Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL1–FSL5

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Interim Report A Background Papers
March 2022

This compendium brings together five background papers released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry'). These background papers provide a high-level overview of topics relevant to Financial Services Legislation Interim Report A.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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BACKGROUND PAPER FSL1

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Initial Stakeholder Views

June 2021

This summary of initial stakeholder views is the first in a series of background papers to be released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation (‘the Inquiry’).

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

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Introduction and Summary

1. The ALRC is committed to listening to the views of stakeholders. This Background Paper summarises the views expressed to the ALRC by stakeholders as at May 2021 on major themes relating to simplification of the legislative framework for corporations and financial services. The views of stakeholders on these and other themes will continue to be considered by the ALRC alongside its own research and analysis to inform the recommendations it ultimately develops.

2. The ALRC is publishing this summary of initial stakeholder views as a way of reflecting on the perspectives encountered over the first eight months of this three-year inquiry, and to keep stakeholders apprised of developments in the ALRC's thinking at this early stage of the inquiry.

3. The ALRC has proactively sought out the views of interested stakeholders on this Inquiry in a number of ways, including holding public webinars, arranging targeted consultations, and attending industry and professional events. The ALRC will call for formal submissions after the release of its first Interim Report on 30 November 2021.

4. In addition, the ALRC has analysed submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the 'Financial Services Royal Commission') that related to legislative complexity, to understand stakeholder views that have already been aired. In this way, the ALRC is seeking to maximise stakeholder input without overwhelming stakeholders with requests for formal submissions or discussions.

5. There has been a level of consensus amongst stakeholders that the law in this area is 'too complex' and in need of simplification. Acknowledging that a degree of legal complexity is necessary to regulate complex and evolving industries, most stakeholders nevertheless recognise that some aspects of complexity are unnecessary and unhelpful. Many stakeholders have identified navigability of the law to be a key concern – it is too difficult to locate relevant parts of the law, and even experienced lawyers cannot always be confident that they are taking into account all relevant provisions and instruments on a particular issue without 'missing something'.

6. Some stakeholders have described the intricacy of key statutory definitions as 'impenetrable'. Many have urged that relevant provisions on a particular topic should be grouped together 'in one place' to the extent possible, rather than spread unpredictably across different levels of the legislative hierarchy. The ALRC has also been urged to consider carefully how principles and norms can be helpfully integrated and balanced with more detailed and prescriptive rules that are also often required. Observations such as these go to the heart of the topics raised in the inquiry Terms of Reference and are guiding the ALRC's approach to the Inquiry.

7. This Background Paper focuses on three principal sources of stakeholder views collated to date: ALRC consultations with stakeholders; comments submitted to ALRC public webinar events; and submissions made to the Financial Services Royal Commission.

8. The ALRC has noted greater resistance to the idea of legislative simplification in certain submissions to the Financial Services Royal Commission than in consultations

for this Inquiry. This variation may be largely due to different perceptions about what 'simplification' of the law might entail. For example, some stakeholders expressed concerns that simplification might in practice mean deregulation, and weakening protection for consumers. Others feared it might mean stripping the law back to principles alone, without a necessary level of detail or certainty to guide industry. Accordingly, it will be important for the ALRC to be transparent throughout the Inquiry about the guiding principles that inform what simplification means and how simplification might best be achieved.

ALRC consultations

Emerging consensus

9. The table below contains a high-level outline of the consensus emerging from the consultations to date on major themes relevant to the Inquiry.

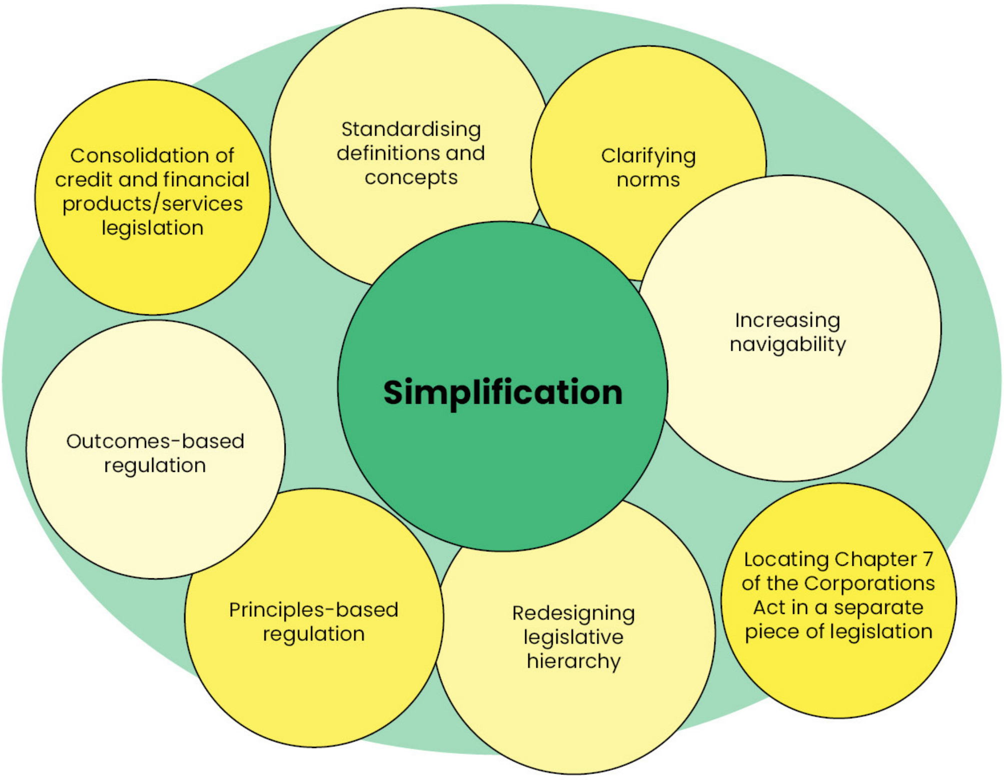
Theme	Comments/reservations	Related themes
Level of support - strong		
Increasing navigability	• Support for greater clarity and coherence in respect of legislative instruments in particular. • Support extends to the use of technology to aid navigability, the use of legislative outlines and other navigation tools.	Redesigning legislative hierarchy Standardising definitions and concepts
Simplification	• Need to articulate what 'simplification' means and test support with examples. • Simplification should not result in less consumer protection (deregulation) or less certainty.	Principles-based regulation
Standardising definitions and concepts	• Both within *Corporations Act* and across legislation (eg the prohibitions against misleading or deceptive conduct and unconscionable conduct). • Locating definitions in one place and sign-posting.	Increasing navigability Redesigning legislative hierarchy
Reinstatement of a body like the former Corporations and Markets Advisory Committee (CAMAC)	• Support for a broader remit (including overseeing the implementation of reform) and broader representation (multi-disciplinary).	
Locating Chapter 7 of the *Corporations Act* in a separate piece of legislation	• Given the objectives of Chapter 7, its location within legislation governing companies/securities is anomalous. • Support for incorporating Part 2 Division 2 of the *ASIC Act*.	Increasing navigability Standardising definitions and concepts

<table>
<tr><th>Theme</th><th>Comments/reservations</th><th>Related themes</th></tr>
<tr><td colspan="3">Level of support - general</td></tr>
<tr><td>Principles-based regulation</td><td>Hesitancy about principles on their own – recognition that principles should be backed by clear policy and accompanied by rules/outcomes/guidance and indicative behaviours.
Recognition of the effectiveness of the Eggleston principles in the takeovers area.</td><td>Simplification</td></tr>
<tr><td>Redesigning legislative hierarchy</td><td>Support for:
use of consistent terminology across primary and secondary legislation and guidance documents
removing unnecessary detail from primary legislation (a minority supported moving more detail into primary legislation, although it was not clear how this might be implemented in practice)
reducing overlap and inconsistencies with secondary legislation
limiting the use of legislative instruments to modify the primary legislation
setting out detailed rules in a more consolidated and thematic way (by reference to subject areas and possibly by reference to sector/industry)
greater reliance on soft law/industry guidance/codes of conduct (although no consensus about what might be appropriate in this regard)</td><td>Increasing navigability</td></tr>
<tr><td>Consolidation of credit and financial products/services legislation</td><td>There is no apparent policy or other reason for bifurcation (subject to clearing any constitutional/referral issues) and current system leads to duplication, inconsistency and complexity/confusion for industry.
Recognition that the benefits would need to justify the cost and other implications.</td><td>Increasing navigability

Standardising definitions and concepts</td></tr>
</table>

Theme	Comments/reservations	Related themes
Level of support - mixed		
Outcomes-based regulation	• Hesitancy as to how to clarify, express and measure consumer outcomes.	Principles-based regulation
Clarifying norms	• Hesitancy as to how norms should be interpreted and embedded in legislation. • Support for the following: ○ expanding objects clauses as part of a principles-based approach; ○ incorporating Hayne norms into objects clauses; and ○ increasing the use of provisions that list matters that the courts must take into account when making certain determinations. • Hesitancy about fairness and its potential imprecision/indefinability but recognition that this is becoming more prominent in areas such as 'unfair trading' or 'unfair dealing'.	Principles-based regulation Standardising definitions and concepts

Figure 1: Visualisation of emerging themes



10. The themes raised by consultees continue to develop and evolve as we conduct ongoing consultations and undertake our own analysis.

Potential policy implications

11. The following is a list of some key policy and related issues identified by stakeholders during the course of ALRC consultations to date:

- The need for transparency of policy objectives in the architecture of the regulation and definition provisions;
- Appropriate rule-making powers for the Australian Securities and Investments Commission (ASIC);
- Vesting consumer protection in a separate agency (or a separate Division within ASIC);
- Rationalising disclosure regimes:
    - Note the relationship and potential overlap with the incoming Design and Distribution Obligations;
    - Continuous disclosure and civil liability regime (strict liability and lack of a defence – problems with ss 1308 and 1309 of the *Corporations Act*);
- Problems applying the retail client/wholesale client distinction (and sophisticated investor exception);
- Problems with the distinction between personal advice and general advice;
- The challenges of defining financial advice narrowly by reference to financial products and whether 'strategic advice' should be distinguished from, rather than regulated in the same way as, 'financial product advice';
- The potential benefits of individual licensing of financial advisers (rather than licensing entities);
- Concerns regarding prescriptive regulation of financial advisers generally and incompatibility with moves to achieve greater professionalisation of the industry;
- The need for harmonisation of state laws and Commonwealth laws in areas such as insurance.

Example provisions described positively

12. The following table outlines (non-exhaustively) some of the statutory provisions and concepts that one or more stakeholders have described positively, or as working well, in ALRC consultations to date:

Section or concept	Any relevant comments
Within Chapter 7 of Corporations Act	
Recent amendments such as Part 7.5A and 7.5B	• More reliance on undefined terms and ASIC Rules helpful. • Section 901J requirement for ASIC to consult in relation to Derivative Transaction Rules helpful.
The 'efficiently, honestly, fairly' standard	• Sensibly interpreted, and is an effective rules-based standard, yet still operates effectively at a principled level.
Financial product and financial service definitions	• The functional definitions are good; the exclusions are the problem. • The distinction between securities and other financial products is a useful gateway to the legislation.
PDS model	• Within disclosure, the PDS model works most effectively.
Market misconduct provisions	• Better systems for determining breaches, and strong judicial leadership (NSWCA) in clarifying the meaning of provisions.
Outside Chapter 7 of Corporations Act	
Chapter 6	• Uses blanket definitions with a suite of exceptions. Perhaps working well because of the role of the Takeovers Panel or because smaller group of operators in Ch 6 area. • Takeover Panel effective because it can make prompt rulings. • More principles-based. In addition, Takeovers Panel is an effective quasi regulator. • The principles are appropriately supported by more detailed rules, and ASIC has worked with practitioners and industry to fix errors. • There is a clearer consensus on what Ch 6 is trying to achieve.
Insolvency (Chapter 5)	• Insolvency practitioners' model – pulled out a number of provisions from the body and moved them to the schedule with renumbering.
Directors' duties (Chapter 2D)	• Principles-based.
Definition of managed investment scheme (Chapter 5C)	• Clearer concept with examples works well.
Buyback provisions (s 257B)	• The use of a table is effective.

Outside the Corporations Act	
Market Integrity Rules	• Consolidated ASX supervision regime.
PPS Act	• Definitions do not do substantive work.
FCA Handbook	• More understandable than ASIC regulatory guidance. • One-stop shop.
Unfair contract terms	• The standard of 'fairness' in the unfair contract terms space has been working effectively.
ASX listing rules	• ASX listing rules are clear.
Reverse mortgage information sheet	• Examples of a template useful for consistency in disclosure.
Reserve Bank's objectives	• Clearly expressed. Focuses and underpins their work.
Financial Services and Markets Act 2000 (UK)	• Relatively short and clear.
Securities Act 1990 (Ontario)	• Model of inclusion aims and principles in legislation – ss 1.1 and 2.1

Example provisions described negatively

13. The following table outlines (non-exhaustively) some of the statutory provisions and concepts that one or more stakeholders have described negatively, or as not working so well, in ALRC consultations to date:

Section or concept	Any relevant comments
Within Chapter 7 of Corporations Act	
Disclosure provisions	• A few consultees noted that there is less need for disclosure in light of DDO. • Impenetrable. • Need simplification. • Can be counter-productive. • None of the many disclosure regimes are helpful. • Should be more standardised. • Should rationalise financial fundraising and product disclosure regimes. • Disclosure is still based on FSR Act model, but legislation has otherwise shifted to more of a DDO model. • More principle-based disclosure regime is required. • Level of what is material is becoming more complicated. • Regime doesn't consider the capabilities of the person receiving disclosure. • People don't understand what is disclosed to them. • Does not work. Consider having standardised products, for which lesser disclosure would be required. Only have detailed disclosure for non-standard products. • Need to bring Chapter 6, 6D and 7 into alignment. • The inclusions in s 710 do not really work. • Section 946AA provides an exemption from the requirement to provide a Statement of Advice, but interacts in a complex, and potentially contradictory way with Reg 7.7.09A. • Unclear re fee disclosure in interaction between ASIC RG 179 and RG 175 and RG 97 in the context of licence variations for an issuer of a managed discretionary account. • Advisers can control disclosure risks if they are better trained/ certified.

Section or concept	Any relevant comments
Financial product definition	• Several consultees noted that it does not make sense to exclude credit. • A few consultees noted that the definition differs from Div 2 Pt 2 of *ASIC Act*. • A few consultees noted that the derivative definition is confusing. • Too complex. • Structure and breadth of definition (in particular, the 'managing a financial risk' element in s 763A(1)(c)) leads to uncertainty. • Functional definition too broad. • Should be streamlined across *ASIC Act*, *Corporations Act*, *NCCP Act*. • Lack of clarity in relation to what 'settled immediately' means for purposes of s 764A(1)(k). • Lack of clarity in relation to making non-cash payments (s 763D). • Many products are simultaneously investment and credit. • Unclear what type of product cryptocurrencies are. • The regulations re-write the definition of derivative. • Non-cash payment definition unclear; people shop around law firms to find the interpretation that suits them.
General/personal advice distinction	• Some consultees noted that the distinction is unclear and that the High Court should not be needed to clarify boundaries. • Distinction is not workable in practice in client interactions. • A lot gets caught up in the definition of 'general advice'. • General advice should be renamed 'product information'. Currently this definition is too difficult to apply. • Unclear re the limited advice programs in large superannuation companies and the advice given by call centres. • Inappropriate in an insurance context. • 'General advice' is a misleading label because it is not really advice.
Retail/wholesale client distinction	• A few consultees noted that the thresholds have not been updated since introduction in 2001. • Confusing (particularly because sometimes product-based and sometimes client-based) and difficult to apply in practice. • Issues with implementation. • Wealth threshold not effective. • Categories not fit for purpose. • Different definitions in *Insurance Contracts Act*.

Section or concept	Any relevant comments
Financial product advice definition	• A few consultees noted that they would like to see a shift away from the 'product' focus in the regulation of advice – eg to recognise strategic advice. • Definition is too broad. • Too complex. • Needs to be streamlined. • Should not include superannuation calculators – they are financial literacy tools.
'Efficiently, honestly, fairly' standard (s 912A)	• Needs clarification. • Civil penalty for breach is inappropriate. • 'Fairness' sitting alongside 'efficient' may mean different things to different people. This is problematic.
Financial service definition	• Concept of 'arranging' (to deal) is undefined (s 766C(2)). • Definition differs from Div 2 Pt 2 of *ASIC Act*. • Could be simplified.
Misleading and deceptive conduct	• Overlap across multiple statutes.
Basic deposit product definition (s 761A)	• Would benefit from simplification. • Too complex and uncertain.
Conflicted remuneration	• Definition in s 960A and s 963A is complicated to work through and generally unclear.
Breach reporting	• Too prescriptive • Changes made in December 2020 cannot be understood by anyone except lawyers and compliance experts
Dealing with client money provisions	• Lack of clarity with respect to definitional provisions setting out when Subdiv A of Div 2 of Part 7.8 applies. • Not effective.
Future of Financial Advice (FOFA) provisions	• Overly complex. • Confusing.
Conflict of interest provisions	• Too complex.
Criminal provisions inc s 1311	• High level of complexity in those provisions. In particular, complex interaction between s 1311 and *Criminal Code*.
Insider trading provisions	• Lack of definition in relation to the concept of 'readily observable matter': s 1042C(1)(a).
Financial services law definition (s 761A)	• Broad definition that can be difficult to interpret.

Section or concept	Any relevant comments
Market rules and derivative transaction rules	• Difficulties with having these outside the Act.
Anti-hawking provisions	• Very complex. Difficult to work out what to do to comply.
Outside Chapter 7 of Corporations Act	
Securities definition	• Several consultees noted that there are too many different definitions within the Act. • Definition is heavily modified according to context, which is confusing. Policy rationale for modifications is not clear. • A broad definition with part specific exclusions would avoid the need to modify the definition itself for each part.
Insolvency (Ch 5)	• Australian insolvency law is overly complex (described by one consultee as 'amongst the most complex and voluminous in the world). • Lack of coherence and consistency of definitions for similar fundamental concepts across personal bankruptcy and corporate insolvency laws. • Needs a root and branch review.
Continuous disclosure (Ch 6CA)	• Would be better if linked to s 1041H. • Why is there a defence available for prospectus disclosure breach but not continuous disclosure? • Due diligence defence for continuous disclosure breaches is necessary.
Managed investment scheme definition (Ch 5C)	• Unclear how distinct from 'financial product'.
Fundraising (Ch 6D)	• Problem with the consumer protections bleeding into sophisticated market.
Small Business Guide	• Should just be repealed.
Definitions of associate/close associate/closely related party	• Too many definitions of very similar but slightly different concepts. • Definition in s 12 is terrible and leads to uncertainty.
s 203D(2) and s 249D Corporations Act	• Inconsistent.
s 1308 and s 1309	• Problematic because criminal liability attaches to failure to take reasonable steps.
Insolvency practice schedule	• Too inflexible.

Section or concept	Any relevant comments
Outside the Corporations Act	
Credit definitions	• Several consultees commented on the existence of different definitions of credit for *NCCP Act* and *ASIC Act* and *Corporations Act*. • Inconsistency in exclusions from consumer credit definition in *NCCP Act* and *Privacy Act* resulting in potential mismatch in particular loans afforded protection under these Acts. • 'Credit assistance' definition also unclear. • New products are falling outside this concept.
Banking Act	• Unclear concepts of 'prudential standard' and 'prudential matters', eg in BEAR. • BEAR has multiple definitions for particular responsible persons, but often end up capturing the same individuals. Compliance complexity results.
Australian Consumer Law	• Confusing. • Inconsistencies with *ASIC Act* in terms of regulation of warranties and use of defined terms.
Small business definition	• Several consultees raised the inconsistent use of the small business definition across and within Acts as an issue.
Credit licensing	• Should be consolidated with AFS licensing.
Responsible lending	• Unclear concepts of 'reasonable inquiries' and 'reasonable steps'.
Unfair contract terms	• This regime undermines contractual certainty and makes it difficult to accurately price the risk.
Statutory unconscionability	• Uncomfortable relationship with general law concepts.

Categories and number of consultees to date

Legal practitioners	**49**
Academics	**38**
Industry bodies	**18**
Financial services providers	**9**
Judges	**6**
Consumer representatives	**3**
Regulators	**3**
Total	**131**

Submissions to the Financial Services Royal Commission

Introduction

14. Most submissions in response to the Interim Report of the Financial Services Royal Commission that addressed issues of legislative and regulatory complexity agreed that the law and regulatory regime are too complex. These include submissions from private individuals, consumer representatives, and industry bodies.

15. Comparing submissions from entities and individuals, there were more mixed views about simplification from entities than from individuals. Some of the entities' concerns included that legislative simplification could result in 'watering down' of consumer protections, or that it could create significant transitional costs for industry (which would be passed on to customers) in adjusting to the new regulatory regime. Some entities therefore urged for a cautious approach to be taken to any simplification process.

16. Amongst the submissions from entities, there was agreement between banking institutions, consumer groups, industry bodies, legal bodies, and a dispute resolution body that the financial services law should be simplified. However, on the question of whether the law is too complicated, the two banking institutions that made submissions expressed slightly different views, as well as the two unions that made submissions. Further qualitative analysis of these submissions can be found below.

17. The Interim Report of the Financial Services Royal Commission asked three specific questions relating to legislative complexity and some submissions responded directly to these questions. Other submissions raised issues of complexity without necessarily explicitly responding to the questions posed. This analysis separately considers the responses to the specific questions and the submissions which raised related issues more generally.

18. Overall, only a small proportion of Financial Services Royal Commission submissions addressed issues of legislative complexity, so it appears not to have been a primary focus of stakeholders in the context of the misconduct being addressed by the Financial Services Royal Commission.

19. The Final Report of the Financial Services Royal Commission included two recommendations that aimed to facilitate 'simplification so that the law's intent is met'.[1] Commissioner Hayne observed that the 'more complicated the law, the harder it is to see unifying and informing principles and purposes'.[2] Accordingly, Recommendations 7.3 and 7.4 called for, as far as possible: elimination of 'exceptions and qualifications to generally applicable norms of conduct'; and express identification of the fundamental norms of behaviour underpinning detailed legislative rules. However, Commissioner Hayne emphasised that the task of simplification would ultimately be much wider, requiring a detailed 'examination of how the existing law fits together and identification of the policies given effect by the law's various provisions', before decisions can be made about 'how those policies can be given better and simpler legislative effect'.[3]

1 See *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report: Volume 1, February 2019) 494–6.
2 Ibid 44.
3 Ibid 496.

Question-based analysis

20. The Interim Report of the Financial Services Royal Commission posed three questions relating to legislative complexity and simplification:

(1) Is the law governing financial services entities and their conduct too complicated?

(2) Should the financial services law be simplified?

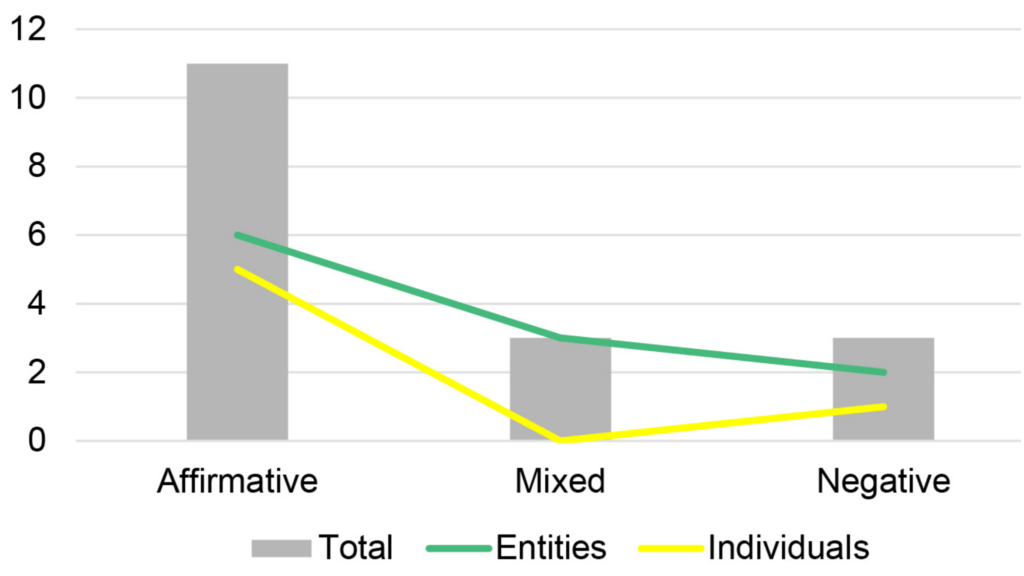
(3) Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?

21. Around 50 submissions (out of a total 902 public submissions) responded directly to each of these questions. Some submissions used identical wording as part of a campaign, and so were treated as one submission for the purposes of this analysis.

22. Whilst the questions posed appear similar on their face, the analysis below demonstrates that most entities and individuals agreed that the law is either too complicated or needs to be simplified, but differed in their views on whether radical simplification of the regulatory regime should be pursued.

23. The following section details some of the main conclusions from the analysis of question responses.

Figure 2. Is the law governing financial services entities and their conduct too complicated?



Number and types of responses in submissions to the Financial Services Royal Commission

24. Individuals were more likely than entities to be concerned about how complicated the law governing financial services entities is: five individuals answered this question affirmatively, whereas only one individual indicated that the law is not too complicated.

25. In contrast, entities had more divergent views: six entities indicated that the legislative regime is too complicated,[4] whereas three entities expressed mixed views and two entities submitted that the regime is not too complicated.[5] The entities that indicated that the law is too complicated were typically large institutions. For example, Westpac and AMP described financial services legislation as 'highly complex'[6] and 'technical'[7] respectively. The two entities that did not find the legislation too complicated were Financial Counselling Australia (an organisation which assists consumers facing financial difficulties) and the Financial Services Council (an industry representative body). Financial Counselling Australia expressed the view that regulation is needed to drive good consumer outcomes, and regulation in this space is necessarily complicated because financial products are themselves complex. The Financial Services Council also described financial services law as 'necessarily complicated and complex'. However, it submitted that the law is not *too* complicated because it 'proceeds by reference to relevant principles which can be applied in a variety of circumstances'.[8]

26. Some submissions warned that if changes to legislation are made, there may be 'some uncertainty until the application of the new laws has been tested and judicially considered'.[9] AMP noted that:

> Any radical simplification of the legislative and regulatory regime would need to maintain the balance between simplification and clarifying technical matters.[10]

4 See, eg, submissions in response to the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry from Citizens Electoral Council, Westpac, AMP, Customer Owned Banking Association, Finance Sector Union, Centre for Law Markets and Regulation. Unless otherwise indicated, all subsequent references in the footnotes are to submissions made to the same Royal Commission. All of the public submissions can be found at https://financialservices.royalcommission.gov.au/Submissions/Pages/interim-report-submissions.html.

5 Community and Public Sector Union Submission; Commonwealth Bank Submission; Legal Aid Queensland Submission; Financial Counselling Australia Submission; Financial Services Council Submission.

6 Westpac Submission [36].

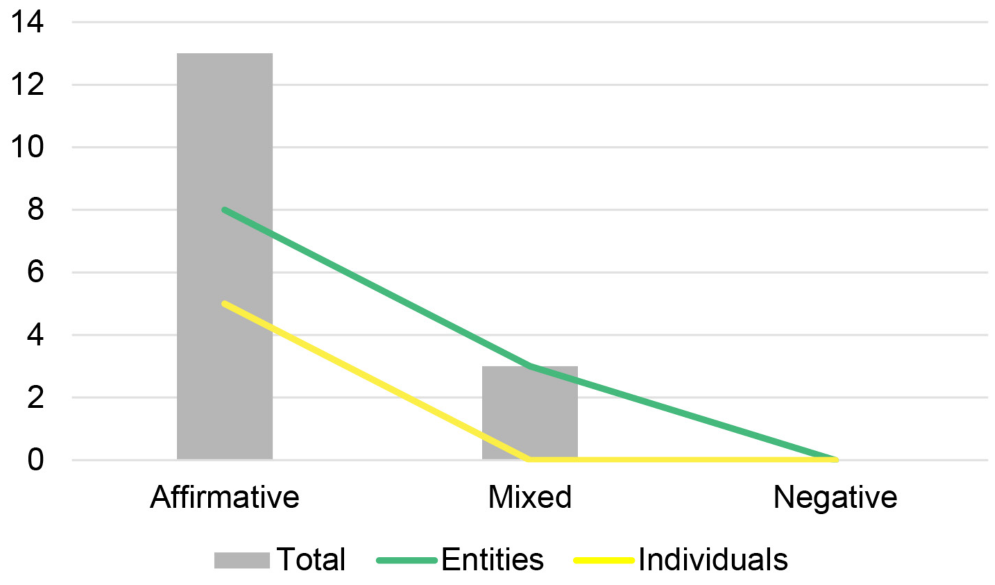
7 AMP Submission [31].

8 Financial Services Council Submission, 17–18.

9 Westpac Submission [36].

10 AMP Submission [31].

Figure 3. Should the financial services law be simplified?



Number and types of responses in submissions to the Financial Services Royal Commission

27. There was a strong consensus amongst entities and individuals that financial services law should be simplified. All of the individuals who made submissions on this question indicated that the law should be simplified.[11] In addition, over 75% of the entities that responded to this question indicated that the legislation should be simplified, with the other entities expressing mixed views on the question.

28. Some submissions stated that legislation could be simplified by being made more principles-based. The Financial Services Council indicated that the fundamental principles applicable to the conduct and behaviour of financial services entities need to be expressed broadly so that the wide range of circumstances which could arise are covered.[12] It also noted that principles-based legislation has the advantage that 'relevant circumstances can be measured against a general yardstick'.[13] The Australian Financial Complaints Authority submitted that the 'fair treatment of customers [should be made] a standalone key principle'.[14] This submission was made on the basis of its view that 'detailed rules cannot constitute an all-embracing comprehensive code of regulation that covers all possible circumstances'.[15]

29. Whilst the Customer Owned Banking Association similarly expressed a preference for a principles-based approach,[16] it also acknowledged that there is a 'tension between regulated entities wanting certainty from regulators about how to interpret the law and too much prescription'.[17]

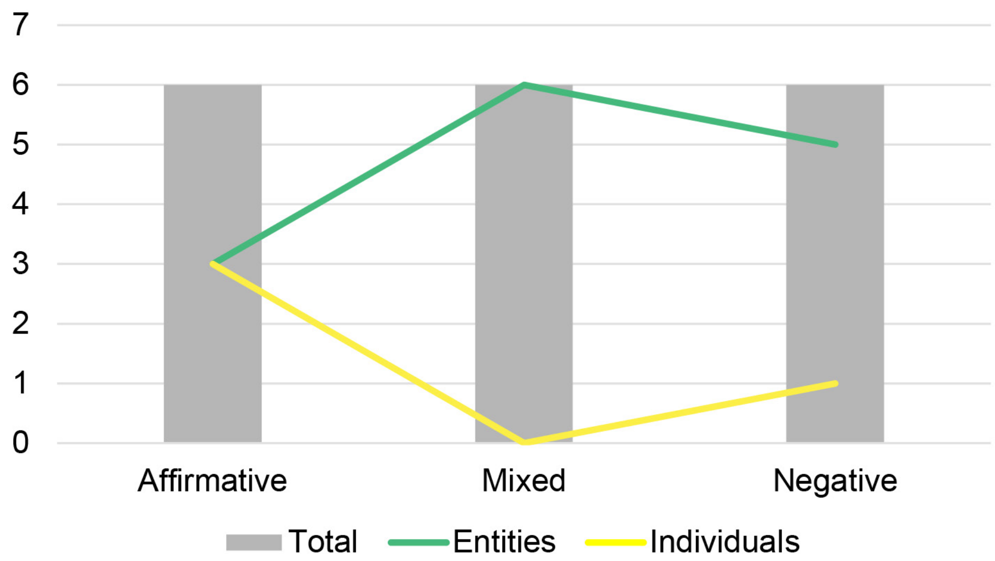
11 There were five submissions from individuals on this question.
12 Financial Services Council Submission, 23.
13 Ibid, 17.
14 AFCA Submission [65].
15 Ibid [58].
16 Customer Owned Banking Association Submission [51].
17 Ibid [58].

30. The Association of Superannuation Funds of Australia, who also expressed the view that the law should be simplified, noted that the principles underpinning the delivery of financial services are simple, but that 'numerous iterative changes over the years in combination with a lack of awareness/understanding of existing provisions' have produced a 'labyrinthine' regime.[18]

31. The entities that expressed mixed views mostly indicated that simplification of the law is required but that the entities would not support simplification if it means reducing consumer protections. For example, the Consumer Action Law Centre noted that

> any simplification should only be considered in the context of removing regulatory loopholes or duplication that creates unnecessary complexity in the law.[19]

Figure 4. Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?



Number and types of responses in submissions to the Financial Services Royal Commission

32. There was general consensus across the submissions that the legislation relating to financial services needs to be simplified. However, both entities and individuals had mixed views on whether there should be 'radical simplification' of the regulatory regime. Of the four individuals who responded to this question, three indicated that there should be radical simplification of the regulatory regime. In contrast, the majority of entities that responded to this question submitted that there should not be radical simplification of the regulatory regime. In particular, the Customer Owned Banking Association, Financial Counselling Australia, Financial Services Council, Legal Aid Queensland and ANZ all warned against radical simplification. Financial Counselling Australia submitted that

> it is hard to see how much of the specific, black letter law could be unwound without dire consequences. Our concern is that 'simplification' in this context could be code for watering down the law.[20]

18 Association of Superannuation Funds of Australia Submission, 2.
19 Consumer Action Law Centre Submission [187].
20 Financial Counselling Australia Submission [131].

33. The Customer Owned Banking Association indicated that radical simplification of the regulatory regime might be costly. In particular, it stated that the

> concept of radically simplifying the regulatory regime is attractive but also raises uncertainty and the possibility of significant transition costs … Any process with the objective of radically simplifying the regulatory regime should be cautious and thorough.[21]

34. Further, of the submissions that expressed mixed views on whether radical simplification of the regulatory regime was required, most expressed the view that radical simplification would go too far and result in increased costs for consumers. For example, the Australian Banking Association submitted that while radical simplification

> could, where appropriate, provide benefits for customers, regulators and the industry … Large scale reform would be complex, costly and time-consuming, and paradoxically, risk increasing the burden to all parties.[22]

35. Only a few bodies advocated for radical simplification. The Finance Sector Union, for example, submitted that there should be a 'radical overhaul' of the current regime but it warned against simplifying the law to a purely principles-based regime[23] because 'pure principles-based regulation which focuses on outcomes requires a regulator with far greater capacity and willingness to enforce the law than currently exists'.[24]

36. The Financial Planning Association also commented on the role of regulators. It remarked that complexity partly results from having multiple regulators which each have a 'different set of regulatory requirements'.[25] It noted that the multiplicity of regimes has a particular impact on small licensees who 'do not usually have the in-house expertise or economies of scale to meet the regulatory demands'.[26] In the context of simplification, it recommended that consideration

> be given to given to the extra complexity and cost associated with having multiple regulators, compared with the pros and cons of a monopolistic regulator for financial advice.[27]

Other comments on complexity, prescription and simplification

37. In addition to the submissions that responded to the Interim Report questions, a small number of other submissions discussed complexity, prescription, principles-based drafting, or legislative design. The majority of these submissions indicated that the financial services legislation is too complex, complicated or confusing. Only one submission stated that the financial services laws are not complicated.[28]

38. The Governance Institute of Australia stated that 'the addition of more layers of regulation rather than adopting the approach of taking a holistic view, has resulted in complexity and confusion for investors'.[29] The Australian Finance Industry Association

21 Customer Owned Banking Association Submission [59].
22 Australian Banking Association Submission, 5.
23 Finance Sector Union Submission, 41.
24 Ibid [238].
25 Financial Planning Association Submission, 19.
26 Ibid.
27 Ibid 20.
28 Anthony Zarro Submission, 2.
29 Governance Institute of Australia Submission, 6.

stated that the complexity of the regulatory environment is compounded by 'ASIC's process driven view of managing compliance obligations'.[30]

39. Other submissions that raised the issue of complexity in the financial service regime focused on a specific part of the regime. For example, Legal Aid NSW submitted that the regulation of unsolicited sales of financial products is confusing.[31]

40. Some submissions compared principles-based legislation with prescriptive legislation and indicated that prescription in legislation might be well-intended, but in practice, creates a culture that ignores the spirit of the law. For example, the Australian Institute of Company Directors submitted that it

> is almost always preferable to adopt an approach which is flexible and principles-based, similar to the ASX Corporate Governance Council Principles and Recommendations, so that boards can adapt governance practices to suit their organisation's circumstances and operating systems rather than adopting a 'tick the box' approach.[32]

41. The Chartered Accountants Australia and New Zealand supported the principles-based approach taken by the Financial Adviser Standards and Ethics Authority on the basis that principles 'encourage greater individual responsibility and accountability'.[33]

30 Australian Finance Industry Association Submission, Annexure 2.
31 Legal Aid NSW Submission, 24.
32 Australian Institute of Company Directors Submission, 14.
33 Chartered Accountants Australia and New Zealand Submission, 5.

