

## IMF's MIS Submission

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IMF#216117v1

## IMF's MIS Submission

1. IMF makes the following submissions in advance of the Treasury Class Actions Roundtable on 10 March 2010, addressing each of the Agenda items.

### A. Executive Summary

The Full Court decision in Brookfield<sup>1</sup> (the "Brookfield Decision") will either be left to stand or be overturned by the High Court of Australia in due course.

The real issues, however, for present discussion are not legal; rather they are matters of policy which are addressed in **section C** below.

IMF does not dispute that funded multi party claims raise regulatory issues; rather IMF submits that the MIS provisions are an inappropriate regulatory mechanism in their application to litigation funding arrangements where no money is provided up front and what is provided, being a promise to provide the funder with a share in the fruits of a cause of action, may turn out to be worthless (refer to **Attachment 3**).

The no win, no fee arrangement means that there is simply no scheme property and there is no situation where the property of the clients need to be protected. No clients take any risk during the procedure other than the risk that the funder will not be able to meet an adverse cost order.<sup>2</sup> That risk will not be ameliorated by treating the litigation funding arrangement as a scheme and requiring registration under Chapter 5C. It is ameliorated by licensing litigation funders, including capital adequacy terms and certification by audit opinion.

Regulation should be made (pursuant to section 601QB of the Corporations Act) modifying the operation of Chapter 5C to make it clear that Chapter 5C does not apply to multi party claims, including representative, group and test cases. Litigation is widely and effectively regulated in Australia on both a State and Federal level by legislation and by rules of Court. It is the funding of litigation which requires regulation, not litigation itself.

In **section G** below, IMF identifies why the licensing regime in Chapter 7 of the Corporations Act is an appropriate, existing structure capable of addressing most, if not all, regulatory concerns.

### B. Should The Brookfield Decision Be Left To Stand?

2. It is IMF's view that the judicial opinions of Finkelstein and Jacobsen JJ are preferable in a legal sense to those of Sundberg and Dowsett JJ. The Full court decision in Brookfield (the "Brookfield Decision") will, however, either be left to stand or be overturned by the High Court of Australia in due course.
3. The real issues for present discussion are not legal; rather they are matters of policy, namely, should the legislature or ASIC exempt multi party actions from the ambit of the managed investment scheme provisions of the Corporations Act.
4. Finkelstein J at first instance in the Brookfield case<sup>3</sup> said at paragraph 37:

The arrangements with the funder and [MBC] do not create a managed investment scheme. This should not come as a surprise. First, with the evident purpose of the

<sup>1</sup> Brookfield Multiplex Ltd v International Litigation Lending Partners Pte Ltd [2009] FCA FC 147

<sup>2</sup> This is the predominant reason why IMF, in providing funding to over 20,000 parties in multi party claims, has received no complaints.

<sup>3</sup> Brookfield Multiplex Ltd v International Litigation Lending Partners Pte Ltd (No.3) [2009] FCA 450

legislation in mind, the essence of a managed investment scheme, stripped of all its technicalities, is a scheme in which people invest money (or money's worth) in a common venture with the expectation of profit that will result from the efforts of others. That is not what has happened here.

5. The majority in the Brookfield Decision referred to this passage and then said at paragraph 29:

In our view, that statement as to the essence of a managed investment scheme is of little assistance in construing the Act and may be misleading. We have referred to the difficulties experienced by the Commission in seeking to identify with precision the subject matter of such a generalization. It abandoned the task as too difficult. With all respect, his Honour's approach seems not to recognize those difficulties. Further, it is difficult to infer an intention to exclude an undefined category of schemes which would otherwise be within para (a) of the s9 definition in light of the extensive list of express exclusions contained in the definition and the power to exclude or exempt others administratively.

6. Jacobsen J, whilst in the minority at paragraph 239 agreed with the majority on this point and said:

Whilst there may be practical difficulties in the discharge of the responsibilities of the responsible entity, for example, in relation to the valuation of the contractual promises, this is not a reason for reading down the meaning of the statutory definition because provision is made for exemptions of schemes which might unintentionally be caught by the definition: see s601QA; Australian Softwood Forests at 130; Knightsbridge Managed Funds at [49].

7. IMF is of the view that:

- (a) the Court in the Brookfield Decision saw the power of the legislature and ASIC to exclude or exempt from the legislation as a release valve which enabled the legislature to draft the managed investment scheme definition widely, knowing that it could exclude particular schemes if those schemes ought not be regulated as managed investments schemes; and
- (b) the legislature and ASIC should view multi party actions as unintentionally caught by the section 9 definition and as a result not to be viewed as schemes requiring regulation.

8. If the legislature is of the view that litigation funding arrangements for multi party claims ought to be regulated as managed investment schemes, then many arrangements going forward will exclude retail claimants and proceed solely for sophisticated and professional investors.<sup>4</sup>

### **C. The Policy Issues?**

9. Requiring registration of each and every scheme comprising a multi party action will add a layer of complexity and cost, likely to seriously impede the availability of multi party actions as a means to enforce market protection regulations. It may result in multi party actions not proceeding at all or only proceeding for the benefit of claimants who are sophisticated or professional investors.

#### **C1. Access to justice**

10. Multi party actions, and in particular funded multi party actions, provide access to justice, which is an important benefit for consumers in our markets and civil justice system. The

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<sup>4</sup> Refer to **Attachment 6** – IMF's ASX Announcement dated 8 March 2010.

President of the NSW Court of Appeal in *Fostif Pty Ltd v Campbells Cash and Carry Pty Ltd*<sup>5</sup> at paragraph 100 said:

These changes in attitude to funders have been influenced by concerns about access to justice and heightened awareness of the cost of litigation. Governments have promoted the legislative changes in response to spiralling costs of legal aid. Courts have recognised these trends and the matters driving them. “Ambulance chasing” still has negative connotations in many quarters, but it is now widely recognised that there are some types of claim that will simply never get off the ground unless traditional attitudes are modified. These include cases involving complex scientific and legal issues. The largely factual account in the book and film “A Civil Action” has demonstrated the social utility of funded proceedings, the financial risks assumed by funders, and the potential conflicts of interest as between group members in mass tort claims propounding difficult actions against deep-pocketed and determined defendants.

11. The decision of the NSW Court of Appeal was endorsed by the High Court.<sup>6</sup>
12. Access to justice will be curtailed and impaired should the Brookfield Decision stand without exemption being made for multi party actions.

## **C2. The importance of encouraging self regulation**

13. Multi party actions have an important role in compensatory enforcement of statutory market protections.
14. Commenting on the identification of cartel offences in the United States, William E Kovacic, general counsel of the Federal Trade Commission, said:

Private participation in monitoring the behavior of actors subject to the law can provide more effective detection of violations when the private monitor is closer than a public inspector to the relevant information.<sup>7</sup>

15. The chairman of the Australian Competition and Consumer Commission, Graeme Samuel, said in 2005:

There seems to be a growing recognition by victims of cartels that they are entitled to seek redress. This coincides with an increased interest from private legal firms (and litigation funders) to pursue such private claims. Compensating victims in private damages actions has been the norm in North America for some time. My expectation is that compensation is set to become more common in Australia too, and this will surely act as a further deterrent.<sup>8</sup>

16. Finkelstein J in *Multiplex*<sup>9</sup> noted the role of representative proceedings in acting as a deterrent when contemplating the circumstance of the representative proceeding ceasing and each group member being left to assert his rights alone is a likely outcome if the Brookfield Decision remains operative, and said:

Most will be forced to give up. That result is unfair for two reasons. It is unfair for those group members who will not be able to pursue any claim at all. It is also unfair because it would undermine the deterrent effect of the existence of sanctions for contraventions of the law regulating securities.<sup>10</sup>

<sup>5</sup> [2005] NSWCA 83

<sup>6</sup> *Campbells Cash and Carry v Fostif* [2006] HCA 41

<sup>7</sup> Kovacic W, “Private Participation in the Enforcement of Public Competition Laws”, speech to Third Annual Conference on International and Comparative Competition Law: The Transatlantic Antitrust Dialogue, May 2003.

<sup>8</sup> Samuel G, “The enforcement priorities of the ACCC”, speech to Competition Law Conference, 12<sup>th</sup> November 2005 at page 26.

<sup>9</sup> *P Davison Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061

<sup>10</sup> At paragraph 54.

### C3. Securities markets

17. Multi party actions have an important role to play in increasing the efficiency of securities markets, particularly those actions concerning continuous disclosure. Moreover, multi party actions are an important alternative to a publicly funded action conducted by ASIC on behalf of investors.

### C4. Scope of the issue

18. It is likely that almost every class, representative or group action currently conducted in Australia is caught by the Brookfield Decision; whether the funding is provided by the lawyers on the record or by a third party.
19. The proceedings will always be conducted by a law firm which is likely to contribute something to the scheme, such as deferred or contingent payment of some or all of its fees. The proceedings will always be funded by the members making cash contributions to the common enterprise, or by the law firm or a litigation funder or a hybrid of these options.
20. If the Brookfield Decision is left to stand it will always be possible to identify a managed investment scheme in these funding arrangements, however structured.
21. There is therefore a threshold question as to whether ASIC should be the regulator of multi party actions, having regard to ASIC's aims:
  - (a) to maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs and the efficiency and development of the economy;
  - (b) to promote the confident and informed participation of investors and consumers in the financial system; and
  - (c) to administer the Corporations Act with a minimum of procedural requirements.

### C5. Regulation by the Court and by statute

22. Multi party actions are generally conducted under statutory provisions giving the Court wide powers to determine who can be a group member and to supervise the proceedings including their funding.
23. Members of class actions are protected by the Court and by statute, in that:
  - (a) Class actions are regulated under the class action provisions of the *Federal Court of Australia Act 1976* and the equivalent State provisions. For example, the Federal Court has a general supervisory power to make *orders to ensure that "justice is done"* in s.33ZF. Section 33V makes clear that settlement or discontinuance cannot occur without the approval of the court. Any settlement must be fair, reasonable and adequate in the interests of the class members, which includes fairness as between members.
  - (b) Class actions are conducted by solicitors whose conduct is regulated by the *Legal Profession Acts* and by their duties as officers of the Court in the conduct of the litigation.
  - (c) The proceeds of a class action are received by a solicitor who has a statutory obligation to pay the monies into a regulated and audited trust account, which is also protected by a statutory compensation scheme.

## **C6. Practical self monitoring**

24. In practice consumers participating in multi party actions are protected due to others having the same interest as they do, (e.g. a large proportion by value of securities class actions comprise "sophisticated investors" some or all of whom are likely to monitor the performance of the funders and law firms). The law firms have an interest in ensuring that the litigation funder honours its commitment to pay fees and expenses, and the funder as a contributor has largely the same interest as the members of the scheme in ensuring that the litigation is pursued.
25. This self interest of parties other than "retail clients" gives those retail clients practical protection from compliance risk, and is a salient fact relevant to whether, and if so what, further regulation is necessary.

## **C7. Use of Resources**

26. There is a serious question whether the resources which will be required to apply Part 5C to multi party action schemes should be expended for that purpose, as there is limited countervailing regulatory benefit.
27. Industry participants could work with ASIC to apply Part 5C to multi party action schemes. However, the costs in doing so will be substantial. These will include legal and consultants fees and extensive executive time for industry participants.

## **C8. Consumer Investment Protection Policy Considerations**

28. The Brookfield Decision noted (at 32) that the following is a fair summary of the risks likely to be encountered by "investors":
- (a) investment or market risk – the risk that the investment will decline in value, either because the market as a whole declines in value or because the particular investments of the scheme decline in value;
  - (b) institution risk – the risk that the institution which operates the scheme will collapse; and
  - (c) compliance risk – the risk that the operator of a scheme will not follow the rules set out in the scheme's constitution or the laws governing the scheme; or will act fraudulently or dishonestly.
29. IMF submits that these risks are not minimized by requiring registration of multi party actions under Chapter 5C and accordingly are not a justification for the application of Chapter 5C.

