* (the Act), excludes a litigation funding scheme from the definition of a managed investment scheme. It also excludes certain types of other schemes such as an approved benefit fund and schemes relating to an externally-administered body corporate.

The definition includes the key elements of a litigation funding scheme, which are that members of the action are obtaining funding from a third party to pay for legal services in order to seek remedies based on either similar circumstances giving rise to common issues of law or fact, or are otherwise appropriately dealt with together.

Items [2], [3] and [4] correct minor typographical and punctuation errors.

Item [5] ensures that any person providing a financial service in relation to a litigation funding scheme (as defined in regulation 5C.11.01) or any lawyer providing a financial service on a contingency fee basis does not need to obtain an Australian financial services licence. A contingency fee arrangement is an agreement pursuant to which payment of a lawyer's fee is contingent on the success of the litigation. The definition of financial services in the Act in sections 9 and 766A includes providing advice for a financial product and dealing in a financial product.

Item [6] requires a person to maintain adequate arrangements for managing conflicts of interest and follow the written procedures for the duration of the litigation funding scheme. It further provides that a person breaching those requirements is committing an offence.

Item [7] exempts financial services licensees and authorised representatives of licensees from the requirement to comply with the requirements in Part 7.7 of the Act when they offer a financial service in relation to a litigation funding scheme which is defined in regulation 5C.11.01 under Item [1]. Part 7.7 contains a range of disclosure and other requirements.

Item [8] provides an exemption from the anti-hawking provisions (which regulate the making of unsolicited invitations to sell financial products) in section 992A of the Act for a litigation

funding scheme as defined in regulation 5C.11.01 under Item [1]. These provisions would have, if this exemption was not provided, prohibited litigation funders from making unsolicited invitations to persons to become a member of a class action or other litigation funding scheme. This is particularly important for class actions, whose viability may depend on being able to canvass and invite large numbers of potential litigants to participate.

Item [9] provides an exemption from the provisions in Part 7.9 of the Act for anyone issuing or selling or recommending the acquisition of or advertising a financial product in relation to a litigation funding scheme as defined in regulation 5C.11.01 under Item [1]. Part 7.9 contains a range of requirements relating to product disclosure, periodic reporting and other matters. These are not considered to be suited to the circumstances of litigation funding schemes, as they were mainly designed for the requirements of investment products.

Item [10] provides an exemption from the provisions in Part 7.10 of the Act for anyone providing a financial service in relation to a litigation funding scheme as defined in regulation 5C.11.01 under Item [1]. Part 7.10 contains a range of miscellaneous requirements, including a general prohibition on engaging in misleading or deceptive conduct. The exemption provides consistency with the other exemptions from the Chapter 7 provisions. Litigation funders are subject to the general consumer protection provisions in the *Competition and Consumer Act 2010* and the *Australian Securities and Investments Commission Act 2001* in matters such as unconscionable or misleading conduct.

Statement of Compatibility with Human Rights

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

Corporations Amendment Regulation 2012 (No. 6)

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 purpose of the Legislative Instrument is to exempt litigation funding schemes from the definition of ‘Managed Investment Scheme’ in the *Corporations Act 2001*. Under a litigation funding scheme, entities which are not a party to the litigation and have no direct interest in its outcome pay for the costs of litigation in exchange for a percentage share of the proceeds if the litigation is successful. These schemes are different in kind from the managed investment schemes regulated under the Corporations Act and it is inappropriate to apply the Act’s requirements to litigation funding schemes. Litigation funding schemes are used in both individual proceedings and in class actions, which are a form of lawsuit where a large group of people collectively bring a claim to court.

Human rights implications

This Legislative Instrument engages Article 14 of the International Covenant on Civil and Political Rights. Article 14 guarantees that all persons shall be entitled to a fair and public hearing by a competent, independent and impartial tribunal established by law in the determination of his rights and obligations in a suit at law. This regulation promotes access to justice by providing an alternative mechanism for plaintiffs to pursue their rights in court. This permits claims to be brought that might not otherwise have been brought in the absence of this reform. For example, the plaintiffs may lack the financial resources to finance their lawsuit or where the compensation for individual plaintiffs is likely to be too small to justify a lawsuit but where the compensation for the entire class is likely to be substantial.