Appendix 1: Quantitative Data

42. Total number of public submissions in response to the Interim Report of the Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry: 902.

Question-based analysis

Is the law governing financial services entities and their conduct too complicated?

	Affirmative	Mixed	Negative	Total
Entity	6	3	2	11
Individual				
Campaign	45	0	0	45
Other	4	0	1	5
Total	55	3	3	61

Should the financial services law be simplified?

	Affirmative	Mixed	Negative	Total
Entity	8	3	0	11
Individual				
Campaign	40	0	0	40
Other	4	0	0	4
Total	52	3	0	55

Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?

	Affirmative	Mixed	Negative	Total
Entity	3	6	5	14
Individual				
Campaign	45	0	0	45
Other	2	0	1	3
Total	50	6	6	62

Word search-based analysis

Complex (Word Stem)

	Affirmative (Too Complex)	Mixed	Negative (Not Complex)	Total
Entity	2	0	0	2
Individual				
Campaign	11	0	0	11
Other	3	1	0	4
Total	16	1	0	17

Complicate (Word Stem)

	Affirmative (Too Complicated)	Mixed	Negative (Not Complicated)	Total
Entity	0	0	0	0
Individual				
Campaign	2	0	0	2
Other	2	0	1	3
Total	4	0	1	5

Confuse (Word Stem)

	Affirmative (Confusing)	Mixed	Negative (Not Confusing)	Total
Entity	4	0	0	4
Individual				
Campaign	2	0	0	2
Other	1	0	0	1
Total	7	0	0	7

Prescriptive (Word Stem)

	Affirmative (Pro Prescriptive)	Mixed	Negative (Anti Prescriptive)	Total
Entity	1	1	6	8
Individual				
Campaign	0	0	0	0
Other	1	0	3	4
Total	2	1	9	12

Principles-Based (Exact Phrase)

	Affirmative (Pro Principles-Based)	Mixed	Negative (Anti Principles-Based)	Total
Entity	3	0	1	4
Individual				
Campaign	0	0	0	0
Other	2	0	0	2
Total	5	0	1	6

Simplify (Word Stem)

	Affirmative (Should Simplify)	Mixed	Negative (Should Not Simplify)	Total
Entity	11	0	1	12
Individual				
Campaign	5	1	0	6
Other	3	0	0	3
Total	19	1	1	21

Appendix 2: Methodology

Question-based analysis

43. This analysis is based on the submissions of entities and individuals to the Financial Services Royal Commission which responded to questions posed by Commissioner Hayne in the Interim Report. The responses to three questions in particular were identified as relevant to the ALRC Financial Services Legislation Inquiry Terms of Reference:

(1) Is the law governing financial services entities and their conduct too complicated?[34]

(2) Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?[35]

(3) Should the financial services law be simplified?[36]

44. All of the submissions to the Interim Report were uploaded to NVivo software. As questions from the Interim Report were not individually numbered, submissions that responded to the above three questions were identified by searching across all of the submissions for the phrases 'too complicated', 'radical simplification' or 'law be simplified'. This approach identified submissions that excerpted the questions in full, or otherwise paraphrased or referenced phrases unique to the questions.

45. Once the relevant submissions were identified, the person responsible for authoring each submission was classified as either an entity or individual. Each submission from an entity was also labelled with its name.

46. The responses to the above three questions from each submissions were categorised in NVivo as being one of affirmative, mixed or negative.

Word search-based analysis

47. The remainder of the submissions that did not respond specifically to the questions posed by Commissioner Hayne in the Interim Report were then isolated and subjected to word queries in NVivo. The aim of these queries was to identify submissions that addressed issues of legislative design without explicitly referring to the relevant questions. The word queries used were: complex, complicate, confuse, prescriptive, principles-based, and simplify. With the exception of 'principles-based', the word stem function in NVivo was used for each of the terms to ensure that all of the words with variant endings were identified. The submissions identified through this process were then manually reviewed to determine whether the use of the search terms related to issues of legislative or regulatory design. Submissions identified as relevant were then categorised in NVivo in the same manner as explained above.

34 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Interim Report: Volume 1, September 2018) 299.

35 Ibid.

36 Ibid 346.

Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL2

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Complexity and Legislative Design

October 2021

This summary of complexity and legislative design is the second in a series of background papers to be released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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Introduction

1. This Background Paper explores the drivers and metrics of *legislative complexity*, and considers how legislative complexity can be managed and reduced through legislative design. In particular, this paper explores the drivers and metrics of complexity in corporations and financial services laws in Australia. The paper also explains why complexity matters to businesses, consumers, professional advisors, parliamentary drafters, and legislators. While this paper focuses on legislative complexity, the broader regulatory ecosystem for financial services is complex in various ways unrelated to legislation. Legislative complexity is just one type of complexity that consumers, businesses, and practitioners have to grapple with in the financial services regulatory ecosystem.

Context for the paper

2. The core task of this Inquiry is to 'simplify and rationalise the law'. The ALRC considers that this task necessitates reducing legislative complexity. The Inquiry Terms of Reference (under Topic B) explicitly acknowledge the need to manage legislative complexity. The Terms of Reference also acknowledge the importance of:

- an adaptive, efficient and navigable legislative framework for corporations and financial services;
- meaningful compliance with the substance and the intent of the law.

3. Legislative complexity can prevent the achievement of both objectives. Legislative complexity also makes it difficult for the law to adapt to and regulate 'the continuing emergence of new business models, technologies and practices', a development referred to in the Inquiry Terms of Reference.

4. Pursuing legislative simplification, and managing or reducing legislative complexity, requires an understanding of legislative complexity. What does it mean? Why does it matter? What drives it? What features of legislation contribute to complexity? How do we measure legislative complexity? How do we manage and reduce legislative complexity?

5. The ALRC is seeking to answer these questions across the course of this Inquiry. In particular, the ALRC is collecting quantitative data on legislative design and legislative complexity in Australia and selected other jurisdictions, currently the United Kingdom and New Zealand. This Background Paper therefore serves to explain the ALRC's conception of legislative complexity, particularly with respect to the data collection project undertaken for the purposes of the Inquiry. Data on some of the metrics set out in this paper will be contained in the first Interim Report, and on the ALRC website.

6. The ALRC considers that it may be possible to create a framework for quantitatively calculating legislative complexity using the metrics of complexity set out in this paper. This idea will be explored in greater detail in future publications.

7. This paper serves to commence and inform a dialogue with stakeholders about the drivers and metrics of legislative complexity, and how complexity should be addressed. The aim of this dialogue is to understand more rigorously how to reduce unnecessary complexity and better manage necessary complexity.

Complexity and Legislation

8. Legal complexity, including legislative complexity, has been of increasing interest to academics, judges, and legal practitioners over the past forty years. In particular, there has been a growing focus on developing clearer understandings of the drivers and metrics of legal complexity, and the features of legislation that can contribute to legislative complexity. The aim of this research has been to better understand how necessary complexity can be managed, and how unnecessary complexity can be reduced or eliminated.

Drivers of complexity → Legislative features → Metrics of complexity

Key Concepts

Drivers of complexity: Refers to the social, political, and economic trends that lead to more or less complex *legislative features.* Drivers also include the limited time and resources available to develop legislation, and the high-level decisions made during the lawmaking and law design process that can result in complex *legislative features*.

Legislative features: Refers to the features of legislation that can make legislation more or less complex. Examples include defined terms, exemptions, and a legislative text's language and length. Some legislative features are present in all pieces of legislation (eg length), whereas others are only present in some (eg defined terms). All legislative features have some potential benefit, and the question is whether the benefit outweighs the disadvantage caused by the complexity of the feature, or whether there is another feature that can achieve the same benefit with less complexity.

Metrics: Refers to the potential quantitative measures of the complexity of a *legislative feature*. For example, metrics relevant to the complexity of definitions in a legislative text may include the number of defined terms and the number of times they are used in the text. Metrics relevant to the complexity of exemptions may include the number of class and individual exemptions granted, and the location of those exemptions (eg the number contained in each of Acts, regulations, and other legislative instruments).

Legislative scheme: Refers to the overarching legislative context in which a single legislative text operates. The scheme includes related primary legislation (ie Acts), delegated legislation (ie regulations and other legislative instruments), and other administrative instruments, such as individual relief. The legislative scheme for corporations and financial services law includes multiple Acts (eg *Corporations Act 2001* (Cth) ('*Corporations Act*') and *ASIC Act 2001* (Cth) ('*ASIC Act*')), as well as hundreds of legislative instruments and thousands of administrative instruments.

Regulatory ecosystem: The legislative scheme is situated within the broader regulatory ecosystem for corporations and financial services. This ecosystem includes case law and other dispute resolution processes that apply the law, as well as Australian Securities and Investments Commission ('ASIC') guidance and codes of conduct.

9. Research into legislative complexity has also developed into a specific field of inquiry for scholars of legal complexity. Legislative features identified by scholars as potentially contributing to overall legislative complexity include cross-references, length, language, legislative hierarchy, exceptions and exemptions, definitions, and frequent legislative change.

10. To manage and reduce legislative complexity, a number of research and reform agendas have emerged, broadly embracing linguistic and structural simplification of legislation, better use of delegated legislation, and the use of technology and drafting to improve the navigability of legislation.

11. This Background Paper seeks to synthesise this literature to produce a clearer understanding of legislative complexity for the purposes of this Inquiry. The paper also seeks to develop a list of quantitative and qualitative metrics which can be used to identify and measure legislative complexity, particularly in the *Corporations Act*.

Legislation

12. Legislative complexity is about complexity in understanding legislation. It is therefore useful to briefly explain the origins of legislation as a system of regulation in a common law jurisdiction such as Australia.

13. In common law jurisdictions such as England and Australia, there is a distinction between judge-made law and legislation made by Parliament. The common law tradition rests on the historical dominance of judge-made law, which regulated most social and economic activities. The core of the common law tradition is 'case law', 'the outcome of solutions found in real cases' adjudicated by courts.[1] This judge-made law historically regulated vast swathes of social and economic life, including property relations, contract, negligence, and defamation, and created and punished crimes and regulated economic relations through a range of torts such as those relating to unfair or deceptive competition and abuse of monopolies.[2]

14. This judge-made law, from the period of the Norman Conquest of England in 1066, existed alongside legislation made by the monarch and, later, the Parliament.[3] This 'legislation was always important'[4] but it remained narrow in its application to social and economic life until the 19th century.

15. A central fact of the common law tradition, therefore, is that the common law coexists alongside legislation, and will apply unless implicitly or, sometimes, explicitly displaced.[5] As French CJ, Bell and Keane JJ noted in *Commonwealth Bank of Australia v Barker*, an example of the coexistence of the common law and legislation exists in the governance of the 'employment relationship': it 'operates within a legal framework defined by statute and by common law principles'.[6]

1 John Baker, *An Introduction to English Legal History* (Oxford University Press, 5th ed, 2019) 207.
2 Ibid Part Two.
3 Baker (n 1) notes that the 'Normans and Angevins … produced a good deal of legislation, variously known as assizes, constitutions, charters, or even statute': 216.
4 Ibid 167.
5 The requirement for explicit displacement of common law rights is a feature of the 'principle of legality': Dennis C Pearce, *Statutory Interpretation in Australia* (LexisNexis Butterworths, 9th ed, 2019) ch 5.
6 *Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169, [1].

16. The common law approach can be contrasted with the civil law tradition in operation in some other countries. The core of the civil law tradition is a 'sharp separation of powers' in the 'system of law and government. It is the function of the legislator to make law, and the judge must be prevented from doing so'.[7] The codes that exist in civil law jurisdictions are therefore underpinned by a distinct ideology, under which the code is a complete statement of the law that displaces other possible sources of law, such as judge-made law or customs.[8] In some circumstances, the centrality of legislation was interpreted to mean that judges 'should not interpret incomplete, conflicting, or unclear legislation', but instead 'should always refer such questions to the legislature for authoritative interpretation'.[9] This would prevent courts from making law.[10] However, there has been a steady shift away from this fundamentalist position and, in modern civil law jurisdictions today, judges do interpret the law so as to substantially develop its 'meaning and application'.[11] Nonetheless, the civil law tradition rejects the notion of judge-made law inherent in the common law tradition.

17. Despite their tradition of judge-made law, common law jurisdictions have seen an exponential expansion in the role of legislation in regulating social and economic life, so that we live in what Ramsay, Crawford, and other scholars refer to as the 'age of statutes'.[12] As Crawford notes, the 'federal Parliament enacted 8401 statutes in the 50-year period between 1967 and 2017, compared to 2656 between 1901 and 1951, which represents a more than threefold increase'.[13]

18. The regulatory scope of the common law, and the rights, obligations and prohibitions it creates, have consequently narrowed. As Ramsay noted in 1992, 'it is now very clear that the way in which significant social problems are resolved is through legislation rather than the courts'.[14] Baker has suggested, in the British context, that 'Government ministers have come to gauge their success in office by the quantity of new legislation for which they can claim responsibility'.[15] Ramsay has also argued that the dominance of legislation has been particularly notable in corporate law, which 'has been dominated by statutes since its earliest days'.[16]

19. Nonetheless, as *Commonwealth Bank of Australia v Barker* indicates, the common law and legislation coexist in many parts of our economic and social life, and legislation does not 'codify' in the sense of replacing all pre-existing common law. The common law tradition of the Australian legal system still has at its core a significant role for the judiciary in interpreting, developing, and applying the law, including the law as established by legislation. This underpins approaches such as principles-based legislative drafting, which relies on judges to interpret legislation by reference to the general principles in the legislation and apply them to particular circumstances, thereby generating case law.

7 John Henry Merryman and Rogelio Perez-Perdomo, *The Civil Law Tradition: An Introduction to the Legal Systems of Europe and Latin America* (Stanford University Press, 4th ed, 2019) 33.
8 Ibid 28–33; Tamar Herzog, *A Short History of European Law: The Last Two and a Half Millennia* (Harvard University Press, 2018) 207–208.
9 Henry Merryman and Perez-Perdomo (n 7) 36.
10 Ibid 39.
11 Ibid 43.
12 Ian Ramsay, 'Corporate Law in the Age of Statutes' (1992) 14 *Sydney Law Review* 474; Lisa B Crawford, 'The Rule of Law in the Age of Statutes' (2020) 48(2) *Federal Law Review* 159, 159 n 1.
13 Crawford (n 12) 162.
14 Ramsay (n 12) 474.
15 Baker (n 1) 224.
16 Ramsay (n 12) 474.

20. It is in the context of an enormous body of legislation affecting all citizens and interacting with the common law that legislative complexity has assumed greater prominence and significance. Legislation today imposes innumerable obligations and prohibitions, affecting all facets of economic and social life. It is therefore essential that legislation is as accessible, navigable, and as limited in its complexity as possible for those who are affected by its provisions and those who are required to comply with it. The effective management of legislative complexity matters more than ever in common law jurisdictions.

What is legislative complexity?

21. The concept of 'legislative complexity' is more nuanced than the ordinary meaning of complexity might convey.[17] This is because legislation in all its forms arguably satisfies the ordinary meaning of 'complex': 'consisting of parts or elements not simply co-ordinated, but some of them involved in various degrees of subordination; complicated, involved, intricate; not easily analysed or disentangled'.[18] However, some pieces of legislation are more complex than others. This variation is sometimes justified: for example, it may reflect variations in the complexity of subject matters with which legislation deals. But variations in legislative complexity are often unjustified: sometimes the variations may be a product of the processes by which law and policy are made.

22. If it is accepted that some degree of complexity exists in all laws, then the challenge for lawmakers is to mitigate *unnecessary* (or avoidable) complexity, as distinct from *necessary* complexity. Necessary complexity is that which is required to achieve the desired outcomes of the legislation. Unnecessary complexity is that which is not essential to achieve those outcomes. Katz and Bommarito refer to this challenge as Einstein's razor: 'make everything as simple as possible, but not simpler'.[19] In other words, an objective of legislative design should be to reduce unnecessary complexity as much as possible. Thus, 'the question of complexity is really a question of necessity. Given a society and a set of normative preferences, how much complexity in the means is necessary to achieve law's desired ends?'[20]

23. The distinction between necessary and unnecessary complexity is implicit in many discussions of legal and legislative complexity. For example, the Parliament's Joint Committee of Public Accounts and Audit noted in 2008 that the

> Committee accepts that complex tax laws will occasionally be required. However, the breadth of complaints during the inquiry about complexity, and the comments that stakeholders have made over the last 20 years, *demonstrate that this complexity has exceeded necessary levels*.[21]

17 'Complexity' has a technical meaning in complexity theory, and this theory suggests there is a fundamental difference between 'complex' and 'complicated'. The ALRC does not use this theoretical framework in relation to documents, such as legislative texts, but this paper uses the framework when discussing systems, including the legal system as a whole. For a discussion of the difference between 'complex' and 'complicated', and an argument that within this framework legislative texts are 'complicated' or even 'simple' rather than 'complex', see Roger Jacobs, 'Legislation in a Complex and Complicated World' [2017] (3) *The Loophole* 19, 22–3.

18 *Oxford English Dictionary* (online at 27/07/2021) 'complex' (adj, def 2(a)).

19 Daniel M Katz and Michael J. Bommarito II, 'Measuring the Complexity of the Law: The United States Code' (2014) 22 *Artificial Intelligence Law* 337, 337.

20 Ibid 339.

21 Joint Committee of Public Accounts and Audit, *Tax Administration* (Report No 410, 2008) 50 (emphasis added).

24. The United Kingdom ('UK') Office of Tax Simplification likewise distinguishes necessary and unnecessary complexity,[22] drawing on Professor Ulph's suggestion that 'fundamental complexity', that which is unavoidable, is distinguishable from 'unnecessary complexity'.[23] Commissioner Hayne also suggested that 'financial services laws will always involve a measure of complexity'.[24]

25. In summary, the ALRC does not consider that legislation will ever be 'simple'. Instead, there is an irreducible core of necessary complexity in every piece of legislation, which is a product of real-world complexity, policy complexity, stakeholder demands, and a range of other drivers discussed in this paper. The degree of necessary complexity will differ for each legislative text, as drivers of complexity will vary across subject matters and over time.

26. Therefore, this paper uses the term 'simplification' to refer to the process of reducing complexity to its necessary core, which includes improving legislation 'in the linguistic and structural sense' and making it 'simpler in the content or conceptual sense'.[25] Simplification in the context of this Inquiry should be understood as wholly distinct from deregulation. During preliminary consultations in relation to this Inquiry, a number of stakeholders expressed concern that the term simplification could be used (either inadvertently or as a euphemism) to mean watering down obligations, or weakening consumer protections. At the same time, the ALRC does not understand simplification to mean stifling innovation, nor banning complex financial products. These are all aspects of policy, with which the ALRC is not primarily concerned in this Inquiry. Instead, the ultimate aim of legislative simplification in this Inquiry is to express and implement existing policy settings more clearly and coherently in the law.

27. Legislative complexity can be both relative and absolute. A particular piece of legislation might be relatively complex in terms of having sections that are longer and denser than other Acts, or using defined terms more frequently than other Acts. In addition, a piece of legislation might be complex in an absolute sense in terms of having a large number of defined terms or conditional statements overall, even though the use of defined terms or conditional statements on a section-by-section basis is unexceptional relative to other Acts. Relative complexity accounts for the size of legislation and allows for meaningful comparison between legislation of different sizes. Absolute complexity disregards the size of the legislation and looks at overall measures of complexity, such as total number of defined terms rather than defined terms as a percentage of all words. The *Corporations Act* is occasionally relatively complex, such as by using defined terms more frequently than almost any other Act, but it is arguably also absolutely complex in the sense of having high overall measures of complexity in relation to particular legislative features.

22 Gareth Jones et al, *Developing a Tax Complexity Index for the UK* (Office of Tax Simplification, 2014) 13–14 <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/285944/OTS_Developing_a_Tax_Complexity_Index_for_the_UK.pdf>.

23 Ibid 1; David Ulph, *Measuring Tax Complexity* (Office of Tax Simplification, 2013) <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/193497/ots_david_ulph_measuring_tax_complexity.pdf>.

24 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Volume 1, 2019) 491.

25 Binh Tran-Nam and Chris Evans, 'Towards the Development of a Tax System Complexity Index' (2014) 35(3) *Fiscal Studies* 341, 346–7.

Why legislative complexity matters

28. Significant legislative complexity is sometimes necessary for legislatures to achieve their objectives.[26] Through detailed legislation, drafters can distinguish 'instances where differential treatment is or might be appropriate'.[27] As Schuck notes, '[l]egal complexity sometimes produces fairer, more refined, more efficient, even more certain, forms of social control'.[28] However, with greater legislative complexity comes trade-offs.

29. **Legislative complexity and compliance:** Legislative complexity complicates the process of complying with the law. Indeed, Godwin, Brand, and Langford have suggested that it is 'relatively uncontroversial' that 'the greater the complexity of legislation and the rules that it embodies … the greater the challenges for achieving compliance'.[29] Roberts has suggested that complexity can mean that a 'reasonably certain conclusion [to a legal question], in some instances, cannot be determined despite diligent and expert research'.[30] Commissioner Hayne also suggested that legislative complexity 'can cause the regulated community to lose sight of what the law is intending to achieve and instead see the law as no more than a series of hurdles to be jumped or compliance boxes to be ticked'.[31]

30. **Legislative complexity and cost:** Complexity requires greater resources from persons whose conduct is affected by legislation and drafters who must predict how a change in the law will affect the legal and regulatory ecosystem as a whole.[32] Excessive complexity can also mean that a 'reasonably certain conclusion can be determined … only after an expenditure that is excessive in time and dollars'.[33] Ramsay argued in 1992 that complexity can 'lead to inefficiency with respect to the costs of obtaining advice in order to comply with the complex requirements and also the opportunity costs involved in the time and energy devoted to compliance with the requirements'.[34] The regulator also incurs costs in the need for regulatory guidance.[35] The extra costs of complying with the law for businesses and practitioners are borne by all Australians in higher costs for goods and services, including for legal advice when exercising rights and understanding obligations.

31. **Legislative complexity, uncertainty, and the rule of law:** Where complexity creates uncertainty in the meaning of legislation, this can result in the 'misapplication of rules'[36] and can mean that the law ceases to be 'capable of guiding one's conduct in order

26 Lance W Rook, 'Laying Down the Law: Canons for Drafting Complex Legislation' (1993) 72(3) *Oregon Law Review* 663, 665.
27 Katz and J. Bommarito II (n 19) 338.
28 Peter H Schuck, 'Legal Complexity: Some Causes, Consequences, and Cures' (1992) 42 *Duke Law Journal* 1, 8.
29 Andrew Godwin, Vivienne Brand and Rosemary Teele Langford, 'Legislative Design – Clarifying the Legislative Porridge' (2021) 38 *Corporate and Securities Law Journal* 280, 281.
30 Sidney I Roberts, 'Overview: The Viewpoint of the Tax Lawyer' (1978) 34(1) *Tax Law Review* 5, 6.
31 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report* (Volume 1, 2018) 162.
32 Katz and J. Bommarito II (n 19) 338; Schuck (n 28) 18: 'A more complex law entails many significant transaction costs which must be accounted for. Such law tends to be more costly and cumbersome to administer, more difficult for lawmakers to formulate and agree upon, and more difficult to reform once established. Administrators and subjects of such law must invest more in order to learn what it means, when and how it applies, and whether the costs of complying with it are worth incurring. Other costs of administering a complex legal system include those related to bargaining about and around the system's rules and litigating over them.'
33 Roberts (n 30) 6.
34 Ramsay (n 12) 478–9.
35 Hui Xian Chia and Ian Ramsay, 'Section 1322 as a Response to the Complexity of the Corporations Act 2001 (Cth)' (2015) 33(6) *Company and Securities Law Journal* 389, 394.
36 Neville Harris, 'Complexity in the Law and Administration of Social Security' (2015) 37(2) *Journal of Social Welfare and Family*

that one can plan one's life'.[37] As Lord Neuberger notes, excessive legislative complexity may mean that the law becomes 'incapable of providing a proper framework within which the state and its citizens can operate'.[38] Chia and Ramsay suggest legislative ambiguity 'may have a chilling effect on lawful and productive activity because persons or companies may not enter into transactions if they are uncertain about their legality'.[39] In addition to potentially reducing compliance with the law, uncertainty therefore fundamentally undermines the ability of individuals or businesses, and their advocates, to understand and effectively exercise their rights under the law.

Complexity in the financial services law in Australia

32. The Australian Government has stated its commitment to 'simplify[ing] the financial services laws to eliminate exceptions and qualifications to the law, where possible'.[40] The Government's response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('Financial Services Royal Commission') noted that the Commission raised concerns that

> over-prescription and excessive detail can shift responsibility for behaviour away from regulated entities and encourage them to undertake a "box-ticking" approach to compliance, rather than ensuring they comply with the fundamental norms of behaviour that should guide their conduct.[41]

33. There is a common view that financial services and corporations legislation is unnecessarily complex. In 1997, the Wallis Inquiry saw 'merit in simplifying the Corporations Law to the greatest extent possible while maintaining its effectiveness'.[42] The ALRC has observed from consultations with stakeholders over the past year that there is 'a level of consensus … that the law in this area is "too complex" and in need of simplification'.[43] Some stakeholders have suggested that not only is the overall legislative scheme for financial services and corporations too complex, but particular provisions of the *Corporations Act* are notably complex.[44] ALRC analysis of submissions to the Financial Services Royal Commission also indicated that there was a consensus amongst stakeholders that 'the law and regulatory regime are too complex'.[45]

34. The judiciary has also described the *Corporations Act* as complex. Writing extra-curially in 1992 during his term as Chief Justice of the High Court of Australia, Sir Anthony Mason referred to the 'Byzantine complexity' of Australian corporations legislation.[46] Similarly, the Federal Court in *Ku v Song* stated in relation to provisions for share transfers, whoever 'coined the expression "as clear as mud" must have been slaving over the extraordinarily, and unnecessarily, complex provisions in the *Corporations Act* and *Corporations Regulations*'.[47] With respect to the use of definitions, the Federal Court in

Law 209, 212.

37 Paul P Craig, 'Formal and Substantive Conceptions of the Rule of Law: An Analytical Framework' [1997] (Autumn) *Public Law* 467, 469.

38 Lord Neuberger, 'General, Equal and Certain: Law Reform Today and Tomorrow' (2012) 33(3) *Statute Law Review* 323, 325.

39 Chia and Ramsay (n 35) 394.

40 Australian Government, *Restoring Trust in Australia's Financial System: Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (2019) 38.

41 Ibid.

42 Stan Wallis et al, *Financial System Inquiry* (Final Report, 1997) 286.

43 Australian Law Reform Commission, 'Initial Stakeholder Views' (Background Paper FSL1, June 2021) [5].

44 Ibid [13].

45 Ibid [14].

46 Sir Anthony Mason, 'Corporate Law: The Challenge of Complexity' (1992) 2(1) *Australian Journal of Corporate Law* 1, 1.

47 *Ku v Song* (2007) 63 ACSR 661, [175].

ASIC v Westpac Banking Corporation stated that the *Corporations Act* contains provisions which are 'not always easy to comprehend, particularly given the complex and prolix, if not labyrinthine, statutory definitions of many of the key concepts or expressions that are employed in the provisions'.[48]

35. Alongside this has emerged an ever-growing body of academic literature opining on the complexity of corporations and financial services legislation and law in Australia.[49] Professor Stephen Bottomley has suggested that it is now 'stating the obvious that the legal terrain in which corporations operate is complex and diverse'.[50]

Drivers of legislative complexity

36. There is no single driver of complexity in legislation, and every piece of legislation has a unique context in which its complexity originated.[51] There are, however, a number of common drivers of legislative complexity, including:

- complexity arising from real-world factors relevant to the legislation;
- subject matter complexity;
- stakeholder demands and external influences;
- policy complexity; and
- legislative design decisions.

37. Each of these drivers of complexity is discussed in detail below.

Real-world complexity

38. One purpose of legislation is to regulate the persons and interactions that occur in society. In societies consisting of millions of citizens with various aspirations, a complex set of rules is often required to achieve that aim. In particular, the law is called upon to regulate developments in 'social interaction, economic exchange, and political behaviour'[52] which are often more complex than they were in the past. As Farina points out, making 'public policy in a heterogeneous society with an ambitious regulatory agenda inevitably implicating complex commitments – the reconciliation of which will necessarily involve an evolving process of contextualizing and adjustment – is not likely to be a high-efficiency undertaking'.[53] This cause of complexity may be considered inevitable and even 'driven by a genuine effort to keep pace with ongoing developments in society', as demands on the state and for regulation grow or change.[54]

48 *Australian Securities and Investments Commission v Westpac Banking Corporation* [2019] FCA 2147 [7] (Wigney J). See also *Imperial Chemical Industries plc v Echo Tasmania Pty Ltd* [2007] FCA 1731, [104]: 'Gaining an understanding of the relevant law … requires hours of study, reference to numerous sections and regulations, which themselves make no sense without reference to numerous definitions, often shrouded in obfuscation, and, needless to say, strewn throughout the *Corporations Act* and the *Corporations Regulations* in various places'.

49 For a summary of this literature, see Chia and Ramsay (n 35) 390–3.

50 Stephen Bottomley, 'Corporate Law, Complexity and Cartography' (2020) 35 *Australian Journal of Corporate Law* 142, 143.

51 See, for example, the discussion of the 'causes of complexity in Australia's tax laws': Joint Committee of Public Accounts and Audit (n 21) 55–61. See also Richard Krever, 'Taming Complexity in Australian Income Tax' (2003) 25(4) *Sydney Law Review* 467.

52 Katz and J. Bommarito II (n 19) 339.

53 Cynthia R Farina, 'The Consent of the Governed: Against Simple Rules for a Complex World' (1997) 72(4) *Chicago-Kent Law Review* 987, 1030.

54 Katz and J. Bommarito II (n 19) 339.

Subject matter complexity

39. The complexity of the subject matter that specific legislation addresses is also a significant cause of legislative complexity, and linked to the idea of real-world complexity. Godwin, Brand and Langford have suggested that the increasing complexity of financial services laws may be partially due to an 'increase in the complexity of retail financial products, the emergence of new financial services providers and new platforms for providing financial services, and the use of technology for regulatory compliance purposes'.[55]

40. Likewise, the Department of the Treasury (Cth) ('Treasury'), in its submission to the Financial Services Royal Commission, noted that to some degree the complexity in financial services law is 'necessitated by the complexity and range of the activities across the risk-reward spectrum that it seeks to regulate – a level of complexity and prescription may be inherent and necessary to support effective regulation of the sector'.[56] In explaining complexity in financial services laws, the Treasury also pointed to the 'the dynamic and diverse nature of financial services, the existence of numerous and complex products, and the often high stakes, particularly for consumers, given that housing and superannuation are the two biggest assets of Australian households'.[57]

Stakeholder and external influences

41. In addition to the complexity of the people, products, services, and issues that legislation seeks to regulate, 'imperfect interactions between the stakeholders involved and the unpredictability of external factors' can all contribute to the complexity of legislation.[58] Such external factors can include pressure to 'prepare legislation in constrained timeframes'.[59]

42. The influence of stakeholders on legislation has been described by the Office of Parliamentary Counsel (UK) as 'one of the key reasons for the increased volume of legislation'.[60] It states that interest groups and individuals increasingly expect the legislature to 'arbitrate on respective rights and duties'.[61] This need for further specification may be due to a 'change in the way society in general, and practitioners in particular, deal with rules'.[62]

43. The Treasury has suggested that legislative complexity in financial services is

> also a consequence of the piecemeal evolution of the legal framework. Overtime, as particular issues have emerged, the policy response has taken into consideration the requests by financial firms for greater clarity and certainty of their obligations – leading to additional layers of prescription in the legal framework.[63]

55 Godwin, Brand and Teele Langford (n 29) 283.
56 Department of the Treasury (Cth), Submission to the Financial Services Royal Commission (Interim Report), *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Undated) 2.
57 Ibid 4.
58 Office of the Parliamentary Counsel (UK), *When Laws Become Too Complex: A Review into the Causes of Complex Legislation* (2013) 19.
59 Attorney-General's Department (Cth), *Causes of Complex Legislation and Strategies to Address These* (2011) 2.
60 Office of the Parliamentary Counsel (UK) (n 58) 7.
61 Ibid.
62 Rook (n 26) 664.
63 Department of the Treasury (Cth) (n 56) 2.

44. Citing Treasury's views, Commissioner Hayne concluded: 'Lobbying for prescription, detail and tailoring has been a significant contributor to the current state of the law'.[64]

45. Stakeholder input is an inevitable and desirable feature of democratic lawmaking, and this underlines the need for stakeholder support for effective legislative simplification.

Policy complexity

46. Complexity in policy can also contribute to complexity in legislation. In the Australian context, the Attorney-General's Department has pointed to unnecessary 'complexity in the underlying policy' as a cause of legislative complexity.[65] Webb and Geyer note that legislative drafters 'are supposed to be carrying out the will of their elected leaders who, unsurprisingly given the complex nature of society, often make contradictory and confusing demands on their expertise'.[66]

47. To achieve complex policy aims, detailed exemptions and carve-ins may be necessary to ensure legislation applies correctly. If these features of legislation are used in an overly prescriptive, or excessive fashion, the overall complexity of the law may be significantly impacted. The Commonwealth Office of Parliamentary Counsel dedicates a significant portion of its guide to 'Reducing complexity in legislation' to addressing policy complexity.[67]

Legislative design preferences

48. The Attorney-General's Department has also pointed to the following legislative design preferences as drivers of complexity:[68]

a. A tendency to respond to policy issues with legislative changes even when legislation is not necessary to address them;

b. An aversion to principles-based legislation;

c. An aversion to judicial discretion; and

d. An aversion to official discretion.

49. In relation to the above drivers of complexity, Godwin, Brand and Langford have suggested that, to a large extent,

> the aversion to principles-based legislation is driven by the other two areas of aversion – namely, aversion to judicial discretion and aversion to official discretion – and is motivated by the belief that a prescriptive, rules-based approach to legislation makes the legislation easier to understand, easier to comply with and easier to enforce.[69]

50. Godwin, Brand and Langford also emphasise 'the desire for legislation to be comprehensive or to operate as a codification of the law' as a cause of legislative

64 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 24) 495.
65 Attorney-General's Department (Cth) (n 59) 2.
66 Thomas Webb and Robert Geyer, 'The Drafters' Dance: The Complexity of Drafting Legislation and the Limitations of "Plain Language" and "Good Law" Initiatives' (2020) 41(2) *Statute Law Review* 129, 136.
67 Office of Parliamentary Counsel (Cth), *Reducing Complexity in Legislation* (Document Release 2.1, June 2016) 14–20.
68 Attorney-General's Department (Cth) (n 59) 2.
69 Godwin, Brand and Teele Langford (n 29) 282.

complexity.[70] They cite Justice Rares' suggestion that 'attempts at codification involving many permutations on a theme are inevitably complex and likely to miss something'.[71]

51. Likewise, former Commonwealth First Parliamentary Counsel, Peter Quiggin PSM QC, has suggested that administrative 'discretion can take the place of a substantial amount of detailed law on how to work out a particular matter'.[72] He has also argued that a legislative drafting preference towards more prescriptive legislation can be driven by 'perception[s] about how courts are interpreting the law in general'.[73] A perception, on the part of drafters and the Parliament, 'that courts will take a reasonable and purposive approach to interpretation' is arguably necessary for principles-based legislation.[74]

Legislative features and legislative complexity

52. This section explores how the ALRC and stakeholders might appropriately determine whether and in what way legislation is unnecessarily complex and in need of simplification.