## **C9. The Investment Risk**

30. The Brookfield Decision stated that the risk of decline in value of the investment was not particularly relevant to a litigation funding arrangement (at 32), but there may be a risk that claims will be devalued by:
- (a) a decline in the fortunes or asset position of the defendant to the litigation - (Registration of a litigation funding scheme under Part 5C of the Act is not capable of providing protection in respect of such a decline. IMF recognises that this risk raises disclosure issues – see clause 4.2 of IMF's Product Disclosure Statement (**Attachment 1**));

- (b) a decline in the fortunes or asset position of the litigation funder – Litigants have access to full financial information of each funder that is a disclosing entity. ASIC is also able to consider this issue in attaching conditions to each funder's AFSL. IMF's AFSL is at (**Attachment 2**). It contains capital adequacy requirements and certification by audit opinion; and
- (c) a decline in the fortunes or asset position of the law firm conducting the litigation – (Registration under Part 5C of the Act is not capable of mitigating such a decline. Regulating the financial position of law firms conducting litigation appears to be beyond ASIC's usual remit. In any event, if the law firm failed, a new law firm could be retained).

#### **C10. The Institution Risk**

- (a) This appears to raise the same issue which is addressed in the two immediately preceding subparagraphs about the possible financial failure of the funder or of the law firm.
- (b) Further, risk of financial failure of a counterparty is a risk in any contractual arrangement where credit is given or where there is to be future performance of an obligation by one or both parties. For example, a new car warranty may be worthless if the dealer fails.
- (c) Risk of financial failure of a counterparty is regulated extensively by insolvency laws aimed at minimising loss and inequities where a financial failure occurs.

#### **C11. The Compliance Risk**

- (a) As a disclosing entity IMF must provide full information about its financial position and prospects.
- (b) In practice, the law firm conducting the group litigation has an interest in overseeing compliance by IMF with the litigation funding arrangement because of its personal interest in being paid its fees and because of their fiduciary duties to their clients.
- (c) Further, risk that a counterparty will breach its contract, or will act fraudulently or dishonestly, is a risk in any and every commercial or consumer contractual arrangement. For example, a supermarket selling eggs may breach its contract for sale by supplying bad eggs.
- (d) There is extensive protection for consumers and for all counterparties from these risks, ranging from the *Trade Practices Act 1974* through the common law to the Criminal Code.

#### **D. If the Brookfield Decision Stands Without Any Exclusion Or Exception, What Amendments To The MIS Provisions Are Necessary?**

31. The regulatory requirements applicable to registered managed investment schemes have been devised, on the whole, to deal with arrangements where investors pay for interests in investments and the investors have capital at risk which must be invested and kept safely by the responsible entity. It contemplates that in the absence of day-to-day control, there are matters which members should have the ability to determine through member voting. They include the ability to remove the responsible entity, to change the constitution and to wind up the scheme.
32. Many of these regulatory requirements are difficult to apply to litigation funding arrangements which have the feature that no money is provided up front by any client and what is provided, being a promise to provide IMF with a share in the fruits of a cause of action, may turn out to

be worthless. **Attachment 3** is a table which sets out certain regulatory provisions, the risk addressed and an explanation of how they are inapplicable or are otherwise addressed by IMF's litigation funding arrangements.

#### **E. Should An Appropriate Carve Out Be Provided From The Definition Of MIS?**

33. Modification of the operation of Chapter 5 by exempting multi party claims from having to be registered is IMF's preferred response to the Brookfield Decision.
34. Alternatively, excluding multi party claims from the definition of "managed investment scheme" in section 9 of the Corporations Act is would achieve the same objectives.
35. The former response enables the funding component of funded multi party claims to be better regulated as a financial service/product under Chapter 7 of the Corporations Act as described in section G below.

#### **F. If A Carve Out Is Appropriate, What Is An Appropriate Definition?**

36. "Multi party claims, including representative, group and test cases."
37. This definition refers to claims rather than proceedings as many funded multi party claims involve preparing and filing proofs with external controllers of companies under external control without resort to legal proceedings.

#### **G. How Should Class Actions Be Regulated?**

##### **G1. Overview**

38. Litigation is widely and effectively regulated in Australia on both a State and Federal level by legislation and by rules of Court. It is the funding of multi party claims – and related issues which require regulation - not multi party claims per se.
39. Funding of multi party claims ought to be regulated by ASIC as each litigation funding agreement ("**LFA**") is financial product and litigation funders provide a financial service to retail clients.
40. Multi party claims occur on a national level. Accordingly national based regulation is appropriate.
41. Any regulation of multi party claims ought, if possible, occur primarily within an existing regulatory regime.
42. Some regulatory matters, peculiar to the legal system, ought to be dealt with by the Courts either on a judgment by judgment basis (as has already occurred) or by rules of Court.
43. IMF submits below that regulation of funders under Chapter 7 of the Corporations Act is the most obvious and applicable way for consumer protection objectives to be achieved for participants in multi party actions.

##### **G2. The essence of a LFA**

44. All LFA's are in writing signed by the funder and by the client. In addition all solicitor retainers entered pursuant to the LFA are in writing and signed by the client and the solicitors.
45. A standard LFA contains the following provisions;

- (a) the funder promises to pay all of the costs of the client's litigation;
- (b) the funder promises to pay any adverse costs (incurred during the term of the LFA) once they are ordered by the court and agreed, assessed or taxed;
- (c) the funder promises to provide any security for costs ordered by the court; and
- (d) in return for promises (a), (b) and (c) the client promises to pay out of any actual receipts, an amount equal to (a) and a percentage of the receipts. Some LFA's assign an interest in this percentage to the funder.

46. Most LFA's also contain the following terms:

- (a) the funder will be responsible for managing the arrangement between the funder and the clients, including the litigation;
- (b) the distribution of control of the litigation between the client, the solicitors and the funder;
- (c) the appointment of solicitors and the execution of retainer agreements by the clients;
- (d) termination by the client and by the funder; and
- (e) arrangements regarding how settlement is to occur.

### **G3. Single and Multi party LFA's**

47. Litigation funders provide LFA's for single party claims and also for multi party claims. The essential elements of the LFA's in each type of action are the same. In the case of multi party funding, there are some extra provisions to take account of the fact that multiple parties are conducting their litigation in common.

48. All single party LFA's are transactions conducted with sophisticated investors. This is because the value of the financial product within the transaction is always higher than \$500,000 (refer section 761G (7)(a) of the Act).

49. In the case of multi party LFA's, some clients are retail clients and some are sophisticated.

### **G4. The LFA is a Financial Product**

50. Each LFA is a bilateral contract between the funder and the client. The LFA is therefore an arrangement pursuant to section 761A of the Act.

51. In turn the LFA, being an arrangement, is a facility as that term is used in section 762C of the Act.

52. Section 763A provides that a facility through which, or through the acquisition of which, a person manages financial risk, is a financial product. Section 763C provides that persons manage financial risk if they:

- (a) manage the financial consequences to them of particular circumstances happening; and
- (b) avoid or limit the financial consequences of fluctuations in or the value of receipts or costs.

53. As a standard LFA provides for the payment of legal costs as and when they are invoiced and for the payment of security for costs and for adverse costs, should they be ordered by the court, it follows that a LFA is a financial product.
54. Section 764A sets out what specifically are to be treated as financial products. That list potentially picks up LFA's in 2 different ways;
  - (a) under sub-paragraph (1)(ba) as an interest in an unregistered managed investment scheme; and
  - (b) under sub-paragraph (1)(c) as a derivative.
55. IMF does not accept that it's funding arrangements amount to an unregistered managed investment scheme caught by section 764A (1) (ba) but the balance of this submission will proceed upon the basis that LFA's are captured by the words of that section.
56. IMF's LFA is a financial product and in particular a derivative as that term is used in sub-paragraph (1)(c) of section 764A.
57. Section 761D of the Act defines a derivative as an arrangement where a party to the arrangement must, or may, be required to provide, at some future time, consideration of a particular kind to someone else and the amount of the consideration or the value of the arrangement is ultimately determined, derived from or varies by reference to the value or amount of something else.
58. In the case of a LFA, the client is required to pay consideration, the value or amount of which will vary depending upon the judgment in the case. At the same time the funder is required to pay amounts in the future depending upon the invoices delivered by the solicitors, by the amount of security ordered by the court or by the amount of adverse costs awarded against the client.
59. LFA's are derivatives in both single and multi party litigation.
60. On the basis that multi party actions are managed investment schemes, then the issue of the LFA in such a scheme is, at the same time, both the issue of a derivative and the issue of an interest in the scheme.
61. Accordingly, LFA's are financial products.
62. Section 766A of the Act provides that a person provides a financial service if they deal in a financial product. Section 766C of the Act provides that dealing in a financial product includes issuing the financial product. Section 761E (3) provides that a derivative is issued when the legal relationship constituting the financial product is entered into by the parties (i.e. when the LFA is signed and delivered). The definition of "issue" in section 9 sets out that an interest in a managed investment scheme is issued when it is made available (i.e. when the funder agrees to proceed with the multi party funding).
63. Accordingly, funders provide a financial service when the client executes and delivers a LFA. In a single client situation this is because the LFA is a derivative. In a multi party situation it is because the LFA is a derivative and might also be an interest in an unregistered managed investment scheme.

#### **G5. Licensing – Section 912A Obligations**

64. Section 911A of the Act requires that any person who carries on a financial services business must hold an Australian financial services license covering the provision of the financial

services. Section 761 A defines financial services business as meaning a business of providing financial services. There seems little doubt, therefore, that litigation funders carry on a financial services business and are therefore required to be licensed.

65. Licensing is therefore, the default position. It is not just a good idea that litigation funders be licensed- it is a requirement of current Federal legislation. ASIC has already acknowledged this fact by licensing IMF.
66. Section 912A sets out the general obligations which are imposed upon the holder of a financial services license. All of the obligations are relevant to litigation funding in that they tend to protect the client, the public and the Courts from inappropriate conduct on the part of litigation funders. From this point on the submission will refer to the funder as though it is a licensee.
67. The first obligation set out in section 912A is that the financial services covered by the license (i.e. the provision of LFA's) are to be provided efficiently, honestly and fairly. Under this provision an incompetent funder, a dishonest funder and a funder who enters into unfair contracts will be in breach of the Act and liable to lose its license.
68. The section then obliges the litigation funder to have in place adequate arrangements for the management of conflicts of interest. This again is a central requirement of litigation funding because such conflicts can arise both as between the position of the funder and the position of the client as well as between the funder, the client and the lawyers.
69. The section then obliges the funder and its representatives to comply with all financial services' laws whether they be Federal or State.
70. Importantly, the funder is then obliged to have adequate financial, technological and human resources so as to enable it to provide its litigation funding services. This is a central requirement for effective litigation funding (i.e. the certitude that the funder will be on hand to pay out any adverse cost orders which may be made years after the LFA is agreed).
71. The section then obliges the funder to ensure that both itself and its representatives are adequately trained and competent to provide the services set out in the LFA.
72. The section also requires that, in relation to retail clients, the funder has a dispute resolution system which complies with section 912A(2).
73. Finally, and most importantly, the section requires that the funder has adequate risk management systems in place.
74. It is difficult to envisage a wider set of requirements suitable for the regulation of litigation funding. It is not only the case that litigation funders are required by law to be licensed; the licensing regime currently in force fits perfectly over the LFA and the obligations of litigation funders both generally and under the LFA.

## **G6. Exemption from Licensing**

75. If an alternative regime is used or introduced to regulate multi party claims, then mass exemptions will be required to excuse litigation funders from compliance with the licensing requirements of the Act. This seems to be counterintuitive.
76. Presently, some litigation funders have been exempted from the necessity to be licensed and their exemptions have been made subject to the condition that they observe only some of the requirements which would be in place had they been licensed.

