


A licensing regime will improve the litigation funding system

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Let's give federal Treasury the benefit of the doubt.

Others may be less charitable. But let's accept that in advising the previous Labor government, Treasury was acting with the best of intentions when in 2010 it pushed through new commonwealth regulations in response to the Federal Court's Multiplex decision.

Something had to be done — and quickly. The October 2009 ruling that litigation funding arrangements constituted managed investment schemes as defined by the Corporations Act had up-ended the class action system.

The decision meant that, for the first time, litigation funding arrangements were dragged into the MIS regulatory net. If litigation funders were going to continue to operate, they would suddenly need to meet registration, licensing, conduct and disclosure requirements.

And that threw every existing — and potential — class action supported by a litigation funding arrangement into doubt.

An added complication came in March 2011 when the NSW Court of Appeal in the Chameleon Mining case ruled that a litigation funding agreement was a financial product as defined in the Corporations Act. Although the decision was later overturned by the High Court, at the time it was given it meant that funders were required to hold an Australian Financial Services Licence.

While some funders, including Omni Bridgeway (then called IMF Bentham), already held an AFSL, the Australian Securities & Investments Commission was forced to step in to provide temporary relief from the requirement for litigation funders to comply with the Corporations

Act (by means of an ASIC class order). This allowed funded class actions already under way to continue pending a more permanent solution.

Treasury's permanent solution, after extensive consultation with all stakeholders, was to end the uncertainty by introducing regulations that exempted litigation funding arrangements from the definition of an MIS and from the requirement to hold an AFSL. The regulations also required funders to have "adequate practices for managing" any potential conflicts of interest and a compliance regime was implemented through guidance issued by ASIC.

At the time, the government said it was driven by the need to preserve access to justice, particularly for consumers, by ensuring the role of litigation funders was not compromised by a heavy and unnecessary regulatory burden.

More recent critics of this decision claim it opened — or reopened — a floodgate for class actions by creating a largely unregulated industry that encouraged a proliferation of smaller litigation funders — including many from overseas attracted to the "light touch" Australian regime.

The number of litigation funders has increased since this 2010 decision, with about 25 now active in Australia. But as class action experts such as Monash University's Professor Vince Morabito has demonstrated, this increase has not led to the "explosion" in class actions in Australia claimed by the noisy opponents of litigation funders who have found their voice during the current parliamentary inquiry into litigation funding and the class action system.

And the significant oversight of litigation funding through existing regulations, the courts and other checks and balance — not the least of which is a lawyer's overriding obligation and fiduciary duty to their clients — have ensured high standards of accountability and behaviour by the vast majority of the industry.

However, the status of litigation funding as a largely unregulated industry has provided ammunition to critics and reignited calls for the reintroduction of a licensing regime — calls that have grown louder during the COVID-19 pandemic.

Omni Bridgeway has long supported the introduction of a licensing regime for all litigation funders operating in Australia. The company (as IMF Bentham) applied for and obtained an AFSL in 2005, believing at that time that litigation funding could be a financial product. We made submissions in support of licensing at the time of Treasury's 2010 consultation on the new conflicts regime, to the Productivity Commission on its inquiry into access to justice

arrangements in Australia's civil justice system in 2013 and, most recently, in our submission to the parliamentary inquiry.

Omni Bridgeway supports the proposal put forward by Treasurer Josh Frydenberg that all litigation funders operating in Australia obtain an AFSL. We are also consulting with ASIC about appropriate modifications to the MIS regime to ensure it is fit for the purpose of applying to funded class actions, including in relation to relief issued by ASIC on August 21.

Once it became clear that it was exempt from a licensing requirement, Omni Bridgeway gave up the licence we previously held in April 2013 but continued to comply with the regulations overseen by ASIC. We reapplied for an AFSL in the context of the current reforms and our application has been approved by ASIC subject to some standard pre-issue filing requirements. (We anticipate these will be met and the licence issued shortly.)

Omni Bridgeway agrees that the regulatory model in force since 2013 placed a light compliance burden on litigation funders and posed minimal regulatory requirements. In our view, a difficulty with this "light touch" approach is that there is no capital adequacy standard to guard against the risk of an undercapitalised funder failing to meet its financial obligations, which can be onerous when cases are lost (impacting the successful defendant owed its costs).

Not everyone is convinced a licensing regime is the right approach. As ASIC noted in its submission to the 2018 Australian Law Reform Commission inquiry into litigation funding and class actions: "We consider the courts are better placed to regulate litigation funders, through court rules and procedure, oversight and security for costs."

It added: "A requirement that a litigation funder obtain an AFS licence will not of itself mean that the funder will be adequately capitalised to meet adverse costs orders, continue to fund litigation or distribute funds to shareholders."

That is why Omni Bridgeway supports the introduction of a licensing regime that includes minimum onshore capital adequacy requirements, disclosure obligations and reporting standards. And we believe that any licensing requirements should be extended to law firms which act as funders of class actions, under "no win, no fee" or contingency fee arrangements.

Appropriately structured and applied, a licensing regime would benefit all parties — class action members, defendants and the courts — and act to increase confidence in the important Australian class actions system.

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