Methodological evolution

53. In pushing for a more academically and conceptually rigorous understanding of legal complexity, legal scholars including Schuck have attempted to identify, in broad terms, the criteria of complexity in a legal system. In 1992, Schuck identified the following criteria of legal complexity:[75]

- Density ['Dense rules are numerous and encompassing. They occupy a large portion of the relevant policy space and seek to control a broad range of conduct, which causes them to collide and conflict with their animating policies with some frequency'];[76]
- Technicality ['Technical rules require special sophistication or expertise on the part of those who wish to understand and apply them. Technicality is a function of the fineness of the distinctions a rule makes, the specialized terminology it employs, and the refined substantive judgments it requires'];[77]
- Institutional differentiation [A highly 'differentiated' system includes many different sources and structures of rules];[78] and
- Indeterminancy [Rules which are 'indeterminate' use 'open-textured, flexible, multifactored, and fluid' concepts that can have unpredictable outcomes in their application to facts].[79]

70 Ibid 283.
71 Justice Steven Rares, *Competition, Fairness and the Courts* (Speech, Competition Law Conference, 24 May 2014) [18].
72 Peter Quiggin, 'The Spectrum of Drafting - from Black Letter to Coherent Principles' in Graeme Cooper (ed), *Executing an Income Tax* (Australian Tax Research Foundation, Conference Series No 25, 2008) 59, 62.
73 Ibid 63.
74 Ibid.
75 Schuck (n 28) 3.
76 Ibid.
77 Ibid 4.
78 Ibid.
79 Ibid. Professor Stephen Bottomley recently applied these criteria to Australian corporations law and concluded that 'Australian corporate law ticks each of' Schuck's proposed criteria for complexity in a legal system: Bottomley, 'Corporate Law, Complexity and Cartography' (n 50) 143–4.

54. The research into complexity in the legal system has developed significantly since Schuck's seminal 1992 article. Two developments have supported increasingly sophisticated understandings of legal complexity: the evolution of complexity theory and the emergence of computational law and legal informatics.

Complexity theory

55. Complexity theory first emerged in mathematics and the natural sciences. It draws on ideas present in physics, biology, chemistry, and statistics.[80] However, it also drew on work in the social sciences, principally from network theory and game theory.[81]

56. Complexity theory posits that complex systems have a range of characteristics, including being 'composed of many elements' which 'interact with each other through one or more interaction types'.[82] Elements are 'characterized by states' which 'are not static but evolve with time'.[83] An example of a state is a 'political preference of a person',[84] with the person being the element who has a particular state in regard to their preference for a particular political party.

57. Interactions can be analysed through networks: 'Interactions are represented as links in the interaction networks' and the 'interacting elements are the nodes in these networks'.[85] Networks can evolve independently, but often interact with one another to create 'multilayer networks'.[86] A number of other characteristics have proven relevant to understanding social systems, such as the law. For example, complex systems are 'non-linear',[87] meaning that the outcomes of system processes can be highly unpredictable and in some circumstances 'the concept of predictability must, for all practical purposes, be abandoned'.[88] They are also 'context-dependent' and 'path-dependent',[89] so that their evolution is determined by the networks in which they are embedded and their historical development.

58. In the 1990s, a number of legal scholars started drawing on complexity theory and its observations in explaining legal systems,[90] which are presented as dynamic networks composed of various elements such as legislators, courts, legal practitioners, litigants, and a range of other actors, institutions and sources of laws and norms.[91]

59. Some of this emerging literature has used complexity theory to better understand legal texts, in addition to legal systems. For example, Bourcier and Mazzega, writing in 2007, suggested that law is a 'complex dynamical system evolving from network

80 Stefan Thurner, Rudolf Hanel and Peter Klimek, *Introduction to the Theory of Complex Systems* (Oxford University Press, 2018) 1–19.
81 Ibid 19–20.
82 Ibid 22.
83 Ibid.
84 Ibid.
85 Ibid.
86 Ibid.
87 Ibid 23.
88 Ibid 6.
89 Ibid 20.
90 JB Ruhl, 'Complexity Theory as a Paradigm for the Dynamical Law-and-Society System: A Wake-Up Call for Legal Reductionism and the Modern Administrative State' (1996) 45(5) *Duke Law Journal* 849; Eric Kades, 'The Laws of Complexity and the Complexity of Laws: The Implications of Computational Complexity Theory for the Law' (1997) 49(2) *Rutgers Law Review* 403; R George Wright, 'The Illusion of Simplicity: An Explanation of Why the Law Can't Just Be Less Complex' (2000) 27(3) *Florida State University Law Review* 715.
91 For a discussion of this literature, see Jamie Murray, Thomas Webb and Steven Wheatley (eds), *Complexity Theory and Law: Mapping an Emergent Jurisprudence* (Routledge, 2019).

structures'.[92] Building on network-based understandings of complexity, they considered that legal complexity could be identified in legal texts through structure-based and content-based measures. Structure-based complexity relates to the networked nature of legal texts, including in the hierarchy of the text (eg chapter, part, division and section) and cross-references between provisions of the law (referred to as 'quotations').[93] Content-based complexity focuses on understanding a law's 'aptitude to produce "legal outputs" or "legal effects"'.[94]

60. Likewise, writing in 2017, Jacobs drew on complexity theory in critiquing legislative texts, though he considered that legislation is 'complicated' or perhaps 'simple' in the typology of complexity theory.[95] By 'simple', Jacobs meant that the 'system is known. How it works is self-evident as the relationship between cause and effect is obvious. You don't need to be an expert to understand it'. In contrast:

> A complicated system is one that is not simple, although it may have simple elements within it. Its complicated nature derives from a combination of the following: large scale, many components, the need for coordination and the need for specialist knowledge. For example, building a car or launching a rocket. The system may not be simple, but it is knowable. It is susceptible to analysis so an understanding of the parts of the system will yield an understanding of the whole system.[96]

61. A complex system, because of the features described at 56–57, has an element of unpredictability in it, and a complete understanding of its operation into the future is therefore unknowable.

> These [complex] systems may include elements that are simple or complicated, but are not reducible to them. Launching a child into life is complex. It is not predictable. What works with one child may not work with the next and success with one child does not predict success with the next. In a complex system the relationship between cause and effect can only be understood in retrospect.[97]

62. As noted at 21, in this Paper a colloquial definition of 'complexity' is adopted that is more consistent with the definition of 'complicated' in complexity theory. However, complexity theory can particularly help enlighten the operation of laws once enacted, which can be deeply unpredictable. This requires research to understand how particular pieces of legislation fit within the broader regulatory ecosystem, and how regulated entities and other participants react to the law. In this sense, a legislative text may not be 'complex' in the complexity theory sense, but the ecosystem in which it operates may be deeply complex in the sense of being highly networked, unpredictable, and unknowable.

63. Finally, a key lesson from complexity theory is that there are normally 'various origins' that combine to make a law complex, so 'it is unlikely that a single influence factor can be identified'.[98] Rather, 'results from complexity theory have shown that in complex systems

92 Danièle Bourcier and Pierre Mazzega, 'Toward Measures of Complexity in Legal Systems' in *ICAIL 2007: Proceedings of the 11th International Conference on Artificial Intelligence and Law* (2007) 211, 211.
93 Ibid 212.
94 Ibid 212–213.
95 Jacobs (n 17) 22–23.
96 Ibid 20.
97 Ibid.
98 Bernhard Waltl and Florian Matthes, Comparison of Law Texts: An Analysis Of German and Austrian Law Texts Regarding Linguistic and Structural Metrics (Conference Paper, Internationales Rechtsinformatik Symposium, Salzburg, Austria, 2015) [3.2].

it is not reasonable to assume monocausality … [it] is more appropriate to assume that a larger set of parameters contribute to the emerging behaviour of a system'.[99]

Computational law

64. Advances in computational power over the past twenty years have accelerated the development of computational analysis of complexity, including in the law.[100] This has also enabled an increased focus on understanding complexity in legal texts, rather than the system as a whole or particular areas of law, and with a particular focus on quantitative measures of complexity.

65. For example, building on earlier work such as that by Bourcier and Mazzega, Bommarito and Katz have identified legislative features that can lead to complexity as related to legislative structure, language and interdependence. The difference in their approach is that it adopts a large-scale quantitative approach to *measuring* complexity. This allowed for unprecedentedly broad analyses of structural and linguistic features of legal texts, with Bommarito and Katz able to analyse the entirety of the US Code (comprising 49 active Titles and millions of words).[101]

66. Bommarito and Katz argue that 'legal complexity can be approximated using the [quantitative research] tools from complex systems [theory] and linguistics'.[102] The focus on linguistic complexity in part reflects a recognition that this is related to 'the human capital expended by a society when an end user is required to review and assimilate a body of legal rules'.[103] Others in the field have also used computational analysis to develop quantitative measures of complexity in legal texts.[104]

Examining legislative complexity through metrics

67. Whilst the legislative features that can lead to legislative complexity can be examined qualitatively, such as through case studies of complexity, close readings of provisions of the text, and analysis through case law and stakeholder feedback on complexity, the research noted above suggests that the complexity of legislative features can also be measured quantitatively. Drawing on approaches such as those proposed by Bommarito and Katz, the complexity of a legislative feature and a piece of legislation can be approximated quantitatively.

68. The next section explores how each legislative feature that can contribute to complexity might be understood and, in particular, what metrics are effective proxies for an analysis of their complexity. A summary of the metrics that the ALRC regards as significant in relation to each legislative feature are included in Table 1.

99 Ibid.
100 In relation to complexity theory, it has been suggested that a 'science of complex systems is unthinkable without computers': Thurner, Hanel and Klimek (n 80) 25.
101 Katz and J. Bommarito II (n 19).
102 Ibid 371.
103 Ibid 340.
104 See, for example, Waltl and Matthes (n 98).

Table 1: Metrics of legislative complexity

Legislative features	Potential metrics
Length	• Page and word count of a legislative text • Word count per provision (eg chapters, parts, divisions, subdivisions, sections)
Structural elements	• Number of sections, subsections, paragraphs, subparagraphs, and sub-subparagraphs within each hierarchical container • Density of structural elements
Cross-references	• Number of internal cross-references (ie to provisions within the same legislative text) • Number of external cross-references (ie to provisions in other legislative texts, such as cross-references from an Act to regulations or another Act)
Obligations	• Number and location of obligations and prohibitions in a legislative text • Number of provisions that provide for consequences for breaching an obligation or prohibition, such as by creating offences, civil penalties, and infringements notices.
Conditional statements	• Number and use of conditional statements (eg 'if', 'where', 'but')
Indeterminate concepts	• Number and use of indeterminate terms in Act (eg 'reasonable', 'fair')
Prescription	• Length of particular provisions, including over time • Intricacy of structural elements in provision • Overall size of provisions relevant to an area of regulation, including in the Act and legislative instruments
Duplication and redundancy	• Number of duplicated or overlapping regulatory regimes (eg multiple licensing regimes serving a similar purpose and with duplicated features) • Number of duplicated or overlapping obligations and prohibitions (eg multiple misleading and deceptive conduct prohibitions) • Number of provisions that are no longer necessary, such as transitional arrangements for new legislation
Definitions	• Number of defined terms in a legislative text or particular provisions • Number of uses of defined terms within a text or particular provisions • Location of definitions within legislative texts and across legislative schemes (eg in the Act or legislative instruments) • Proportion of all words that are potentially subject to a definition • Number of definitions that have certain characteristics, such as only applying in certain contexts

Legislative features	Potential metrics
Language	• Readability measures, including the Flesch Reading Ease score • Vocabulary size (eg number of words comprising the vocabulary of the text or provision) • Entropy (which is a numerical score identifying the variability of a text's language use and potentially subject matter) • Average word and sentence length in legislative text or provision
Legislative hierarchy	• Number and size of legislative instruments made under an Act • Number of legislative instruments under Act which notionally amend the Act
Exceptions	• Number and type of class exemptions and exclusions in an Act, and their location in the Act, regulations, or other legislative instruments • Number and type of individual relief instruments
Legislative change	• Number of amendments to Acts in total and per year • Development of inconsistent alphanumeric numbering systems (eg 12BAA)

69. In addition to the above legislative features that may lead to complexity in legislation, a number of potential features of the ecosystem may serve as an indicator that legislation or provisions of legislation are too complex. These include:

a. Litigation- and dispute-related data: Metrics for this include court judgments in relation to different Acts or particular provisions, as well as use of Act-specific dispute resolution regimes such as the Australian Financial Complaints Authority in the context of financial services legislation.

b. Compliance-related data: Metrics for this include prosecutions and civil enforcement, as well as Act-specific processes for identifying breaches. This includes, for example, breach reporting to ASIC in the context of financial services legislation. This data can identify parts of an Act that may be operating inappropriately.

Structural legislative features

70. The structure of legislation can include a number of legislative features that can lead to legislative complexity. The Office of Parliamentary Counsel (Cth) has concluded: 'Poorly structured legislation can be a cause of complexity. ... Adopting a clearer and more logical structure is a useful step in reducing that complexity'.[105]

71. Analysis of structural legislative features focuses on the constituent elements of legislation and the way that related content is grouped together.[106] Legislation is structured hierarchically in what the ALRC refers to as 'structural elements', which include chapters, parts, divisions, subdivisions, sections, subsections, paragraphs, subparagraphs, and, rarely, sub-subparagraphs. Not all Acts will use all types of structural elements (for example, some Acts do not contain chapters).

105 Office of Parliamentary Counsel (Cth) (n 67) 6.
106 Katz and J. Bommarito II (n 19) 347.

72. Legislative complexity can result from a number of structurally-related legislative features, as outlined below.

The length of legislation

73. Long legislation, and particularly long provisions such as sections, parts, and chapters, can make legislation more difficult to follow,[107] and can be a sign of structural incoherence or over-prescriptiveness. In addition to Act length, the Office of the Parliamentary Counsel (Cth) notes that 'overly long sections' can mean 'that the reader struggles to maintain a clear understanding of what a particular section is trying to achieve'.[108] Prescriptiveness can exacerbate the problems of length insofar as

> clarity can be impaired by too much specificity—in law as in other communicative endeavours. Expressive acts flout norms of communicative rationality when they multiply detail needlessly: an audience has finite time to read and listen and limited capacity to remember.[109]

74. Importantly, the length of legislation cannot be considered in isolation from the length of any associated legislative instruments. The Office of the Parliamentary Counsel (UK) has remarked that a 'short Act that requires the user to go to a complicated set of Regulations is not, overall, a simplifying measure'.[110]

Structural elements

75. Understanding the structure of legislation can be useful for understanding its complexity and 'can highlight the level of intricacy present in a given [legislative] architecture'.[111]

76. In the context of Commonwealth Acts, the number of higher-level structural elements (eg chapters, parts, divisions, and subdivisions) may be used to provide an indication of the diversity (or breadth) of subject matters with which an Act deals, while the number of lower-level structural elements (eg sections, subsections, paragraphs, and subparagraphs) may be an indication of the level of detail (or depth) it includes. The number of lower-level structural elements contained within a higher-level structural element may be a metric for establishing relative complexity in terms of the intricacy of the provisions. For example, identifying particular chapters and parts of an Act that contain a large number of subsections and paragraphs may highlight areas of notable prescriptiveness and intricacy. The number of divisions and subdivisions within a particular part may also be an indication of the diversity of subject matter that part covers.

Cross-references

77. Cross-references in a legislative text reflect the extent to which the operation of one provision depends on the operation of another. Cross-references can be internal (eg cross-references to other provisions in the same Act) or external (eg cross-references to provisions in other Acts). Definitions are a form of cross-referencing, because each use of a defined term requires a reader to have regard to the definition of that term.

107 Office of Parliamentary Counsel (Cth) (n 67) 2, 4.
108 Ibid 2.
109 Paul Yowell, 'Legislation, Common Law and the Virtue of Clarity' in Richard Ekins (ed), *Modern Challenges to the Rule of Law* (LexisNexis NZ, 2011) 101, 118, quoted in Crawford (n 12) 166.
110 Office of the Parliamentary Counsel (UK) (n 58) 7.
111 JB Ruhl and Daniel M Katz, 'Measuring, Monitoring, and Managing Legal Complexity' (2015) 101 *Iowa Law Review* 191, 215.

Cross-references may lead to greater legislative complexity. However, cross-references are often necessary and may reduce the length and repetitiveness of a legislative text. An increasing body of research has emerged to understand interdependencies, of which cross-references are a significant cause, within legislation and the legal system.

78. Some scholars have attempted to apply complex network theory or computational legal studies approaches to visualise the complexity of 'interdependence' in the legal system. For example, when considered as a network, 'legislative and executive rules can be linked with case citations and language in judicial opinions, creating a macro-network model'.[112] By considering statutes as a 'network of dependencies',[113] it is possible to identify highly referenced provisions which might either lead to 'cascading failure' if they are ineffective or which, if improved, might 'affect the operation and viability of other statutes'[114] and materials.

79. Metrics for cross-references are easily obtained by computationally counting the number of references to other provisions and Acts. More sophisticated analysis can be conducted on highly structured legislative texts that use XML, which allows for the creation of network maps such as those described above.

Obligations and Prohibitions

80. Provisions containing obligations and prohibitions, as well as the consequences that may flow from breaching them, may be unnecessarily complex if they are unduly long, structured inappropriately, duplicative, or overly intricate.

81. The Office of the Parliamentary Counsel (Cth) has noted that 'if the important concepts in a legislative measure are not stated as its central elements, but are obscured by other material such as procedural detail, overly complex provisions are likely to result'.[115] Appropriately structuring these provisions may mean placing provisions which apply to a large majority of readers before less important or operative details.[116] It is arguable that obligations and prohibitions, particularly where they attract significant penalties or are offences, are important to many readers, and should therefore be located and structured in such a way that they are easy to find and understand. The number of obligations and prohibitions in a legislative text may in itself be complex, given the challenge on a regulated person to navigate and comprehend the overall body of regulatory requirements to which they are subject.

Conditional Statements

82. Conditional statements create legislative complexity, though they are an inevitable feature of legislative design. Conditional statements are words such as 'if', 'except', 'but', 'provided', 'when', 'where', 'whenever', 'unless' and 'notwithstanding'. Each of these words indicates a fork in the road for a reader of legislation. For example, a rule may apply 'if' a requirement or list of requirements is satisfied, but might be subject to a 'but' that means the rule does not apply in certain circumstances.

112 JB Ruhl, Daniel M Katz and Michael J Bommarito II, 'Harnessing Legal Complexity' (2017) 355(6332) *Science* 1377, 1378.
113 Ibid.
114 Ibid.
115 Office of Parliamentary Counsel (Cth) (n 67) 6.
116 Ibid.

83. Conditional statements may lead to unnecessary complexity when their use becomes excessive or they are used in a particularly complex ways. Conditional statements can be measured computationally by counting the presence of certain words and their location and use, a task undertaken by scholars of legislative complexity at MIT and Harvard.[117] They can be considered at the level of an Act or provision.

Indeterminate concepts

84. Words or concepts are potentially indeterminate if their application to a particular set of facts may be subject to multiple interpretations. Consequently, their interpretation by courts may be less predictable than if a more determinate word or concept were used.

85. In a recent review of debates around 'uncertain' terms, Bigwood and Dietrich observe the fact 'that a legal concept is capable of being described as "nebulous" in its nature, "vague" in its meaning(s), or "uncertain" in its application(s) is often advanced as a weighty, if not decisive, reason for rejecting it'.[118] However, potentially indeterminate terms are an inevitable and in many ways desirable legislative feature. These concepts are used to ensure that a rule or standard applies appropriately in a variety of cases. Bigwood and Dietrich argue:

> In many instances, the law, given its complex nature and society's expectations of what it is meant to deliver, cannot avoid resort to concepts whose meanings are unfixed and whose applications leave considerable scope for expert judgement — so-called 'leeway of choice'.[119]

86. Likewise, indeterminate terms may be used in principles-based legislation to reduce other types of complexity, such as prescriptiveness, length, linguistic diversity, and density of obligations and prohibitions. Bigwood and Dietrich also note that arguments against 'uncertainty' are often highly selective,[120] and have suggested that if 'vagueness were a sufficient reason for repudiating legal concepts and criteria, large portions of current law would be eviscerated'.[121]

87. However, the use of such words can increase the difficulty of interpretation. In their study on complexity in German laws, Waltz and Matthes identified 62 indeterminate legal terms and counted their appearance throughout German law texts.[122] Schuck also considered that 'open-textured, flexible, multi-factored, and fluid' concepts potentially contribute to legislative complexity.[123] Although measuring indeterminacy requires a degree of subjective judgment in choosing 'indeterminate' words, it does provide one way of seeing which laws include more 'complexity-driving terms'.[124]

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117 William Li et al, 'Law Is Code: A Software Engineering Approach to Analyzing the United States Code' (2015) 10(2) *Journal of Business and Technology Law* 297. The approach was suggested in Kades (n 90) 425. It has since been cited by other scholars as an approach to measuring complexity: Patrick McLaughlin et al, 'Is Dodd-Frank the Biggest Law Ever?' (2021) 7(1) *Journal of Financial Regulation* 149, 154.

118 Rick Bigwood and Joachim Dietrich, 'Uncertainty in Private Law: Rhetorical Device or Substantive Legal Argument?' (2021) 45(1) *Melbourne University Law Review* (advance), 2.

119 Ibid 3.

120 Ibid 2–3.

121 Rick Bigwood, 'Throwing the Baby Out with the Bathwater? Four Questions on the Demise of Lawful-Act Duress in New South Wales' (2008) 27(2) *University of Queensland Law Journal* 41, 79.

122 Bernhard Waltl and Florian Matthes, 'Towards Measures of Complexity: Applying Structural and Linguistic Metrics to German Laws' in Rinke Hoekstra (ed), *Legal Knowledge and Information Systems* (IOS Press, 2014) 153, 160.

123 Schuck (n 28) 4.

124 Waltl and Matthes (n 122) 159. See also Waltl and Matthes (n 98) [3.3.2]. Waltl and Matthes noted that some scholars have suggested that vague terms fall into one of three categories: evaluation, quantification and time.

88. Examining the use of indeterminate terms, in consultation with stakeholder feedback, can identify indeterminate terms that unnecessarily contribute to legislative complexity. A metric for this could be to identify indeterminate concepts that are unnecessarily complex and then computationally consider their use in the Act or particular provisions. One example of unnecessarily complex use of indeterminate terms may be a requirement that is subject to multiple standards of 'reasonableness'.

Linguistic legislative features

89. Language has long been understood as a legislative feature that can lead to complexity. For example, the Explanatory Memorandum to the Company Law Review Bill 1997 (Cth) suggested that an obstacle to 'users of the law find[ing] out and understand[ing] their rights and obligations under the [Corporations] Law' is the 'unnecessarily complex language' of the law, which means that businesspeople require 'professional advice (eg from accountants or lawyers) before undertaking routine company activities'.[125] The focus on plain language in legislation, which was a cornerstone of the Commonwealth's 'Tax Law Improvement Project' in the 1990s,[126] is fundamentally a recognition that language, when used in certain ways, may contribute to legislative complexity.

90. Interrogating this legislative feature means measuring how the language used in legislation impacts on the ability for users to understand the law.[127] Different users of legislation have different abilities to process the language used in legislation which may relate to their social and educational backgrounds.[128] However, an impression of the complexity of language can be ascertained by measuring 'readability' and other linguistic features. These metrics are aimed at an understanding of 'linguistic complexity that seeks to model the "cost" of assimilating the language contained within each element' of the law.[129] Reducing the complexity of language as a legislative feature can also manage legislative complexity that is irreducible for various reasons, such as because it has its roots in policy or subject matter.

91. The ALRC has identified the following metrics that may be used to measure the complexity of language as a legislative feature.

92. **Readability metrics:** There are various readability measures, including the Flesch Reading Ease score, which can be used to measure readability. Critics of readability scores point out that readability scores do not capture all of the complexities which could appear in a text.[130] However, 'to compare different texts and to classify them based on a uniform method is an accepted method in other disciplines'.[131] Further, multiple different readability measures can be used to analyse whether there are differences in results. The UK Office for Tax Simplification has focused on measuring the complexity of legislation through readability scores among other methods.[132]

125 Explanatory Memorandum, Company Law Review Bill 1997 (Cth) [2.6].
126 Australian Taxation Office, *Tax Law Improvement Project: Building the New Tax Law* (Information Paper No 2, April 1995) 12.
127 Of course, different groups use legislation, and these groups have become increasingly diverse in the last 20–30 years: Office of the Parliamentary Counsel (UK) (n 58) 19.
128 See, for example, Waltl and Matthes (n 122) 156 where the authors describes this as 'understandability' and differentiate it from readability.
129 Katz and J. Bommarito II (n 19) 352.
130 See, for example, Duncan Berry, 'Legislative Drafting: Could Our Statutes Be Simpler?' (1987) 8(2) *Statute Law Review* 92, 100. The author queries whether the Flesch Reading Index really assists in measuring readability.
131 Waltl and Matthes (n 122) 156.
132 Webb and Geyer (n 66) 137–8.

93. **Linguistic diversity metrics:** This measures the total size of the vocabulary (ie unique words) used in legislation and the number of 'stems' they are based on (eg the stem of 'provided' and 'provider' is 'provid'). Relative measures of linguistic diversity may examine the number of unique words per 1000 words, for example. Linguistic diversity 'drives the inhomogeneity of texts and is an indicator for the number of distinct topics covered by a law'.[133] However, research of this kind on German laws found that the readability of a German legislative text was not influenced by the number of unique words used within a text. This could mean that linguistic diversity is not necessarily a contributor to the complexity of legal texts.[134]

94. **Linguistic entropy metrics:** Entropy is a measure of conceptual diversity in a text. Proposed by Shannon in 1948,[135] it is a numerical score that seeks to reflect the diversity of language and concepts used within a legislative text. When an individual is reading an Act with greater entropy, the person will encounter a greater range of concepts than they would encounter if reading a lower entropy text. Entropy can serve as a proxy for the cognitive difficulty which a person will experience in reading a text, given 'it is more difficult for an individual to understand a set of concepts with high variance than one comprised of homogeneous material'.[136]

Legislative hierarchy

95. Acts may be linked to delegated legislation, notably in the form of regulations and other legislative instruments, through the legislative hierarchy. The legislative hierarchy can contribute to overall legislative complexity in a number of ways. The ALRC has identified particular complexity in three legislative features: consistent use of legislative hierarchy, notional amendments, and the proliferation of legislative instruments. Each of these features is explored further below.

Consistent use of legislative hierarchy

96. An inconsistent use of the legislative hierarchy in a legislative scheme may be complex and reduce the readability and navigability of the scheme. Inconsistency occurs where a person navigating a legislative scheme is unable to clearly identify where certain types of provisions will be located. For example, in a legislative scheme with an inconsistent hierarchy a reader may have to search the Act, regulations, and regulator-made legislative instruments to identify exemptions potentially relevant to their circumstances. A consistent hierarchy would see exemptions, or particular types of exemptions, clearly located in one type of instrument or potentially one instrument.

97. Inconsistency can arise within a single legislative scheme, as in the example above, or across legislative schemes. A significant body of guidance from the Senate Standing Committee for the Scrutiny of Delegated Legislation,[137] the Office of the Parliamentary Counsel (Cth),[138] and Department of Prime Minister and Cabinet seeks to ensure principled

133 Waltl and Matthes (n 122) 160.
134 Ibid 161.
135 Claude Shannon, 'A Mathematical Theory of Communication' (1948) 27 *The Bell System Technical Journal* 379.
136 Michael J Bommarito II and Daniel M Katz, 'A Mathematical Approach to the Study of the United States Code' (2010) 389 *Physica A* 4195, 4199.
137 Senate Standing Committee for the Scrutiny of Delegated Legislation, *Guidelines* (1st ed, 2020) 27–29.
138 Office of Parliamentary Counsel (Cth), Drafting Direction 3.8, 'Subordinate legislation' (Document release 5.5, Reissued June 2020).

and relatively consistent legislative hierarchies.[139] This guidance reflects a particular Commonwealth legislative hierarchy whereby particular provisions are to be included in the primary Act, and others in delegated legislation. For example, this guidance generally suggests that the following should go in an Act:

a. Provisions creating offences or civil penalties which impose significant criminal penalties;

b. amendments to Acts of Parliament;

c. provisions imposing high or substantial fees and charges;

d. procedural matters that go to the essence of the legislative scheme; and

e. significant questions of policy including significant new policy or fundamental changes to existing policy.

98. Where a legislative scheme complies with the general principles and guidelines on Commonwealth legislative hierarchies, readers may be able to predict where particular provisions will be located and therefore navigate the scheme with more ease. Legislative schemes that depart from these principles, particularly where they do so to a significant extent, have a legislative hierarchy that is inconsistent with accepted standards of legislative design and are therefore potentially inconsistent with other legislative schemes. This may be complex for businesses, practitioners, and lawmakers who frequently have to navigate between legislative schemes. Each of these schemes may have their own unique internal legislative hierarchy, which may be internally consistent or inconsistent.

99. However, the guidance recognises that it is sometimes necessary to depart from the principles for consistent legislative hierarchies across legislative schemes. This may ensure particular pieces of legislation remain flexible and adaptable, such as where dynamic provisions are located in delegated legislation so that they can be easily amended. In such cases, a scheme is still arguably less complex if it has an internally consistent legislative hierarchy. For example, a legislative scheme may be less complex if it has just one type of instrument containing certain classes of obligations, where it is thought necessary to place these in delegated legislation rather than the Act. A consistent internal legislative hierarchy may therefore reduce complexity even where the internal hierarchy is inconsistent with general principles of Commonwealth legislative hierarchies.

Notional amendments

100. The ALRC has identified notional amendments as potentially detracting significantly from the readability and navigability of legislation. These amendments are known as 'notional amendments' because the amendments are not apparent on the face of the legislation, yet they have the same legal effect as amending the legislation directly.[140] Notional amendments can also be known as 'modifications', as defined in the glossary on the Federal Register of Legislation.

139 Department of the Prime Minister and Cabinet (Cth), *Legislation Handbook* (2017).

140 For a discussion of 'notional amendments' in the context of the *Corporations Act*, see Stephen Bottomley, 'The Notional Legislator: The Australian Securities and Investments Commission's Role as Law-Maker' (2011) 39(1) *Federal Law Review* 1.

101. Notional amendments can mean that the text of an Act does not reflect the ultimate effect of the law, nor is the existence of notional amendments apparent to the reader of the Act. Notional amendments can fundamentally change the substance of an Act or legislative instrument, such as by imposing new obligations or amending obligations for a particular class of persons. Such amendments, whether to an Act or another piece of delegated legislation, can therefore lead to legislative complexity. As Van Geelen notes, notional amendments can also mean 'there is not one current version of the law; there are several'.[141] This creates obvious complexity as users of legislation have to determine the version of the law that applies to their circumstances, often by piecing together the effect of various legislative instruments that contain notional amendments.

102. Metrics relevant to understanding current use of notional amendments include the number of instruments making notional amendments, and the number and substance of these amendments.

103. Notional amendments to an Act are generally created through exercises of powers contained in 'Henry VIII clauses'. This type of clause enables the making of instruments that omit, insert or amend provisions of an Act (rather than supplementing the operation of an Act, such as by providing the content of a defined term or a monetary threshold). Instruments made under Henry VIII clauses in Australia do not amend the text directly. This means that the amendment does not appear in the Act compilation on the Federal Register of Legislation. An example of such a clause is s 1362A of the *Corporations Act* which was introduced in 2020.[142] This section gave the Treasurer a temporary power to make notional amendments or exemptions in relation to *any* provision of the *Corporations Act* lasting up to six months.

104. By permitting modifications to an Act without the same public lawmaking processes as Acts, instruments made under Henry VIII clauses can lead to instability and unpredictability in legislation. The instruments can also result in complexity in legislation when they are used to tailor provisions of the Act to particular persons, products, or circumstances.

Proliferating legislative instruments

105. A large number of legislative instruments may make legislation less navigable, less accessible, and more complex. Relevant metrics may include the number of legislative instruments made under an Act, and the length of such instruments.

Exceptions and exemptions

106. Exceptions in Acts and delegated legislation can make legislation more complex to understand and apply. This is because 'the number of factual situations or assessments involved in the determination of a rule's applicability' affects the rule's complexity.[143] Exemptions can also 'reduce accessibility to the law, leading to a lack of clarity about the full extent of a legislative framework'.[144] This feature can be measured by counting the number of exemptions and considering their location within the legislative hierarchy. For example, legislation may be more complex where it requires a reader to examine multiple

141 Tess Van Geelen, 'Delegated Legislation in Financial Services Law: Implications for Regulatory Complexity and the Rule of Law' (2021) 38(5) *Company and Securities Law Journal* 296, 307 (italics removed).
142 *Corporations Act 2001* (Cth) s 1362A.
143 Julia Black, *Rules and Regulators* (Clarendon Press, 1997) 23.
144 Debra Angus, 'Things Fall Apart: How Legislative Design Becomes Unravelled' (2017) 15(2) *New Zealand Journal of Public and International Law* 149, 150.

legislative sources to understand the scope of a provision. In the *Corporations Act*, a reader frequently must have regard to the Act, regulations, and dozens of other legislative instruments in determining the application of particular regulatory regimes.[145]

107. Furthermore, a large number of exceptions and exemptions can obscure a regulatory regime's underlying principles. Commissioner Hayne noted that exceptions and 'limitations encourage literal application' of a law, and this has the effect of making it 'more complicated' to discern the law's 'unifying and informing principles and purposes'.[146] Based on this proposition, the number of exemptions and exclusions in an Act may affect the discernibility of the Act's principles and purposes, and increase its complexity.

108. Exemptions can also be subject to conditions. These effectively create an alternative regulatory regime for those relying on the exemption, and the potential to create such regimes can mean that exemptions 'become a de facto legislative scheme if the law does not keep pace with developments'.[147] The accretion of exemptions in place of law reforms that address the source of exemptions can occur because managing a 'regulatory environment through an exemptions process is an attractive option for regulators because of the flexibility, immediacy and control it can provide'.[148]

109. This legislative feature can be measured by counting and locating the number of exemptions and exclusions in an Act and legislative instruments. This can provide a useful indication of how complex the legislative scheme is with respect to navigability, as well as how complicated it is to discern its core principles and purposes.

110. Where exemption powers are considered necessary, Angus argues they 'should be exceptional, rather than the norm. Such powers should not supplant a proper legislative amendment process, shore up an incomplete policy process or allow arbitrary exceptions to the law'.[149] They should also be subject to 'clear criteria, time limits and transparency requirements'.[150] Any conditions that can be imposed on exemptions should also be 'consistent with the requirements of the empowering legislation and no more onerous than the requirements they replace'.[151] Overall, 'stewardship and oversight is needed to prevent legislative design from becoming unravelled by the use of exemptions from legislative requirements'.[152]

111. In addition to contributing to legislative complexity, extensive use of exemptions and exclusions is a symptom of complexity and other problems in legislation, such as over-prescriptiveness. Exemptions and exclusions highlight parts of the legislation that are not operating appropriately for a sufficiently broad range of circumstances. In particular, exemptions by regulatory agencies, which are often visible only to highly engaged stakeholders,

145 Parts 7.6 (Financial Services Licensing) and 7.9 (Financial Product Disclosure) are notable examples in this regard.
146 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 24) 44. In *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1, [2012] FCA 1028 [813], [948] the Court similarly noted that complicated exceptions can themselves add to the complexity of the law, especially when the court has to 'waste its time wading through [the] legislative porridge' to work out which exceptions might apply.
147 Angus (n 144) 153.
148 Ibid.
149 Ibid 151.
150 Ibid 152.
151 Ibid 152–153.
152 Ibid 159.

can lead to a disconnect between the state of the law and its actual operation as there is no overall picture about the need for a law change. If numerous exemptions are continually being granted by regulatory agencies, there is an issue whether the law is fit for purpose.[153]

Prescription

112. For the purposes of this analysis, prescription can refer to either the imposition of detailed rules and requirements (including conduct obligations) in a certain regulatory area or the breadth of the regulatory areas that are subject to detailed rules and requirements. Prescription is often a necessary feature of legislation. For example, writing of welfare law, Harris has suggested that there will always be 'an inherent necessity for prescription of the diverse circumstances and needs to which a welfare system is expected to be responsive'.[154] The same is arguably true of many areas of the law, and in this sense there is no irreconcilable tension between 'principles' at the general level and 'prescription' at the detailed level. The two can and often must go hand in hand. But prescription, particularly where it reflects the density and technicality of rules,[155] can lead to legislative complexity. This complexity is likely to be excessive and unjustified where the prescription is disproportionate when measured against the capacity of the regulated community to understand, and comply meaningfully with, the legislation.