77. The problem with exemption is that all of the oversight and enforcement provisions of the Act do not apply to the exempt party so that ASIC, in reality, exercises no real control over the exempted funder other than that they comply with the conditions of the exemption.
78. There is no sensible argument for the exemption of litigation funders from the legal requirement that they be licensed to carry on their business of litigation funding.

#### **G7. Cooling off period**

79. Retail clients may need time to reconsider their position after they have executed a LFA especially as it is likely to be a once in a life time decision.
80. Section 1019B requires a funder to provide a 14 day cooling off period to allow retail clients time to reconsider the transaction.

#### **G8. Compensation Arrangements**

81. Section 912B of the Act requires that, if litigation funders provide their service to retail clients, they must have in place arrangements for compensating those retail clients for loss or damage suffered because of any breach of the obligations referred to in **section G5** above.
82. Section 912B (2) provides that the arrangements must comply with regulations made for that purpose.
83. Regulation 7.6.02AAA provides that a funder must hold professional indemnity insurance that is adequate having regard to;
  - (a) the funders membership of a dispute resolution system; and
  - (b) the volume of business, the number and kind of clients, the kinds of business and the number of representatives employed by the funder.
84. Under these arrangements a licensed litigation funder would be required to hold sufficient professional indemnity insurance to ensure that any damage it may cause to clients is covered by that insurance.
85. Not to hold such insurance would be a breach of the Act and would lead to loss of the funder's license.

#### **G9. Disclosure**

86. Because LFA's are financial products, Part 7.9 of the Act applies to a funder when it's LFA's are issued to clients (i.e. when the LFA is executed by both parties and is unconditional).
87. Section 941A of the Act requires a funder to give a retail client a financial services guide. The guide must contain all of the information referred to in section 942B (2) of the Act (being information regarding the funder and the business conducted by the funder).
88. It is an offence for the funder not to provide a financial services guide as required by the Act.
89. Section 1012B requires the funder to provide a product disclosure statement either at or before the point of issue of the LFA.

90. The product disclosure statement must contain the following information about the funder and the LFA:
- (a) the benefits to be produced by the LFA;
  - (b) any significant risks associated with the LFA;
  - (c) the costs and any amounts payable by the client;
  - (d) any commission or other similar payments to be made to the funder;
  - (e) significant characteristics or features of the LFA and the rights terms, conditions and obligations arising from the LFA;
  - (f) the dispute resolution system covering complaints by clients about the LFA or the funder; and
  - (g) any cooling off regime.
91. As can be seen, this list of requirements for a product disclosure statement relating to a LFA is entirely appropriate for information, provision to, and protection of funded clients in multi party claims.
92. A funder which has an obligation to provide a product disclosure statement commits an offence by not doing so (refer section 1021C) and, in addition, the client may take action under section 1022B for any damages or loss caused by that failure. The Court has extensive powers under section 1022C in dealing with any funder who fails to provide the product disclosure statement, including a power to declare the LFA to be void and to order that any payment under the LFA be returned to the client.

#### **G10. Oversight by ASIC**

93. ASIC currently employs numerous trained staff capable of overseeing licensed litigation funders and enforcing the provisions of the Act and the licenses held by funders.
94. The cost and time involved in replicating this enforcement staff would be so high as to, by itself, be a compelling reason against regulation other than by ASIC under the terms of the Act.
95. Section 912E requires all funders to give such assistance to ASIC as ASIC reasonably requests from time to time during its surveillance activity. Funders are specifically required to give ASIC access to their books and records and any other information requested by ASIC.
96. Under section 912D, the funder must advise ASIC of any breach or likely breach of the Act or any other financial services legislation.
97. Under section 912C, ASIC may give notice to a funder to provide a statement to ASIC regarding the financial services provided to clients and/or the conduct of the business carried on by the funder. Under this section, ASIC may also require the funder to provide an audit report to ASIC.

#### **G11. Enforcement**

98. Both ASIC and the courts are given strong enforcement powers over licensed litigation funders by various provisions of the Act.

99. Section 915C empowers ASIC to suspend or cancel a funder's license if:
- (a) the funder has not complied with the obligations referred to in section G5 above;
  - (b) ASIC has reason to believe that the funder will not so comply; and
  - (c) ASIC is no longer satisfied that the representatives of the funder remain of good fame and character.
100. Under section 920A, ASIC can ban persons from being involved in the provision of litigation funding and pursuant to section 921A the Court may cancel a license held by a litigation funder or itself make permanent banning orders against persons involved in litigation funding.

## **G12. Multi Party Cases**

101. Litigation funders often provide funding for multi party cases involving hundreds and, in some cases, thousands of clients. In these cases, the day to day running of the litigation is in the hands of the solicitors for the representative party (in a class action) or all the clients (in a group action) subject to direction on such day to day matters by the funder and the representative.
102. If the litigation funder is licensed, then all of the obligations and client protections referred to above are in place.
103. In circumstances where the funder is licensed under the Act, the additional protections put in place by part 5C are not substantial and in many cases would not be applicable.
104. For instance, the compliance plan, required for a managed investment scheme, would be almost unworkable in the context of multi party litigation which runs according to rules and regulations set down on a day to day basis by the Courts, by legislation and by rules of Court. If the litigation itself or the conduct of the litigation is thought to be part of the scheme, then any compliance plan could not effect how the litigation would proceed through the courts.
105. In the same way the constitution of such a scheme would ordinarily provide for client meetings, voting and the like. Again litigation cannot be controlled in any way by the provisions of such a constitution.
106. The LFA signed by both the client and the funder provides for decision making amongst the group and, in relation to settlement in class actions, the decision making is, in any event, subject to the oversight of the Court (i.e. the Court must approve the settlement before it can be put into place).
107. It seems reasonable to suggest that the LFA and the retainer agreement between the clients and the solicitors takes the place of the constitution and the compliance plan and basically fulfills the same requirements. Further, **Attachment 4** is a table that looks at each potential protection provided to investors by Chapter 5C and identifies how the interests of members are currently protected without Chapter 5C regulation.
108. All litigation funding arrangements are based upon a no win, no fee agreement. This means that there is simply no scheme property and there is no situation where the property of the clients needs to be protected. No clients take any risk during the procedure other than the risk that the funder will not be able to meet an adverse cost order if one is made during the course of the litigation. That risk will not be ameliorated by treating the LFA as a scheme or requiring that the scheme be registered.

109. In addition, the ability of one member of the class to wind up the arrangements so as to defeat the interests of all other members in the class is highly inappropriate. This factor alone is a strong argument against treating litigation funding arrangements as a managed investment scheme.

110. The part of the LFA which covers funding (as distinct from what is to be done with the funding) is a discrete and relatively small part of the LFA which is already well regulated by the licensing provisions of the Act.

### **G13. Recommendations**

111. A regulation should be promulgated pursuant to section 764A (1) (n) that all LFA's are financial products (this will remove any uncertainty on this question caused by the peculiar nature of derivatives under the Act).

112. All litigation funders should be licensed as issuers of financial products. No exemptions should be provided.

113. Conditions on each license should require that all LFA's be in writing, signed by the parties to the agreement.

114. A regulation should be promulgated, pursuant to section 601Q, to exempt multi party claims from Chapter 5C.

115. All litigation funders should be public companies (this will carry with it greater transparency through the reporting provisions of the Act for public companies and by the requirement that the public company funder be audited pursuant to the provisions of the Act).

### **G14. Other Matters**

116. It would be appropriate for those States which have not yet abolished the torts of maintenance and champerty to now do so. Not to do so is inconsistent with the notion that LFA's are financial products regulated by Federal law.

117. Any necessity for litigation funders to disclose the existence and terms of LFA's to the Court is best left to rules of Court. This is the subject of a recent submission by IMF to the Federal Court of Australia (refer to **Attachment 5**).

118. There should be no statutory requirements as to the content of LFA's including matters such as caps on commission and other commercial considerations. The existing law regulates unfair contracts and the free market will determine commission rates and other commercial aspects of funding transactions.

119. Matters affecting the solicitors involved in the funding litigation should be left to the legal regulators. This would include matters such as the involvement of solicitors in litigation funding companies, disclosure of funding arrangements and the requirement that the clients directly retain the solicitors.



**IMF (Australia) Ltd**

**Combined Financial Services Guide and Product  
Disclosure Statement**

**Dated the 18th day of January 2010**

## 1. **Introduction**

- 1.1 This document is provided to you by IMF (Australia) Ltd which is referred to as “IMF”, “us” or “we”.
- 1.2 It is provided to you pursuant to sections 941A and 1012B of the Corporations Act (“the Act”) because you have sought litigation funding services from us and is divided into the following two parts:
  - (a) a Financial Services Guide; and
  - (b) a Product Disclosure Statement.

## 2. **Financial Services Guide**

- 2.1 This guide is to help you decide whether to use our litigation funding services.
- 2.2 The guide is given to people who ask us to fund their claims and litigation. It explains:
  - (a) what money we might receive if you enter into a litigation funding agreement with us; and
  - (b) how you can complain about our service should you wish to do so.
- 2.3 We provide litigation funding services pursuant to written litigation funding agreements. If we decide to fund your claim, we will negotiate the terms of a written agreement with you.
- 2.4 Our litigation funding agreements are “financial products” as that term is used in the Act. For the purposes of the Act, if we offer to enter into a litigation funding agreement with you and you accept our offer, we:
  - (a) have “issued” a financial product to you; and
  - (b) are providing a “financial service” to you (as that term is used in the Act).
- 2.5 You are dealing with a company, IMF (Australia) Ltd, whose ABN is 45 067 298 088. Our shares are listed for quotation on the Australian Securities Exchange (“ASX”) under the stock code “IMF”. Our contact details are set out on the last page of this document. We also maintain a web site at [www.imf.com.au](http://www.imf.com.au).
- 2.6 Our web site contains the following information which may help you to decide whether to use our financial services:
  - (a) our audited accounts;
  - (b) our Corporate Governance Manual;
  - (c) our Privacy Policy;
  - (d) public announcements made by us to the ASX; and
  - (e) general information about litigation funding.
- 2.7 Our Chairman is Robert Ferguson and our Managing Director is Hugh McLernon. Both may be contacted by telephone on +61 2 8223 3567.
- 2.8 No other companies, entities or persons (other than our officers and employees) are involved in any way in the provision of our financial services.
- 2.9 A litigation funding agreement is a contract which both you and IMF may enforce.
- 2.10 We hold Australian Financial Services Licence No. 286906 and are lawfully entitled to enter into litigation funding agreements with retail and wholesale clients pursuant to the provisions of the Act and the conditions of that licence.

- 2.11 A copy of the licence will be made available to you upon request. A copy may also be sourced from our web site.
- 2.12 When we enter into litigation funding agreements, we are acting on our own behalf and not on behalf of you or anyone else. We cannot and do not make any recommendations as to whether you should enter into a litigation funding agreement with us. We will not provide you with any advice on the meaning, effect or content of the litigation funding agreement. Since we are the other party to the agreement, it would not be appropriate for us to provide you with such advice. We recommend that you obtain your own independent advice on the meaning, effect and content of the litigation funding agreement before you decide whether to execute it.
- 2.13 Once the litigation funding agreement is executed, you and IMF will have similar (but not the same) interests because we both stand to benefit from a successful resolution of your claim.
- 2.14 Our litigation funding agreements are entered into on a “no win, no fee” basis. This means that we will not be paid any money unless and until:
- (a) you have executed a litigation funding agreement;
  - (b) your claim has been settled or concluded by a judgment in your favour; and
  - (c) you have received at least some of the settlement or judgment moneys. (You will never be asked to pay more than you have actually received.)
- 2.15 The litigation funding agreement explains how any money we will be paid is calculated.
- 2.16 Clause 5 of our Corporate Governance Manual, which can be found on our website, explains how our dispute resolution process works.
- 2.17 IMF is also a member of the Financial Ombudsman Service scheme. You can contact the Chief Ombudsman, Colin Neave AM, by ringing 1300 780 808 (within Australia) or +61 3 9613 7333 (outside Australia) or by sending a fax to +61 3 9613 7345.

### **3. Product Disclosure Statement**

- 3.1 We have prepared this Product Disclosure Statement.
- 3.2 In general terms, we will decide whether we want to enter into a litigation funding agreement with you by assessing:
- (a) the strength of your claim;
  - (b) the type of claim;
  - (c) when your claim arose;
  - (d) the jurisdiction in which your claim will be heard;
  - (e) the amount of your claim;
  - (f) any legal or factual difficulties;
  - (g) the ability of the proposed defendant to pay you if you are successful; and
  - (h) how much documentary evidence there is to support your claim.
- 3.3 To assist us in making our initial assessment, we may require you to provide us with documents and other information. We will treat this information as confidential.
- 3.4 We do not charge anything for our initial assessment.
- 3.5 If we decide not to fund your claim, we will return your documents to you promptly.
- 3.6 If we decide to fund your claim, we will offer to enter into a litigation funding agreement with you.
- 3.7 The litigation funding agreement will cover three major areas:
- (a) investigation;

- (b) litigation management; and
  - (c) funding.
- 3.8 If we enter into a litigation funding agreement with you, we will continue to investigate your claim.
- 3.9 We will appoint the solicitors to provide the relevant legal work to you on the terms of an agreement, referred to as the Standard Lawyers Terms. This is an agreement between us and the solicitors. The solicitors will also wish to have a retainer agreement directly with you.
- 3.10 We will pay the following costs: - incurred during the term of the funding agreement
  - (a) the reasonable legal fees of prosecuting the relevant proceedings;
  - (b) expenses reasonably incurred by the solicitors including counsel's fees and expert fees ;
  - (c) court costs;
  - (d) out of pocket expenses associated with our investigation and project management; and
  - (e) any costs of the other side that are ordered to be paid.
- 3.11 We will pay the costs charged by the solicitors, as agreed. We will seek reimbursement from you of the costs we pay, but only from any recoveries you obtain from any settlement or judgement in the proceedings. If you do not win your litigation and receive payment from the other side then you will have nothing to pay to IMF.
- 3.12 We will also provide any other non-legal assistance which you or your solicitors may reasonably request.
- 3.13 If, in any litigation, you are required to provide security for the other side's legal costs, we will provide that security on your behalf by:
  - (a) paying money into court or providing a bank guarantee if required to do so by order of the court;
  - (b) providing our guarantee to the defendant or to the court; or
  - (c) providing a Deed Poll to the other side and to the Court undertaking to be directly liable for all of the costs.
- 3.14 We will provide the solicitors with their day to day instructions. However you can override our instructions if you wish and in the event of any conflict arising between your interests and those of IMF, your interests are to prevail. In the case of funding agreements with insolvency practitioners, instructions to the solicitors are given by the insolvency practitioner, although we may assist in that respect.
- 3.15 If your claim is unsuccessful and you are ordered to pay the other side's costs, we will pay those costs on your behalf. If your claim is settled or successfully concluded by judgment in your favour, we will be entitled to receive from any recovery:
  - (a) repayment of all money we have paid on your behalf;
  - (b) a project management fee; and
  - (c) an agreed percentage of your recovery.
- 3.16 The litigation funding agreement provides for any recoveries in respect of your claim to be paid into the solicitor's trust account and to be distributed to IMF in respect of its entitlements referred to above (with the balance available to you, subject to any other obligations you may have).
- 3.17 We will not charge for any non-financial assistance we provide to you during the course of any litigation other than our project management fee.

- 3.18 Except where you are suing in the same legal proceedings with others (being multi party cases, including class actions referred to in paragraph 7 below), only you can decide whether to settle your claim. We may, however, ask you to obtain senior counsel's opinion on any settlement offer with the opinion being binding on you and us (except in the case of funding agreements with insolvency practitioners). We will pay for that opinion. In multiparty cases there are specific clauses in the funding agreement that deal with the circumstances in which you can be bound by a global settlement. In addition, with respect to class actions, there are court rules that deal with settlement.
- 3.19 After you execute a litigation funding agreement, you will have a 21 day "cooling off" period. During that period you may tell us that you wish to terminate the litigation funding agreement. You may tell us by letter, email or fax.
- 3.20 If you decide to terminate the litigation funding agreement during that period, we will not charge you anything.
- 3.21 After the 21 day "cooling off" period has ended, you will only be able to terminate the litigation funding agreement in accordance with its terms.
- 3.22 We may terminate the litigation funding agreement at any time by giving you 7 days written notice.
- 3.23 If you enter into a litigation funding agreement and your claim goes to trial, you may be required to give evidence in court. You may also be required to provide copies of all your relevant documents to the other side. We do not pay you to give evidence, to gather and supply your documents to your solicitors or to help with the case generally.
- 3.24 If other people have the same or similar claims as you, we may decide to fund their claims too. This may mean that you and they become claimants in the same litigation or that you become a representative party or are represented by another (usually in a class action). You will not become a representative party without your written consent. Multiparty litigation is referred to in paragraph 7 below.

#### **4. Risks**

- 4.1 The most obvious risk is that you may commence litigation and lose. If that happens, and subject to paragraph 4.4, you will not be required to pay any money. You will, however, lose the time and effort you have put into the litigation.
- 4.2 Even if you are successful with your litigation, the other side may not be able to pay all of the judgment sum. As we only get paid from any money you actually obtain, we are always careful to investigate whether the other side will be able to pay you. Of course, we can never guarantee that they will have enough money to do so.
- 4.3 As explained in paragraph 3.22, we may terminate the litigation funding agreement. If that happens, we may lose all the money we have paid and will receive nothing for any work we have put into your claim. If we terminate the litigation funding agreement and you later receive some money in respect of your claim, you must still reimburse us from that money for the legal and other expenses we have paid on your behalf. Extremely few litigation funding agreements are terminated by us.
- 4.4 As your claim proceeds, we will pay your legal costs, court costs and other funded expenses on a monthly basis. As a company, however, we could become insolvent and be unable to meet any order that you pay the other side's legal costs. You will need to make your own assessment of our financial position. Audited accounts of the company are contained on our web site.
- 4.5 We are not aware of any taxation implications for you if you enter into a litigation funding agreement with us. You should obtain your own independent taxation advice in this regard.

#### **5. Dispute Resolution**

- 5.1 If you are unhappy with any part of our service, please see Clause 5 of the Corporate Governance Manual which can be found on our web site. That clause explains our internal complaint resolution procedure.

- 5.2 If you have a complaint, you should raise it first with the investment manager who has been responsible for your litigation funding agreement. Any complaints will then be dealt with in accordance with the procedure set out in Clause 5.
- 5.3 If we cannot resolve your complaint ourselves, you can use the external dispute resolution procedure provided by the Financial Ombudsman Service - see paragraph 2.17 above.
- 5.4 Your complaints will be dealt with by the Ombudsman at no cost to you.
- 5.5 This Product Disclosure Statement has been provided by us because we may offer to enter into a litigation funding agreement with you. Our contact details are:

IMF (Australia) Ltd  
Level 5, 32 Martin Place  
SYDNEY NSW 2000

Attention: Diane Jones

Tel: +61 2 8223 3567  
Fax: +61 2 8223 3555  
Email: [djones@imf.com.au](mailto:djones@imf.com.au)

## **6. Privacy**

- 6.1 Our privacy policy can be found on our website. IMF will adhere to that policy
- 6.2 From time to time we will make contact with you regarding this and other Litigation in which you are, or may wish to become, involved.

## **7. Multi-Party Litigation**

- 7.1 From time to time IMF funds more than one person with the same or similar claims. The cases may be funded as representative actions (otherwise known as class actions) or as a group action.
- 7.2 In class actions, hundreds of clients and sometimes thousands of clients are joined into the one set of proceedings. Such class actions may include persons who have not entered into a funding agreement with IMF.
- 7.3 Common questions of law or fact are answered for the benefit of all members of the class and then, in a secondary set of proceedings, the separate claim of each client is determined (if there is no earlier settlement).
- 7.4 The costs in these matters are paid by IMF and any recoupment from settlement or judgement is divided between the clients on a pro rata basis according to the size of their claim.
- 7.5 In this way, if the legal costs paid by IMF in a class action are say \$4M and a clients claim represents say 1 % of the total claim, then the amount deducted from the payment to that client in respect of their share of the costs is \$40,000.
- 7.6 The solicitors acting in the class action determine the size of each clients claim for the purposes of determining the costs to be reimbursed to IMF by each client.
- 7.7 Because of the large number of class members it is not possible to permit each client to appoint solicitors. In these class actions there is one set of solicitors appointed for all members of the class.
- 7.8 Generally, only the representative party will be required to provide documentation and to give evidence during the course of the initial part of the proceedings (i.e. where the common questions are answered by the Court). If the matter is not settled (and most cases are settled at that point) then it may be necessary for all clients to provide discovery of their documentation and to give evidence on their own particular matter. All clients are expected to provide material to establish the amount of their loss for the purpose of settlement.

- 7.9 If there is a lump sum settlement of the class action then the distribution to each client is determined on a pro rata basis depending on the size of their claim. Settlement of class actions can only occur with the consent of the Court.
- 7.10 You may be given the opportunity to opt out of a class action in which you are either the representative or are represented, with the consequence that you are no longer included in the action. If you opt out, the litigation funding agreement provides that you will still be obliged to pay to IMF its entitlements, from any recovery you make in respect of your claims that were included in the class action. If you do not make any recovery then you will have no obligation to pay anything to IMF.
- 7.11 As is usually the case in class actions, control of the proceedings is in the hands of the representative, the solicitors and IMF. Control of the second part of the proceedings is in the hands of each individual client and the solicitors.
- 7.12 Because of the expense involved in class actions, funding will not occur unless sufficient numbers agree to become members of the class.
- 7.13 In addition class actions may be managed investment schemes under the Corporations Act and may require registration.
- 7.14 No matter, which is a Managed Investment Scheme, will proceed unless IMF and the solicitors involved receive an exemption from ASIC under the Corporations Act permitting the Managed Investment Scheme to go forward without registration or the Corporations Act and/or the regulations made there under are amended to remove the necessity for such registration.

## **8. Group Actions**

- 8.1 In some cases large groups of clients are joined together in what is known as a group action where each client is a party to the proceedings.
- 8.2 This type of proceeding has the advantage that all questions of liability and damage are answered in the one hearing.
- 8.3 In group actions, all clients will be required to provide documentation and to give evidence relating to their claim.
- 8.4 In group actions IMF pays all legal costs and pays the defendant's costs if the action is not successful, incurred during the term of the funding agreement.
- 8.5 The points made in paragraph 7.11 to 7.13 above also apply to group actions.
- 8.6 In group actions a committee of clients may be formed to make decisions on behalf of all clients in respect of the day to day conduct of the case.

Dated the 18th day of January 2010

# Australian Financial Services Licence

IMF (AUSTRALIA) LTD.

ABN: 45 067 298 088

Licence No: 286906

was licensed as an Australian Financial Services Licensee pursuant to section 913B of the Corporations Act 2001. The conditions of the licence are hereby varied from the date hereunder. The licensee shall continue to be licensed as an Australian Financial Services Licensee subject to the conditions and restrictions which are prescribed, and to the conditions contained in this licence and attached schedules.

Effective 4 February 2010

## Authorisation

1. This licence authorises the licensee to carry on a financial services business to:
    - (a) deal in a financial product by:
      - (i) issuing, applying for, acquiring, varying or disposing of a financial product in respect of the following classes of financial products:
        - (A) derivatives; and
        - (B) interests in managed investment schemes excluding investor directed portfolio services;
- to retail and wholesale clients.



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## Schedule of Conditions

### Compliance Measures to Ensure Compliance with Law and Licence

2. The licensee must establish and maintain compliance measures that ensure, as far as is reasonably practicable, that the licensee complies with the provisions of the financial services laws.