113. Identifying prescription and the degree of complexity it introduces requires both quantitative and qualitative analysis of legislative texts and schemes. A quantitative analysis means identifying distinct subject matter of legislation and considering its level of prescription. Distinct subject matter, such as particular regulatory regimes, may be identified in a legislative text at the level of chapters, parts, divisions, and subdivisions. Potentially prescriptive—and in some cases overly prescriptive—subject matter can be quantitatively identified by examining provisions which are particularly long, which have grown longer over time, or which have intricate structural elements (eg they are densely packed with subsections, paragraphs, subparagraphs). Identifying prescription in a legislative scheme requires a consideration of the size and intricacy of legislative instruments, including regulations, as they relate to particular subject matter. For example, ALRC research in the *Corporations Act* has focused on understanding prescription in disclosure, which has tens of thousands of words and highly intricate provisions associated with it in the Act, *Corporations Regulations 2001* (Cth) ('*Corporations Regulations*'), and ASIC legislative instruments.

114. Having identified potentially prescriptive areas of a legislative text, a qualitative assessment is required to understand the degree of prescription and to consider whether the prescription is necessary and therefore justified. This is often a matter of judgment on which reasonable minds may differ. Prescription may be unnecessary where 'the fineness of the distinctions a rule makes' is excessive,[156] or where the density of the rules means that they are 'numerous and encompassing' in a way 'which causes them to collide and conflict with their animating policies with some frequency'.[157]

153 Ibid 153.
154 Harris (n 36) 224.
155 Schuck (n 28) 4.
156 Ibid.
157 Ibid 3.

Duplication and redundancy

115. Duplicated, redundant, and overlapping provisions and regulatory regimes are a legislative feature that can contribute to overall legislative complexity. Consolidating provisions and regimes by removing duplicated, redundant, and overlapping provisions and regulatory regimes may simplify the law. It may also mean that other legislative features that contribute to overall complexity are reduced. Eliminating overlapping regimes, for example, may mean that fewer concepts, obligations, and prohibitions are needed in legislation.

116. In writing about Australia's tax laws, Cooper identified as among its 'structural flaws' 'regime duplication and overlap (typically by legislative accretion)' and a 'failure to remove legislative detritus'.[158] Duplicated and overlapping regimes can mean that too 'many matters … do not admit simple answers', and as a legislative feature they are 'perhaps the most annoying and unnecessary design defect' in legislation.[159]

117. The ALRC has identified duplication and overlap in a range of provisions of the *Corporations Act*. Previous ALRC research has shown that '92 offences within the *Corporations Act* relate to defective disclosure or false, misleading, or deceptive conduct'.[160] The consequence of this duplication are significant. As has been observed, the 'myriad provisions regulating misleading conduct have been described as … "a labyrinth that defies navigation, let alone rational analysis"'.[161] The ALRC's research concluded that, in relation to duplication,[162]

> Effective regulation of corporate misconduct requires balancing the competing demands of achieving sufficient specificity in offence provisions with the complexity that ensues from excessive specificity therein.

118. Duplication may sometimes be necessary or justified. For example, sometimes it may be justified to create tailored licensing regimes in the same Act where the entities being licensed are significantly different, and tailoring of the regime cannot appropriately occur within a single licensing scheme. Chapter 7 of the *Corporations Act* includes separate licensing regimes, with some specific associated conduct obligations, for persons operating financial markets, derivative trade repositories, clearing and settlement facilities, significant financial benchmarks, and financial services businesses. This may be justified given the different activities engaged in, though it is also arguable that tailoring of regulatory regimes could occur through licensing conditions and rules applicable to particular licence authorisations rather than wholly separate licensing regimes.

119. An example of unnecessary duplication and overlap may be the dozens of provisions in the *Corporations Act* that require a person to 'notify ASIC' of a matter. These provisions can have a variety of consequences attached to their breach, and can apply in different ways to different persons. This model of overlapping and duplicated provisions may be contrasted with one in which a higher level obligation to notify ASIC of a range of matters

158 Graeme S Cooper, 'Fixing the Defective Jigsaw' (Forthcoming) 45 *Melbourne University Law Review* 1, 4.
159 Ibid 5.
160 Australian Law Reform Commission, *Corporate Criminal Responsibility* (Final Report No 136, 2020) 79.
161 Ibid citing Elise Bant and Jeannie Marie Paterson, 'Developing a Rational Law of Misleading Conduct' in M Douglas, J Eldridge and C Carr (eds), *Economic Torts in Context* (Hart Publishing, 2020).
162 Ibid.

is included in a single provision, for which a series of consequences may be applicable and where courts are relied on to select the most appropriate consequence for breach.

120. Measuring this legislative feature should be done both qualitatively and quantitatively. Quantitative computational analysis may identify obligations or prohibitions that appear frequently. Qualitative analysis can then examine the provisions that contain these duplicated and overlapping obligations or prohibitions to determine whether their duplication is necessary. This process may highlight redundant provisions, such as transitional and consequential provisions contained at the end of many Acts.

Definitions

121. Defined terms can contribute to legislative complexity.[163] The Office of the Parliamentary Counsel (Cth) notes that a 'large number of concepts within a single scheme can be difficult for a reader to bear in mind and can therefore lead to complexity. Of course, for inherently complex schemes, large numbers of concepts might be unavoidable'.[164] But, definitions can also reduce legislative complexity by achieving consistent interpretation of terms and by reducing the need for repetition of text. Thus, to gain a holistic picture on the use of defined terms in an Act, the number, use, location, and content of defined terms should be analysed.

Legislative change

122. Legislative change is an inherent and desirable feature of legislation. But change also has consequences. The statute book is 'an ever-evolving network of complex information that expands organically and is extremely difficult to map'.[165] This difficulty is exacerbated when legislation is amended regularly in a way that does not make clear how existing and new legislation fit together.[166] Frequent amendment also results in changes to the existing 'scheme structures' which makes both the 'legislative and procedural arrangements' associated with the law more complex.[167]

123. Frequent amendment arguably increases the risk that changes will be undertaken 'without a review of existing provisions, or the legislation as a whole',[168] which the Commonwealth Attorney-General's Department suggests can be a cause of complexity. Godwin, Brand and Langford note that patchwork legislative amendments result in an 'inherent risk of incoherence' that is only 'exacerbated by legislation that is the product of continuing evolution over a long period of time'.[169] A potential metric for identifying incoherent or patchwork legislative change is the emergence of widespread use of alphanumeric provisions (eg s 12BAA). These may suggest a lack of forethought in the initial policy and legislative design stage, or that there has not been sufficient review of the legislation as a whole, as the Attorney-General's Department suggests is necessary.

163 Definitions as a legislative feature can be particularly problematic in the regulation of financial services. In *Ku v Song* (2007) 63 ACSR 661 [175], the Court noted that 'Gaining an understanding of the relevant law … requires hours of study, reference to numerous sections and regulations, which themselves make no sense without reference to numerous definitions, often shrouded in obfuscation, and, needless to say, strewn throughout the *Corporations Act* and the *Corporations Regulations* in various places'.

164 Office of Parliamentary Counsel (Cth) (n 67) 7.

165 Office of the Parliamentary Counsel (UK) (n 58) 14.

166 Ibid 13.

167 Harris (n 36) 210–11.

168 Attorney-General's Department (Cth) (n 59).

169 Godwin, Brand and Teele Langford (n 29) 283.

124. The Board of Taxation has noted that 'refinements to complex legislation will be required even after the legislation has been enacted. New issues will inevitably surface as the legislation is applied to real-life transactions, often not contemplated during the legislative design phase despite the best efforts of all involved'.[170] In addition, the Board has described legislative change as 'a necessary and healthy part of maintaining a complex system'.[171] Thus, a balance must be struck between keeping the law up to date and ensuring that it does not become too complex by virtue of constant amendment.

125. In addition to the emergence of alphanumeric provisions, legislative change as a legislative feature can be measured through the number of amendments per year for Acts or for particular provisions within an Act, such as a Chapter or Part.

Proxies for identifying legislative complexity

126. The ALRC considers that metrics can be identified that are not directly related to particular legislative features, but which may indicate that legislation is overly complex. They are therefore proxies for identifying legislative complexity.

127. The ALRC considers that data on litigation, disputes and compliance may be relevant in identifying areas of complexity within legislation. Particular provisions that are subject to litigation may be affected by uncertain drafting, complex definitions, or overly prescriptive content, all of which may necessitate the involvement of courts or other dispute resolution bodies. Disputes and non-compliance with legislation may also be the result of unnecessarily complex legislative regimes more broadly, which can make compliance with the law difficult.

128. However, proving causation between legislative complexity and non-compliance or high levels of legal disputes is difficult (if not impossible). Some breaches of the law will simply be the result of deliberate non-compliance or underinvestment in compliance processes. Likewise, court resolution of disputes between private parties is an ordinary feature of our legal system, and high levels of litigation can simply reflect high volumes of activity affected by provisions of an Act or legislative scheme.

129. The ALRC therefore consider dispute and compliance-related data to be relevant only in indicating potential areas of complexity, which should then be subject to more rigorous qualitative and quantitative analysis. For example, financial product and services disclosure is among the areas in which AFCA disputes are most frequently lodged. ALRC quantitative and qualitative analysis suggests this is one of the most unnecessarily complex areas of the *Corporations Act*, including in terms of prescriptiveness, use of legislative instruments, definitions, and exceptions and exemptions.

170 Tax Design Review Panel, *Better Tax Design and Implementation* (2008) 38.
171 Ibid.

Managing and reducing complexity

130. This section summarises some of the broad approaches suggested in the literature for better managing necessary complexity and reducing unnecessary complexity. One of the most useful approaches for managing necessary complexity—improving the navigability of legislation—will be considered in another Background Paper. This section discusses other ways of managing complexity, such as: simplification of drafting and better legislative design; better use of delegated legislation; and, frequent review and improvement of laws.

Simplification of drafting and better legislative design

131. Simplification of drafting and legislative design can reduce unnecessary complexity and better manage necessary complexity. Historically, legislation in most common law jurisdictions was written for lawyers.[172] Therefore, 'the principal goal of the drafter was precision, not readability or intelligibility by ordinary citizens'.[173] As Professor Ross Grantham has stated[174]

> most of the law on the statute books remains technically and formally expressed. It also continues to be drafted against the background of the common law and thus a presumption that the reader has a body of technical legal knowledge and experience with which to read, understand, and to contextualise the words of the statute.

132. It is against this background that efforts to 'simplify' the law or draft it using 'plain English language' have emerged. In 1987, the Law Reform Commission of Victoria stated that the law 'should be drafted in such a way to be intelligible, above all, to those directly affected by it. If it is intelligible to them, lawyers and judges should have no difficulty in understanding it and applying it'.[175]

133. Simplification in this sense is to be distinguished from making legal rules 'less nuanced, shorter and easier to understand' without regard to related policy consequences.[176] Instead, simplification is aimed at making the law comprehensible by those whose conduct is governed and by those whose interests might be affected'.[177]

134. A number of the different drafting approaches are posited to lead to simplification in legislative drafting. Plain English in law has been described as a 'style of writing … that best conveys to the reader who is to do (or not to do) what and when'.[178] The Law Reform Commission of Victoria in its report *Plain English and the Law* favoured an approach whereby legal documents are written in 'plain English'.[179]

135. There are other approaches to drafting that are similarly intended to simplify the law. In particular, general principles drafting, or 'European style' drafting, 'is one of

172 Ross Grantham, 'To Whom Does Australian Corporate and Consumer Legislation Speak?' (2018) 37(1) *University of Queensland Law Journal* 57, 57.
173 Ibid 57–8. Grantham cites Office of Parliamentary Counsel (Cth) (n 67) [7].
174 Grantham (n 172) 58.
175 Law Reform Commission of Victoria, *Plain English and the Law* (Report No 9, 1987) [69].
176 Katz and J. Bommarito II (n 19) 338.
177 *Casaclang v Wealthsure Pty Ltd* (2015) 238 FCR 55, [236].
178 Anthony Watson-Brown, 'In Search of Plain English – the Holy Grail or Mythical Excalibur of Legislative Drafting' (2012) 33(1) *Statute Law Review* 7, 7. For a comprehensive history on Plain English drafting in Australia, see Ian Turnbull, 'Legislative Drafting in Plain Language and Statements of General Principle' (1997) 18(1) *Statute Law Review* 21.
179 Law Reform Commission of Victoria (n 175).

several names for the style used when the drafter deliberately states the law in general principles and leaves the details to be filled in by the courts, by subordinate legislation or in some other way'.[180] In Australia, this approach has been criticised on the basis that 'the commercial world often insists on detailed statements'.[181] However, the ALRC questions whether this limitation still endures today; in consultation with lawyers, industry, and consumer groups, the ALRC has been told that the *Corporations Act* is overly complex because of its prescriptiveness and that a more principles-based drafting approach would be preferred.

136. Sir William Dale, writing in 1977, identified and attacked many of the legislative features that can characterise poor legislative design. These include excessively long sections,[182] which were a feature of drafting in common law jurisdictions and which the Office of the Parliamentary Counsel (Cth) also criticises.[183] Dale criticised the poor structuring of Acts, including the failure to prioritise core concepts and principles.[184] Complexity, he suggested, also came from the use of unnecessary defined terms and the use of phrases such as 'except where the context otherwise requires' or 'subject to the provisions of this Act'.[185] These 'distract the reader, and depreciate the value of what [the reader] is told'.[186] Dale valued the concision and general absence of 'conditions, qualifications, reservations, warnings and other interceptions of the communication' in French and Swedish law.[187] He called for the adoption of 'drafting techniques … which serve the purpose of clarity'.[188] This requires 'an absence of undue length',[189] 'to be less fussy over detail, to be more general and concise; and to situate each rule where it belongs, in an orderly and logical development'.[190] It also requires reducing cross-references, which though 'saving space' increase 'the vexation'.[191] He considered principles to be core to better drafting, and he praised French laws in which 'a manifestation of principle is combined with an orderly development of detail'.

137. The need to balance simplicity and precision is a challenge for lawmakers and drafters. As Ian Turnbull QC has stated: 'In moving towards a simpler style, it is a matter of delicate judgment to decide how high the standard of precision should be, and how many words can be omitted without losing precision'.[192] This delicate judgement is deeply subjective. For example, critics of simplification projects argue that reductions in 'regulatory compliance requirements do not eliminate the complex interplay between the regulators, regulated, public, and the state, they just conceal it … simplification may have the effect of increasing uncertainty by making regulatory relationships and industrial obligations unclear to the regulated, regulators, judicial bodies, and citizens'.[193]

180 Turnbull (n 178) 26.
181 Ibid 27. See also page 28, where Turnbull points to the Attorney-General of Australia's comment at a 1992 conference in Parliament House relating to the corporations law: 'The law is already too general for some practitioners. They want the law spelt out, and not left to bureaucrats or courts to interpret'.
182 William Dale, *Legislative Drafting: A New Approach* (Butterworths, 1977) 55.
183 Office of Parliamentary Counsel (Cth) (n 67) 4.
184 Dale (n 182) 12.
185 Ibid.
186 Ibid.
187 Ibid 13.
188 Ibid 333.
189 Ibid 331.
190 Ibid 335.
191 Ibid 332.
192 Ian Turnbull, 'Clear Legislative Drafting: New Approaches in Australia' (1990) 11(3) *Statute Law Review* 161, 165.
193 Webb and Geyer (n 66) 145.

138. There are other views on ways that drafting and structure could be improved. For example:

- Morrison has advocated for the increased use of 'safe harbours' in drafting;[194]
- Horn has argued for increased use of headings in legislation; and[195]
- Stewart has suggested that section headings be framed as questions.[196]

139. The Attorney-General's Department has also suggested that legislation be tested with focus groups or exposure drafts be released early for public comment.[197] This process could assist drafters to determine if the structure or content of draft legislation is too complex. It has also suggested that legislation be tested 'for continuing relevance'.[198]

140. The Office of the Parliamentary Counsel (Cth) can directly manage some aspects of complexity by exercising its editorial powers. Currently, s 15V of the *Legislation Act 2003* (Cth) gives the First Parliamentary Counsel ('FPC') the power to make editorial changes and other changes to Acts and instruments. Changes can only be made if the FPC considers them necessary to 'bring the Act or instrument into line, or more closely into line, with legislative drafting practice being used by the Office of Parliamentary Counsel; to correct an error, or to ensure that a misdescribed amendment of the Act or instrument is given effect to as intended'.[199] Notably, the FPC cannot make changes that change the effect of the law, and the power is therefore very circumscribed.[200] The Office of the Parliamentary Counsel (Cth) publishes data on the exercise of the FPC's editorial powers.[201] These powers can help address minor unintended quality issues in Commonwealth legislation. But they also underline the limited formal power of the Office of the Parliamentary Counsel (Cth) to improve legislative design and reduce legislative complexity without broader stakeholder support, notably from policymakers and parliamentarians.

141. In Australia, changes that are not appropriate for FPC editorial changes are made through Statute Update Acts, which used to be called Statute law revision Acts.[202] Some changes are also made as part of department-specific amendment Acts.[203] For example, in early 2021, Treasury consulted on miscellaneous amendments to Treasury portfolio laws.[204] The draft explanatory memorandum explains that 'Minor and technical

194 Andrew Stumpff Morrison, 'Case Law, Systematic Law, and a Very Modest Suggestion' (2014) 35(2) *Statute Law Review* 159, 173: 'With a safe harbor, the rule-writers lays down a general, relatively vague standard … To this general standard is added one or more specific, more objectively delineated categories of conduct that will be conclusively deemed not to violate the standard'.

195 Nick Horn, 'Legislative Section Headings: Drafting Techniques, Plain Language, and Redundancy' (2011) 32(3) *Statute Law Review* 186. However, Horn recognises that little research has been done on whether headings assist user understanding.

196 Gordon Stewart, 'Legislative Drafting and the Marginal Note' (1995) 16(1) *Statute Law Review* 21, 22.

197 Attorney-General's Department (Cth) (n 59) 4.

198 Ibid 6.

199 *Legislation Act 2003* (Cth) s 15V(2). The Office of the Parliamentary Counsel's (Cth) approach to using the power is summarised in Office of Parliamentary Counsel (Cth), Drafting Direction 4.4, 'Minor, technical and editorial changes (including changes using FPC's editorial powers)' (Document release 3.0, Reissued October 2019).

200 *Legislation Act 2003* (Cth) s 15V(6). The Parliamentary Counsel Office (NZ) is similarly restricted in editorial changes it can make: *Legislation Act 2019* (NZ) s 86.

201 Federal Register of Legislation, 'Editorial Changes Reports' <www.legislation.gov.au/Content/EditorialChanges>.

202 Office of Parliamentary Counsel (Cth), Drafting Direction 4.4, 'Minor, technical and editorial changes (including changes using FPC's editorial powers)' (Document release 3.0, Reissued October 2019) 4.

203 For example, the *Treasury Laws Amendment (2020 Measures No. 6) Act 2020* (Cth) includes 31 pages of minor amendments.

204 Department of the Treasury (Cth), 'Miscellaneous Amendments to Treasury Portfolio Laws 2021' <treasury.gov.au/consultation/c2021-167053>.

amendments are periodically made to Treasury legislation … to remove anomalies, correct unintended outcomes and generally improve the quality of laws'.[205]

Effective use of delegated legislation

142. Delegated legislation can also help manage the complexity of Acts.[206] Jacobs has argued that legislation that regulates complex social systems, like financial markets, requires a 'greater degree of delegation than Parliaments may be used to'.[207] To this end, Jacobs argues that the legislative hierarchy should have one or more of the following features:

- flexibility to accommodate evolution of the system;
- the capacity for regulators to choose different methods of regulation to suit the situation;
- the capacity to undertake small interventions; and
- flexibility to accommodate and learn from results of experimentation.

143. However, an increase in the use of delegated legislation can contribute to the complexity of an Act and the legislative scheme. Thus, flexibility must be balanced against maintaining coherence in legislation.

144. The complexity caused by extensive use of delegated legislation might be reduced by structuring legislative instruments thematically and avoiding notional amendments to Acts. For example, APRA conducts much of its prudential regulation through thematically consolidated legislative instruments. Likewise, accounting standards in Australia are consolidated thematically and published in legislative instruments. Each of these instruments operate as relatively self-contained statements of rules and requirements, rather than as notional amendments to an Act.

145. Parliamentary processes for oversight of delegated legislation include disallowance and sunsetting. Disallowance refers to the process by which an instrument may be repealed if a notice of motion to disallow the instrument is introduced in the House of Representatives or the Senate within a short period and it is not voted down. Sunsetting refers to the automatic repeal of delegated instruments after 10 years, unless they are remade. Both processes are set out in the *Legislation Act 2003*.

146. An increasing number of Commonwealth regulations and other legislative instruments are exempt from sunsetting.[208] These exemptions include many instruments made under the *ASIC Act*, *Corporations Act*, *Competition and Consumer Act 2010*, *Aviation Transport Security Act 2004, CrossBorder Insolvency Act 2008, Extradition Act 1988, Fair Work Act 2009, Financial Framework (Supplementary Powers) Regulations 1997, Foreign Acquisitions and Takeovers Act 1975,* and the *National Consumer Credit Protection Act 2009*. In addition, many types of legislative instruments are not subject to parliamentary disallowance.[209]

205 Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures for Consultation) Bill 2021: Miscellaneous and Technical Amendments [1.3].
206 See discussion in Stephen Bottomley, 'Where Did the Law Go? The Delegation of Australian Corporate Regulation' (2003) 15 *Australian Journal of Corporate Law* 1, 9.
207 Jacobs (n 17) 19.
208 *Legislation (Exemptions and Other Matters) Regulation 2015* (Cth) Part 5.
209 Ibid Part 4.

Reviewing the statute book

147. One approach to managing the complexity in the statute book is to conduct regular reviews of the stock of legislation. Godwin, Brand and Langford argue that legislative review is extremely important.[210] They suggest that the 'inherent risk of incoherence resulting from patchwork amendments over a long period of time could be mitigated by more rigorous review of legislation'.[211]

148. New Zealand has a Legislation Design and Advisory Committee ('LDAC') which examines the stock of existing laws and encourages agencies to proactively review their legislative instruments. The *Legislation Act 2012* (NZ) also provides that the 'Attorney-General must prepare a draft 3-yearly revision programme for each new Parliament'.[212] The purpose of this programme is to 'make New Zealand statute law more accessible, readable, and easier to understand'.[213] Some European jurisdictions also have formal processes in place to review the stock of legislation.[214]

149. The Board of Taxation recommended in its Better Tax Design and Implementation report that the Government ensure 'greater priority is given to the ongoing care and maintenance of the tax system'.[215] Similar efforts to better manage the stock of tax legislation have been attempted in the UK.[216]

150. The Commonwealth Attorney-General's Department suggests that the statute book be reviewed periodically to reduce duplication, which contributes to complexity. It has also acknowledged that many 'Bills are introduced in Parliament without any outside assessment of readability and useability. This means that it is difficult to ensure the end user will be able to understand the impact of the Bill on their rights and interests'.[217]

151. Individual departments are also encouraged to take a stewardship approach to their lawmaking. The Government recently reiterated this in a new Regulator Performance Guide. As the website for Guide suggests, the 'Australian Government has adopted a stewardship approach to regulation where Ministers, Secretaries and Agency Heads are ultimately responsible for ensuring the regulations and regulatory approaches under their authority are fit for purpose'.[218]

152. Likewise, the Commonwealth Legislation Handbook provides general guidance on lawmaking by departments. It recommends working with the Office of the Parliamentary Counsel (Cth) to identify 'how to avoid unduly complex legislation and whether there might be alternative approaches which would permit simpler legislation'.[219] It also encourages departments working on amendments or new laws to 'consider whether any aspects of

210 Godwin, Brand and Teele Langford (n 29) 289–290.
211 Ibid 289.
212 *Legislation Act 2012* (NZ) s 30(1).
213 Ibid s 3(e).
214 See Edward Donelan, 'European Approaches to Improving Access to and Managing the Stock of Legislation' (2009) 30(3) *Statute Law Review* 147.
215 Tax Design Review Panel (n 170) 35 (Recommendation 16).
216 Webb and Geyer (n 66) 137.
217 Attorney-General's Department (Cth) (n 59) 4.
218 Department of the Prime Minister and Cabinet (Cth), 'Regulator Performance Guide and Supporting Material' <deregulation.pmc.gov.au/priorities/regulator-best-practice-and-performance/regulator-performance-guide>. See also, Department of the Prime Minister and Cabinet (Cth), *Regulator Performance Guide* (July 2021) 3.
219 Department of the Prime Minister and Cabinet (Cth), *Legislation Handbook* (n 139) [3.3].

the proposed approach add complexity, and whether there are any acceptable alternative approaches that would be less complex'.[220]

153. The Office of the Parliamentary Counsel's (Cth) guide to drafting services also notes that drafters will 'raise issues of complexity in the drafting process with instructors, and will be proactive in suggesting ways that complexity might be reduced'.[221] It also suggests that:

> Drafters may decide to include a "complexity flag" (which is a specially formatted note) in a draft if they think that the policy creates or adds to complexity. In some cases flags relate to the basic policy or fundamental aspects of how the policy is to be implemented. In other cases flags relate to matters of detail or particular provisions. Instructing agencies need to consider the flags and advise the drafters what they wish to do.[222]

154. Independent review bodies can also serve a legislative stewardship role. In Australia, a Corporations and Markets Advisory Committee (CAMAC) existed from 1989 to 2014 and had the ability to make recommendations about any matter connected with a proposal to make or amend corporations legislation. It had the ability to consider the stock of legislation and make law reform proposals on an ongoing basis.

155. It is possible that the Office of the Parliamentary Counsel (Cth) could adopt more of a 'stewardship' role in which it focuses more squarely on reviewing and managing the stock of legislation in priority areas, such as areas that frequently change. However, this would likely require improved resourcing and potential changes to its mandate and powers.

Legislative blueprint

156. Another way of managing legislative complexity is to have a legislative blueprint which explains the manner in which a piece of legislation should be amended in future years to maintain the law's fundamental policy aims and its design philosophy. The existence of explicit blueprints for certain areas of law remains rare. Tax law appears to be the main area in which a legislative design philosophy has been expressed. This is reflected in the Office of the Parliamentary Counsel's (Cth) Drafting Direction 1.8,[223] which is the only Direction relating to a particular area of law. The focus on principles for better tax law design has been longstanding. The Board of Taxation in 2004 recommended that a design team 'monitor the early implementation of substantive new law to ensure that the legislation is operating as intended by identifying legislative refinements that are needed and ensuring that appropriate administrative products and guidance material are in place'.[224] This type of approach could assist to manage inherent legislative complexity.

220 Ibid [5.16].
221 Office of Parliamentary Counsel (Cth), *OPC's Drafting Services—A Guide for Clients* (6th ed, 2016) [33].
222 Ibid [34].
223 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006).
224 Tax Design Review Panel (n 170) Recommendation 22.

Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL3

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Improving the Navigability of Legislation

October 2021

This discussion of legislation and its navigability is the third in a series of background papers to be released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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Introduction

1. The Terms of Reference for the ALRC's Review of the Legislative Framework for Corporations and Financial Services Regulation highlight the importance of having 'an adaptive, efficient and navigable legislative framework for corporations and financial services'. This Background Paper discusses the range of features and techniques that can be used to make legislation more navigable.

2. Legislation is easier to navigate if a reader can more easily find in legislation the information they need for their purposes. Easier to navigate legislation contributes to simplification by making the law both easier to find and easier for a reader to find their way around. Features relating to the drafting as well as the presentation of legislation can be used to make legislation easier to navigate.

3. Technology also offers solutions to make legislation more navigable, particularly in respect of its electronic publication and presentation. Better use of technology in publishing legislation, particularly the use of Extensible Markup Language ('XML'), opens up a range of possibilities for users of legislation to customise how they engage with legislation. For regulated entities, this could include significantly streamlining the development and maintenance of compliance systems.

4. There is a relatively modest body of empirical research considering whether legislative features aid readers by improving navigability. The existing work suggests that further research could usefully be undertaken to gain a greater understanding of the range of users of legislation and whether aids to navigation are effective.

5. Although the focus of this Paper is on Acts of Parliament, much of what is discussed may also have application to delegated legislation. Wherever possible, examples are used to illustrate the features discussed below, with a particular focus on examples drawn from the *Corporations Act 2001* (Cth) ('*Corporations Act*'). If an example is located in an appendix rather than the text of the discussion, then there will be a hyperlink to that appendix and a link to return to the in-text discussion.

Navigability

6. Navigability refers to the ability of a person who uses legislation to find, and find their way around, the law. Just as a map and signposts can help a traveller reach a destination more easily, so too can more navigable legislation help a reader to find what they need in the law.[1] Navigability is important at three levels: across the statute book (Acts of Parliament) as a whole, between Acts and delegated legislation, and within individual pieces of legislation.

7. Navigability at the level of the statute book refers to being able to find the statutory law on one topic as easily as possible.[2] Locating the law on one topic is made more difficult when it is spread across several Acts.[3] So too when multiple topics are (sometimes

1 Ronan Cormacain, 'Legislative Drafting and the Rule of Law' (PhD Thesis, University of London, 2017) 63.

2 New Zealand Law Commission, *Presentation of New Zealand Statute Law* (Report No 104, 2008) [1.21]. For a discussion of the insights that cartography has for the design of corporations law more generally, see Stephen Bottomley, 'Corporate Law, Complexity and Cartography' (2020) 35 *Australian Journal of Corporate Law* 142.

3 New Zealand Law Commission (n 2) [1.21].

counterintuitively) combined into one Act. The *Corporations Act*, for example, covers diverse topics such as the structure and regulation of corporations, corporate insolvency and insolvency practitioners, financial services law, and consumer protection. In complex areas of the law it may not be possible to house all of the relevant statutory provisions in one Act, so navigability across different Acts is important.

8. Aside from being contained in multiple Acts, the law may also be spread across the legislative hierarchy. This means that navigability involves both a 'horizontal' aspect (between Acts, as discussed above) and a 'vertical' aspect (between an Act and delegated legislation[4] made under that Act). Delegated legislation presents a particular challenge to 'vertical' navigability because although an Act may indicate that regulations or other legislative instruments can be made under it, the text of an Act does not indicate whether any have, in fact, been made. In the case of the *Corporations Act*, both extensive regulations and other legislative instruments have been made, often covering the same topic, such that a reader may need to consult three legislative sources to locate the law. So too is there a large amount of regulatory guidance contained in Regulatory Guides issued by ASIC. Although these are not legislative in character, they are nonetheless important and often need to be navigated by users of the *Corporations Act*.

9. Navigability within individual pieces of legislation is also important, for two main reasons. First, a single section of legislation will rarely provide a complete answer to a legal question or the entirety of the law on one topic. One simple reason for this may be because the provision uses a defined term, and that definition is contained elsewhere in the legislation. Second, and relatedly, the rules of statutory interpretation require that an Act be read as a whole. This means it is important that all other relevant provisions can be identified.

10. While navigability may be an end in itself, it is better viewed as one aspect of making the law accessible. According to the New Zealand Law Commission, 'one aspect of the rule of law is to ensure that Acts of Parliament are accessible and available.'[5] The law is accessible if it is publicly available, navigable, and able to be understood.[6] According to Dr Ronan Cormacain, navigability is one of several principles that can be used to facilitate the drafting of legislation in accordance with the rule of law.[7] Complex legislation, even if publicly available, is unlikely to be accessible legislation because it will be difficult to navigate, read and understand. Complex legislation can therefore present a challenge to the rule of law.[8]

4 Delegated legislation, sometimes called subordinate legislation, is a term used to describe legislation made not directly by an act of Parliament, but made under the authority contained in an Act of Parliament. This includes Regulations and a range of other instruments. Delegated legislation is ordinarily made by the executive arm of government pursuant to power granted (delegated) to it by an Act of Parliament. See Parliament of Australia, 'Delegated Legislation', *Parliament of Australia* <www.aph.gov.au/About_Parliament/House_of_Representatives/Powers_practice_and_procedure/Practice7/HTML/Chapter10/Delegated_legislation>.

5 New Zealand Law Commission (n 2) iv; see also Australian Law Reform Commission, *Principled Regulation: Federal Civil & Administrative Penalties in Australia* (Report No 95, 2002).

6 New Zealand Law Commission (n 2) [16]–[18].

7 Cormacain (n 1) 12.

8 Lisa B Crawford, 'The Rule of Law in the Age of Statutes' (2020) 48(2) *Federal Law Review* 159; William Isdale and Christopher Ash, 'Legislative Morass and the Rule of Law: A Warning, and Some Possible Solutions' <https://www.auspublaw.org/2021/05/legislative-morass-and-the-rule-of-law-a-warning-and-some-possible-solutions/>.

Empirical research and user experience testing

11. To date, there has not been a substantial amount of empirical research exploring how users (or readers) engage with legislation and what insights that may offer for legislative drafting.[9] In particular, there has been little research to determine whether particular drafting techniques or aids to navigability are effective. Two examples of surveys undertaken in Australia and the United Kingdom are outlined below, and the findings of other research are discussed in the context of specific navigability aids.

Australian Legislation Users Survey

12. In 2010, the Office of Parliamentary Counsel (Cth) ('OPC') commissioned a study aimed at understanding whether 16 particular drafting features made Commonwealth legislation easier to read and understand ('2010 OPC Survey').[10] Though questions were aimed predominantly at understanding and readability, respondents were specifically asked whether four features made legislation easier to navigate:

- decentralised tables of contents;
- subsection headings;
- diagrams; and
- the new format of legislation.

13. The survey found that the majority of features rated very positively among respondents and revealed some differences in satisfaction levels regarding particular features between different user groups.[11] Insights from the survey in relation to specific features are highlighted when discussing those features below.

14. A limitation of the 2010 study was its selective reliance on a relatively narrow range of legislation users. All user groups were either legally qualified,[12] involved in court processes,[13] or involved in the process of developing legislation.[14] The vast majority of survey respondents were familiar with legislation.[15] The survey did not account for the views of those who administer legislation (such as regulators), infrequent or inexperienced users of legislation, and members of the general public. Although the OPC acknowledged that members of the general public are potential users of Commonwealth legislation, the general population was not included in the survey because of difficulties in selecting an appropriate sample.[16]

9 This can be distinguished from other empirical research which has focused on examining the readability of legislation, using readability measures such as the Flesch Readability Index. See, for example, a study that compared the readability of the *Income Tax Assessment Act 1936* (Cth) with the *Income Tax Assessment Act 1997* (Cth): David Smith and Grant Richardson, 'The Readability of Australia's Taxation Laws and Supplementary Materials: An Empirical Investigation' (1999) 20(3) *Fiscal Studies* 321.

10 Office of Parliamentary Counsel (Cth), *Results of the 2010 Legislation Users Survey* (2010).

11 Ibid 4–5.

12 Such as judges, barristers and solicitors.

13 Namely, 'staff of Federal Court judges, Family Court Judges, Federal Magistrates and AAT members'.

14 Namely, 'Commonwealth Public Servants from instructing areas and advising areas in Departments': Office of Parliamentary Counsel (Cth) (n 10) 1.

15 Ibid 7. Of the respondents, 57% reported that they had worked with Commonwealth legislation for more than 10 years and 27% for more than 21 years.

16 Peter Quiggin PSM, 'A Survey of User Attitudes to the Use of Aids to Understanding in Legislation' [2011] (1) *The Loophole* 96, 96.

United Kingdom study on drafting and presenting legislation

15. In 2012 and 2013 the United Kingdom Office of Parliamentary Counsel and the National Archives (UK) commissioned a study examining 'whether some particular drafting techniques or drafting styles are better understood than others' and, if so, 'which techniques and styles are best understood'.[17] In a 2014 paper, Alison Bertlin, Deputy Parliamentary Counsel at the UK Office of Parliamentary Counsel, provided a detailed discussion of the study and its findings.