### Financial Requirements for Market Participants and Clearing Participants

3. Where the licensee is a market participant in a licensed market, or a clearing participant in a licensed CS facility, conditions 4 to 10 (inclusive) do not apply to the licensee.

### Base Level Financial Requirements

4. The licensee must:
  - (a) be able to pay all its debts as and when they become due and payable; and
  - (b) either:
    - (i) have total assets that exceed total liabilities as shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's total assets would currently not exceed its total liabilities; or
    - (ii) have adjusted assets that exceed adjusted liabilities calculated at the balance date shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's adjusted assets would currently not exceed its adjusted liabilities; and
  - (c) meet the cash needs requirement by complying with one of the following five options:
    - (i) Option 1 (reasonable estimate projection plus cash buffer) – refer to definition of "Option 1" under this licence; or
    - (ii) Option 2 (contingency based projection) – refer to definition of "Option 2" under this licence; or
    - (iii) Option 3 (financial commitment by an Australian ADI or comparable foreign institution) – a requirement that an Australian ADI or a foreign deposit-taking institution approved in writing by ASIC as an eligible provider gives the licensee an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee, or the amount for which the licensee is liable to its creditors at the time of the demand to the licensee's creditors or a trustee for the licensee's creditors, that the licensee reasonably expects will apply for at least three months, taking into account all commercial contingencies for which the licensee should reasonably plan; or
    - (iv) Option 4 (expectation of support from an Australian ADI or comparable foreign institution) – a requirement that the licensee:
      - (A) is a subsidiary of an Australian ADI or a corporation approved by ASIC in writing for the purpose of this condition; and
      - (B) reasonably expects that (based on access to cash from its related bodies corporate) it will have adequate resources (when needed) to meet its liabilities for at least the next three months (including any additional liabilities that the licensee might incur during that period), taking into account all adverse commercial contingencies for which the licensee should reasonably plan; and



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## Schedule of Conditions

- (C) ensures that a responsible officer of the licensee has documented that the officer has the reasonable expectation for at least the following three month period together with the reasons for forming the expectation, the contingencies for which the licensee considers it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; or
- (v) Option 5 (parent entity prepares cash flow projections on a consolidated basis) – a requirement that the licensee ensures that:
- (A) the cash flows of the licensee and each of its related bodies corporate, other than any body regulated by APRA ("licensee group"), are managed on a consolidated basis; and
- (B) there is a body corporate within the licensee group of which all members of the licensee group are subsidiaries that is not a body regulated by APRA ("parent entity"); and
- (C) the parent entity complies with Option 1 or Option 2 as if it were the licensee, cash flows of any member of the licensee group were cash flows of the licensee and any cash held by a member of the licensee group, other than as trustee or as trustee of a relevant trust, were so held by the licensee; and
- (D) a report by the parent entity's auditor that is a registered company auditor is given to ASIC with the licensee's annual audit report under condition 11 of this licence, in relation to each financial year of the licensee and for any other period that ASIC requests, by a date that ASIC requests, with respect to compliance by the parent entity with Option 1 or Option 2 as they would apply in accordance with subparagraph (C), reflecting the report that would be required from the auditor of a licensee, for that period purporting to comply with Option 1 or Option 2; and
- (E) either of the following applies:
- Alternative A – the parent entity has provided an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee or to meet the licensee's liabilities which the licensee reasonably expects will apply for at least the next three months taking into account all adverse commercial contingencies for which the licensee should reasonably plan; or
- Alternative B – the licensee reasonably expects that (based on access to cash from members of the licensee group), it will have adequate resources to meet its liabilities (including any additional liabilities that the licensee might incur while the commitment applies) for at least the next three months taking into account all adverse commercial contingencies for which the licensee should reasonably plan and a responsible officer of the licensee has documented that the officer has the reasonable expectation in respect of at least the following three months together with the reasons for forming the expectation, the contingencies for which the licensee considers it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; and
- (F) the licensee has no reason to believe that the parent entity has not complied with the requirement at subparagraph (C) or has failed to comply in a material respect with its obligations under Chapter 2M of the Act or, if the parent entity is not a company, under any other laws (whether law in Australia or not) relating to financial reporting that apply to it.



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## Schedule of Conditions

For 5 years after the end of the last financial year that includes a part of the period to which any document prepared for subparagraph (c)(iv)(C) or Alternative B in subparagraph (c)(v)(E) relates, the licensee must keep the document and give it to ASIC if ASIC requests.

### Financial Requirements for Holding Client Money or Property

5. If at any time the licensee:
- (a) is required to hold money in a separate account under Division 2 of Part 7.8 of the Act; or
  - (b) holds money or other property on trust for a client or is required to do so under Regulation 7.8.07(2) of the Corporations Regulations or otherwise; or
  - (c) has the power to dispose of a client's property under power of attorney or otherwise;
- the licensee must ensure that the licensee has at least \$50,000 in surplus liquid funds ("SLF") unless the total value of the money and property for all clients is less than \$100,000 excluding:
- (d) money that has satisfied a client's liability on an insurance contract where the licensee is acting under a binder or section 985B of the Act applies, or property acquired by investment of that money; or
  - (e) the value of property where the licensee merely holds a document of title, and the client has legal title to the property.

### Financial Requirements for Licensee Transacting with Clients

6. If the licensee incurs actual or contingent liabilities of the relevant kind by entering into a transaction with a client(s) in the course of providing a financial service to the client(s), the licensee must have adjusted surplus liquid funds ("ASLF") of the sum of:
- (a) \$50,000; plus
  - (b) 5% of adjusted liabilities between \$1 million and \$100 million; plus
  - (c) 0.5% of adjusted liabilities for any amount of adjusted liabilities exceeding \$100 million, up to a maximum ASLF of \$100 million.
- This condition does not apply to the licensee if:
- (d) the total of:
    - (i) the current liabilities that would be included in the calculation of the licensee's adjusted liabilities; and
    - (ii) the contingent liabilities that if crystallised would be a current liability and be included in the calculation of the licensee's adjusted liabilities,is less than \$100,000; or
  - (e) the licensee has no:
    - (i) liabilities to clients that would be included in calculating its adjusted liabilities; or
    - (ii) contingent liabilities to clients which if crystallised would be included in calculating its adjusted liabilities,other than under debentures the licensee issued under Chapter 2L of the Act.



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For the purpose of paragraphs (d) and (e), the licensee may disregard a liability or a contingent liability that:

- (f) is a contingent liability that is neither a derivative nor a liability from underwriting securities or managed investment products; or
- (g) the licensee reasonably estimates has a probability of less than 5% of becoming an actual liability; or
- (h) is covered by money or property that the licensee holds in a separate account under Part 7.8 of the Act or on trust for clients; or
- (i) is adequately secured as defined in paragraph (a) or (b) of the definition of "adequately secured" under this licence; or
- (j) is a liability incurred by entering into a transaction on a licensed market that is to be settled using a clearing and settlement facility, the operation of which is authorised by an Australian CS facility licence; or
- (k) is under a foreign exchange contract and the licensee is required to have \$10 million of tier one capital under another condition of this licence because the licensee has entered a foreign exchange contract as principal; or
- (l) is under a derivative where:
  - (i) the licensee does not make a market in derivatives; and
  - (ii) the licensee entered into the dealing for the purposes of managing a financial risk; and
  - (iii) either the licensee's dealings in derivatives are not a significant part of its business or of the business of it and its related bodies corporate taken together; and
  - (iv) the licensee did not enter into the dealing on the instructions of another person; or
- (m) is under a foreign exchange contract where the licensee:
  - (i) does not make a market in foreign exchange contracts; and
  - (ii) entered into the contract for the purposes of enabling a payment in one of the currencies under the foreign exchange contract; and
  - (iii) did not enter into the foreign exchange contract on the instruction of another person.
- (n) occurs in circumstances where a licensee agrees to provide credit to another person under a margin lending facility and the credit remains undrawn or a portion of the credit remains undrawn.

In this condition, a reference to a client includes a person who acquires or disposes of financial products in a transaction that the licensee entered into at a price the licensee stated in the course of making a market.

## Reporting Triggers and Requirements for Financial Requirement Conditions of this Licence

7. The licensee must ensure the reporting requirements under conditions 8 and 9 of this licence are met where either paragraph (a) or paragraph (b) applies:
- (a) the trigger points described in paragraphs (i) and (ii) below occur:
    - (i) the licensee has adjusted liabilities of more than \$1 million and less than or equal to \$100 million; and
    - (ii) the licensee has an ASLF of less than 5.5% of adjusted liabilities; or
  - (b) the trigger points described in paragraphs (i), (ii) and (iii) below occur:
    - (i) the licensee has adjusted liabilities of more than \$100 million; and



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- (ii) the licensee does not have \$100 million ASLF; and
  - (iii) the licensee has an ASLF that is less than \$500,000 above the minimum ASLF required under condition 6 of this licence.
8. Where the licensee's ASLF is below the trigger points, the licensee must not enter into any transactions with clients that could give rise to further liabilities, contingent liabilities or other financial obligations until the licensee's board or other governing body has certified in writing that, having conducted reasonable enquiry into its financial position, there is no reason to believe that the licensee will fail to comply with its obligations under section 912A of the Act.
9. Where the licensee's board or other governing body has made the certification required under condition 8, the licensee must ensure that the licensee's board or other governing body certifies in writing at least monthly that, having conducted reasonable enquiry into its financial position, there is no reason to believe that the licensee will fail to comply with its obligations under section 912A of the Act until the licensee's ASLF continuously exceeds the trigger point for a period exceeding one month.
10. The licensee must keep each certification issued by the licensee's board or other governing body under conditions 8 and 9 of this licence for at least 5 years from the date of such certification. The licensee must provide ASIC with a copy of each certification within 3 business days of the date of each certification.

## Audit Opinion on Financial Requirements

11. The licensee must lodge with ASIC an opinion by a registered company auditor ("the audit opinion") addressed to the licensee and ASIC for the following periods:
- (a) for each financial year, at the same time the licensee is required to lodge a balance sheet under Part 7.8 of the Act; and
  - (b) for any period of time that ASIC requests, by the date ASIC requests the audit opinion to be lodged; that states whether during:
  - (c) any part of the period for which the licensee:
    - (i) relied on being a market participant or a clearing participant, on a positive assurance basis, the licensee was a participant in the market conducted by:
      - (A) ASX; or
      - (B) SFE, that restricted its financial services business to participating in the market and incidental business supervised by SFE; and
    - (ii) relied on being a body regulated by APRA, on a positive assurance basis, the licensee was a body regulated by APRA; and
  - (d) any remaining part of the period:
    - (i) in the auditor's opinion, the licensee:



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- (A) complied with all the financial requirements under conditions 4 to 10 (inclusive) of this licence other than paragraph 4(c) of this licence, except for paragraph (e) of the definition of "Option 1" under this licence if the licensee purports to comply with "Option 1"; and
  - (B) except for any period stated in the report when the licensee purports to comply with subparagraph 4(c)(iii), (iv) or (v), had at all times a projection (covering at least the following 3 months) that purports to, and appears on its face to comply with, paragraph (a) of the definition of "Option 1" or paragraph (a) of the definition of "Option 2" under this licence (depending on which option the licensee purports to be complying with); and
  - (C) except for any period stated in the report when the licensee purports to comply with subparagraph 4(c)(iii), (iv) or (v), correctly calculated the projections on the basis of the assumptions the licensee adopted for the projections described in subparagraph (d)(i)(B) of this condition; and
  - (D) for any period when the licensee relied on subparagraph 4(c)(iii) of this licence, has obtained from an Australian ADI or a foreign deposit-taking institution approved in writing by ASIC as an eligible provider an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee, or the amount for which the licensee is liable to its creditors at the time of demand to the licensee's creditors or a trustee for the licensee's creditors; and
  - (E) for any period when the licensee relied on subparagraph 4(c)(iv), following an examination of the documents prepared for subparagraph 4(c)(iv)(C), the licensee complied with subparagraph 4(c)(iv)(A) and subparagraph 4(c)(iv)(C) for the period to which the report relates; and
  - (F) for any period when the licensee relied on subparagraph 4(c)(v), the licensee complied with subparagraph 4(c)(v)(A) and (B); and
  - (G) for any period when the licensee relied on Alternative A in subparagraph 4(c)(v)(E), the parent entity has provided an enforceable and unqualified commitment to pay on demand from time to time an unlimited amount to the licensee or to meet the licensee's liabilities.
- (ii) except for any period stated in the report when the licensee purports to comply with subparagraph 4(c)(iii), (iv) or (v), following an examination of the documents the licensee relies on in complying with "Option 1" or "Option 2" as defined under this licence, the auditor has no reason to believe that:
- (A) the licensee did not satisfy the requirements of paragraph 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions of this licence; or
  - (B) the licensee failed to comply with the cash needs requirement using either "Option 1" or "Option 2" as defined under this licence (as applicable) except for:
    - (1) paragraphs (a), (c) and (e) of the definition of "Option 1" as defined under this licence; or
    - (2) paragraphs (a) and (c) of the definition of "Option 2" as defined under this licence; or
  - (C) if the licensee relied on "Option 1" as defined under this licence, the assumptions the licensee adopted for its projection were unreasonable; or
  - (D) if the licensee relied on "Option 2" as defined under this licence, the basis for the selection of assumptions to meet the requirements for its projection adopted was unreasonable; and
- (iii) for any period when the licensee relied on subparagraph 4(c)(iv), following an examination of the documents prepared for subparagraph 4(c)(iv)(C), the auditor has no reason to believe that:



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- (A) the licensee did not satisfy the requirements of paragraph 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions in this licence; and
- (B) the basis for the selection of the assumptions adopted was unreasonable; and
- (iv) for any period when the licensee relied on subparagraph 4(c)(v) under Alternative B, following an examination of the documents prepared for Alternative B, the auditor has no reason to believe that:
  - (A) the licensee did not satisfy the requirements of paragraph 912A(1)(h) of the Act for managing the risk of having insufficient financial resources to comply with the conditions in this licence; or
  - (B) the basis for the selection of the assumptions adopted was unreasonable.

### Security Bond Compensation Requirements

12. The licensee must lodge and maintain with ASIC a security approved by ASIC for the amount of \$20,000.

### External Disputes Resolution Requirements

13. Where the licensee provides financial services to retail clients, the licensee must be a member of one or more External Disputes Resolution Scheme(s) ("EDRS") which covers, or together cover, complaints made by retail clients in relation to the provision of all of the financial services authorised by this licence.
14. Where the licensee ceases to be a member of any EDRS, the licensee must notify ASIC in writing within 3 business days:
- (a) the date the licensee ceases membership of the EDRS(s); and
  - (b) the reasons the licensee's membership of the EDRS(s) has ceased (including circumstances where the EDRS is no longer operating, failure by the licensee to renew their membership of the EDRS or where the EDRS has terminated the licensee's membership of the EDRS); and
  - (c) details of the new EDRS(s) the licensee intends to or has joined (including the date the membership commences and the name of the EDRS); and
  - (d) details that provide confirmation that the licensee is covered by EDRS(s) covering complaints made by retail clients in relation to the provision of all of the financial services authorised by this licence.

### Prohibition to Operate Managed Discretionary Account Service

15. The licensee must not provide an MDA service to a retail client except when operating a registered scheme.

### Retention of Financial Services Guides, Statements of Advice and Material Relating to Personal Advice

16. Where the licensee provides financial product advice to retail clients, the licensee must ensure that copies (whether in material, electronic or other form) of the following documents are retained for at least the period specified:
- (a) each Financial Services Guide ("FSG") (including any Supplementary FSG) given by or on behalf of the licensee, or by any authorised representative of the licensee while acting in that capacity - for a period



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commencing on the date of the FSG and continuing for at least 7 years from when the document was last provided to a person as a retail client; and

- (b) a record of the following matters relating to the provision of personal advice to a retail client (other than personal advice for which a Statement of Advice ("SOA") is not required or for which a record of the advice is kept in accordance with subsection 946B(3A) ):
- (i) the client's relevant personal circumstances within the meaning of subparagraph 945A(1)(a)(i); and
  - (ii) the inquiries made in relation to those personal circumstances within the meaning of subparagraph 945A(1)(a)(ii); and
  - (iii) the consideration and investigation conducted in relation to the subject matter of the advice within the meaning of paragraph 945A(1)(b); and
  - (iv) the advice, including reasons why advice was considered to be "appropriate" within the meaning of paragraphs 945A(1)(a) to (c),  
for a period of at least 7 years from the date that the personal advice was provided;
- (c) any SOA provided by or on behalf of the licensee, or by any authorised representative of the licensee while acting in that capacity - for a period of at least 7 years from the date the document was provided to the client.

17. The licensee must establish and maintain measures that ensure, as far as is reasonably practicable, that it and its representatives comply with their obligation to give clients an FSG as and when required under the Act. The licensee must keep records about how these measures are implemented and monitored.

## Terms and Definitions

In this licence references to sections, Parts and Divisions are references to provisions of the Corporations Act 2001 ("the Act") unless otherwise specified. Headings contained in this licence are for ease of reference only and do not affect interpretation. Terms used in this licence have the same meaning as is given to them in the Act (including, if relevant, the meaning given in Chapter 7 of the Act) and the following terms have the following meanings:

**actual or contingent liabilities of the relevant kind** means:

- (a) an actual or contingent monetary liability; or
- (b) an actual or contingent liability under a non-standard margin lending facility, in the circumstances determined under the terms of the facility, to transfer marketable securities to the client.

**adequately secured** means:

- (a) secured by an enforceable charge over financial products (other than financial products issued by the licensee or its associate) if:
  - (i) the financial products are:
    - (A) regularly traded on:



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- (1) a financial market (as defined in subsection 767A(1) of the Act and disregarding subsection 767A(2) of the Act) operated by a market licensee or a licensee other than the licensee or its associate that in the reasonable opinion of the licensee produces sufficiently reliable prices to assess the value of the security provided by the charge;
  - (2) an ASIC-approved foreign market under ASIC Regulatory Guide 72 (formerly referred to as Policy Statement 72) as at the date of this licence; or
  - (3) a foreign market approved in writing for the purpose by ASIC; or
- (B) interests in a registered scheme for which withdrawal prices are regularly quoted by the responsible entity and the licensee believes on reasonable grounds that withdrawal may be effected within 5 business days; and
- (ii) the market value of these financial products equals not less than 120% of the amount owing or not less than 109% of the amount owing if the financial products are debt instruments; or
- (b) secured by a registered first mortgage over real estate that has a fair market valuation at least equal to 120% of the amount owing; or
- (c) owing from an eligible provider; or
- (d) secured by an enforceable charge over amounts owing to another licensee which themselves are adequately secured.

**adjusted assets** means the value of total assets as they would appear on a balance sheet at the time of calculation made up for lodgement as part of a financial report under Chapter 2M of the Act if the licensee were a reporting entity:

- (a) minus the value of excluded assets that would be included in the calculation; and
- (b) minus the value of any receivable of the licensee that would be included in the calculation, up to the amount that the licensee has excluded from adjusted liabilities on the basis that there is an enforceable right of set-off with that receivable; and
- (c) minus the value of any assets that would be included in the calculation that are encumbered as a security against liability to a person that provides a security bond to ASIC up to the amount of the bond; and
- (d) minus the value of any assets that would be included in the calculation that may be required to be applied to satisfy a liability under a credit facility that is made without recourse to the licensee up to the amount of that liability excluded from adjusted liabilities; and
- (e) plus
  - (i) the amount of any eligible undertaking that is not an asset; or
  - (ii) if the eligible undertaking is for an unlimited amount, an unlimited amount;

provided that if the eligible undertaking is given by a person who is an eligible provider only because of paragraph (b) of the definition of "eligible provider" under this licence, the amount added may be no more than one quarter of the eligible provider's net assets (excluding intangible assets) as shown in the most recent audited financial statements lodged with ASIC; and



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- (f) for calculating ASLF, plus the value of any current assets of any trust (other than a registered scheme) of which the licensee is trustee as if they would appear on the balance sheet as assets of the licensee except to the extent the value exceeds the sum of:
- (i) the current liabilities of the trust as if they would appear on the balance sheet as assets of the licensee; and
  - (ii) any adjustments to ASLF that are a result of current assets, liabilities and contingent liabilities of the trust for accounting purposes being included in calculating adjustments; and
- (g) for calculating ASLF, plus the value of the applicable percentage as set out in paragraphs (c)(i) and (iii) of the definition of "standard adjustments" under this licence of the value of any current assets that would be acquired in return for paying a contingent liability as set out in paragraphs (c)(i) and (iii) of the definition of "standard adjustments" under this licence up to the value of the applicable percentage of the relevant contingent liability.

**adjusted liabilities** means the amount of total liabilities as they would appear on a balance sheet at the time of calculation made up for lodgement as part of a financial report under Chapter 2M of the Act if the licensee were a reporting entity:

- (a) minus the amount of any liability under any subordinated debt approved by ASIC; and
- (b) minus the amount of any liability that is the subject of an enforceable right of set-off, if the corresponding receivable is excluded from adjusted assets; and
- (c) minus the amount of any liability under a credit facility that is made without recourse to the licensee; and
- (d) for calculating ASLF, plus the amount of the total current liabilities of any trust (other than a registered scheme) of which the licensee is trustee as if they would appear on the balance sheet as liabilities of the trustee; and
- (e) plus the value of any assets that are encumbered as a security against another person's liability where the licensee is not also liable, but only up to the amount of that other person's liability secured or the value of the assets encumbered after deducting any adjustments under this licence, whichever is lower.

**adjusted surplus liquid funds or ASLF** means surplus liquid funds minus either:

- (a) the standard adjustments (refer to the definition of "standard adjustments" under this licence); or
- (b) such other adjustments as ASIC may from time to time consent to in writing.

**clearing participant** means a clearing participant in the licensed clearing and settlement facility ("CS Facility") as defined in the operating rules of Australian Clearing House Pty Limited ("ACH"), as at the date of this licence, that complies with those operating rules relating to financial requirements, taking into account any waiver by ACH.

**derivative** means "derivatives" as defined in section 761D of the Act (including regulation 7.1.04 of the Corporations Regulations) and:

- (a) includes "managed investment warrants" as defined in this licence; and
- (b) excludes "derivatives" that are "foreign exchange contracts" as defined in this licence.



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### **eligible custodian** means:

- (a) an Australian ADI; or
- (b) a market participant or a clearing participant; or
- (c) a subcustodian appointed by a person of the kind referred to in (a) or (b) of this definition.

### **eligible provider** means:

- (a) an Australian ADI; or
- (b) an entity (other than a registered scheme of which the licensee or the licensee's associate is the responsible entity):
  - (i) whose ordinary shares are listed on a licensed market or an ASIC-approved foreign exchange under ASIC Regulatory Guide 72 (formerly referred to as Policy Statement 72) as at the date of this licence; and
  - (ii) that had net assets (excluding intangible assets) of more than \$50 million, as shown in the most recently audited financial statements of the provider lodged with ASIC; and
  - (iii) that the licensee has no reason to believe no longer has net assets of at least that amount; or
- (c) an Australian government (i.e. the Commonwealth or a State or Territory government) or a government of a country that is a member of the Organisation for Economic Co-operation and Development ("OECD country government"), or an agency or instrumentality of an Australian or OECD country government; or
- (d) a foreign deposit-taking institution that is regulated by an ASIC - approved regulator; or
- (e) a foreign deposit-taking institution approved in writing by ASIC for this purpose; or
- (f) an Australian CS facility licensee; or
- (g) an entity approved by ASIC in writing for this purpose.

### **eligible undertaking** means the amount of a financial commitment that is:

- (a) payable on written demand by the licensee (disregarding any part previously paid or any amount that would be repayable as a current liability or, for calculating NTA, as a liability by the licensee if money were paid), provided by an eligible provider in the form of an undertaking to pay the amount of the financial commitment to the licensee, and that:
  - (i) is an enforceable and unqualified obligation; and
  - (ii) remains operative (even if, for example, the licensee ceases to hold an AFS licence) until ASIC consents in writing to the cancellation of the undertaking; or
- (b) approved in writing by ASIC as an eligible undertaking.

### **excluded assets** means:

- (a) intangible assets (i.e. non-monetary assets without physical substance); and
- (b) except when allowed under paragraphs (e) or (f) of this definition, assets owing or receivables ("receivables") from or assets invested in, any person who:
  - (i) is an associate of the licensee; or



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- (ii) was an associate of the licensee at the time the liability was incurred or the investment was made; or
- (iii) became liable to the licensee because of, or in connection with, the acquisition of interests in a managed investment scheme the licensee operates; and
- (c) except when allowed under paragraph (g) of this definition, assets:
  - (i) held as a beneficial interest or an interest in a managed investment scheme; or
  - (ii) invested in any superannuation product, in respect of which the licensee or its associate may exercise any form of power or control; and
- (d) except when allowed under paragraphs (e) or (f) of this definition, receivables from the trustee of any trust in respect of which the licensee or its associate may exercise any form of power or control; and
- (e) despite paragraphs (b) and (d) of this definition, a receivable is not excluded to the extent that:
  - (i) it is adequately secured; or
  - (ii) the following apply:
    - (A) it is receivable as a result of a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm's length basis; and
    - (B) no part of the consideration in relation to the transaction is, in substance, directly or indirectly invested in the licensee; and
    - (C) the total value of such assets (before any discount is applied) is not more than 20% of the assets less liabilities of the licensee; and
    - (D) for the purposes of calculating ASLF, the amount is further discounted by 10% of the value after any adjustment required by paragraph (a) or (b) of the definition of "adjusted surplus liquid funds" in this licence; or
  - (iii) the following apply:
    - (A) it is receivable from an insurance company that is a body regulated by APRA and results from a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm's length basis; and
    - (B) there is no reason to believe that any amount invested in the licensee would not have been invested if the transactions that caused the receivable had not taken place or were not at the time of the investment expected to take place; and
    - (C) there is no reason to believe that the recoverability of the receivable will materially depend on the value of an investment by any person in the licensee; and
    - (D) the total value of the receivables under this subparagraph (iii) before any adjustment required by paragraph (a) or (b) of the definition of "adjusted surplus liquid funds" in this licence is applied is not more than 60% of the adjusted liabilities of the licensee disregarding this subparagraph (iii); or
  - (iv) ASIC consents in writing to the licensee treating the amount owing as not being an excluded asset; and
- (f) despite paragraphs (b) and (d) of this definition, the licensee can include a receivable amount to the extent that it is owing by way of fees from, or under rights of reimbursement for expenditure by the licensee out of property



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of, a superannuation entity as defined in the Superannuation Industry (Supervision) Act 1993, an IDPS or a registered scheme ("scheme") to the extent that the receivable:

- (i) exceeds amounts invested by the scheme in, or lent (other than by way of a deposit with an Australian ADI in the ordinary course of its banking business) directly or indirectly by the scheme to, the licensee, a body corporate the licensee controls, a body corporate that controls the licensee or a body corporate that the licensee's controller controls; and
  - (ii) if receivable by way of fees, represents no more fees than are owing for the last 3 months; and
  - (iii) if receivable under rights of reimbursement for expenditure by the licensee, has not been receivable for more than 3 months; and
- (g) despite paragraph (c) of this definition, the licensee does not have to exclude a managed investment product unless any part of the amount invested is, in substance, directly or indirectly, invested in the licensee.

**foreign exchange contracts** means "foreign exchange contracts" as defined in section 761A of the Act (including regulation 7.1.04 of the Corporations Regulations) and includes "derivatives", as defined in section 761D of the Act, that are foreign exchange contracts.

**managed investment warrant** means a financial product:

- (a) that is a financial product of the kind referred to in subparagraph 764A(1)(b)(ii) or 764A(1)(ba)(ii); and
- (b) would be a derivative to which section 761D applies apart from the effect of paragraph 761D(3)(c); and
- (c) that is transferable.

**market participant** means:

- (a) a participant as defined in the operating rules of ASX Limited ("ASX"), as at the date of this licence (other than a Principal Trader, unless the Principal Trader is registered as a Market Maker), who complies with the ASX's operating rules that relate to financial requirements, taking into account any waiver by ASX; or
- (b) a participant in the licensed market operated by Sydney Futures Exchange Limited ("SFE") that:
  - (i) restricts its financial services business to participating in the licensed market and incidental business supervised by SFE; and
  - (ii) complies with the SFE's operating rules, as at the date of this licence, that relate to financial requirements, taking into account any waiver by SFE.

**MDA service** means a service with the following features:

- (a) a person ("the client") makes client contributions; and
- (b) the client agrees with another person that the client's portfolio assets will:
  - (i) be managed by that other person at their discretion, subject to any limitation that may be agreed, for purposes that include investment; and



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- (ii) not be pooled with property that is not the client's portfolio assets to enable an investment to be made or made on more favourable terms; and
- (iii) be held by the client unless a beneficial interest but not a legal interest in them will be held by the client; and
- (c) the client and the person intend that the person will use client contributions of the client to generate a financial return or other benefit from the person's investment expertise.

**net tangible assets or NTA** means adjusted assets minus adjusted liabilities.

**old law securities options contracts** means "options contracts" as defined under section 9 of the Act immediately prior to 11 March 2002 which were "securities" as defined under section 92(1) of the Act immediately prior to 11 March 2002.

**Option 1** means the reasonable estimate projection plus cash buffer basis where the licensee is required to:

- (a) prepare a projection of the licensee's cash flows over at least the next 3 months based on the licensee's reasonable estimate of what is likely to happen over this term; and
- (b) document the licensee's calculations and assumptions, and describe in writing why the assumptions relied upon are the appropriate assumptions; and
- (c) update the projection of the licensee's cash flows when those cash flows cease to cover the next 3 months or if the licensee has reason to suspect that an updated projection would show that the licensee was not meeting paragraph (d) of this definition; and
- (d) demonstrate, based on the projection of the licensee's cash flows, that the licensee will have access when needed to enough financial resources to meet its liabilities over the projected term of at least 3 months, including any additional liabilities the licensee projects will be incurred during that term; and
- (e) hold (other than as trustee) or be the trustee of a relevant trust that holds, in cash an amount equal to 20% of the greater of:
  - (i) the cash outflow for the projected period of at least 3 months (if the projection covers a period longer than 3 months, the cash outflow may be adjusted to produce a 3-month average); or
  - (ii) the licensee's actual cash outflow for the most recent financial year for which the licensee has prepared a profit and loss statement, adjusted to produce a 3-month average.

For the purposes of this definition references to the licensee's cash flow include the licensee's own cash flow and any cash flow of a relevant trust but do not include cash flows of any other trust.

For the purposes of paragraph (e) of this definition, "cash" means:

- (A) current assets valued at the amount of cash for which they can be expected to be exchanged within 5 business days; or
- (B) a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least a month;



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but does not include any cash in a relevant trust if the licensee has reason to believe that the cash will not be available to meet all of the projected cash flows of the licensee.

**Option 2** means the cash needs requirement on the contingency-based projection basis where the licensee is required to:

- (a) prepare a projection of the licensee's cash flows over at least the next 3 months based on the licensee's estimate of what would happen if the licensee's ability to meet its liabilities over the projected term (including any liabilities the licensee might incur during the term of the projection) was adversely affected by commercial contingencies taking into account all contingencies that are sufficiently likely for a reasonable licensee to plan how they might manage them; and
- (b) document the licensee's calculations and assumptions, and describe in writing why the assumptions relied upon are the appropriate assumptions; and
- (c) update the projection of the licensee's cash flows when those cash flows cease to cover the next 3 months or if the licensee has reason to suspect that an updated projection would show that the licensee was not meeting paragraph (d) of this definition; and
- (d) demonstrate, based on the projection of the licensee's cash flow, that the licensee will have access when needed to enough financial resources to meet its liabilities over the projected term of at least 3 months, including any additional liabilities the licensee might incur during that term.

For the purposes of this definition references to the licensee's cash flow include any cash flow of a relevant trust.

**regulated trust account** means:

- (a) a trust account maintained by an authorised trustee corporation under the law of a State or Territory; or
- (b) a solicitor's trust account; or
- (c) a real estate agent's trust account; or
- (d) a trust account maintained by an entity other than the licensee and that provides protections similar to the accounts described in paragraphs (a) to (c) of this definition, and is approved by ASIC for the purpose in writing.

**relevant trust** means, for the purposes of the definitions of "Option 1" and "Option 2" of this licence, a trust:

- (a) where substantially all of the financial services business carried on by the licensee is carried on as trustee of a trust; and
- (b) that it is not a registered scheme or a superannuation entity as defined in subsection 10(1) of the Superannuation Industry (Supervision) Act 1993.

**standard adjustments** means:

- (a) discounts as follows:



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- (i) 8% for the values that reflect obligations to pay the licensee a certain sum maturing beyond 12 months unless the interest rate applicable is reset to reflect market interest rates at least annually; and
- (ii) 16% for the values that reflect any assets other than:
  - (A) an obligation to pay the licensee a certain sum; or
  - (B) a derivative; or
  - (C) an interest in property held in trust by another licensee under Division 3 of Part 7.8 of the Act or the rights to money held by another licensee in an account under section 981B of the Act; and
- (b) 8% of the values that reflect others' obligations to pay the licensee a certain sum except to the extent that the asset is adequately secured or is a right against another licensee in respect of money or property held by that other licensee in an account under section 981B or held in trust under Division 3 of Part 7.8 of the Act; and
- (c) the following amounts for contingent liabilities and contingent liabilities of any trust (other than a registered scheme) of which the licensee is trustee:
  - (i) 5% of any contingent liabilities that can be quantified under an underwriting or sub-underwriting of financial products except:
    - (A) during the 5 business days after the commitment is assumed; and
    - (B) during any period it is unlawful to accept applications for the financial products to which the underwriting relates (such as under subsection 727(3) or section 1016B) and the period ending 5 business days after the first day on which it becomes lawful to accept applications; and
    - (C) to the extent that the underwriter holds funds from persons seeking to acquire the financial products subject to the underwriting; and
  - (ii) 5% of the potential liability of any contingent liabilities that can be quantified under a derivative other than to the extent there is an offsetting position in any of the following or a combination of the following:
    - (A) the "something else" for the purposes of paragraph 761D(1)(c) of the Act; and
    - (B) another derivative relating to that something else; and
    - (C) a thing that is so similar to the something else as to make the probability of net loss from the liability under the derivative exceeding any increase in the value of the thing less than 5% in the reasonable and documented opinion of the licensee,  
except to the extent that the licensee is of the reasonable opinion that the risk that they will become liabilities (or become liabilities to a greater extent than taken into account for the purposes of applying the adjustment) because of a change in the price or value of the something else is trivial; and
  - (iii) 20% of the potential liability of any contingent liabilities that can be quantified under a guarantee or indemnity;
- (d) the relevant percentage as set out in subparagraphs (c)(ii) and (c)(iii) of the amounts that in the licensee's reasonable opinion is the maximum amount that the licensee may be liable for in relation to a contingent liability referred to in paragraph (c) where the maximum liability cannot be quantified; and
- (e) where the licensee has agreed to sell an asset that it does not hold, the amount of the adjustment that would apply if it held that asset is to be applied against adjusted assets.



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For the purposes of this definition, the risk that a contingent liability will become a liability may be treated as trivial if the probability that this will occur is reasonably estimated by the licensee as less than 5%.