16. Bertlin noted that the National Archives had 'amassed a considerable body of research about users' of the UK legislation website and identified three main categories of users.[18] A 'persona' was attributed to each:

- non-lawyers who need to use legislation in their job;
- members of the public seeking to enforce their legal rights or those of a relative or friend; and
- lawyers.[19]

For the purposes of the study's in-person user testing, 12 participants, each matching one of these 'personas', were selected.

17. The online survey component of the study presented respondents with alternative versions of an example legislative provision addressing five drafting topics: conditional statements, formulas, use of the expression 'subject to', 'second sentences', and 'sandwich provisions'.[20]

18. Conditional statements and the expression 'subject to' would be familiar parts of language to most readers of legislation. While not all readers would regularly encounter formulas in legislation, most people would be familiar with the concept. Bertlin explained 'second sentences' in these terms:

> Occasionally a second (unnumbered) sentence is used in a subsection. This happens typically where a subsidiary proposition is closely related to the first sentence or does not merit a subsection in its own right. A second sentence can be useful to signal, at the end of a subsection, that the subsection is subject to some other provision. This device offers a way to avoid opening the subsection with the possibly distracting, and certainly inelegant, phrase 'Subject to subsection (x)'.[21]

17 Alison Bertlin, 'What Works Best for the Reader? A Study on Drafting and Presenting Legislation' [2014] (2) *The Loophole* 25, 29. The study comprised an online survey that was completed by 1,901 respondents and partially completed by over 3,300 people. In-person user testing was also conducted.

18 Ibid 27.

19 Ibid.

20 Ibid 31–41.

21 Ibid 40.

19. A ‘sandwich provision’, according to Bertlin, describes a provision with opening and concluding text with paragraphs in between.[22] An example used in the study was as follows:

> If –
>
> (a) any goods are exported or brought to any place in the United Kingdom for the purpose of being exported, and
>
> (b) export of the goods is, or would be, contrary to any prohibition or restriction,
>
> the goods may be forfeited and any person knowingly concerned in the export, or intended export, of the goods is guilty of an offence.[23]

20. For the online survey, an example provision was prepared and redrafted in different ways for each topic. According to Bertlin, ‘All the versions for each topic were intended to be examples of good drafting’, with the intention being that ‘no version should be clearly “worse” than any other’.[24] For each of the five topics

> participants were shown one of the versions, then asked a comprehension question; they were then shown one or two alternative versions (options) and asked ‘Which option do you feel would best support you to work out the answer to the question?’[25]

21. Summarising the study’s conclusions, Bertlin noted that, ‘Not surprisingly, the survey did not produce conclusive evidence that any one drafting style is generally clearer or better understood than another’.[26] The study led the UK Office of Parliamentary Counsel to change its drafting guidance in some respects. However, the dominant and unexpected finding to come out of the in-person testing according to Bertlin was

> the striking level of difficulty that users of legislation have in making sense of it. This greatly outweighed any observations about how one drafting style compared with another. Readers seem to have very little grasp of how legislation is structured and organised. Their ‘mental model’ of it is simply not very good. This was true not just for members of the public but for participants of all types, including some of the lawyers.[27]

22. This finding pointed to ‘a pressing need to help readers to “find their feet” when reading legislation’.[28] This observation suggests that the navigability of a statute and tools to help a user orient themselves are important. The potential use of guides that are aimed at orienting a reader are discussed under the heading ‘Simplified outlines and guides’ below.[29]

23. Bertlin’s concluding observations on the study suggest that online surveys can be a useful way of gathering data on comparative drafting styles, even if not definitive as to whether one is necessarily better than another, and that users of legislation have abundant feedback to offer.[30]

22 Ibid 42.
23 Ibid 41.
24 Ibid 30.
25 Ibid.
26 Ibid 47.
27 Ibid 45.
28 Ibid 46.
29 See [88]–[100] below.
30 Bertlin (n 17) 48–49.

The potential for further research

24. The ALRC's first Interim Report will discuss how data-driven research can offer important insights into legislative complexity and the potential for improvement. Given the complexity of drafting legislation and the importance of a drafter's judgement in performing the task,[31] it is perhaps not surprising that there has been limited empirical research on navigability.

25. While anecdotal evidence may be useful in formulating improvements to legislative drafting, the efficacy of improvements would ideally be assessed by empirical analysis, and that analysis used to generate further improvements. Reflecting on the 2010 OPC Survey, Peter Quiggin PSM, former First Parliamentary Counsel of OPC, hoped that OPC would be able to undertake further research in the future.[32] The United Kingdom study demonstrates the potential to use a website, such as the Federal Register of Legislation in Australia, to obtain user feedback and data from a wider range of legislation users than the 2010 OPC Survey. The potential for further research will be discussed in the ALRC's first Interim Report.

Aids to navigation

26. This section discusses the range of features and techniques that may be used to make legislation more navigable. In the Australian context, this means legislation as published on the authoritative Federal Register of Legislation. Although it is not an authoritative source, Australian legislation is also available on the website of the Australasian Legal Information Institute ('AustLII').[33] The drafting features and techniques discussed here are largely drawn from literature on legislative drafting as well as official guidance for drafters issued in Australia, New Zealand, Canada and the United Kingdom. This section does not focus on non-authoritative, commercially produced versions of legislation, but highlights useful features of those publications where relevant.

27. At the Commonwealth level in Australia, there is a range of guidance available to legislative drafters. This includes the publicly available OPC Drafting Manual, Drafting Directions, Plain English Manual, and Guide to Reducing Complexity in Legislation, as well as internal resources that are not published more widely.[34] While the majority of these materials take the status of guidance, Drafting Directions are described as 'an authoritative series of pronouncements on a range of drafting issues … issued by First Parliamentary Counsel [FPC] after consultation with all drafters and editorial staff'.[35] These, and other documents described as having the 'status of a Drafting Direction', contain 'rules that should be followed by drafters unless they obtain an exemption in a particular case from FPC'.[36] Guidance, both Australian and international, otherwise frequently recognises that it is just that — guidance — and that most design choices are matters for a drafter's judgement.

31 See, eg, Thomas Webb and Robert Geyer, 'The Drafters' Dance: The Complexity of Drafting Legislation and the Limitations of "Plain Language" and "Good Law" Initiatives' (2020) 41(2) *Statute Law Review* 129.
32 Quiggin (n 16) 102.
33 Australasian Legal Information Institute, 'Australasian Legal Information Institute' <www.austlii.edu.au/>.
34 Office of Parliamentary Counsel (Cth), *Drafting Manual* (Edition 3.2, July 2019) [1]–[13].
35 Ibid [3].
36 Ibid [5].

28. In some places, this Paper makes particular reference to OPC Drafting Direction 1.8, entitled 'Special rules for Tax Code drafting'.[37] This Drafting Direction recognises the unique nature of the several pieces of legislation comprising the Tax Code, including the *Income Tax Assessment Act 1997* (Cth) ('*ITA Act 97*'). The *ITA Act 97* is currently the longest Commonwealth Act, and the only Act longer than the *Corporations Act*.

29. The *ITA Act 97* and other legislation comprising the Tax Code are products of the Taxation Law Improvement Project ('TLIP') which was established in 1993 with the aim of rewriting and simplifying Australian taxation legislation.[38] In some respects, the TLIP is incomplete because large portions of taxation legislation, including the *Income Tax Assessment Act 1936* (Cth), have not undergone the rewriting and simplification process. Nevertheless, Drafting Direction 1.8 recognises that the 'features of design, drafting style and presentation' of the Tax Code distinguish it from other legislation.[39] As will be discussed further below and in the ALRC's first Interim Report, some of those features and the guidance contained in Drafting Direction 1.8 may be applicable to legislation more generally.

30. Many of the specific aids discussed in OPC guidance are not directed solely at navigability, but rather the more general aims of making legislation easier to read and to understand. The OPC Drafting Manual, for example, groups several features under the heading 'Readability Aids'.[40] This observation underscores the interrelationship between the navigability and readability of legislation, as well as the importance of a drafter's judgement in pursuing these goals.

31. In terms of legal effect, navigability aids fall into one of the following categories:

- Parts of the text of a statute, and therefore part of the law. This would include, for example, cross-references or signposts that are part of the text of a provision.
- Features that do not form part of the operative text of a provision, but still form part of an Act and therefore have interpretive effect. By virtue of s 13 of the *Acts Interpretation Act 1901* (Cth) ('*Acts Interpretation Act*'), this would include the vast majority of aids to navigability and readability, such as headings, notes and examples.
- Features that affect the presentation, as distinct from the drafting, of legislation and that do not form part of an Act. This may include technological aids, such as hyperlinks that are applied when legislation is published in electronic form and after being passed by the Parliament.

Aids most relevant to the use of definitions

32. The ALRC's first Interim Report will focus on the use of definitions in corporations and financial services legislation. The use of defined terms unavoidably makes legislation less navigable, because a reader must look somewhere other than the text they are reading to give the defined term meaning. For this reason, particular mention is made of definitions throughout this Background Paper. This section focuses on techniques that can be used

37 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006).
38 For a brief discussion of the Taxation Law Improvement Project, see Smith and Richardson (n 9).
39 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) [3].
40 Office of Parliamentary Counsel (Cth), *Drafting Manual* (Edition 3.2, July 2019) 32.

to lessen the impact that defined terms have on navigability. Potential reforms will be discussed in greater detail in the ALRC's first Interim Report.

Identifying terms when they are defined and tagging concepts

33. Commonwealth legislation uniformly uses bold and italic formatting to identify when a term is being defined by a statutory provision.[41] This is the case regardless of whether the term is defined as part of a dictionary or interpretation provision, or in a standalone section. Other techniques used in conjunction with bold and italic formatting include the use of general definitions sections at the start of an Act[42] and using the word 'definition' in a section heading if the whole section is devoted to defining a single term.[43] While the words 'meaning of' have commonly been used in section headings to indicate that a term is defined, current guidance suggests that the word 'definition' is to be preferred.[44]

34. Bold and italic formatting is also used for 'tagged concepts', which create a defined term for a limited part of an Act, usually only the narrative of the section or subsection containing the tagged concept.[45] Tagged concepts, sometimes referred to as 'labels' by OPC guidance,[46] can be distinguished from defined terms because they are not treated as having a meaning independent of the narrative in which they are contained.[47] OPC Drafting Direction 1.8 acknowledges that a tagged concept may be used in more than one section provided the text of a later section helps a reader to find where the label is applied to that concept.[48]

35. Results of the 2010 OPC Survey showed that 82% of respondents were satisfied with the usefulness of the tagging of concepts.[49] An example of the use of tagged concepts in the *Corporations Act* is below.

Example: Tagged concepts

588ZA Employee entitlements contribution orders

Making of employee entitlements contribution order

(1) The Court may make an order under subsection (2) (an ***employee entitlements contribution order***) in relation to an entity (the ***contributing entity***) if the Court is satisfied that:

(a) a company (the ***insolvent company***) is being wound up; and

41 It should be noted, however, that not all concepts created by Commonwealth legislation are necessarily treated as being defined and therefore bold and italicised. See, for example, s 200A of the *Corporations Act* which specifies 'when [a] benefit is given in connection with retirement from an office or position'. Although s 200A creates the concept of 'a benefit given in connection with a person's retirement', which is used in ss 200F and 200G, the concept is not formatted in in the same manner as a defined term or tagged concept.

42 Office of Parliamentary Counsel (Cth), Drafting Direction 1.5, 'Definitions' (Document release 4.0, Reissued May 2019) 5.

43 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [149].

44 Ibid.

45 Office of Parliamentary Counsel (Cth), Drafting Direction 1.5, 'Definitions' (Document release 4.0, Reissued May 2019) [22]; Office of Parliamentary Counsel (Cth) (n 10) 47.

46 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) Attachment B [42].

47 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [24].

48 Ibid [45]; Office of Parliamentary Counsel (Cth), Drafting Direction 1.5, 'Definitions' (Document release 4.0, Reissued May 2019) [22].

49 Office of Parliamentary Counsel (Cth) (n 10) 48.

(b) an amount (the ***unpaid entitlements amount***) of the entitlements of one or more employees (within the meaning of Part 5.8A) of the insolvent company that are protected under Part 5.8A has not been paid; and

(c) the contributing entity is a member of the same contribution order group (see subsection (6)) as the insolvent company; and

(d) the contributing entity has benefited, directly or indirectly, from work done by those employees; and

(e) that benefit exceeds the benefit that would be reasonable in the circumstances if the insolvent company and the contributing entity were dealing at arm's length; and

(f) it is just and equitable to make the order.

…

Dictionaries, indexes and the location of definitions

36. The location of defined terms and lists of those terms can affect navigability. The typical approach is to include a general definitions section near the start of an Act containing either a full definition of terms used in the legislation or a 'signpost definition' indicating where the term is fully defined.[50] In this way, the dictionary should provide a complete list of terms that are defined in the legislation as well as acting as a 'map' to where defined terms are located. In the case of long legislation, the OPC Plain English Manual suggests including an alphabetical index at the end of the statute, identifying all key concepts.[51]

37. Ideally, there should be only one dictionary in an Act, or where multiple dictionaries are used, a single index that lists all defined terms used in an Act. This is not the case for the *Corporations Act*. Section 7 of the *Corporations Act* (which appears in Part 1.2 headed 'Interpretation') provides:

7 Location of other interpretation provisions

(1) Most of the interpretation provisions for this Act are in this Part.

(2) However, interpretation provisions relevant only to Chapter 7 are to be found at the beginning of that Chapter.

(3) Also, interpretation provisions relevant to a particular Part, Division or Subdivision may be found at the beginning of that Part, Division or Subdivision.

(4) Occasionally, an individual section contains its own interpretation provisions, not necessarily at the beginning.

While this section has limited utility in terms of actually directing readers to the location of other interpretation provisions, it at least alerts readers to the fact that defined terms are spread throughout the Act.

50 Office of Parliamentary Counsel (Cth), Drafting Direction 1.5, 'Definitions' (Document release 4.0, Reissued May 2019) [6].
51 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [169].

38. OPC drafting guidance recognises the utility of 'just in time' definitions.[52] A 'just in time' definition is one placed in or near to the provision to which it is most relevant. An example from the *Corporations Act* is below, where the term 'restructuring relief period' is defined immediately before a provision that uses the term. It can be observed that notwithstanding OPC guidance that 'definition' is to be used in a section heading that defines a term in preference to the expression 'meaning of',[53] the following example employs the expression 'meaning of'.[54]

Example: 'Just in time' definition

Division 7 of Part 5.3B *Corporations Act*

458D Meaning of *restructuring relief period*

In this Act:

restructuring relief period means the period:

(a) beginning on 1 January 2021; and

(b) ending on 31 March 2021.

458E When is a company *eligible for temporary restructuring relief*?

When is a company eligible for temporary restructuring relief?

(1) A company is ***eligible for temporary restructuring relief*** if:

(a) before the end of the restructuring relief period, the directors of the company:

(i) make a declaration in writing that sets out the matters mentioned in paragraphs (b), (c) and (d) and, if there is a prescribed form for the declaration, is in the prescribed form; and

…

39. 'Just in time' definitions can be used to assist the narrative flow of legislation or to ensure that if a reader consults only one part of an Act an important defined term is brought to their attention. Using hyperlinking or a 'hover box' to display the definition of a term could effectively convert all defined terms into 'just in time' definitions in electronically published legislation, reducing the need for using the current 'just in time' method. A 'hover box' or 'hover over' feature is a feature that can be embedded into websites to produce a 'pop-up box' containing text when a cursor is placed above certain text or that text is clicked on. These and hyperlinking are discussed further under the heading 'Technological aids' below.[55]

40. OPC Drafting Direction 1.8 states that for Tax Code legislation there is a policy 'to use "just in time" definitions wherever possible: in other words, to find the point in the narrative where the definition is most useful to the reader'.[56] The primacy given to 'just in

52 Office of Parliamentary Counsel (Cth), Drafting Direction 1.5, 'Definitions' (Document release 4.0, Reissued May 2019) [13].
53 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [149].
54 *Corporations Amendment (Corporate Insolvency Reforms) Act 2020* (Cth) Sch 2 Item 2.
55 See [126]–[132] below.
56 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0,

time' definitions is complemented by other drafting features that aid navigability in the Tax Code legislation, discussed further below.[57]

41. Drafting guidance issued by the United Kingdom Office of the Parliamentary Counsel also acknowledges that the significance of a definition can influence its location. It suggests that a definition 'that is key to understanding a provision will often be best up front, either where it is first used or in introductory material', while a definition that is 'merely clarificatory will often be left to the end so that the reader can get on with reading the main story before getting bogged down in the definitional detail'.[58] It may not always be straightforward, however, to distinguish between a significant and 'merely clarificatory' defined term.

42. The ALRC agrees with commentary on this approach that such a distinction may be difficult to maintain.[59] In any event, the UK guidance agrees that a comprehensive list of all defined terms should include a 'signpost' for where each definition is located.[60]

43. Canadian guidance suggests that definitions 'should be set out in the first section of the Act, unless they apply only to a particular Part, section or group of sections. In that case, they should be placed at the beginning of the passage in question.'[61] It does not comment on the option of including a comprehensive index, dictionary or glossary.

44. Another advantage of having a comprehensive alphabetical list of defined terms with signposts to full definitions is that the full definitions can then be structured thematically, so that readers can be directed to a suite of key definitions relevant to a particular topic. See, for example, Part 15 of the *Native Title Act 1993* (Cth), and Part 1.2 of the *Social Security Act 1991* (Cth), each of which sets out defined terms in both alphabetical and thematic orders.

45. Some guidance and commentators express views on whether a dictionary or index provision should be towards the start or towards the end of a piece of legislation. The ALRC does not consider that either of these alternatives is clearly preferable to the other. For some readers, definitions may be more helpfully visible if included in early provisions. However, there may also be advantages in allowing readers to engage first with key substantive provisions, leaving more 'technical' matters such as definitions until later provisions. Given the increasing popularity of electronic and online versions of legislation, the location of a dictionary provision is less likely to have an impact, as long as readers can be effectively and efficiently directed to it.

Identifying defined terms when they are used

46. The desirability of identifying a defined term when it is used in the text of an Act has been recognised for some time. Writing in 1988, Robert Eagleson lamented the inability of legal drafters to identify defined terms in the body of an Act, meaning 'that readers have in effect to memorise the definitions section or continually refer to it'.[62] The OPC Plain

Issued May 2006) Attachment B [26].

57 See [48]–[50] below.

58 Office of the Parliamentary Counsel (UK), *Drafting Guidance* (2020) [4.1.20]–[4.1.21].

59 Bilika Simamba, 'The Placing and Other Handling of Definitions' (2006) 27(2) *Statute Law Review* 73, citing G.C. Thornton, *Legislative Drafting* (4th ed, Butterworths, 1996).

60 Office of the Parliamentary Counsel (UK) (n 58) [4.1.22].

61 Uniform Law Conference of Canada, 'Canadian Legislative Drafting Conventions' (No date) [8] <ulcc-chlc.ca/Civil-Section/Drafting/Drafting-Conventions>.

62 Robert D Eagleson, 'Legislative Lexicography' in EG Stanley and TF Hoad (eds), *Words: For Robert Burchfield's Sixty-Fifth*

English Manual also recognises the value of identifying defined terms, but acknowledges that

> So far we haven't found a way of marking them without distracting the eye from the main text or causing other problems. Until we do, consider alerting the reader to the most important definitions by putting notes beneath the relevant provisions.[63]

47. In consultations with the ALRC, stakeholders expressed concern at there being no simple way to identify whether a term in legislation is defined or not. From the perspective of navigability, identifying a defined term has the benefit of alerting a reader that they may need to look elsewhere to fully understand a provision, without the reader having to memorise or continually refer to the dictionary.

48. Aside from notes, one technique used to a limited extent in Commonwealth legislation is marking defined terms with an asterisk on the first occasion a defined term is used within a subsection. This technique is not widely used other than in Tax Code legislation and the *Aged Care Act 1997* (Cth), with OPC guidance suggesting that is not a technique of general application.[64] According to OPC Drafting Direction 1.8, using asterisks rather than notes to signpost definitions in the Tax Code legislation 'has led to a big reduction in the number of notes required' in rewriting the legislation.[65]

49. Even in Acts in which asterisks are used, defined terms that are used very extensively throughout the legislation are not asterisked, with each piece of legislation containing a section setting out the terms that are defined but not asterisked.[66] As the example further below shows, the current approach of placing an asterisk only at the beginning of a defined term (and not also at the end of that term) means that it is not apparent whether the term comprises one word or several.

50. Both the *ITA Act 97* and the *Aged Care Act 1997* (Cth) contain a footer that tells a reader where they can find the definitions of asterisked terms. In both Acts, that location is a single dictionary located towards the end of the Act. According to OPC Drafting Direction 1.8, 'This footer is the first stage in signposting from the asterisked defined term to the actual definition',[67] with the aim being 'for the reader to find the defined term in the Dictionary as easily as possible'.[68] The example from the *ITA Act 97* below includes the text of the footer used in that Act. This type of footer, however, will only be apparent on a copy of the Act downloaded and viewed in either document or printed form; it does not appear when the text of the legislation is viewed online via the Federal Register of Legislation. In the latter case, a reader needs to rely on s 2-10 of the *ITA Act 97* which explains the use of asterisks and location of the Dictionary.

51. OPC guidance acknowledges that markings can be visually distracting.[69] In addition, it is unclear what impact asterisks may have for a visually-impaired person who may use

Birthday (DS Brewer, 1988) 81, 89 extracted in *The Loophole: The newsletter of the Commonwealth Association of Legislative Counsel* 2(4), 31.

63 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [147].

64 Office of Parliamentary Counsel (Cth), Drafting Direction 1.6, 'Asterisking to identify defined terms' (Document release 1.1, Reissued September 2020).

65 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) [25].

66 Ibid [34]-[35]. See, for example s 2-15 of the *Income Tax Assessment Act 1997* (Cth).

67 Ibid Attachment B [24].

68 Ibid Attachment B [28].

69 Office of Parliamentary Counsel (Cth), Drafting Direction 1.6, 'Asterisking to identify defined terms' (Document release 1.1,

text-to-voice software to access legislation. Presumably, it may vary by software or user preferences whether an asterisk is read aloud, but its effect from the listener's perspective may either be distracting or welcomed as an aural signal that a term is defined.

52. AustLII operates an online, freely accessible database of legal resources. The database includes extensive collections of Australian legislation, case law and commentary. The AustLII website uses automated 'markup' software to hyperlink much of the content it publishes.[70] In legislation, for example, defined terms and references to subsections appear in blue underlined text, with a hyperlink to the defined term or subsection. The AustLII website notes, however, that due to the automated nature of the software and the nature of the English language, links may occasionally be incorrect or out of context.[71]

53. An example of each technique (note, asterisks and AustLII hyperlinking) is below.

Example: Note

Section 208 *Corporations Act*

208 Need for member approval for financial benefit

(1) For a public company, or an entity that the public company controls, to give a financial benefit to a related party of the public company:

(a) the public company or entity must:

(i) obtain the approval of the public company's members in the way set out in sections 217 to 227; and

(ii) give the benefit within 15 months after the approval; or

(b) the giving of the benefit must fall within an exception set out in sections 210 to 216.

Note 1: Section 228 defines ***related party***, section 9 defines ***entity***, section 50AA defines ***control*** and section 229 affects the meaning of ***giving a financial benefit***.

Note 2: For the criminal liability of a person dishonestly involved in a contravention of this subsection, see subsection 209(3). Section 79 defines ***involved***

Example: Asterisk

Section 15-2 *Income Tax Assessment Act 1997* (Cth)

152 Allowances and other things provided in respect of employment or services

(1) Your assessable income includes the value to you of all allowances, gratuities, compensation, benefits, bonuses and premiums *provided to you in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by you (including any service as a member of the Defence Force).

Reissued September 2020) [13].

70 Australasian Legal Information Institute, 'Frequently Asked Questions' <www.austlii.edu.au/faq.html>.

71 Ibid.

(2) This is so whether the things were *provided in money or in any other form.

(3) However, the value of the following are not included in your assessable income under this section:

(a) a *superannuation lump sum or an *employment termination payment;

(b) an *unused annual leave payment or an *unused long service leave payment;

(c) a *dividend or *nonshare dividend;

(d) an amount that is assessable as *ordinary income under section 65;

(e) *ESS interests to which Subdivision 83AB or 83AC (about employee share schemes) applies.

Note: Section 23L of the *Income Tax Assessment Act 1936* provides that fringe benefits are nonassessable nonexempt income.

*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Example: AustLII Hyperlinking

Section 171 *Corporations Act*

Register of debenture holders

(1) The register of debenture holders must contain the following information about each holder of a debenture:

(a) the debenture holder's name and address;

(b) the amount of the debentures held.

Note: See subsection 168(2) for the coverage of ***debenture*** .

(2) A company's failure to comply with this section in relation to a debenture does not affect the debenture itself.

54. In the AustLII example immediately above, the term 'holder' links to the definition of the term 'hold' in s 9. However, 'hold' is a relational definition; that is, it is a term that only takes on its legislatively defined meaning *in relation to* particular subject matter.[72] The term 'hold' only takes on its defined meaning if used in relation to a 'copy of a licence'. This means that the definition is not applicable in s 171 and the hyperlink in s 171 is out of context.

55. This highlights a potential challenge for any system of identifying and hyperlinking to defined terms. Namely, decisions need to be made and parameters established regarding

72 Relational definitions will be discussed in greater detail in the ALRC's first Interim Report.

the extent to which defined terms should be identified in legislation. Furthermore, these parameters need to be clearly communicated to readers. There are five main issues in this respect.

56. The first issue is whether every instance of a defined term should be identified or only instances of terms being used in their defined sense, with the latter requiring an element of interpretive judgment. In the AustLII example above, this would be a choice between whether the term 'holder', as a derivative part of speech of the defined term 'hold', should be identified as a defined term or not. OPC guidance on asterisking acknowledges this issue with regard to relational definitions, noting that if a term is defined in a relational way then 'it should only be asterisked in the legislation when the term is used in a context that attracts the defined meaning' and not when used in its ordinary meaning.[73] The absence of an asterisk cannot, however, be relied upon by a reader to conclude that any term that is *not* asterisked is *not* being used in a defined sense. Section 950-100(2) of the *ITA Act 97* provides, for example:

> The asterisks used to identify defined terms form part of this Act. However, if a term is *not* identified by an asterisk, disregard that fact in deciding whether or not to apply to that term a definition or other interpretation provision.

57. OPC guidance suggests inserting a provision to this effect in any legislation that uses asterisks to identify defined terms. This is a necessary consequence of the practice of only asterisking the first use of a defined term in a subsection and not subsequent uses. The OPC has indicated that it may be appropriate at some stage to include a similar provision in the *Acts Interpretation Act* so as to apply across all Commonwealth Acts.[74]

58. A second issue, also illustrated by the example of the term 'holder' noted above, is whether different grammatical forms of defined terms should be underlined when they are used. In the case of asterisking in the Tax Code legislation, OPC guidance advises drafters to include signpost definitions for different grammatical forms of defined terms and to mark them with asterisks in accordance with the usual rules for using asterisks.[75] As Drafting Direction 1.8 notes, this is not legally necessary because s 18A of the *Acts Interpretation Act* provides that other parts of speech and grammatical forms of a defined term have corresponding meanings. However, doing so 'promotes the aim of helping the reader to match the definition with occurrences of the defined term'.[76]

59. A third issue is whether only terms defined in (or by) the same Act should be marked in *that Act*, or whether terms that are defined by other legislation should also be identified. In the case of the *Australian Securities and Investments Commission Act 2001* (Cth) ('*ASIC Act*'), for example, s 5(2) effectively provides that terms not defined in the *ASIC Act* but defined or used in the *Corporations Act* have the same meaning in the *ASIC Act*.

73 Office of Parliamentary Counsel (Cth), Drafting Direction 1.6, 'Asterisking to identify defined terms' (Document release 1.1, Reissued September 2020) [18].

74 Office of Parliamentary Counsel (Cth), Drafting Direction 1.6, 'Asterisking to identify defined terms' (Document release 1.1, Reissued September 2020) [33]–[34].

75 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) 25; Office of Parliamentary Counsel (Cth), Drafting Direction 1.6, 'Asterisking to identify defined terms' (Document release 1.1, Reissued September 2020) [30].

76 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) 25.

60. Some terms are also defined in generally applicable interpretation legislation, such as the *Acts Interpretation Act*, which defines terms for the purposes of all Commonwealth Acts. The question then arises whether terms defined by the *Acts Interpretation Act* should be identified in other legislation. If this were not done, but other defined terms were marked up, then a reader may be given a false sense of security that only marked terms are defined, and overlook the need to consider *Acts Interpretation Act* interpretive provisions. Two other factors would complicate marking terms defined by the *Acts Interpretation Act*. The *Corporations Act* is one of eight Commonwealth Acts to which (in whole or in part) a point-in-time version of the *Acts Interpretation Act* applies, as opposed to the currently in force *Acts Interpretation Act*.[77] The effect of s 5C of the *Corporations Act* is to apply the *Acts Interpretation Act* as in force on 1 January 2005, meaning different Acts may require different annotations. Further, some terms that are defined by the *Acts Interpretation Act* may be defined differently for the purposes of particular Acts, with the effect that the *Acts Interpretation Act* definition is overridden.

61. Even if legislation does not indicate the use of defined terms (as is the case for most Commonwealth legislation), interpretation legislation still presents a challenge: readers are assumed to be aware of the existence of the *Acts Interpretation Act* and its implications. It is likely, however, that only legally trained readers would be aware of the *Acts Interpretation Act*. In some jurisdictions, such as Queensland, notes are sometimes used to alert readers to the existence of an important defined term in the applicable interpretation legislation. An example from the Queensland Criminal Code[78] is below.

Example: Cross reference to interpretation legislation

Section 119A *Criminal Code* (Qld)

119A Meaning of *family*

(1) Each of the following is a member of a person's ***family***—

(a) a spouse of the person;

(b) a child of the person;

(c) a parent, grandparent, grandchild or sibling of the person, including—

(i) if the person is an Aboriginal person, a person—

(A) who is recognised under Aboriginal tradition as a member of the Aboriginal person's family; and

Note—

'Aboriginal tradition' is defined under the *Acts Interpretation Act 1954*. See schedule 1 of that Act.

(B) with whom the Aboriginal person has a relationship like that between an individual and a parent, grandparent, grandchild or sibling of the individual; or

77 The other Acts are: the *ASIC Act*, the *Mutual Recognition Act 1992*, the *Trans-Tasman Mutual Recognition Act 1997*, the *Criminal Code Act 1995*, the *Water Act 2007*, the *Fair Work Act 2009* and the *Personal Property Securities Act 2009*.

78 *Criminal Code Act 1899* (Qld) Sch 1.

(ii) if the person is a Torres Strait Islander, a person—

(A) who is recognised under Island custom as a member of the Torres Strait Islander's family; and

Note—

'Island custom' is defined under the *Acts Interpretation Act 1954*. See schedule 1 of that Act.

…

62. A fourth issue is whether, and the extent to which, markings should be applied in delegated legislation. Delegated legislation uses defined terms, including terms defined by the instrument in question and terms defined by enabling (or other) Acts. At the Commonwealth level, not all delegated legislation is drafted by OPC (although regulations, a particular type of delegated legislation, are uniformly drafted by OPC). Achieving consistency in identifying defined terms would require significant coordination and potentially sharing of technology across Commonwealth departments and agencies. If consistency were not achieved, then there is a risk that readers may be misled by delegated legislation that differs from the approach taken in Acts.

63. A fifth question is whether the markings to identify defined terms should form part of the legislative text itself as passed by Parliament, or be applied only when publishing the legislation. Markings in the Act as passed by Parliament would form part of the Act by virtue of s 13 of the *Acts Interpretation Act* and therefore potentially have interpretive effect. Section 950-100(2) of the *ITA Act 97*, referred to at [56] above, recognises this.

64. There appears to be no published empirical research or user testing of aids designed to identify defined terms, and no recognised best practice around the world. Bertlin notes that as part of the user-testing sessions in the 2013 UK study a prototype 'hover over' feature for highlighting definitions was tested, however the findings are not discussed.[79]

65. As OPC guidance recognises, one of the main challenges to identifying defined terms when they are used in legislative text is finding a method that does not distract the reader. This suggests that a solution may lie in the presentation, rather than drafting, of legislation. While an authoritative version of the legislation could be produced without markings identifying defined terms, technology could be used to publish both that version and an electronic version containing identifiers. If this was done, then it would be necessary to inform readers that the markings made in publishing the text do not form part of the law itself, and that to the extent there are any errors arising from the involvement of human judgement or technology, then the original version of the legislation would prevail. While this may detract from the utility of the marked-up version, the use of hyperlinks or a 'hover box' containing a definition (for example) could provide a reader with an accessible way to view a full definition and verify that the term is in fact both defined and used in its defined sense. It should be noted that a technological solution would still face many of the issues outlined above when setting the parameters for identifying defined terms.

66. Drawing on the analysis contained in this Paper, the ALRC's first Interim Report will discuss potential options for reform aimed at improving the navigability of legislation that uses defined terms.

79 Bertlin (n 17) 45.

Aids in drafting

67. This section focuses on aids to navigation that are 'built in' to an Act during the drafting process, and therefore form part of the Act itself.

Short titles

68. The short titles to legislation can aid navigability across Acts by indicating the subject matter of legislation and contributing to the logical order of statues.[80] In an article analysing the history of legislative titles and a trend towards the use of political 'sloganeering' in titles to Australian legislation, Professor Graeme Orr observed that

> The descriptiveness of legislative titles is not therefore simply a citation handle and memory jog: it is a necessary part of any accessible and comprehensible scheme. It will assist cataloguers and those who build bibliographies and databases, as it should form a reliable, initial guide to classification. The classificatory instinct is often mocked or undervalued, but it is pivotal to both legal scholarship and practice. … Similarly, those researching the law (essentially a process of de-classification) directly benefit from a well-described short title, since they can use it as the first hint as to which, out of thousands of pieces of legislation, are worth pursuing.[81]

69. The title of the *Corporations Act* offers little assistance to a person in search of Australian financial services law, the vast majority of which is contained in Chapter 7 of that Act. Similarly, a reader would not necessarily expect to find consumer and investor protection provisions in the *ASIC Act*, which primarily sets up, and describes the powers of, the Australian Securities and Investments Commission. This can be compared with the *Competition and Consumer Act 2010* (Cth), which as its title suggests contains both competition law and consumer law. That Act also contains provisions establishing the relevant regulatory body, the Australian Competition and Consumer Commission.

Headings and tables of contents

70. Headings are arguably one of the most important features that help a reader to navigate within a statute. Few people ever have the need to read a statute from start to finish, so headings are the method a reader is most likely to use to find the parts of an Act relevant for their purposes. Even with the use of electronic word search functions, headings still play an important role. For example, a provision will likely be more relevant if the term being searched is in the heading of a provision, rather than the body of the provision alone. This is because, as discussed below, a heading should indicate the main topic or purpose of the section. In addition, one of the first things a reader sees when opening legislation on either the Federal Register of Legislation or AustLII is the table of contents which lists the number and heading of each section.

71. Headings are uniformly used to establish the structural elements of legislation: chapters, parts, divisions, subdivisions and sections. Headings may also be used for subsections. Ideally, legislation should be structured by grouping together provisions that deal with a common subject matter and using a heading to specify the topic that those provisions address.[82] Headings to a section should also indicate the substance of that section.

80 Cormacain (n 1) 63.
81 Graeme Orr, 'Names Without Frontiers: Legislative Titles and Sloganeering' (2000) 21(2) *Statute Law Review* 188, 196.
82 Office of Parliamentary Counsel (Cth), *Drafting Manual* (Edition 3.2, July 2019) [107].

72. Headings from the level of chapters to sections are used to populate the table of contents at the beginning of an Act. A table of contents therefore operates as a basic 'map' of the legislation, with each heading acting as a signpost. The dual role of section headings is recognised by Gordon Stewart, who observed that individual headings should indicate the content of a section, and collectively they should indicate the contents of an Act.[83] The list of headings contained in the table of contents reproduce an Act's structure. The separate but related role of structure in aiding navigation is discussed further below.[84]

73. Drafting guidance from New Zealand also emphasises the importance of headings, advising drafters to use them 'liberally'.[85] The New Zealand Parliamentary Counsel Office publishes a Plain Language Standard and Checklist for the drafting of legislation. Part of the Checklist asks, 'Are headings useful and do they aid navigation?', advising drafters to check that headings:

- use key words placed early in the heading;
- clearly indicate specific topics or summarise main messages;
- work well together;
- appear frequently enough to help readers scan and find specific information easily';
- are reasonably brief (no longer than one line); and
- have a clear and consistent hierarchy.[86]

Section headings

74. Section headings 'are presumed to help readers find what they need to know faster, and understand it more easily when they find it'.[87] Nick Horn has noted that there is little empirical research to test this proposition, but that studies in relation to educational documents have shown that headings:

- 'can be an aid to recall, search, and retrieval';[88]
- reduce search times in text;[89] and
- 'are particularly effective for readers with prior knowledge of the subject matter of the text'.[90]

Subsection headings

75. The OPC Plain English Manual suggests that subsection headings may be helpful in long sections of an Act.[91] After performing 'usability testing', Stewart concluded that subsection headings significantly reduced the time it took readers to locate relevant provisions compared to equivalent sections without subsection headings.[92]

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83 Gordon Stewart, 'Legislative Drafting and the Marginal Note' (1995) 16(1) *Statute Law Review* 21, 37.
84 See [83]–[86] below.
85 Parliamentary Counsel Office (New Zealand), 'Principles of Clear Drafting' <www.pco.govt.nz/clear-drafting/>.
86 Parliamentary Counsel Office (New Zealand), 'Checklist for Applying Our Standard' <www.pco.govt.nz/pco-plain-language-checklist/>.
87 Nick Horn, 'Legislative Section Headings: Drafting Techniques, Plain Language, and Redundancy' (2011) 32(3) *Statute Law Review* 186, 186.
88 Ibid 192, citing James Hartley and Mark Trueman, 'A Research Strategy for Text Designers: the Role of Headings' (1985) 14 *Instructional Science* 99, 149–153.
89 Ibid 192, citing Marieke Kools et al, 'The Effects of Headings in Information Mapping on Search Speed and Evaluation of a Brief Health Educational Text' (2008) 34(6) *Journal of Information Science* 833, 842.
90 Ibid, citing Stephen Wilhite, 'Headings as Memory Facilitators: The Importance of Prior Knowledge' (1989) 81 *Journal of Educational Psychology* 116.
91 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [114].
92 Stewart (n 83) 58–59.

76. The 2010 OPC Survey found that 84% of respondents found subsection headings useful, with 88% agreeing that subsection headings made legislation easier to navigate.[93]

77. Some commercial publishers also include subsection headings where they are not used in the text of legislation. In its annual publication of Australian Corporations Legislation, for example, Thomson Reuters calls these subsection headings 'side notes', which are inserted in square brackets and bold formatting before the substantive text.[94]

78. Subsection headings may also assist in relatively short sections or when multiple subsections follow a repetitive format, meaning it is difficult to immediately distinguish between them. In the case of repetition, subsection headings help a reader scan a section to identify the most relevant information quickly. The example of s 798G of the *Corporations Act* at **Appendix A** demonstrates the helpful use of subsection headings in a relatively short section.

Questions as headings

79. Through user-testing, Stewart also set out to test the usefulness of headings taking the form of questions. Stewart concluded from his research that although the benefits were not universal, redrafting statement headings to questions generally reduced the time it took readers to use legislation to answer a scenario-based question.[95] This suggests that headings framed as questions may assist navigability.

80. The 2010 OPC Survey found that 75% of respondents were satisfied that questions as headings made legislation easier to read and understand.[96] Comments by way of feedback suggested that questions as headings 'could be off-putting for frequent users of legislation' and there was a risk that a question may mislead a reader if not phrased correctly or lead a reader to overlook relevant information in other sections.[97] The OPC Plain English Manual appears to have drawn on this feedback, stating:

> It looks friendly to put the occasional section heading in the form of a question. However, it can be overdone. The question form can be irritating, because it narrows the scope of the headings. On the other hand, the non-question form can use a key word or phrase that is capable of answering a variety of questions.[98]

Decentralised tables of contents

81. Decentralised tables of contents are additional to the table of contents included at the start of an Act. They are intended to 'aid in the navigability of large units of legislative text'.[99] Decentralised tables of contents are used extensively in the *ITA Act 97*.

82. The results of the 2010 OPC Survey showed that 70% of respondents were satisfied with the usefulness of decentralised tables of contents, and 82% agreed that they made legislation easier to navigate.[100]

93 Ibid 57–58.
94 *Corporations Legislation 2020* (Thomson Reuters, 2020) ix.
95 Stewart (n 83) 56.
96 Office of Parliamentary Counsel (Cth) (n 10) 53.
97 Ibid 55.
98 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [167].
99 Office of Parliamentary Counsel (Cth) (n 10) 23.
100 Ibid 24–25.

Structure and parallel structures

83. An organised and coherently structured Act should be easier to navigate. As Cormacain notes, in practice this means 'that users can see at a glance the general thrust of the Act and see, again at a glance, which provisions are relevant to them'.[101] Cormacain summarises the contrasting approaches to structuring legislation suggested by two authors: Thring, who 'suggested stating the law first and then how the law was to be administered'; and Xanthaki, who proposes a 'layered approach' whereby legislation is structured 'in different layers, corresponding to the different users of it'.[102]

84. OPC guidance advises drafters to arrange provisions so that the relationship between them is as clear as possible.[103] OPC guidance also recognises that 'poorly structured legislation can be a cause of complexity', particularly if 'important concepts … are not stated as its central elements, but are obscured by other material such as procedural detail'.[104] Aspects of the *Corporations Act*, and Chapter 7 in particular, arguably suffer from this problem.

85. The OPC Guide to Reducing Complexity gives the example of Part 3-2 of the *Fair Work Act 2009* (Cth) as being structured in a clear way by introducing the key concept first (being a person who is 'protected from unfair dismissal'), before describing when a person is 'unfairly dismissed', then the remedies for an unfair dismissal, and then procedural matters.[105] In the *Fair Work Act 2009* the administrative provisions that establish and govern various industrial bodies have been located towards the end of the Act, and after the provisions dealing with matters of greatest importance to most readers. This can be contrasted with its predecessor legislation which contained almost 100 pages dealing with the same matters at the start of that Act.[106]

86. Legislation may also be made more navigable by using parallel structures where that piece of legislation regulates multiple similar subjects in the same way.[107] Part 7.2, Part 7.3 and the first four Divisions of Part 7.6 of the *Corporations Act* demonstrate the use of parallel structures, as summarised at **Appendix B**.

87. In its third Interim Report, the ALRC will address the question of how the provisions contained in Chapter 7 of the *Corporations Act* could be reframed or restructured to improve that legislation.

101 Cormacain (n 1) 70.
102 Ibid 70–71, citing Henry Thring, *Practical Legislation: The Composition and Language of Acts of Parliament* (Her Majesty's Stationery Office, 1877) and Helen Xanthaki, *Drafting Legislation: Art and Technology of Rules for Regulation* (Hart Publishing, 2014).
103 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [102].
104 Office of Parliamentary Counsel (Cth), *Reducing Complexity in Legislation* (Document Release 2.1, June 2016) [36].
105 Ibid [38].
106 Ibid [39]–[40].
107 Cormacain (n 1) 72.

Simplified outlines, guides and diagrams

88. A simplified outline aims to give a reader a general understanding of what a piece of legislation is about.[108] Simplified outlines aid navigability by helping readers to ascertain relevance to their needs and giving an overview of coming provisions.[109] Simplified outlines also aid readers by making 'the structure of legislation, sequence of events, nature of events and relationship of events clear to readers to permit faster movement through the legislation'.[110]

89. OPC Drafting Direction 1.3A notes that a variety of other labels such as 'Guide', 'Simplified overview' and 'Overview' have been used in the past, but that the single label 'simplified outline' is now to be used for consistency and clarity.[111] A key reason for this 'is to emphasise to readers, including courts, that the outline represents a simplification of the relevant legislative scheme, which may be in the nature of a summary and may be incomplete'.[112]

90. The 2010 OPC Survey asked respondents about 'overviews' and 'guides', both of which it seems may now fall within the description of a simplified outline. Results showed that 80% of respondents were satisfied with the usefulness of both features.[113]

91. Drafting Direction 1.3A contains detailed guidelines on the use of simplified outlines, including:

- Almost all new principal Acts should contain a simplified outline.[114]
- Simplified outlines may be useful in both Acts and other instruments.[115]
- 'In addition to a simplified outline for an Act, there should also be simplified outlines for at least one level of unit in the Bill (i.e. Chapter/Part/Division)', and 'a simplified outline must then be included at that level throughout the Bill'.[116]
- 'Opening with a "theme statement" that states in very general terms what the operative provisions are about can be very helpful'.[117]
- Words like 'object' and 'purposes' should be avoided in simplified outlines to help distinguish them from objects provisions, which have a different role.[118]
- Simplified outlines may use a less formal writing style, including 'a lighter or more conversational tone' than substantive provisions.[119]
- Formatting devices that indicate a defined term should not be used in a simplified outline, and if necessary conventions that are widely used in the community should be used to explain terms.[120]

108 Office of Parliamentary Counsel (Cth), Drafting Direction 1.3A, 'Simplified outlines' (Document release 1.2, Reissued November 2016) [19].
109 Ibid.
110 Ibid [20].
111 Ibid [32]–[33].
112 Ibid [34].
113 Office of Parliamentary Counsel (Cth) (n 10) 15–20.
114 Office of Parliamentary Counsel (Cth), Drafting Direction 1.3A, 'Simplified outlines' (Document release 1.2, Reissued November 2016) [9].
115 Ibid [14]–[18].
116 Ibid [36].
117 Ibid [25].
118 Ibid [57]–[59].
119 Ibid [48].
120 Ibid [55]–[56].

92. Like headings, simplified outlines form part of an Act and can be used when construing the Act.[121] Drafting guidance reminds drafters, and advises that

> Everything in a simplified outline must have a substantive provision underlying it, and drafters should check carefully to ensure that simplified outlines do not conflict with, or detract from, substantive provisions. In particular, simplified outlines should never be used as quick fixes for poorly-drafted substantive provisions.[122]

93. The *Corporations Act* does not uniformly use simplified outlines or other forms of guide. In Chapter 7, s 760B is headed 'Outline of Chapter' and contains a table which briefly summaries the contents of each Part of the Chapter. Section 908AA contains a helpful simplified outline for Part 7.5B relating to the regulation of financial benchmarks. Section 908AA is copied at **Appendix C**. Examples of simplified outlines can also be found at the Part level outside of Chapter 7 of the *Corporations Act*.[123] The ALRC will consider the use of simplified outlines and guides in more detail in its third Interim Report examining how Chapter 7 of the *Corporations Act* could be reframed or restructured.

94. Section 717 of the *Corporations Act*, contained in Chapter 6D relating to corporate fundraising, contains a section described as an 'overview' which summarises the disclosure requirements for a person to offer securities. Part of s 717 is extracted at **Appendix D**. The ALRC invites stakeholder feedback on whether provisions such as s 717 are helpful and how they may best be presented.

95. OPC Drafting Direction 1.8 prescribes requirements for the use of 'guides' in most Tax Code legislation, advising a drafter that:

> You must provide information at the start of each Division and Subdivision to give readers an idea of what to expect from the Division or Subdivision. This information must always include a table of Subdivisions or a table of sections (as appropriate). You should always include a Guide to a Division, unless there is good reason not to. You may choose to include a Guide to a Subdivision.

96. Drafting Direction 1.8 also expands on what is meant by a 'theme statement':

> A theme statement is the text that you put in a box at or near the start of a Guide. As originally conceived, its true function is to state in one or 2 sentences (at most) what the Division or Subdivision is about…
>
> A theme statement is meant to encapsulate rather than to summarise. In particular, it is meant to establish the relevance of the provisions to the reader. A theme statement is thus different from a simplified outline.[124]

97. As noted at [91] above, Drafting Direction 1.3A (which has been issued more recently than Drafting Direction 1.8) suggests that a 'theme statement' may form part of a simplified outline.

121 *Gheko Holdings Pty Ltd v The Chief Executive Medicare* [2013] FCA 164 [30].
122 Office of Parliamentary Counsel (Cth), Drafting Direction 1.3A, 'Simplified outlines' (Document release 1.2, Reissued November 2016) [30].
123 See, for example, s 167AB (relating to Part 2B.8 and mutual capital instruments) and s 1550 (relating to Part 10.25 and transitional provisions relating to the Insolvency Practice Schedule).
124 Office of Parliamentary Counsel (Cth), Drafting Direction 1.8, 'Special rules for Tax Code drafting' (Document release 1.0, Issued May 2006) [59]–[60].

98. Part 1-2 of the *ITA Act 97* is headed 'A Guide to this Act' and contains information that aims to orientate readers, particularly new readers, to the Act.[125] Subdivisions 2-A and 2-B, which explain the structure of the Act, are reproduced at the example below.

99. The *ITA Act 97* is currently the longest Commonwealth Act, so it is perhaps not surprising that guides are used extensively. The findings of the UK study and Bertlin's observations discussed above,[126] however, suggest that navigation guides and other orientation materials may also aid readers of legislation that is shorter and less complex than the *ITA Act 97* as well.

Example: Guide

Subdivisions 2-A and 2-B *Income Tax Assessment Act 1997* (Cth)

Subdivision 2A—How to find your way around

21 The design

This Act is designed to help you identify accurately and quickly the provisions that are relevant to your purpose in reading the income tax law.

The Act contains tables, diagrams and signposts to help you navigate your way.

You can start at Division 3 (What this Act is about) and follow the signposts as far into the Act as you need to go. You may also encounter signposts to several areas of the law that are relevant to you. Each one should be followed.

Sometimes they will lead down through several levels of detail. At each successive level, the rules are structured in a similar way. They will often be preceded by a Guide to the rules at that level. The rules themselves will usually deal first with the general or most common case and then with the more particular or special cases.

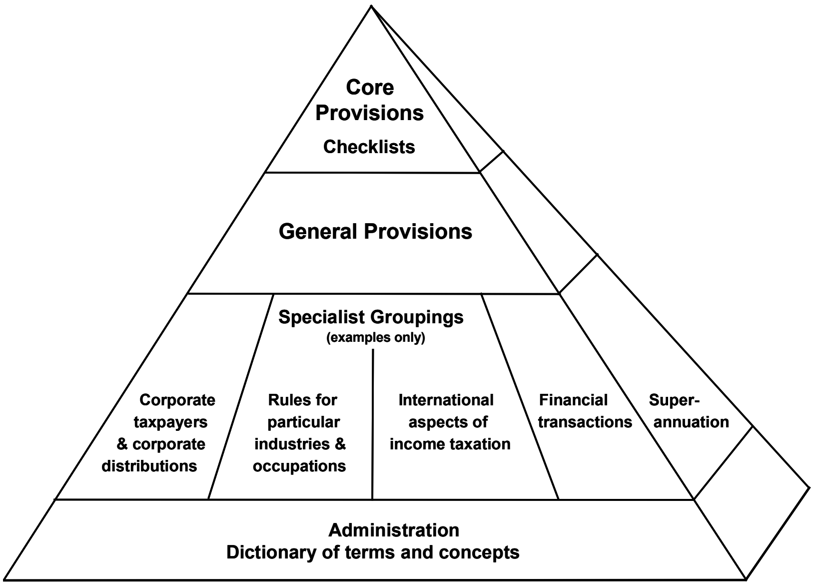
Subdivision 2B—How the Act is arranged

25 The pyramid

This Act is arranged in a way that reflects the principle of moving from the general case to the particular.

In this respect, the conceptual structure of the Act is something like a pyramid. The pyramid shape illustrates the way the income tax law is organised, moving down from the central or core provisions at the top of the pyramid, to general rules of wide application and then to the more specialised topics.

125 Explanatory Memorandum, Income Tax Assessment Bill 1996 (Cth) 21.
126 See [21] above.



100. The 2010 OPC Survey noted that diagrams, such as flow charts, may be used to give a simple overview of an Act and its structure, with 73% of respondents agreeing that diagrams made legislation easier to navigate.[127] The 2010 OPC Survey gave the example of s 3-6 of the *Aged Care Act 1997* (Cth), which is copied at **Appendix E**. That provision and diagram have subsequently been repealed and not replaced. Current drafting guidance does not appear to comment on the use of diagrams.

Objects provisions

101. Though not specifically designed to aid navigability, objects provisions may achieve a similar effect to headings and overviews by indicating the general subject matter of an Act, or part of an Act, to a reader. Objects provisions were thought to be useful by 82% of respondents to the 2010 OPC Survey.

102. Objects provisions are commonly used when construing the words of a statute. While an objects provision cannot override otherwise clear words of a statute, they can be used to resolve uncertainty or ambiguity[128] and to 'give practical content to terms such as "reasonable", "justification" and "satisfactory"' by interpreting such terms in light of an Act's legislative purposes.[129] In this way, objects provisions may also be relevant when interpreting defined terms.

127 Office of Parliamentary Counsel (Cth) (n 10) 68.
128 *Minister for Urban Affairs and Planning v Rosemount Estates Pty Ltd* (1996) 91 LGERA 31, 78.
129 *Russo v Aiello* (2003) 215 CLR 643 [5].

Notes

103. Notes to legislative provisions can be used for a number of purposes, including for identifying defined terms. Notes may contain what have variously been described as 'see' references, cross-references and signposts, which all perform similar functions.[130] Notes aid navigation by alerting a reader to the existence of important information that is not otherwise apparent and indicating where that information can be found (whether within the same Act or another piece of legislation).

104. Though the 2010 OPC Survey did not ask respondents whether notes improved navigability, some respondents commented that they thought notes improved navigability and 87% of respondents were satisfied with the usefulness of notes.[131]

105. Notes form part of an Act and may be used as an aid to construction. Putting aside examples contained in notes, discussed below, notes are otherwise subordinate to substantive text and in the event of any conflict, the substantive text prevails.[132]

Examples

106. Examples in legislation are primarily intended to illustrate the meaning of provisions.[133] Examples may also aid navigability, particularly where they perform the role of a cross-reference or potentially save a reader from needing to cross-refer to another legislative provision. Two illustrations of the use of examples that aid navigability in the *Corporations Act* are at **Appendix F**.

107. Though the questions asked did not include navigability, 80% of respondents to the 2010 OPC Survey indicated that they were satisfied with the usefulness of examples in legislation.[134]

108. Section 15AD of the *Acts Interpretation Act* provides that examples of a provision's operation are not exhaustive and, since 2011, has provided that examples may extend the operation of the provision. By contrast, 15AD as in force on 1 January 2005, and therefore applicable to the *Corporations Act* and *ASIC Act*,[135] provided that if an example was inconsistent with a provision, then the prevision prevailed. The Explanatory Memorandum explained the amendment of s 15AD as follows

> If Parliament has enacted an example in a Commonwealth Act, this shows an intention that the example should be covered whether or not it strictly falls within the scope of the provision. However, the amended provision [s 15AD] will state that the example 'may extend the operation of the provision' so that a court can assess whether this is in fact appropriate when interpreting a particular provision that includes an example.[136]

130 See, eg, Ross Carter and Matthew Green, 'The Enactment Is Self-Explanatory … or Is It?—Explanatory Provisions in New Zealand Legislation' (2007) 28(1) *Statute Law Review* 1.
131 Office of Parliamentary Counsel (Cth) (n 10) 38–41.
132 *Director of Public Prosecutions v Walters* (2015) 49 VR 356 [50]; *Fair Work Ombudsman v Wongtas Pty Ltd* (2011) 195 FCR 55 [47].
133 Office of Parliamentary Counsel (Cth), *Plain English Manual* (December 2013) [159].
134 Office of Parliamentary Counsel (Cth) (n 10) 33.
135 *Corporations Act 2001* (Cth) s 5C; *Australian Securities and Investments Commission Act 2001* (Cth) s 5A.
136 Explanatory Memorandum, Acts Interpretation Amendment Bill 2011 (Cth) [103].

Format

109. Like structure, formatting plays a role in the readability and navigability of legislation. As part of the 2010 OPC Survey, respondents were asked to provide feedback on OPC's formatting and conventions. Compared with previous formatting, the 'new' format had the following features (which includes some already discussed above):

- wider left and right margins;
- greater line spacing between units;
- section numbers appearing before section headings;
- greater prominence given to section headings;
- standardised tables of contents for every Act;
- definitions appearing in bold, italicised font; and
- simplified enacting words in prominent text.[137]

110. The survey results showed that 88% of respondents agreed that the format made legislation easier to navigate.[138] Further, 91% and 72% agreed, respectively, that it made legislation easier to read and to understand.[139]

Technological aids in publication and presentation

111. In addition to drafting techniques, there is scope for improving the navigability by applying aids to legislation as it is published on a publicly available website.

112. In Australia, it appears that the legislative drafting agencies of all jurisdictions are responsible for both the drafting and publication of legislation on the internet. At the Commonwealth level, for example, the OPC is responsible for maintaining the Federal Register of Legislation. This also appears to be common internationally. The United Kingdom is an exception, where the roles of drafting and publication are split between the United Kingdom Office of Parliamentary Counsel, responsible for drafting legislation, and the National Archives, which is responsible for maintaining the UK legislation website.

Incorporating explanatory notes

113. The UK includes 'explanatory notes' with most Acts. These notes are 'created by the government department responsible for the subject matter of the Act (or Measure) to explain what the Act sets out to achieve and to make the Act accessible to readers who are not legally qualified.'[140] The content of these notes is analogous to some content that appears in Explanatory Memoranda in Australia (the UK does not use Explanatory Memoranda for Acts).

114. Explanatory notes are consolidated and integrated into the UK legislation website for each Act. This means a person does not have to review potentially hundreds of Explanatory Memoranda to the Principal Act and any amending legislation to understand the effect and purpose of each section, as is currently the case in Australia. Each section of an Act has an explanatory note, which summarises the effect and sometimes the

137 Office of Parliamentary Counsel (Cth) (n 10) 81.
138 Ibid 83.
139 Ibid.
140 The National Archives (UK), 'Frequently Asked Questions' <www.legislation.gov.uk/help>.

purpose of the section. Such an aid could be particularly useful in locating explanatory material relevant both to provisions that define terms and provisions using those terms.

115. An explanatory note is included in each statutory instrument, but 'is intended to give a concise and clear statement of the substance of the instrument' rather than a detailed breakdown of each provision.[141]

116. Consolidated provision-specific explanatory notes arguably help to reduce complexity in navigating and reading legislation. This approach could be implemented in Australia given much of the material necessary for UK-like explanatory notes is already included in Explanatory Memoranda. The main limitation is the functionality of the Federal Register of Legislation, which has limited capability for section-specific linking and is focused on Act-level information such as Explanatory Memoranda for originating Bills, Act legislative instruments (which use Explanatory Statements), and Act-related Bills. There is no linking of information to specific sections, and it is necessary to read the relevant Explanatory Memoranda or Explanatory Statement to each amending Bill or legislative instrument to understand the sections they affect. A further challenge would be ensuring that Commonwealth departments and agencies, which are responsible for drafting Explanatory Memoranda and Statements, draft the materials in a way that would allow the OPC to efficiently and affordably integrate the materials into section-specific explanatory notes.

Annotations

117. The UK National Archives, publisher of UK legislation, makes extensive use of post-publication annotations. Annotations

> are notes that appear at the foot of a piece of legislative text on legislation.gov.uk. They are mainly used to provide the authority for amendments or other effects on the legislation, but they may also be used to convey other editorial information.
>
> Each annotation has a reference number and the nature of the information it contains is conveyed by the annotation type. For instance, F-notes identify amendments where there is authority to change the text, and I-notes contain information about the coming into force of a provision.[142]

118. These annotations can make clear where notional amendments have been made to a provision, when changes to a provision occurred, or whether delegated legislation has been authorised and created under the provision. For example, the following is an extract from the *Financial Services and Markets Act 2000* (UK), which includes extensive annotations.

141 Ibid.
142 Ibid.

Example: UK legislation annotations

[F1 1L **Supervision, monitoring and enforcement**

(1) The FCA must maintain arrangements for supervising authorised persons.

(2) The FCA must maintain arrangements designed to enable it to determine whether persons other than authorised persons are complying—

(a) with requirements imposed on them by or under this Act, in cases where the FCA is the appropriate regulator for the purposes of Part 14 (disciplinary measures), F2...

[F3 (aa) with requirements imposed on them by the Alternative Investment Fund Managers Regulations 2013, or]

(b) with requirements imposed on them by any qualifying EU provision that is specified, or of a description specified, for the purposes of this subsection by the Treasury by order.

(3) The FCA must also maintain arrangements for enforcing compliance by persons other than authorised persons with relevant requirements, within the meaning of Part 14, in cases where the FCA is the appropriate regulator for the purposes of any provision of that Part.]

Textual Amendments

F1 Pt. 1A substituted for Pt. 1 (24.1.2013 for specified purposes, 19.2.2013 for specified purposes, 1.4.2013 in so far as not already in force) by Financial Services Act 2012 (c. 21), **ss. 6(1)**, 122(3) (with Sch. 20); S.I. 2013/113, art. 2(1)(b)(c)(2), Sch. Pts. 2, 3, 4; S.I. 2013/423, art. 3, Sch.

F2 Word in s. 1L(2) omitted (22.7.2013) by virtue of The Alternative Investment Fund Managers Regulations 2013 (S.I. 2013/1773), reg. 1, **Sch. 1 para. 3**

F3 S. 1L(2)(aa) inserted (22.7.2013) by The Alternative Investment Fund Managers Regulations 2013 (S.I. 2013/1773), reg. 1, **Sch. 1 para. 3**

Modifications etc. (not altering text)

C1 S. 1L modified by S.I. 2002/1775, reg. 12(2) (as amended) (1.4.2013) by The Financial Services Act 2012 (Consequential Amendments and Transitional Provisions) Order 2013 (S.I. 2013/472), **Sch. 2 para. 77(7)(a)(i)**

C2 S. 1L(1) applied (with modifications) (26.7.2013 for specified purposes, 1.4.2014 in so far as not already in force) by The Financial Services Act 2012 (Consumer Credit) Order 2013 (S.I. 2013/1882), arts. 1(1), **3(2)(a)**

C3 S. 1L(2) applied (with modifications) (26.7.2013 for specified purposes, 1.4.2014 in so far as not already in force) by The Financial Services Act 2012 (Consumer Credit) Order 2013 (S.I. 2013/1882), arts. 1(1), **3(2)(b)**

C4 S. 1L(2)(3) excluded by S.I. 2018/1149, reg. 64 (as inserted (1.3.2019) by The Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 (S.I. 2019/405), regs. 1(2), 3)

119. The UK National Archives uses a range of note types, each of which uses a letter in the text of the legislation. The purpose of each note type is listed in **Appendix G**. For example, 'F-Notes' are used to indicate amendments to the text of the statute, such as amendments and repeals, and 'C-Notes' are 'used to denote the effect when the meaning, scope or application of an Act or provision etc. is changed in some way, but without there being any authority to alter the text'.[143] These notes greatly assist a reader by not only alerting them to the existence of instruments that affect the operation of the provision, but also by hyperlinking to the instruments themselves.

120. In the Australian context, the equivalent to a 'C-Note' could be used to indicate where delegated legislation has modified or excluded the operation of the provision of an Act, as is frequently done in respect of the *Corporations Act*. The extent of modifications and other changes to the operation of the *Corporations Act* made by delegated legislation will be discussed in greater detail in the ARLC's first and second Interim Reports.

121. The 'legislative histories' and 'history notes' published by the Office of the Queensland Parliamentary Counsel ('OQPC') offer precedents for a drafting office publishing annotations to a legislative text. Legislative histories and history notes record textual amendments made by the Parliament (or the delegated lawmaker in the case of subordinate legislation) and by the Parliamentary Counsel under the *Reprints Act 1992* (Cth). However, they do not record non-textual modifications such as those recorded in

143 The National Archives (UK), *Guide to Revised Legislation on legislation.gov.uk* (October 2013) 12.

C-Notes in the UK. Users can toggle in-line history notes on and off on the Queensland legislation website.

122. Several commercial publishers also make extensive use of post-publication annotations. Thomson Reuters and LexisNexis, for example, annually publish a title that consolidates the *Corporations Act*, *ASIC Act*, related legislation and regulations in a single publication. In addition to substantive commentary, those titles typically also include annotations after each section that contain cross-references to relevant regulations, other legislative instruments, ASIC Regulatory Guides, court rules, forms and section-specific amendment history.

Conferral of powers

123. The UK legislation website includes a list for each Act of all sections that confer powers to make delegated legislation. This can be useful for accountability purposes and for identifying matters in relation to which future regulations or other statutory (legislative) instruments may be made. The Federal Register of Legislation has no analogous summary, but does include incomplete lists of instruments made under Acts and legislative instruments. These are available on the 'Series' page for a particular legislative text, under the tab 'Enables'.

Consolidated legislative and guidance documents

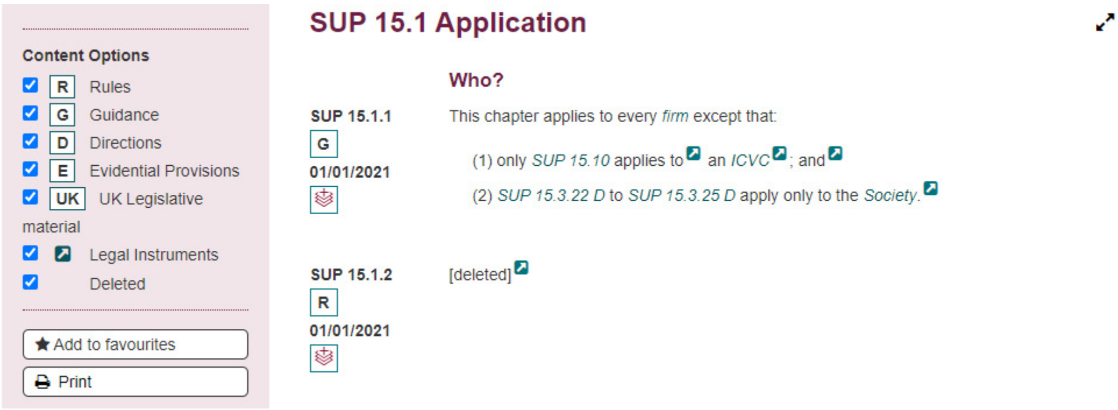
124. The UK Financial Conduct Authority ('FCA') Handbook is an example of a document that integrates legislative materials such as regulations, regulator-made legal instruments, regulator guidance, and evidential provisions, in one location.[144] The FCA Handbook is designed in a way that makes it modular: it can be accessed in a hierarchical form that reflects the numbering of rules[145] or through a topic-based table of contents.[146] Functionality built into the online version of the Handbook also allows readers to 'switch on and off' rules, guidance, evidential provisions, and UK legislative material using check-boxes under the heading 'Content Options'. An example screenshot is below. The example also includes an arrow symbol with the label 'Legal Instruments', which allows a reader to select whether to display the symbol within text to indicate the existence of, and hyperlink to, relevant legal instruments. The 'Deleted' check-box gives an option to display deleted provisions. This functionality allows a reader to generate a more tailored version depending on their needs, such as if they just wish to view rules rather than guidance.

144 An evidential provision is a 'rule, contravention of which does not give rise to any of the consequences provided for by other provisions of the Act; and which provides' either or both that 'contravention may be relied on as tending to establish contravention of such other rule as may be specified; or compliance may be relied on as tending to establish compliance with such other rule as may be specified': Financial Conduct Authority (UK), *FCA Handbook* ('evidential provision').

145 See, eg, www.handbook.fca.org.uk/handbook.

146 See, eg, www.handbook.fca.org.uk/handbook/browse-topics/.

Example: FCA Handbook ‘Content Options’



125. ASIC has trialled consolidating regulatory guidance and enforceable rules in Regulatory Guide 271 *Internal dispute resolution* (July 2020). This single document includes a number of ‘enforceable paragraphs’, made enforceable through *ASIC Corporations, Credit and Superannuation (Internal Dispute Resolution) Instrument 2020/98*, interspersed with guidance on complying with the standards and requirements in the Regulatory Guide. A similar outcome could be achieved by making rules (in a legislative instrument) more informal and guidance-like. It would seem there is little to be achieved by only consolidating guidance and enforceable rules on an ad-hoc basis as readers may not fully appreciate that what otherwise appears to be guidance may occasionally also contain rules carrying the force of law.

Hyperlinking

126. A hyperlink is a ‘piece of text in a hypertext document which, when selected or clicked onscreen, causes another related object… to be displayed or activated’.[147] Hyperlinks are generally clearly identified, such as by colouring, italicisation, underlining, or highlighting. Hyperlinks frequently use URLs to link to webpages, including to internal parts of a particular webpage. Hyperlinks are useful for improving user experience in navigating long documents.

127. Hyperlinks are used in tables of contents on the Federal Register of Legislation, but they are not used in the text of legislation itself. Hyperlinked tables of contents are not available for every Act or instrument. Further, the utility of hyperlinked tables of contents is limited by the fact that a person must first identify the level of an Act (such as Chapter) in which the provisions they are searching for are situated so as to expand the correct drop-down elements of the table of contents. In the case of the *Corporations Act*, this also means knowing which of its seven volumes contains the relevant provisions. An example screenshot using the *Corporations Act* is at **Appendix H**. (A list at the beginning of each volume of the *Corporations Act* shows the span of numbered sections contained in each volume of the Act. This list only aids a reader if they are aware of the section number they are searching for, and the section numbers are not hyperlinked.)

128. Hyperlinks are a useful way to manage cross-references in legislation and are used in a number of jurisdictions domestically and internationally:

147 *Oxford English Dictionary* (online at 7 July 2021) ‘hyperlink, *n.*’ (def 1).

- New Zealand legislation website: Hyperlinks are used for cross-references to provisions within the same legislation (internal cross-references) and to provisions in other legislation (external cross-references). They also inconsistently hyperlink to other Acts that are mentioned in the text of an Act or instrument. Hyperlinks are identified through blue text of the same font and size as other text.
- New South Wales legislation website: Hyperlinks are used for external cross-references to Acts and instruments, but these links do not link directly to the section that is cross-referenced. Hyperlinks are identified in blue text.
- Queensland legislation website: Hyperlinks are used for internal and external cross-references, including directly to the particular provision that is cross-referenced. Hyperlinks are identified in blue text.
- The United Kingdom legislation website: Hyperlinks are not used for cross-referenced provisions in the text of legislation. However, the National Archives, the publisher of legislation, hyperlinks internal and external cross-references that appear in annotations to the text (discussed above). This includes links to provisions in Acts or instruments that amended the text of a provision or that modify the effect of a provision through a notional amendment. These hyperlinks are identified through blue text of the same font and size as other text in annotations.
- The UK FCA Handbook website: All internal and external cross-references to a provision are hyperlinked to the location of the cross-referenced provision. Hyperlinked provisions are italicised and in blue text.[148]
- The US Codes: Through XML, some external cross-references are hyperlinked. This is then converted to XHTML for more user-friendly viewing.[149]

Hyperlinking, 'hover boxes' and defined terms

129. As discussed above and illustrated by the AustLII example,[150] hyperlinking can be used to improve the navigability of legislation by both highlighting as well as taking a reader to the definition of a term. In the AustLII example, when a person clicks on the hyperlink they are taken to the provision that defines the term and, if the provision contains more than one term (such as in a dictionary), the location of the term within it. If a reader wishes to return to the provision they were reading then they need to use their internet browser to navigate back.