For the purposes of paragraphs (a) and (b) of this definition, discounts apply against the value of current assets:

- (f) used in calculating “adjusted assets” in this licence; and
- (g) of any trust (other than a registered scheme) of which the licensee is a trustee (see subparagraph (f)(ii) of the definition of “adjusted assets” in this licence); and
- (h) that are deducted under paragraph (c) of the definition of “adjusted assets” in this licence as assets to which recourse may be had for a liability of the licensee where the licensee's liability is limited to those assets but the total discounts applied to those assets shall not exceed any excess of the value of the licensee's assets to which recourse may be taken over the amount of the liability; and
- (i) that is the applicable percentage of the current assets that would be acquired in return for paying a contingent liability referred to in subparagraph (c)(i) or (iii) of this definition including rights against a sub-underwriter (see paragraph (g) of the definition of “adjusted assets” in this licence).

The licensee does not have to apply the discounts to the value of amounts payable from a client in the ordinary course of its financial services business for financial products that the client has agreed to buy, if the money is required to be – and in the reasonable estimation of the licensee probably will be – paid no more than 5 business days after the client became liable.

**surplus liquid funds or SLF** means adjusted assets minus adjusted liabilities:

- (a) plus any non-current liabilities that were used in calculating adjusted liabilities and the value of any assets that are encumbered (where the licensee is not liable and the assets do not secure another person's current liability) that were deducted when calculating the licensee's adjusted liabilities; and
- (b) minus any non-current assets that were used in calculating adjusted assets; and
- (c) if the licensee is an eligible provider under paragraph (b) of the definition of “eligible provider” under this licence – plus one quarter of the value of the licensee's non-current assets minus any intangible assets and the amount of its non-current liabilities.

**trigger point** means either of the trigger points described in condition 7 of this licence.



## Applicability of Regulatory Requirements

Provision	Risk	Applicability or how otherwise addressed
<p><b>Scheme Property</b></p> <p>Ensure that scheme property is clearly identified as scheme property and held separately from the property of the responsible entity (s 601FC(1)(i)).</p> <p>Pursuant to s 601 FC (2) scheme property is to be held on trust for scheme members.</p> <p>Scheme property must be valued at regular intervals as required by s 601 FC (i)(j).</p> <p>All payments out of scheme property must be made in accordance with the constitution and the Act.</p> <p>"Whilst there may be practical difficulties in the discharge of the responsibilities of the responsible entity, for example, in relation to valuation of the contractual promises, this is not a reason for reading down the meaning of the statutory definition because provision is made for exemptions of schemes which might unintentionally be caught by the definition: see s 601QA; Australian Softwood Forests at 130; Knightsbridge Managed Funds at [49]."</p> <p>Section 601FG Acquisition of interest in scheme by responsible entity. Majority in Brookfield Decision determined that the Funder had an interest in the scheme. However, Section</p>	<p>Scheme property is lost through fraud or negligence, scheme property is exposed to the creditors of the responsible entity (or any custodian appointed to hold scheme property) or property records are not properly maintained</p>	<p>Scheme property is (on the Brookfield Decision majority analysis) the promises provided to the funder to pay the funder a share of the recoveries (Resolution Sum).</p> <p>Given the promises are made to the funder to support the payment to the funder of an amount arising from the litigation, it is difficult to see how this property could be separated from the funder's own property. It is the funder's own property.</p> <p>The promises are a chose in action and do not require the degree of protection afforded to property which is capable of transfer without recourse.</p> <p>The 'promises' can not be valued in the usual sense. Each claim is for an amount and the possibility of a return depends upon the success of the litigation and enforceability of any judgment.</p> <p>Unless the responsible entity maintains a certain level of net tangible assets, then a third party custodian must be appointed to hold scheme property which generally must have \$5 million in net tangible assets. Given that scheme property in this case comprises a chose in action, it is difficult to see how this could be extended to the promises comprising scheme property.</p> <p>The cash which is received on settlement or successful conclusion of the litigation is held in a solicitor's trust account and</p>

<b>Provision</b>	<b>Risk</b>	<b>Applicability or how otherwise addressed</b>
<p>601FG assumes a uniformity of interests so they have equal value and can only be issued at the same price as each other.</p>		<p>subject to regulation under the State based regulatory regimes applicable to solicitors. The trust account is subject to audit and beneficiaries have claims under State based fidelity fund regimes in the event of defalcation.</p>
<p><b>Change in Responsible Entity</b></p> <p>Section 601FK and following provides for the change of the responsible entity. A change of responsible entity can take place on the responsible entity retiring or being removed by members.</p>	<p>The risk is that the scheme is being operated by a person who no longer wishes to pursue the scheme as responsible entity, or that the scheme members (or ASIC) wish to ensure another person is responsible for its operation.</p>	<p>Realistically a change of responsible entity can only take place if the funding arrangements are assumed by a new responsible entity. This would require, among other things, that the new responsible entity repay the outgoing responsible entity for the amounts expended on the litigation and commit to assume the ongoing funding risks.</p> <p>A typical managed investment scheme does not have a responsible entity with arguably a greater exposure than the other participants. This highlights the fact that the managed investments regime is designed to protect investors who have a capital exposure gained by 'paying' money or money's worth for an interest in the scheme. In this case, the responsible entity has a greater capital exposure and risk of loss than the participants, while the litigation is being determined.</p>
<p><b>Right to withdraw</b></p> <p>Section 601KA deals with member's right to withdraw. The assets of a litigation funding scheme are not be capable of being realised and so any such scheme would be illiquid. Accordingly, withdrawal could only be permitted with a withdrawal offer made by the responsible entity.</p>	<p>The risk is that members do not have a right to withdraw that is fair in the circumstances or that they are permitted to withdraw from an illiquid scheme in circumstances where there is not sufficient cash available to meet the withdrawal request (and remaining members are disadvantaged as a consequence)</p>	<p>Provisions do not readily apply – if a member withdrew they could receive no consideration as such, given that the scheme would not have any available money and the member's claim value is contingent on the success of litigation. This highlights how provisions of the managed investments regime do not readily apply to this arrangement.</p>

<p><b>Consideration for an interest</b></p> <p>Sections 601GA(1)(a) requires that a scheme constitution make adequate provision for the consideration that is to be paid to acquire an interest in the scheme and RG 134.27 - 30 requires that this be an independently verifiable price. Other requirements of section 601GA(1) raise similar difficulties for litigation funding arrangements.</p>	<p>The risk is that members are not treated equitably.</p>	<p>Provisions do not apply to litigation funding arrangements.</p>
<p><b>Member Voting</b></p> <p>Part 2G.4 and relevant sections within Chapter 5C deal with member voting and matters on which scheme members are entitled to vote. Generally, members can vote on a change of responsible entity, a change to the constitution and removal of the responsible entity and to choose a new responsible entity. They can also vote on the winding up of the scheme.</p>	<p>To enable members to vote on key decisions concerning the operation of the scheme.</p>	<p>In each case, there is a tension between the members collectively voting to alter a contractual arrangement that each of them has chosen to enter with the responsible entity and the affect on individual members rights in the event that a vote was held. Also there is the question of how to calculate votes which depend upon a register of members as such and the value of their interests. How is this value determined given it is based on contingent litigation rights? This is also complicated by the Funders 'interest' in the scheme which in the short term, could be said to outweigh the value of the individual claimant's interest, given the priority return as a result of the Funder's preparedness to outlay cash to pursue a result for all litigants.</p> <p>It is difficult to see how these provisions will operate given the funder's own significant financial interest in the funding arrangements (and therefore its interest in the scheme) and the difficulties in valuing members' interests by which their rights to vote are determined.</p> <p>It is also worth noting that the</p>

		<p>members' register for a registered scheme is available for all persons to inspect and obtain copies (s 169 and 173, Corporations Act). There is a question as to whether this is in the interests of the litigants.</p>
<p><b>Financial Reports</b></p> <p>Part 2M deals with the preparation of financial reports.</p>	<p>To ensure that scheme members are adequately informed about the scheme (trust's) financial performance.</p>	<p>The majority in the Brookfield Decision may have determined that the promises were being, or were to be, held on trust but the nature of the arrangements is such that the 'liabilities' are being incurred by the litigation funder in its own capacity, with a right to recover only in the event that the multi party action is successful and there is a sum available from which its expenses can be met.</p> <p>Again this differs from a typical managed investment scheme where members bear scheme expenses on an ongoing basis from scheme property, after having paid an amount of money or assets which generate income so that expenses can be met from their money or assets.</p>



### ANNEXURE C

Provision	Obligation	Comment
601FC(2)	Scheme property held on trust	Inappropriate for intangible chose in action; resolution sum dealt with separately via solicitor's trust account
601FC(3) 601FD(2) 601FE(2)	Duty of RE overrides other duties	Solicitor's duty to group members paramount
601FD(1)(e) 601FE(1)(b)	Not to make improper use of position to gain advantage or to cause detriment to scheme members	Solicitor's duty
601FF	ASIC may check compliance with Act, constitution and compliance plan	Supervision of court, solicitor subject to <i>Legal Profession Act</i> regulation
601FG	RE may acquire interest in scheme but not for less than any other person or to disadvantage of members	Inapplicable
601FH	Liquidator's right of indemnity	Inapplicable
601FJ-601FT	Changing RE	Solicitor may be changed at any time upon 7 days notice after consultation with funder. Funder may only be terminated if in breach (fair given no money upfront from group members)
601GA(1)(a)	Constitution must prescribe consideration to acquire interest	Funding agreement
601GA(1)(b)	Constitution must prescribe powers of RE dealing with scheme property	Funding agreement and retainer spell out obligations
601GA(1)(c)	Constitution must prescribe method for complaint resolution	Solicitor subject to <i>Legal Profession Act</i> regulation provides mechanisms for complaints re conduct and legal fees. Funding agreement provides dispute resolution mechanism re settlement. Overall arrangements subject to court's supervision.
601GA(1)(d)	Constitution must deal with winding up	Generally inapplicable though funding agreement does provide detailed prescription re distribution of resolution sum
601GA(2)	Constitution must prescribe rights to RE for fees, only available for proper performance of duties	Funder's commission prescribed by agreement only available if resolution sum following either judgment by court or settlement approval. Solicitor's fees regulated by retainer and <i>Legal Profession Act</i> regulation, subject to court approval
601GA(3)	Power to borrow or raise money must be prescribed by constitution	Inapplicable

**ANNEXURE C**

<b>Provision</b>	<b>Obligation</b>	<b>Comment</b>
601GA(4) 601KA-601KE	Right to withdraw from scheme must be provided by constitution	Funding agreement has cooling off period, court procedures deal with opting out and opting in, group member may terminate if funder in breach
601GC	Constitution changed by special resolution of members	Inappropriate for funding arrangements to change mid-litigation since group members put up no money upfront. Overall arrangements subject to court supervision.
601HA(1)(b) 601JA-601JJ	Compliance plan must ensure adequate arrangements for compliance committee, various provisions re compliance committee	Unnecessary, solicitor's duties to group members subject to <i>Legal Profession Act</i> regulation and overall supervision of court
601HA(1)(d)	Compliance plan must be audited	Unnecessary, solicitor's duties to group members subject to <i>Legal Profession Act</i> regulation and overall supervision of court
601HA(1)(e)	Compliance plan must ensure adequate arrangements for keeping records	Solicitor's duties to group members subject to <i>Legal Profession Act</i> regulation and overall supervision of court
601HB-601HI	Provisions re compliance plans	Not relevant for reasons set out above
601LA-601LE	Related party transactions	Not relevant.
601MA	Member may recover loss for contravention of chapter	Group member may recover loss for solicitor's negligence
601MB	Member's right to withdraw if scheme operated contrary to part	Group member may terminate arrangements if funder in breach, opting out and opting in provisions subject to court order, litigation funding arrangements subject to general court supervision
601NA-601NG	Winding up	Generally inapplicable, funding arrangements provide for what is to occur on successful resolution. Unsuccessful outcome group members owe nothing.
601PA-601PC	De-registration	Inapplicable