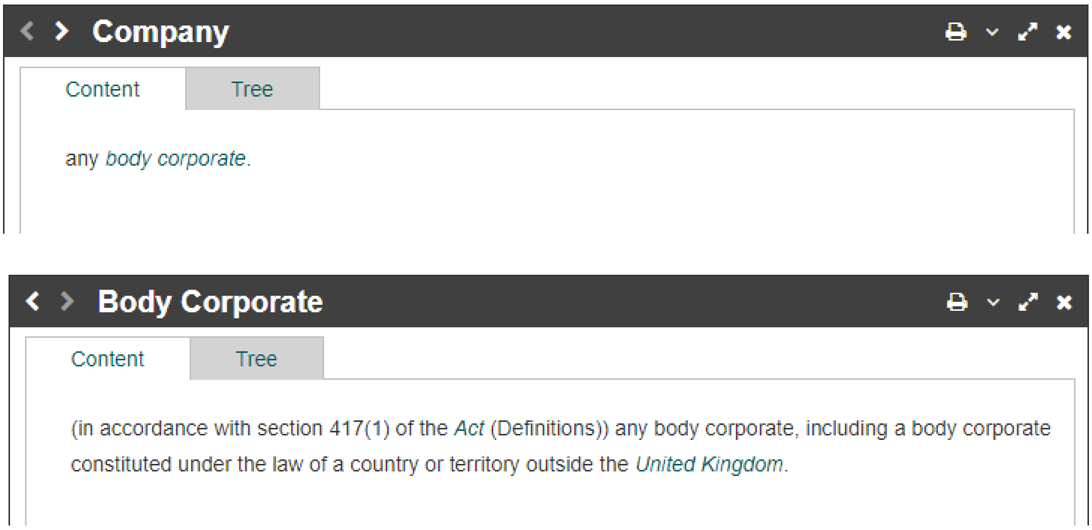
130. The UK FCA Handbook demonstrates how hyperlinks need not take readers away from the text they are reading. All uses of a defined term in the Handbook are hyperlinked to the text of the definition, and when the hyperlink is clicked a small window appears that shows the defined term and a 'tree' of defined terms relevant to the term that was hyperlinked. Defined terms that appear within the first hyperlinked term are also hyperlinked (identifiable by the same italic formatting and blue text). The example screenshots below show the small window that appears after clicking first on the term 'company' and then the defined term 'body corporate' within the definition.

148 See, for example, Financial Conduct Authority (UK) (n 144), COBS 2.1 Acting honestly, fairly and professionally: www.handbook.fca.org.uk/handbook/COBS/2/?view=chapter.

149 See, for example, US Code Title 12 (Banks and Banking) as published online: https://uscode.house.gov/view.xhtml?path=/prelim@title12&edition=prelim.

150 See [52]–[54] above.

Example: Definition hyperlink result in the UK FCA Handbook



131. One further option is the use of 'hover boxes', which differ from hyperlinks in that the text need not be clicked on to produce the pop-up box; the box instead appears when a cursor is placed (or 'hovers') above the linked word. This type of functionality (sometimes called a 'tooltip') is not widely used in legislation, but is used in other types of internet publications.[151]

132. Terms with more than one meaning in the same piece of legislation would present a difficulty for any functionality that links from a defined term to its definition. To function, either both definitions would need to be contained in the same location or the existence of multiple definitions be made apparent to the reader in some other way. In the case of the UK FCA Handbook, where a term has more than one meaning (such as in different parts of the Handbook) all definitions of the term appear when it is clicked on, regardless of location.

Point-in-time versions

133. Point-in-time analysis is frequently necessary in litigation and to understand rights and obligations. The Federal Register of Legislation allows a person to access historical versions of Acts and instruments. However, some websites facilitate this more easily. For example, the New South Wales legislation website allows a person to enter a date and the website generates the version of legislation in force at that time. The Queensland legislation website has similar functionality, offering users a timeline setting out all point-in-time versions for the legislation. A user can enter a specific date to call up the relevant version of the legislation at that date. The timeline also allows the user to generate 'on-the-fly' comparisons between different point-in-time versions, though this functionality only works between XML-based versions of legislative texts (i.e. those published since about 2015). This generates a version of the legislative text with either traditional tracked

151 See, for example, the Wikipedia entry for 'Tooltip', which demonstrates the functionality itself: https://en.wikipedia.org/wiki/Tooltip.

changes (underlined insertions, struck-through omissions) or colour-coding (green insertions, red omissions).

134. The Queensland legislation website also publishes indicative reprints of selected principal Acts that would be amended by Bills before Parliament. These show the effect of proposed amendments contained in the Bill. Like 'on-the-fly' comparisons described above, indicative reprints show changes according to the user's selection in traditional track changes or colour-coding. Indicative reprints offer improved understanding and scrutiny of proposed amendments, and can ensure that the effect of amendments on the existing legislative text and scheme are fully appreciated by lawmakers and other interested persons. In consultation, the OQPC advised the ALRC that indicative reprints were developed and published in response to needs identified by stakeholder representatives. This further demonstrates the adaptability of using XML.

135. While the Commonwealth website allows only historical versions of the whole Act, the UK legislation website also allows a person to easily identify and access point-in-time changes to particular sections (or Part or Chapter). It does this by showing a timeline of changes to a section when the person is viewing that section, with hyperlinks to the historical versions. The website also gives viewers the option of viewing historical versions of the whole Act.

136. Some commercial providers offer similar functionality. TimeBase, for example, publishes a large number of legislative items across all Australian jurisdictions offering access to point-in-time versions of whole Acts, and individual sections.[152] Additional functionality offered by TimeBase includes 'red-line' comparisons and links to amending legislation.

Tracking enabled instruments

137. It is important to identify instruments that may be relevant to complying with an Act or other instrument. The Federal Register of Legislation website is a leader in this regard. It includes a hyperlinked table for each piece of legislation with the instruments that are enabled under that legislation. However, the ALRC has identified that this appears incomplete in some cases — with instruments that are enabled not always listed under the enabling Act or instrument. The UK annotation system, while not providing a consolidated list of enabled instruments, allows a person to see where an instrument has been made under a particular provision (P-notes).[153]

138. As noted above, commercial publishers also use annotations to list legislative instruments relevant to particular provisions of the *Corporations Act*.

152 TimeBase, 'TimeBase Point-in-Time' <www.timebase.com.au/products/Point-in-Time.html>.

153 Note, however, that the *Guide to Revised Legislation on legislation.gov.uk*, extracted at Appendix G, suggests that P-Notes may only be used for commencement instruments and not necessarily more generally.

XML – Extensible markup language

What is XML?

139. XML means ‘extensible markup language’. XML is a language comprised of ‘character data’ and ‘markup’. For example, character data in the below is in plain text, while markup is in bold.

<section Id="section-1A">

<num>1A</num><heading>Prohibition on misleading and deceptive conduct</heading>

<subsection>

<content>A corporation must not engage in misleading or deceptive conduct</content>

</subsection>

</section>

140. If the markup was removed, the character data would simply say:

> 1A Prohibition on misleading and deceptive conduct
>
> A corporation must not engage in misleading or deceptive conduct

141. XML allows for the marking up of documents so that they can be read by a computer in a meaningful way. Without markup, a computer has no way to know whether the document is an Act, a judgment, or a string of random characters. It also cannot break a document up into semantically meaningful parts without markup — all the computer sees in a non-marked-up document is a string of characters. XML is a non-proprietary language and is easy to modify.

142. There are generally two types of markup: structural and semantic.[154] Structural markup ‘refers to the categorisation of different parts of a document based on their functionality’.[155] In legislative texts this includes, for example, breaking up text into Chapters, Parts, Divisions, Sections and Subsections. Semantic markup

> identifies parts of the document (e.g., headings, names, references, provisions). In this way the ‘meaning’ of the different parts can then be ‘understood’ by machines as well, in the sense that a machine will be able to distinguish such parts and consequently to process them accordingly.[156]

143. Markup is principally comprised of ‘elements’ (eg <section>) which can have ‘attributes’ (eg Id="section-1A"). Attributes can also be used to modify the appearance of the character data when it is published (eg Font="Arial" Size="12"). Elements can be used within elements, as is the case in the earlier example: <subsection> appears within the <section> element. Elements must have a start tag (eg <section>) and an end tag (eg </section>). End tags are indicated through the presence of the forward slash (/), but are otherwise identical to the start tag.

154 Fabio Vitali, ‘A Standard-Based Approach for the Management of Legislative Documents’ in Giovanni Sartor et al (eds), *Legislative XML for the Semantic Web Principles, Models, Standards for Document Management* (Springer, 2011) 39.
155 Ibid.
156 Ibid.

144. All XML must have a 'root element' in which all other elements appear. This means that XML is a hierarchical language, with cascading levels of elements possible. This makes it ideal for representing legislation, which is hierarchical in its nature, following the structure: Chapter, Part, Division, Section, Subsection, Paragraph and so on.

145. As noted, elements can have 'attributes'. The below example is extracted from the XML for the *Mental Health Act 2016* (Qld), with elements in bold and attributes in italics.

Example – XML elements and attributes

<act *title="Mental Health Act 2016" bill.title="Mental Health Bill 2015" year.introduced="2015" year.passed="2016" year.assent="2016" no="5" publication.date="2021-03-08"*>

146. This provides for the inclusion of 'metadata' about elements. For example, the above tells a computer information about the Act element, including its title, the originating Bill, as well as its year of introduction, passage and assent. In UK legislation, this information is included in a '<meta>' element that makes it clear it is metadata relating to the whole Act rather than one single element.

147. What makes XML particularly useful is its 'extensibility'. Elements and attributes can be developed in any way to create a 'vocabulary' (eg <section> means section of a legislative text) and 'schema' that is subject matter-specific. A schema is a collection of hierarchical elements and attributes (eg <section> appears below <act> and can have certain attributes) that can form the basis of an XML document.

148. Schema can be validated against a Document Type Definition ('DTD') document, which provides the 'grammar' of elements and attributes permitted in an XML document.[157] A DTD also specifies the permitted hierarchy of elements and the permitted relationships that elements and attributes can have to each other. For example, a DTD might specify that a '<subsection>' element must appear below a '<section>', and that a '<section>' element must have the attribute 'ID' (eg 'ID="Section-12D"'). DTDs offer a way of ensuring that XML documents are validly created, which ensures they will be consistently machine-readable. Other markup languages, such as HTML, do not necessarily have these processes to ensure they are 'well-formed',[158] and many HTML documents will be inconsistently formatted.

149. The extensibility of XML has allowed drafting offices to develop legislation-specific vocabularies and schema. The UK, New Zealand and the USA have all developed their own XML vocabularies and schema for writing and publishing legislation.[159] Likewise, Queensland, South Australia, New South Wales, Tasmania and Western Australia have all developed different schema for their publication of legislation in XML.[160]

157 World Wide Web Consortium, 'Extensible Markup Language (XML) 1.1 (Second Edition)' <www.w3.org/TR/xml11/>.
158 Ibid.
159 The United States has developed 'US Legislative Markup (USLM)' as a derivative of the LegalDocML (Akoma Ntoso) standard: see https://www.govinfo.gov/features/beta-uslm-xml. The UK has developed its own scheme (see https://www.legislation.gov.uk/schema/legislation.xsd) but also makes all its legislation available in Akoma Ntoso.
160 Michael Rubacki, 'Free Access Online Legislation in a Federation: Achievements of Australian Governments and Issues Remaining' (Research Paper No 2013–28, UNSW Law, May 2013) 7.

150. An international standard XML schema for legal documents has been developed in the form of LegalDocML (Akoma Ntoso).[161] The schema was developed to allow

> information to be described and classified in a uniform and organized way so that content is structured into meaningful elements that can be read and understood by software applications, so that the content is made “machine readable” and more sophisticated applications than on-screen display are made possible.[162]

151. According to the Inter-Parliamentary Union, 67% of parliaments with legislative management systems use XML for at least some of their work, of which 40% use XML to publish legislative materials such as Acts and Bills.[163]

The Federal Register of Legislation

152. The Federal Register of Legislation does not currently use XML. However, the Federal Register of Legislation does make effective use of HyperText Markup Language (HTML), which is used to create webpages. HTML is also a markup language, however it uses a preset list of elements and so is limited in its extensibility.

153. The Federal Register of Legislation uses the ‘class’ attribute for HTML elements to include useful markup on the semantic content of Acts and Regulations (both of which are drafted by the OPC). For example, Federal Register of Legislation identifies headings (eg ‘SubsectionHead’, ‘ActHead5’), provision types (eg ‘subsection’, ‘paragraph’), and definitions (eg ‘Definition’, ‘definition’). This markup appears to be an accidental consequence of the Word formatting that the OPC uses and not all markup is intuitive for other users (eg ActHead5). Unlike XML, HTML used on the Federal Register of Legislation is not structured hierarchically and identification of defined terms does not always include the whole text of the definition (unlike in jurisdictions that use XML). There is currently little useful markup in Commonwealth legislation other than Acts and regulations, because other instruments are not generally drafted using the OPC template.[164]

What are the benefits of XML?

154. XML supports the move to the ‘semantic web’:

> This means that the legal information available over the Internet is increasingly processed according to its content (or meaning), and not only as a pure text (as a sequence of words, to be read by a human). This result is usually achieved by embedding in the natural language text special computer readable specifications, which can be processed in various ways: for retrieving the document, for accessing related information, for determining the legally binding content of the document, for applying the rules it includes, and so on. XML tagging is normally used to embed such meta-textual information in legal documents… Ways of specifying derogations and modifications in legal documents have been devised, which allow legal texts currently in force to be automatically constructed.

161 United Nations Department of Economic and Social Affairs, ‘Akoma Ntoso: XML for Parliamentary, Legislative & Judiciary Documents’ <www.akomantoso.org/>.

162 United Nations Department of Economic and Social Affairs, ‘What It Is’, *Akoma Ntoso: XML for parliamentary, legislative & judiciary documents* <www.akomantoso.org/?page_id=25>.

163 Inter-Parliamentary Union, *World E-Parliament Report* (2018) 54.

164 Some delegated legislation, such as some legislative instruments made by ASIC, appear to use the OPC template.

> XML provides a metalanguage enabling individuals and communities to define tags for expressing the structure of documents, and for including further information (metadata) in the documents, so that they can be automatically processed according to such structure and additional information.[165]

155. By making legislation machine-readable, XML is also a useful but not sufficient step for the development of a range of regulatory technologies (sometimes referred to as 'RegTech') and eventually, if desirable, 'rules as code'.[166] RegTech can support innovation that underpins more effective compliance, including through simpler development of business rules for staff. This is the practical side of implementing legal obligations and developing compliance systems for firms.

156. Several consultees have told the ALRC that developing and maintaining systems for compliance with financial services regulation imposes a considerable burden on their business. Frequent legislative amendment presents a particular challenge for maintaining compliance systems. Updating compliance systems can take some time, and notwithstanding consultation between industry and lawmakers, stakeholders report that they sometimes find it challenging to implement changes to compliance systems before new laws commence. Making legislation machine-readable and more amenable to RegTech may help to reduce the burden of developing and maintaining compliance systems, particularly in the event of any substantial reforms.

157. Publishing legislation in XML format also lowers the barriers to entry for those engaged in developing RegTech. This is principally because it saves the additional step of taking the currently formatted legislation and converting it into something more amenable to machine-reading. At present, the need to do this may act as a significant barrier or disincentive.

158. Because XML vocabularies and schemas are extensible, they can be developed with as much or as little 'markup' and metadata as desired. This also means basic structural and semantic markup can be provided by, for example, the Federal Register of Legislation, which can then be supplemented by more extensive semantic markup by private publishers or RegTech developers.

159. Common semantic markup included by public authorities include cross-references to other provisions within the legislation or in other legislative texts (which supports hyperlinking), identifying defined terms, dates of amendments and changes to the text of a provision (including notional amendments), and identifying basic semantic features such as headings and provision numbers.

165 Giovanni Sartor, 'Legislative Information and the Web' in Giovanni Sartor et al (eds), *Legislative XML for the Semantic Web: Principles, Models, Standards for Document Management* (Springer, 2011) 13. 16.

166 For a brief introduction to the concept of 'rules as code', see the New South Wales Government's *Emerging Technology Guide: Rules as Code*: https://www.digital.nsw.gov.au/digital-transformation/policy-lab/rules-code.

160. However, the potential list of elements or attributes is limitless. For example, campaigners in the USA have pointed to the adoption of XML as paving the way for

> a transformation of methods to track federal dollars. XML tags could be used to identify appropriation line items and assess their impact on the overall budget. Once appropriations were enacted… the legislative data could be mapped with executive branch data sources to give a picture of the end-to-end lifecycle of federal spending — from budget to allocation to disbursement to award to sub-award.[167]

161. Likewise, XML could be used to markup obligations and prohibitions in an Act, or civil penalty and offence provisions. This could look like either of the following (very simplified XML):

Option A: Using elements to indicate an offence provision

```
<section>
    <offenceprov>
            <content>A corporation must not engage in misleading or deceptive conduct</content>
    </offenceprov>
</section>
```

Option B: Using attributes to indicate an offence provision

```
<section provtype="offence">
    <content>A corporation must not engage in misleading or deceptive conduct</content>
</section>
```

162. The use of XML markup also enables more granular search functionality across whole legislation databases. The advanced search function of the Federal Register of Legislation allows users to search across three content types: ‘Full text including title and brief description’, ‘Title and brief description’, or ‘Title only’.[168] By contrast, the legislation websites of Queensland and New South Wales, which use XML formatting, allow for searching across seven content types: ‘All Content’, ‘Title’, ‘All Headings’, ‘Part/Division Headings’, ‘Schedule Headings’, ‘Defined Terms’, or ‘Historical Title’.[169] The Tasmanian legislation website, another jurisdiction that uses XML, offers 11 content types in its search function.[170]

167 Adam Mazmanian, ‘Congress Posts U.S. Code in XML’, *Federal Computer Week* <www.fcw.com/articles/2013/08/02/us-code-xml.aspx>.

168 Australian Government, ‘Advanced Search’, *Federal Register of Legislation* <www.legislation.gov.au/AdvancedSearch>.

169 Queensland Government, ‘Search’, *Queensland Legislation* <www.legislation.qld.gov.au/search/inforce>; New South Wales Government, ‘Search’, *New South Wales Legislation* <www.legislation.nsw.gov.au/search>.

170 Tasmanian Government, ‘Search’, *Tasmanian Legislation* <www.legislation.tas.gov.au/search>.

163. Finally, XML also brings benefits for drafters. In consultation with the ALRC, the OQPC suggested that their move to XML, in addition to broader changes introduced through their eLegislation project

> enabled [OQPC] to rationalise and repurpose resources to other areas of the business, and remove repetitive, mundane, and non-rewarding manual tasks, processes and steps. It also enabled [OQPC] to rationalise legislation production workflows and interactions (touch-points) within OQPC, streamlining the production processes to meet tighter turn-around times required by government….
>
> It also enabled increasing interoperability and data-sharing opportunities between other jurisdictions using XML and validating DTDs offering standardised formats and readable document structures.[171]

164. The OQPC's experience of introducing XML is consistent with that of other drafters. Michael Rubacki, a drafter of 30 years, has written that XML-adoption supports 'streamlining of in-house processes for both drafting and publishing', as well as the 'portability, inter-usability and longevity of data'.[172] XML can easily be converted into PDF or HTML for publication on the web, and carries across much of its markup to these human-readable document types (eg hyperlinked cross-references). The OQPC publishes all its legislation in XML, PDF and HTML, having previously published only in PDF. Victoria is now the only state or territory to publish its legislation only in PDF or Microsoft Word, though the Northern Territory does not use meaningfully marked-up HTML.

165. While XML may bring benefits for users of legislation, drafters, lawmakers, and RegTech developers, there are necessarily costs in transitioning to XML. Drafting offices need to be supported to make the transition, including by way of necessary funding. Regarding its own transition, the OQPC noted that

> Intensive training was undertaken to transition all staff from unstructured to structured document creation and understanding validation of documents. This was conducted with third-party trainers who assisted with the DTD and EDD documents development. All drafters were able to transition to the new drafting format and systems.[173]

166. OQPC's transition to XML came as part of a broader eLegislation project, which was specifically funded

> to simplify duplication and manual processes in the drafting, development, and publishing of Queensland legislation and in the process of updating statute book documents to a more universal store format with document format longevity.[174]

171 Office of the Queensland Parliamentary Counsel, Advice Correspondence (23 September 2021).
172 Rubacki (n 160) 8.
173 Office of the Queensland Parliamentary Counsel, Advice Correspondence (23 September 2021).
174 Office of the Queensland Parliamentary Counsel, Advice Correspondence (23 September 2021).

The potential for reform and steps towards interoperability

167. The Australasian Parliamentary Counsel's Committee ('APCC') consists of the heads of legislation drafting offices in all Australian jurisdictions and New Zealand.[175] The APCC 'provides a forum for discussion about the development of legislation and the management of those drafting offices, and an IT Forum for those drafting offices', as well as for coordinating Australian national uniform law schemes.[176]

168. As discussed above, several Australian jurisdictions and New Zealand currently publish legislation in XML format. The APCC, and its IT Forum, may therefore be an appropriate forum to assist the OPC if it were to move to publishing legislation in XML format.

169. It may also be desirable in the long-term to standardise XML markup schema for legislative texts in Australia, or to ensure that XML can easily be translated between jurisdictions. For example, the UK publishes legislation in both its own bespoke XML schema (UKML) and the internationally recognised LegalDocML (Akoma Ntoso) schema. Publishing legislation in a common schema means that laws from multiple jurisdictions are able to be processed by a computer program designed to read only that common schema (Akoma Ntoso). Commonwealth, state and territory legislation in Australia generally adopts a similar structure and share similar semantic features, so translating between schema adopted by different Australian jurisdictions should be possible.

170. Uniformity in schema or guaranteed ability to translate between schemas in Australia would bring benefits for those developing technologies to process legal texts, such as to create RegTech products. Ensuring at least interoperability of legislative texts for machine-reading programs could be a potential focus of the APCC, and may be a useful consideration if the OPC were to adopt XML at the Commonwealth level.

175 Australasian Parliamentary Counsel's Committee, 'About Us', *Australasian Parliamentary Counsel's Committee* <www.pcc.gov.au/about.html>.
176 Ibid.

Appendices

Appendix A

Example: Subsection headings

Section 798G *Corporations Act*

798G Market integrity rules

(1) ASIC may, by legislative instrument, make rules (the ***market integrity rules***) that deal with the following:

(a) the activities or conduct of licensed markets;

(b) the activities or conduct of persons in relation to licensed markets;

(c) the activities or conduct of persons in relation to financial products traded on licensed markets.

Note: The market integrity rules will not apply in relation to all licensed markets: see subsection 798H(2).

(3) ASIC must not make a market integrity rule unless the Minister has consented, in writing, to the making of the rule.

Emergency rules

(4) Despite subsection (3), ASIC may make a market integrity rule without the consent of the Minister if ASIC is of the opinion that it is necessary, or in the public interest, to protect people dealing in a financial product or class of financial products.

(5) However, if ASIC does so, ASIC must:

(a) provide the Minister, on the following day, with a written explanation of the need for the rule; and

(b) amend or revoke the rule in accordance with any written directions of the Minister.

Minister's instruments are not legislative instruments

(6) None of the following is a legislative instrument:

(a) a consent given under subsection (3);

(b) a direction given under paragraph (5)(b).

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Appendix B

Example: Parallel structure		
Part 7.2—Licensing of financial markets	Part 7.3—Licensing of clearing and settlement facilities	Part 7.6—Licensing of providers of financial services
Division 1—Preliminary		Division 1—Preliminary
Division 2—Requirement to be licensed	Division 1—Requirement to be licensed	Division 2—Requirement to be licensed or authorised
Division 3—Regulation of market licensees Subdivision A—Licensee's obligations Subdivision B—The market's operating rules and procedures Subdivision C—Powers of the Minister and ASIC	Division 2—Regulation of CS facility licensees Subdivision A—Licensee's obligations Subdivision B—The facility's operating rules and procedures Subdivision C—Powers of the Minister, ASIC and the Reserve Bank in relation to licensees	Division 3—Obligations of financial services licensees
Division 4—The Australian market licence Subdivision A—How to get a licence Subdivision B—The conditions on the licence Subdivision C—When a licence can be varied, suspended or cancelled	Division 3—The Australian CS facility licence Subdivision A—How to get a licence Subdivision B—The conditions on the licence Subdivision C—When a licence can be varied, suspended or cancelled	Division 4—Australian financial services licences Subdivision A—How to get a licence Subdivision B—The conditions on the licence Subdivision C—When a licence can be varied, suspended or cancelled
Division 5—Other matters	Division 4—Other matters	

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Appendix C

Example: Simplified outline

Section 908AA *Corporations Act*

908AA Simplified outline of this Part

Administrators of significant financial benchmarks must be licensed under this Part. Administrators of other financial benchmarks may voluntarily opt in to the same licensing scheme.

Licensees are subject to certain obligations.

ASIC may make financial benchmark rules that apply in relation to licensees and the financial benchmarks they administer.

ASIC may also make compelled financial benchmark rules to deal with circumstances such as the failure of a licensee to administer a significant financial benchmark specified in its licence.

Offences and civil penalty provisions apply to conduct that could unduly manipulate a financial benchmark.

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Appendix D

Example: Overview

Section 717 *Corporations Act*

717 Overview of procedure for offering securities

The following table summarises what a person who wants to offer securities must do to make an offer of securities that needs disclosure to investors under this Part and gives signposts to relevant sections:

Offering securities (disclosure documents and procedure)			
	Action required	**Sections**	**Comments and related sections**
1	Prepare disclosure document, making sure that it: · sets out all the information required · does not contain any misleading or deceptive statements · is dated and that the directors consent to the disclosure document.	710 711 712 713 713C 713D 713E 714 715 716	Section 728 prohibits offering securities under a disclosure document that is materially deficient. Section 729 deals with the liability for breaches of this prohibition. Sections 731, 732 and 733 set out defences.
2	Lodge the disclosure document with ASIC	718	Subsection 727(3) prohibits processing applications for nonquoted securities for 7 days after the disclosure document is lodged.

…

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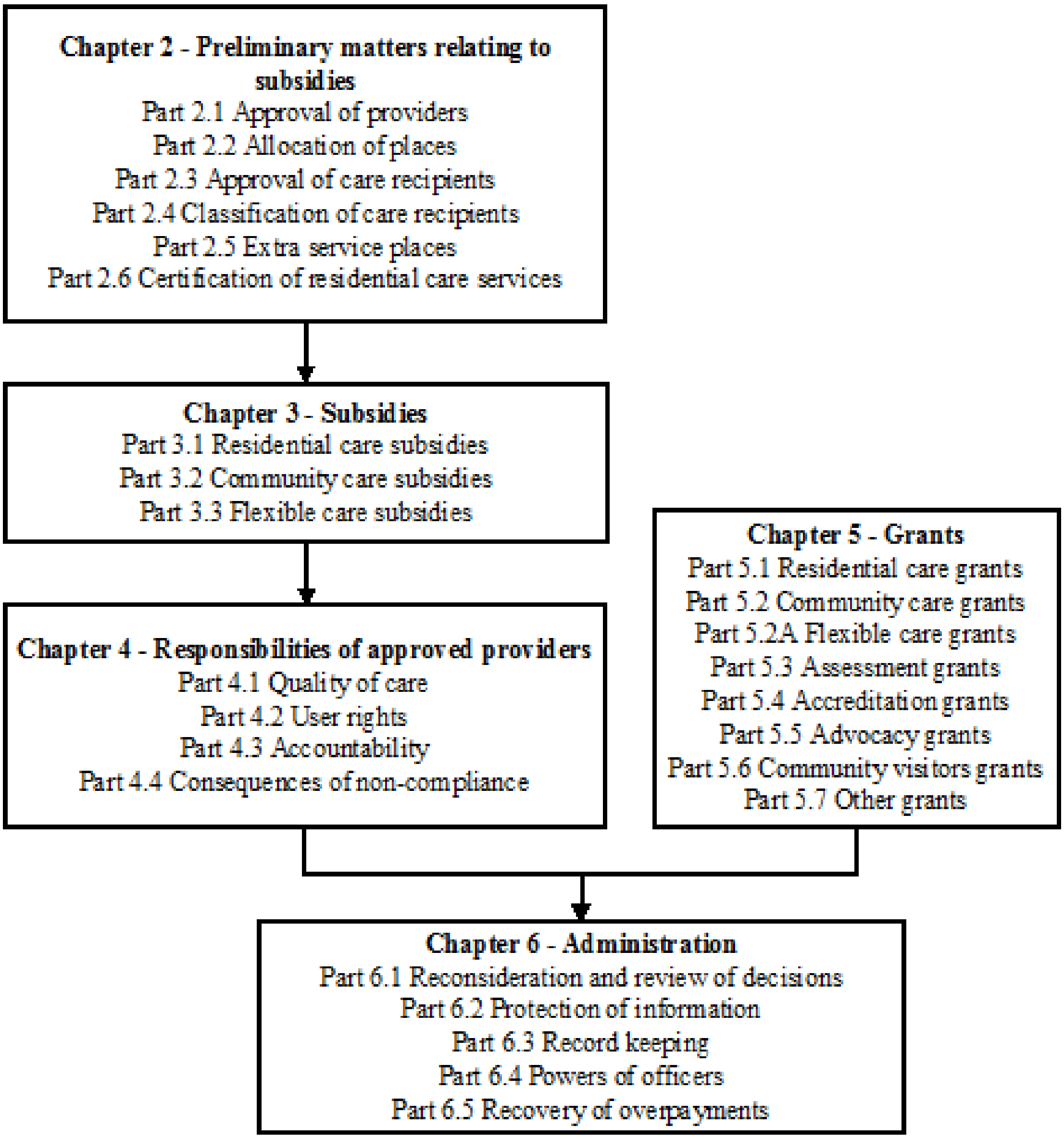
Appendix E

Example: Diagram

Section 3-6 *Aged Care Act 1997* (Cth) (now repealed)

3-6 The structure of this Act

This diagram sets out the basic structure of this Act.



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Example 1: Examples

Section 51F *Corporations Act*

51F Meaning of ***PPSA retention of title property***

Definition

(1) Property is ***PPSA retention of title property*** (short for Personal Property Securities Act retention of title property) of a corporation if:

(a) the property is personal property; and

(b) the property is used or occupied by, or is in the possession of, the corporation; and

(c) the corporation does not have title to the property; and

(d) a PPSA security interest is attached to the property, within the meaning of the *Personal Property Securities Act 2009*; and

(e) the corporation is the grantor in relation to the PPSA security interest, within the meaning of that Act.

Examples: The following personal property is ***PPSA retention of title property*** if a PPSA security interest attaches to the property by virtue of the transaction concerned, and the grantor is a corporation:

(a) property that is the subject of an agreement to sell subject to retention of title, or a hire purchase agreement, that secures the payment or performance of an obligation (see subsection 12(2) of the *Personal Property Securities Act 2009*);

(b) property that is the subject of a lease, or a consignment agreement, that secures the payment or performance of an obligation (see subsection 12(2) of the *Personal Property Securities Act 2009*);

(c) goods that are the subject of a commercial consignment (see subsection 12(3) of the *Personal Property Securities Act 2009*);

(d) goods that are leased or bailed under a PPS lease (see subsection 12(3) of the *Personal Property Securities Act 2009*).

References to property of a corporation

(2) A reference in this Act to the property of a corporation does not include a reference to any PPSA retention of title property of the corporation, unless provided otherwise expressly or by necessary implication.

Note: See also the definition of ***property*** in section 9.

Example 2: Examples

111M Member approval

(1) This section applies if:

(a) a provision of this Act provides that one or more conditions must be satisfied for there to be member approval (however described) in relation to the body corporate; and

Example: Division 3 of Part 2E.1.

(b) the governance standards (within the meaning of the *Australian Charities and Notforprofits Commission Act 2012*) provide that one or more conditions must be satisfied for there to be such member approval.

(2) Paragraph (1)(a) does not apply to a condition that a person give to another person particular information that relates to the matter that is the subject of the member approval.

Example: Paragraph 218(1)(b).

(3) The provision mentioned in paragraph (1)(a) has effect, in relation to the body corporate, as if it, instead of providing for the conditions mentioned in that paragraph, provided for the conditions mentioned in paragraph (1)(b).

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Appendix G

UK Legislation Annotation types — Extract from the Guide to Revised Legislation on legislation.gov.uk (October 2013)

- C-notes - Modifications etc (not altering text)

  'C' stands for 'Cross-notes', so called because of the way in which they were presented in the hard copy predecessors to the revised content on legislation.gov.uk. This annotation type is used to denote the effect when the meaning, scope or application of an Act or provision etc. is changed in some way, but without there being any authority to alter the text. Typical expressions of effects of this kind are 'modified', 'applied', 'excluded', 'extended', 'restricted', etc.

- E-notes – Geographical Extent information

  This annotation type contains information about the geographic extent of the Act or relevant part of it.

  E-notes are at present used very sparingly, mainly to indicate some complexity or change in the extent which is not adequately reflected in the extent provision of the Act (although they have been used more extensively in the past). They are also used where there are multiple versions of a provision created for different geographical extents.

- F-notes - Amendments (Textual)

  'F' stands for 'Footnotes'. This annotation type is used for amendments, including repeals, where there is authority to change the text.

- I-notes - Commencement information

  'I' stands for 'In-force'. This annotation type contains information about the coming into force of a provision and will typically state whether it is partly or wholly in force, give the date or dates of commencement and cite relevant provisions of the Act and any commencing instruments.

  At present, I-notes are used only if there is some complexity in the commencement. If the provision came into force on one day for all purposes, no I-note will be created and the in-force date will be the same as the start date of the earliest version of the provision.

- M-notes - Marginal citations

  This annotation type is so called because it used to appear in the margin of the Queen's Printer's copy of primary legislation. M-notes recite the year and number of an Act or instrument mentioned in the text.

- P-notes - Subordinate legislation made

  'P' stands for 'Power exercised'. Where a provision of primary legislation confers power to make subordinate legislation and that power is exercised (i.e. an instrument is made in pursuance of it), that exercise may be recorded in a P-note. The annotation will cite any instruments made under that power.

  At present, the P-note annotation type is used only in respect of the making of commencement orders (distinguished by a 'C' series number after the number of the instrument) or other exercises of a power to appoint a day.

- X-notes - Editorial information

  The X-note annotation type is used sparingly to alert users to anything they may need to be aware of in using the text. They have been used, for example, to explain potential difficulties arising from variations in pre-SLD [Statute Law Database] editorial practice over the years or to point to uncertainties in the text of very old Acts.

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Appendix H

Example: Federal Register of Legislation Table of Contents

TABLE OF CONTENTS. Expand All | Collapse All

- ⊞ Volume 1
- ⊟ Volume 2
  - ⊞ Chapter 2L—Debentures
  - ⊟ Chapter 2M—Financial reports and audit
    - ⊞ Part 2M.1—Overview
    - ⊞ Part 2M.2—Financial records
    - ⊞ Part 2M.3—Financial reporting
    - ⊟ Part 2M.4—Appointment and removal of auditors
      - ⊟ Division 1—Entities that may be appointed as an auditor for a company or registered scheme
        - 324AA Individual auditors, audit firms and authorised audit companies
        - 324AB Effect of appointing firm as auditor—general
        - 324AC Effect of appointing firm as auditor—reconstitution of firm
        - 324AD Effect of appointing company as auditor
        - 324AE Professional members of the audit team
        - 324AF Lead and review auditors
      - ⊞ Division 2—Registration requirements

TOC HIDE

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Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL4

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Historical Legislative Developments

November 2021

This summary of key historical legislative developments is the fourth in a series of background papers to be released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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Introduction

1. This Background Paper summarises key historical legislative developments in two theoretically distinct (but overlapping) areas of regulation relevant to this Inquiry: corporations and financial services. The evolution of corporate and financial services regulation in Australia over time has resulted in greater uniformity across Australia, and increasing federalisation. Limits under the *Australian Constitution* on Commonwealth power to legislate in these areas has significantly shaped the development of the regulatory landscape in the time since Federation. A series of interconnecting reforms have drawn the regulation of these two areas closer together, with the effect that the central framework for financial services regulation is now found in Chapter 7 of the *Corporations Act 2001* (Cth) ('*Corporations Act*').

2. Australia's financial sector has itself evolved dramatically over the past several decades. The deregulation of the Australian economy in the 1980s, combined with a significant increase in global capital flowing into Australia, fostered innovation and greater competition in the financial services industry.[1] In 1996, Edey and Gray observed:

> Like other industrial countries, Australia has experienced major changes to its financial system in recent decades. The net effect has been a transformation in the Australian financial system from a relatively closed, oligopolistic structure in the 1950s and 1960s, based predominantly on traditional bank intermediation, to a more open and competitive system offering a much wider variety of services from an array of different providers. This process of financial system evolution, while driven largely by market forces, has been assisted by prevailing regulatory and supervisory arrangements.[2]

3. The current legislative framework for financial services was designed at the end of the 1990s, during which

> economic, political and social factors — including financial sector deregulation, changes to occupational superannuation arrangements, and expanding equity-market participation rates resulting from privatisations and demutualisations — had brought increasing numbers of middle-class households into the market for financial products and services. The funds management and financial advice industries began to grow. At the same time, innovation in the design of financial products resulted in the creation of new and sometimes complex financial arrangements and facilities, blurring the boundaries between traditional classes of products and creating opportunities for regulatory arbitrage.[3]

4. This Background Paper provides an overview of the structural development of Australian corporations and financial services regulation, from prior to Federation to the modern *Corporations Act*. It considers early steps toward greater uniformity, before moving to discuss the co-operative schemes and the development of national regulators. It then considers in detail the reforms that occurred in the 1990s and into the early 2000s, which resulted in the passage of the *Corporations Act* and the *Financial Services Reform Act 2001* (Cth) ('*FSR Act*'), before discussing the regulation of credit and its relationship with these regulatory frameworks. It concludes by discussing in detail the current

1 Stan Wallis et al, *Financial System Inquiry* (Final Report, 1997) 5. See also Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper, Reserve Bank of Australia Conference, 1996).

2 Edey and Gray (n 1).

3 Pamela Hanrahan, 'Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households' (Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Background Paper 7, April 2018) 5–6 (footnotes omitted).

constitutional framework that underpins these regulatory regimes and the implications of that framework, including its implications for potential reforms.

5. The history of corporate and financial services regulation in Australia is critical to the present Inquiry for several reasons. First, it explains how the architecture of Australian corporate and financial services regulation attained its current shape. While a focus on the constitutional framework may appear somewhat esoteric, it is critical to understanding the current legislative framework and why a number of problems that have been evident for decades seem to remain, notwithstanding frequent amendments to the *Corporations Act.* Secondly, it reveals the increasing scope of regulation over time, as the Australian economy has grown in sophistication. Thirdly, it reveals the parallel development and evolution of financial services regulation over the course of the twentieth century as the financial services industry itself continued to evolve and innovate.

6. The analysis in this Background Paper is particularly relevant to three topics to be discussed in Interim Report A in this Inquiry:

- the definition of 'financial product' which underpins the scope of application of key legislation;
- the 'freezing' of the *Acts Interpretation Act 1901* (Cth) ('*Acts Interpretation Act*') for the purposes of key legislation; and
- the location within the Commonwealth statute book of major aspects of corporate and financial services regulation (which will be the focus of Interim Report C in this Inquiry).

7. In this Background Paper, the terms 'corporate regulation', 'corporations legislation', and 'companies legislation' refer to the laws relating to the formation, conduct, governance, and dissolution of companies, and the regulation of companies. The words 'company' and 'corporation' are used interchangeably in this Paper. The terms 'financial services regulation' and 'financial services legislation' are used to refer to the laws relating to financial products and financial services and their regulation. There is some cross-over between both terms, particularly in relation to securities. The term 'financial regulation' is a broader term used to refer to the regulation of the financial system more broadly, including prudential regulation.

Australian company law prior to Federation

8. While companies have been part of commercial life in Australia since the earlier part of the nineteenth century,[4] it was not until after the passage of the *Companies Act 1862* (UK) that legislation providing for the incorporation of corporations was enacted.[5] Prior to this time, corporations in Australia existed either as unincorporated joint stock companies or as companies incorporated under specific legislation.[6] By 1874, most of the Australian colonies had adopted legislation based upon the 1862 Act in the UK,[7] with

4 Phillip Lipton, 'A History of Company Law in Colonial Australia: Economic Development and Legal Evolution' (2007) 31(3) *Melbourne University Law Review* 805, 808–14.

5 The *Companies Act 1862* (UK) was a 'consolidation of the companies legislation in England': Ibid 814.

6 Ibid 808–14.

7 With some innovations, although the extent of these is a matter of debate: Ibid 806–7, 818–22; Rob McQueen, 'Limited Liability Company Legislation — The Australian Experience' (1991) 1(1) *Australian Journal of Corporate Law* 22, 24; The Hon Justice RI Barrett, 'Towards Harmonised Company Legislation — "Are We There Yet"?' (2012) 40(2) *Federal Law Review* 141, 142.

Queensland the first to do so in 1863.[8] This legislation was not accompanied by dedicated regulatory structures,[9] with enforcement lying with either a Master of the Supreme Court, the Registrar-General or the Titles Office depending on the particular colony.[10]

9. Near the end of the nineteenth century, Victoria became a significant proponent of company law reform[11] following a mining boom in the 1880s and a market crash in the 1890s that culminated in the enactment of the *Companies Act 1896* (Vic).[12]

The constitutional framework established at Federation

10. In the debates leading up to Federation in 1901, there was discussion about whether the proposed Commonwealth Parliament should have broad powers over corporate regulation.[13] Ultimately, it was decided not to confer 'unqualified federal power' over corporate regulation on the Commonwealth Parliament.[14]

11. Instead, the 'corporations power' included in s 51(xx) of the *Australian Constitution* gave the Commonwealth Parliament power to make laws 'with respect to'

> foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth.

12. At the time of Federation, commerce was generally state-centric, in that it was organised based upon the particular state in question. In the area of financial services, this was reflected in separate banks and insurers. Corporations incorporated in other states were treated as foreign corporations.[15] There was concern about granting broad power to the Commonwealth, and a desire on the part of the states to preserve the increasing revenue derived from corporations.[16] The constitutional framework that was adopted was the product of this context.

13. The scope of the corporations power has been the subject of significant litigation since Federation. Section 51(xx) is restricted to 'constitutional corporations': foreign,[17] trading[18] or financial[19] corporations. Critically, s 51(xx) does not confer power to legislate for the incorporation of corporations[20] — it is limited to constitutional corporations; namely, foreign corporations, and trading or financial corporations *formed* within the limits of the

8 Lipton (n 4) 814; Barrett (n 7) 141.
9 McQueen (n 7) 27.
10 Ibid 25.
11 Barrett (n 5) 144.
12 John Waugh, 'Company Law and the Crash of the 1890s in Victoria' (1992) 15(2) *UNSW Law Journal* 356, 356, 381, 386, 388; Lipton (n 4) 817, 824, 827.
13 Rob McQueen, 'An Examination of Australian Corporate Law and Regulation 1901-1961' (1992) 15(1) *UNSW Law Journal* 1, 10; Katie Watson, 'The Historical Development of Corporate Law in Australia: Politics and Possibilities' (2017) 32(2) *Australian Journal of Corporate Law* 122, 135–8.
14 McQueen (n 13) 10. For a discussion of the views at the Constitutional Convention as to the corporations power in s 51(xx) of the *Australian Constitution*, see Suzanne Corcoran, 'Corporate Law and the Australian Constitution: A History of Section 51(xx) of the Australian Constitution' (1994) 15(2) *The Journal of Legal History* 131, 135–7.
15 Barrett (n 7) 142–4.
16 McQueen (n 13) 10.
17 Corporations formed outside the limits of the Commonwealth: see *New South Wales v Commonwealth* (1990) 169 CLR 482, 498, 504; *Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia v Queensland Rail* (2015) 256 CLR 171.
18 Determined through consideration of whether the activities of a corporation involve 'trading': see *R v Trade Practices Tribunal; Ex parte St George County Council* (1974) 130 CLR 533; *R v Federal Court of Australia; Ex parte Western Australian National Football League (Inc)* (1979) 143 CLR 190; *Commonwealth v Tasmania* (1983) 158 CLR 1, 116–8, 179, 240, 293.
19 Corporations that engage in financial activities or which are intended to engage in such activities: see *State Superannuation Board v Trade Practices Commission* (1982) 150 CLR 282, 305.
20 See *New South Wales v Commonwealth* (n 17); *Huddart Parker and Co Pty Ltd v Moorehead* (1909) 8 CLR 330.

Commonwealth. The High Court of Australia ('High Court') has held that a law will be a law 'with respect to' a constitutional corporation if it makes the corporation an 'object of statutory command' through imposing a duty or liability or conferring a right or privilege on a constitutional corporation.[21]

14. Other heads of power relevant to the regulation of corporations and financial services include:

- s 51(i) — 'trade and commerce with other countries, and among the States';
- s 51(ii) — 'taxation; but so as not to discriminate between States or parts of States';
- s 51(v) — 'postal, telegraphic, telephonic, and other like services';
- s 51(xiii) — 'banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money';
- s 51(xiv) — 'insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned';
- s 51(xvii) — 'bankruptcy and insolvency';
- s 51(xxxix) — 'matters incidental to the execution of any power vested by this Constitution in the Parliament or in either House thereof, or in the Government of the Commonwealth, or in the Federal Judicature, or in any department or officer of the Commonwealth';[22] and
- s 122 — 'The Parliament may make laws for the government of any territory surrendered by any State to and accepted by the Commonwealth, or of any territory placed by the Queen under the authority of and accepted by the Commonwealth, or otherwise acquired by the Commonwealth, and may allow the representation of such territory in either House of the Parliament to the extent and on the terms which it thinks fit'.

15. As a consequence, no comprehensive standalone Commonwealth companies legislation was passed in the years following Federation.

The Uniform Companies Acts

16. Following Federation, Victoria continued to be the most innovative Australian jurisdiction in terms of corporate law reform. A series of *Companies Acts* were passed in Victoria in 1910, 1915, 1929 and 1938.[23]

17. In 1958, the *Companies Act 1958* (Vic) was enacted. It contained a number of provisions that were 'innovative, progressive and in some cases controversial',[24] including the introduction of statutory directors' duties. The resultant 'great disparity' between company law in Victoria and other states and territories[25] coincided with an appetite for greater uniformity in company law across the different Australian jurisdictions.

21 *New South Wales v Commonwealth* (2006) 229 CLR 1 [179]–[181].
22 For example, the establishment of the now-defunct Australian Coastal Shipping Commission, a Commonwealth statutory corporation, was held to be incidental to the execution of powers conferred by ss 51(i) and 98 of the *Australian Constitution*: *Australian Coastal Shipping Commission v O'Reilly* (1962) 107 CLR 46, 54.
23 Barrett (n 7) 145.
24 Ibid 148.
25 HAJ Ford, 'Uniform Companies Legislation' (1962) 4(2) *University of Queensland Law Journal* 133, 134.

18. Nonetheless, following unsuccessful referenda in 1913 and 1919,[26] and Commonwealth reticence to enact a federal statute under existing heads of power,[27] the 'attainment of a uniform company statute … awaited the securing of agreement by various States and Territories to enact parallel legislation'.[28] While there was a recognition of the benefits of uniformity, there remained an inability to achieve this unless the states and territories themselves took action.

19. Legislation based on a draft Bill prepared following meetings between Commonwealth, state, and territory governments was enacted between 1961 and 1963.[29] While a 'remarkable achievement',[30] from the 'very beginning, there was only partial uniformity' as the legislation of each jurisdiction was 'not in fact identical'.[31]

20. Legislative changes following the recommendations of the Eggleston Committee in 1967 lessened the uniformity between the different jurisdictions. Further divergence came with enactment of the Securities Industry Acts in 1970. In Dr Austin's view, the fact the Uniform Companies Acts could not achieve total uniformity 'signalled the impossibility of national uniformity as long as each State was separately in charge of its law reform agenda'.[32]

Corporate and securities regulation in the 1970s

21. The work of the Eggleston Committee, together with allegations of misconduct during the minerals and markets boom of 1969–70, led New South Wales, Victoria, Western Australia and Queensland to enact the Securities Industry Acts.[33] The first of these was the *Securities Industry Act 1970* (NSW).[34] These Acts were 'not identical and this lack of consistency was criticised by the Rae Committee',[35] which had been set up to investigate the events of the minerals and markets boom. Revised legislation, marked by greater uniformity, was enacted by these states in 1975.[36] Futures regulation came later in the decade, with the enactment of the *Futures Market Act 1979* (NSW).[37]

22. During this period the state and territory corporate regulators evolved into 'Commissioners for Corporate Affairs' or 'Corporate Affairs Commissions'.[38] These agencies remained state and territory-based. The Eggleston Committee had recommended the establishment of a national companies commission,[39] and recommendations for a federal securities regulator were again made in 1974 by the Rae Committee.[40]

26 Barrett (n 7) 147.
27 Ford (n 25) 134.
28 HAJ Ford, 'Uniform Companies Legislation: Its Effect in Victoria' (1962) 3(4) *Melbourne University Law Review* 461, 462. See also Barrett (n 7) 148–52.
29 Geoffrey Sawer, 'Federal-State Co-operation in Law Reform: Lessons of the Australian Uniform Companies Act' (1963) 4(2) *Melbourne University Law Review* 238, 238.
30 Ibid 239.
31 Barrett (n 7) 152. See also RP Austin, 'Corporate Law Reform: Some Reflections on the Reform Experience of the Last 30 Years' (Paper, Corporate Law Teachers Association Conference, 7–9 February 2021) 7.
32 Austin (n 31) 7.
33 Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis Butterworths, 10th ed, 2021) [1.42].
34 Ibid.
35 Ibid. See also R Baxt, HAJ Ford and GJ Samuel, *An Introduction to the Securities Industry Acts* (Butterworths, 1977) 26.
36 Baxt, Ford and Samuel (n 35) 26; Black and Hanrahan (n 33) [1.42].
37 Black and Hanrahan (n 33) [1.44]. Before this, futures were regulated through self-regulation of members of the exchange: see Remo Giuffre, 'Regulation of the Commodity Futures Market in Australia' (1982) 5(1) *UNSW Law Journal* 170, 174.
38 HAJ Ford, RP Austin and IM Ramsay, *Ford's Principles of Corporations Law* (Butterworths, 9th ed, 1999) [2.180].
39 Bernard Mees and Ian Ramsay, 'Corporate Regulators in Australia (1961–2000): From Companies' Registrars to ASIC' (2008) 43(3) *Australian Journal of Corporate Law* 212, 215.
40 Ibid 217.

23. The Whitlam Government had attempted to achieve uniformity in regulation through its Corporations and Securities Industry Bill and National Companies Bill, but neither of these were enacted before the dismissal of the Prime Minister in 1975.[41]

24. The governments of New South Wales, Victoria and Queensland did, however, come together in 1974 to form the Interstate Corporate Affairs Commission ('ICAC'). Despite this platform for cooperation between these states in relation to corporate regulation, regulatory powers remained vested in state corporate affairs commissions.[42] In the view of Mees and Ramsay, 'ICAC was misbegotten … and born largely powerless'.[43]

The advent of co-operative legislative schemes

The first co-operative scheme

25. In December 1978, an agreement was reached between the Commonwealth and the states and territories to establish a co-operative scheme for corporations and securities legislation. To implement this agreement, the Commonwealth and the states passed mirroring legislation,[44] leading to a Companies Code in each state that was consistent with the Commonwealth legislation.[45] This legislation 'was essentially a consolidation of the earlier companies legislation with some reforms drawn from the National Companies Bill'.[46]

26. This first co-operative scheme also included the enactment of the *Securities Industry Act 1980* (Cth), which was subsequently applied by state and territory legislation. This resulted in a series of Securities Industry Codes.[47] The Securities Industry Codes regulated the formation and operation of stock exchanges, the licensing and conduct of securities dealers and investment advisers, and imposed prohibitions on market misconduct.[48] Other aspects of securities regulation, such as the regulation of disclosure on public offerings, was found in the Companies Codes.[49] These Codes were followed by the *Futures Industry Act 1986* (Cth),[50] with mirroring state and territory Futures Industry Codes.[51]

27. By the latter part of the 1980s, there was a harmonised complex of statutory regimes, based upon regulation of companies, securities and futures. This coincided with the formation of the ASX in 1987, following a merger of separate state stock exchanges.[52]

28. Under the *Securities Industry Act 1980* (Cth), the definition of 'securities' included: products such as debentures, stocks, shares, bonds or notes; options contracts within the scope of the legislation; and prescribed interests. The definition of 'securities' did not include bills of exchange, futures contracts, promissory notes, or certificates of deposit

41 Ford, Austin and Ramsay (n 38) [2.190].
42 Mees and Ramsay (n 39) 216.
43 Ibid.
44 The Commonwealth legislation consisted of the *Companies Act 1981* (Cth) and the *Companies (Acquisition of Shares) Act 1981* (Cth), which were passed as laws of the Australian Capital Territory under s 122 of the *Australian Constitution*.
45 Ford, Austin and Ramsay (n 38) [2.210].
46 Ibid.
47 Robert Baxt, Christopher Maxwell and Selwyn Bajada, *Stock Markets and the Securities Industry: Law and Practice* (Butterworths, 3rd ed, 1988) 24.
48 R Baxt et al, *An Introduction to the Securities Industry Codes* (Butterworths, 2nd ed, 1982) 3.
49 Ibid 2.
50 Black and Hanrahan (n 33) [1.44].
51 Paul Latimer, 'Futures Market Regulation in Australia: What is it Trying to Achieve?' (1990) 13(2) *UNSW Law Journal* 370, 371.
52 Mees and Ramsay (n 39) 236.

issued by a bank, such that the regulatory regime did not apply to those products.[53] The *Futures Industry Act 1986* (Cth) adopted a 'wide definition' of a 'futures contract'.[54] It included commodities and adjustment agreements, together with futures options and prescribed exchange-traded options. Interest and currency swaps, and forward exchange and interest rate contracts to which banks or merchant banks were a party, were excluded, however.[55]

29. Perhaps most significantly, the co-operative scheme also established the National Companies and Securities Commission ('NCSC'), which was supervised by a council of ministers.[56] It was established by the *National Companies and Securities Commission Act 1979* (Cth) and 'for the most part acted as a national regulator of takeovers and markets'.[57] However, its investigative and enforcement powers were limited[58] and many routine functions of the NCSC were delegated to state regulators, which continued to operate.[59] Mees and Ramsay describe the NCSC as 'very much an expanded ICAC, rather than a fully national body'.[60] The Hon Justice Barrett has described the NCSC as follows:

> This was, in concept and on paper, a truly national regulator. But the state agencies continued and many of the functions of the national body were performed by those agencies as delegates under a structure that proved unwieldy and produced dispute and friction about demarcation and administrative matters.[61]

30. The NCSC's role in relation to broader securities and financial services regulation did expand with the economic reforms that occurred later in the 1980s, following the Hawke Government's adoption of the recommendations of the Campbell Committee. The Campbell Committee had been established by the predecessor Fraser Government, and tasked with an inquiry into the Australian financial system as regulated by the co-operative scheme.[62]

31. The Insurance and Superannuation Commission was also established in 1987.[63] Insurance, other than State insurance, had been regulated by Commonwealth legislation for some time through laws passed under s 51(xiv) of the *Australian Constitution*.[64] At the time the Commission was established, relevant legislation included:

- the *Insurance Act 1973* (Cth) and *Life Insurance Act 1945* (Cth), which regulated 'entrance into the insurance industry';[65] and
- the *Insurance (Agents and Brokers) Act 1984* (Cth), which regulated insurance intermediaries.

53 *Securities Industry Act 1980* (Cth) s 4(1).
54 Explanatory Memorandum, Futures Industry Bill 1986 (Cth) [12].
55 *Futures Industry Act 1986* (Cth) s 4.
56 Ford, Austin and Ramsay (n 38) [2.210].
57 Black and Hanrahan (n 33) [1.47].
58 Mees and Ramsay (n 39) 227–8.
59 Ford, Austin and Ramsay (n 38) [2.210].
60 Mees and Ramsay (n 39) 227.
61 Barrett (n 7) 157.
62 Mees and Ramsay (n 39) 231.
63 Ibid 236.
64 Frank Marks and Audrey Balla, *Guidebook to Insurance Law in Australia* (CCH Australia, 3rd ed, 1988) 4–5.
65 Ibid. The *Life Insurance Act 1945* (Cth) was later replaced by the *Life Insurance Act 1995* (Cth). Insurance contracts were, and continue to be, governed by the *Insurance Contracts Act 1984* (Cth) and *Marine Insurance Act 1909* (Cth).

The Corporations Law

32. In 1988, following pressures on the existing co-operative scheme during the 1980s,[66] the Joint Select Committee on Corporations recommended that the Commonwealth enact 'comprehensive legislation covering company law, takeovers, and the securities and futures industries'.[67] The Hawke Government, believing that such legislation was likely to be constitutional,[68] enacted the *Corporations Act 1989* (Cth), the *Close Corporations Act 1989* (Cth), and the *Australian Securities Commission Act 1989* (Cth).

33. New South Wales, South Australia, and Western Australia challenged the constitutionality of the 1989 legislation. In *New South Wales v Commonwealth* ('the *Incorporation Case*'),[69] the High Court held that s 51(xx) of the *Australian Constitution* does not empower the Commonwealth Parliament to legislate for the incorporation of corporations. The Hon Justice Black and Professor Hanrahan have observed that the effect of that decision was that 'comprehensive nationwide companies and securities legislation was impossible without co-operation between the Commonwealth and the states'.[70]

34. The *Incorporation Case* led to an agreement between the Commonwealth and the states and territories reached in 1990 at Alice Springs. This established a new co-operative scheme, whereby the 1989 legislation was amended by the *Corporations Amendment Act 1990* (Cth) such that it applied in the Australian Capital Territory, with the states and Northern Territory then enacting legislation applying the 1989 legislation 'as if it were a law of the Commonwealth' so as to form what appeared to be a single national Corporations Law.[71]

35. As Austin explains, the new co-operative scheme:

> again [relied] on State as well as Commonwealth legislative power, but the new scheme would seek to clothe the regulatory system with Commonwealth features, including a truly national Commission, cross-vested jurisdiction for the Federal Court, and Commonwealth administrative law.[72]

36. A significant feature of the new scheme was the creation of the Australian Securities Commission ('ASC'),[73] the predecessor to the Australian Securities and Investments Commission ('ASIC'). For the first time, it was the sole regulator — it did not operate in conjunction with state and territory regulators,[74] and so could establish consistency nationally in its approach to regulation.[75] Among other developments, the ASC established a 'national companies database',[76] conducted a number of significant investigations, and placed a 'markedly new emphasis … on consumer protection and lodgement compliance'.[77]

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66 Austin (n 31) 12.
67 Corcoran (n 14) 150.
68 Black and Hanrahan (n 33) [1.48].
69 *New South Wales v Commonwealth* (n 17).
70 Black and Hanrahan (n 33) [1.48].
71 Ibid. Although, 'there were really eight Corporations Laws in force in Australia, one for the Australian Capital Territory, one for each of the six states and one for the Northern Territory': Ibid [1.49].
72 Austin (n 31) 13.
73 For a history of the ASC, see Mees and Ramsay (n 39) 240–251.
74 Black and Hanrahan (n 33) [1.48].
75 Mees and Ramsay (n 39) 239.
76 Ibid 243.
77 Ibid 244.

37. Another novel aspect of the Corporations Law was its use of cross-vesting in an attempt to enable the Federal Court of Australia ('Federal Court') and state courts to determine matters under the Corporations Law.[78] The purported conferral of state jurisdiction on the Federal Court[79] would ultimately prove fatal to the Corporations Law scheme.

Securities and futures regulation under the Corporations Law

38. With the establishment of the Corporations Law, regulation of securities and futures markets (and related intermediaries) was brought fully within the omnibus statute for corporate regulation. Other financial products, such as superannuation and insurance, remained wholly outside these regulatory statutes.[80] Securities regulation was situated in Chapter 7 of the Corporations Law and futures regulation was found in Chapter 8. The regulatory regime that applied depended on whether a financial product came within the definition of 'securities' or a 'futures contract'. [81] The division between both concepts was similar to that achieved under the predecessor scheme.

39. As the Corporations Law continued to operate into the 1990s, however, the utility of this distinction between securities and futures regulation began to break down:

> The current regulation of securities and futures markets has not adequately accommodated market developments or financial innovation. The definition of 'futures contract' is widely acknowledged as unsatisfactory and the distinction between securities and futures is challenged by innovative financial products which exhibit characteristics of both types of instruments.[82]

The reforms of the 1990s

40. The 1990s were a pivotal decade for corporate and financial services regulation in Australia. The reforms of the 1990s occurred through two interconnected channels: first, the increasing federalisation of corporations and securities regulation, together with the establishment of ASIC; and secondly, the construction of the contemporary system of Australian financial regulation following the Financial System Inquiry chaired by Stan Wallis ('Wallis Inquiry'). The enactment of these reforms was affected by the constraints of the constitutional framework, and the need to overcome constitutional limits on Commonwealth legislative competence had a strong influence on the shape of the legislative architecture.

41. Reforms to the Corporations Law during the 1990s included:

- the *Corporations Legislation Amendment Act 1991* (Cth) (insider trading);
- the *Corporate Law Reform Act 1992* (Cth) (benefits to directors of public companies and related parties, voluntary administration, insolvent trading, and voidable transactions);
- the *Corporate Law Reform Act 1994* (Cth) (indemnification of directors and disclosure);

78 Black and Hanrahan (n 33) [1.50].
79 See Cheryl Saunders, 'In the Shadow of Re Wakim' (1999) 17(8) *Company and Securities Law Journal* 507, 507.
80 Department of the Treasury (Cth), *Financial Markets and Investment Products* (Corporate Law Economic Reform Program, Proposals for Reform: Paper No 6, 1997) 22.
81 See *Corporations Law* ss 72, 92.
82 Department of the Treasury (Cth) (n 80) 34.

- the *First Corporate Law Simplification Act 1995* (Cth) (simplified drafting, share buy-backs, proprietary companies, and simplified company registers);
- the *Company Law Review Act 1998* (Cth) (simplified drafting, incorporation, particular corporate structures, meetings, par value shares, and reductions in capital); and
- the *Managed Investments Act 1998* (Cth) (collective investment schemes).[83]

42. A particularly significant change was brought about by the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth), which enacted significant consumer protection reforms. These are discussed in [57] below.

The role of law reform and advisory bodies

43. Corporate law reforms in the 1990s were marked by the significant role played by law reform and advisory bodies, both generalist and specialist.

44. The first of these was the Corporations and Securities Advisory Committee ('CASAC'). The original such body, the Companies and Securities Law Review Committee ('CSLRC') had been established in 1978 in the context of the first co-operative scheme.[84] Following the establishment of the Corporations Law, the CSLRC was eventually replaced by CASAC.[85]

45. In 2002, with the enactment of the *FSR Act*, CASAC became the Corporations and Markets Advisory Committee ('CAMAC').[86] It continued to produce a range of reports,[87] until it was defunded in 2014 and formally abolished in 2018.[88] Like its predecessor, CAMAC 'provided a source of independent advice to the responsible Minister on the administration of the relevant laws or changes to them'.[89] It focused on 'substantive questions of law'.[90]

46. While CASAC worked on substantive law reform in the 1990s, the Corporate Law Simplification Program, established within the Attorney-General's Department (Cth) was engaged in 'clarifying and simplifying the way the law was expressed'.[91]

47. The *First Corporate Law Simplification Act 1995* (Cth) was a product of the work of the Corporate Law Simplification Program.[92]

48. In 1996, the Australian Government replaced the Corporate Law Simplification Program with the Corporate Law Economic Reform Program ('CLERP'), which was overseen by the Department of the Treasury (Cth) ('Treasury').[93]

49. The ALRC also had a role in the corporate law reforms of the 1990s, collaborating with CASAC on the law reform report that led to the enactment of the *Managed Investments*

83 Ford, Austin and Ramsay (n 38) [2.291].
84 Ian Ramsay, 'A History of the Corporations and Markets Advisory Committee and Its Predecessors' in Pamela Hanrahan and Ashley Black (eds), *Contemporary Issues in Corporate and Competition Law: Essays in Honour of Professor Robert Baxt AO* (LexisNexis Butterworths, 2019) 56, 57.
85 Ibid 59.
86 Ibid 60.
87 See Ibid 69–70.
88 Ibid 67–69.
89 Ibid 60.
90 Austin (n 31) 15.
91 Ibid.
92 Ian Govey, 'Corporate Law Simplification Program: Progress to Date, Objectives, and Forward Plans' (Speech, Sydney, 28 March 1996). See also Explanatory Memorandum, First Corporate Law Simplification Bill 1995 (Cth) [1.3].
93 Austin (n 31) 15.

Act 1998 (Cth).[94] Corporate insolvency law reforms enacted in the 1990s were also the product of an ALRC report.[95]

The Wallis Inquiry

50. Concurrently with its reforms to corporate law, the Australian Government established the Wallis Inquiry in 1996. In establishing the Inquiry, the then-Treasurer, the Hon Peter Costello MP, explained:

> The Inquiry is charged with providing a stocktake of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The forces driving further change will be analysed, in particular, technological development. Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.[96]

51. By 1996, it had been observed that:

> Financial markets have been transformed over the past two decades by three key developments. Firstly, the dismantling of barriers to international capital flows and the process of globalisation have resulted in a massively increased volume of cross-border financial transactions. Secondly, the functional integration of hitherto discrete areas of financial activity has led to the emergence of financial conglomerates combining traditional banking with securities operations and other non-bank business. Finally, financial innovation has produced a vast new market in derivative products that simply did not exist 15 years ago.[97]

52. When it reported in 1997, the Wallis Inquiry made 115 recommendations. Among those most relevant for present purposes were recommendations:

- to establish a single Commonwealth agency for each of conduct regulation and prudential regulation in the financial system[98] (described by some commentators as a 'functionally-based model' of financial regulation, rather than an 'institutional' or 'integrated' model);[99]
- to impose prudential regulation on deposit taking, insurance, and superannuation;[100]
- to establish a single regulator for prudential regulation that is separate from the Reserve Bank of Australia,[101] with the Reserve Bank to retain responsibility for monetary policy, systemic stability, and payments system regulation;[102]
- to establish a single regulator for 'corporations, financial market integrity and consumer protection' through combining the functions of the Australian Securities Commission, the Insurance and Superannuation Commission and the Australian Payments System Council;[103]

94 Australian Law Reform Commission and Companies and Securities Advisory Committee, *Collective Investments: Other People's Money* (ALRC Report No 65, 1993). Both the ALRC and CASAC also collaborated on a report relating to superannuation: Australian Law Reform Commission and Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (ALRC Report No 59, 1992).
95 Australian Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 1988).
96 Wallis et al (n 1) vii.
97 Richard Dale, 'Regulating the New Financial Markets' (Paper, Reserve Bank of Australia Conference, 1996).
98 Wallis et al (n 1) recs 1, 31–2.
99 For a discussion of functionally-based, institutional, and integrated models, see Andrew Godwin and Ian Ramsay, 'Twin Peaks — The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) 26(4) *Journal of Banking and Finance Law and Practice* 240, 240.
100 Wallis et al (n 1) rec 30.
101 Ibid recs 31–32. 31–2.
102 Ibid 26.
103 Ibid rec 1.

- that the single regulator for corporations, financial market integrity, and consumer protection 'should administer all consumer protection laws for financial services';[104]
- to adopt 'a single regime to license advisers providing investment advice and dealing in financial markets';[105]
- to introduce 'a single set of requirements for investment sales and advice';[106]
- to introduce 'consistent and comparable' disclosure requirements;[107]
- to 'replace existing separate *Corporations Law* regulation of securities and futures contracts' with 'a broad definition of "financial products" subject to generic requirements and supplemented by specific regulation for particular classes of products';[108] and
- that the states and territories should retain responsibility for consumer credit laws, subject to a review of the Uniform Consumer Credit Code after it had been in operation for two years.[109]

Implementation of Twin Peaks: The creation of APRA and ASIC

53. A central recommendation of the Wallis Inquiry was the separation of prudential and conduct regulation through the 'Twin Peaks' model.[110] The distinction between prudential and conduct regulation is significant. Prudential regulation is concerned with 'financial safety', while conduct regulation is concerned with 'the conduct and disclosure obligations of issuers and financial intermediaries, and the integrity of financial markets'.[111] Due to evolution in the concept of prudential regulation over time, however, there has been more of a blurring between the two forms of regulation.[112]

54. The Australian implementation of the model has been summarised by Dr Godwin, Professor Ramsay and Dr Schmulow as follows:

> The Twin Peaks model was pioneered in Australia following recommendations by the Wallis Inquiry, which was established in 1996 to review the financial system. The model separates financial regulation into two broad functions: market conduct regulation (which includes consumer protection) and prudential regulation. Each of these functions is vested in a separate regulator. In Australia, market conduct regulation is vested in the Australian Securities and Investments Commission (ASIC) and prudential regulation is vested in the Australian Prudential Regulation Authority (APRA). The central bank, the Reserve Bank of Australia (RBA), remains responsible for monetary policy and financial stability, including ensuring a safe and reliable payments system.[113]

104 Ibid rec 3.
105 Ibid rec 13.
106 Ibid rec 15.
107 Ibid rec 8.
108 Ibid rec 19.
109 Ibid rec 6. See further [90] below.
110 For a description of the Wallis Inquiry's consideration of the Twin Peaks model, see Michael Taylor, 'The Three Episodes of Twin Peaks' in Andrew Godwin and Andrew Schmulow (eds), *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021) 17, 17, 24.
111 Pamela Hanrahan, 'Twin Peaks after Hayne: Tensions and Trade-Offs in Regulatory Architecture' (2019) 13(2–3) *Law and Financial Markets Review* 124, 124.
112 See Gail Pearson, 'Twin Peaks and Boiling Frogs: Consumer Protection in One or Two Ponds?' in Andrew Godwin and Andrew Schmulow (eds), *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021) 305; M Scott Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (2020) 31(1) *Journal of Banking and Finance Law and Practice* 51; Cindy Davies, Samuel Walpole and Gail Pearson, 'Australia's Licensing Regimes for Financial Services, Credit, and Superannuation: Three Tracks toward the Twin Peaks' (2021) 38(5) *Company and Securities Law Journal* 332.
113 Andrew Godwin, Ian Ramsay and Andrew Schmulow, 'Twin Peaks in Australia: The Never-Ending Trek?' in Andrew Godwin and Andrew Schmulow (eds), *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021) 71, 71.

55. Under the model, the Australian Competition and Consumer Commission ('ACCC') retained responsibility for the regulation of competition in the financial system.[114] A key aspect of the reforms involved the abolition of the Insurance and Superannuation Commission and its functions being split between the Australian Prudential Regulatory Authority ('APRA') and ASIC.

56. APRA was established by the *Australian Prudential Regulatory Authority Act 1998* (Cth). Dr Carmichael has explained that:

> In total, nine existing agencies were combined to form APRA. At APRA's core were the banking regulators previously located in the RBA, and the insurance and pension regulators previously located in the Insurance and Superannuation Commission (ISC).[115]

57. Through the enactment of the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth), the ASC was transformed into ASIC through amendments to the *Australian Securities Commission Act 1989* (Cth). The Act itself was renamed the *Australian Securities and Investments Commission Act 1989* (Cth). As the then-Treasurer explained in his Second Reading Speech:

> Responsibility for consumer protection and market integrity vested in a single entity will enable ASIC to adopt a functional and objective-based regulatory approach, thereby promoting competitive neutrality and permitting better comparability by consumers of different financial products and services. The amalgamation of consumer protection functions in a single regulator is supported by industry and consumer groups. There will, of course, be close co-operation between ASIC and the Australian Competition and Consumer Commission.
>
> The functions relating to insurance and superannuation were previously exercised by the Insurance and Superannuation Commissioner, a position which will be abolished with the commencement of this bill. The consumer protection functions relating to aspects of banking and the payments system were previously exercised by the Australian Payments System Council, which is also to be disbanded.[116]

58. Importantly, the reforms establishing APRA and ASIC did not effect significant change in the substantive law applying to the financial system. This was to come later through the work of CLERP.[117]

59. Implementing the 'Twin Peaks' model has not been without difficulties,[118] including in establishing boundaries between prudential and conduct regulation.[119] This has been particularly acute in relation to superannuation.[120]

Reforms to consumer protection legislation

60. The establishment of ASIC as the single regulator for consumer protection in relation to financial services necessitated reforms to the federal consumer protection legislation. Prior to the transformation of the ASC into ASIC in 1998, the ACCC had enforced the applicable general consumer protection provisions of the *Trade Practices Act 1974* (Cth) in relation to financial products and services.

114 Jeffrey Carmichael, 'Reflections on Twenty Years of Regulation under Twin Peaks' in Andrew Godwin and Andrew Schmulow (eds), *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021) 32, 35.
115 Ibid.
116 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 March 1998, 1653 (The Hon Peter Costello MP).
117 Ibid.
118 See Carmichael (n 114) 39–44.
119 Ibid 50; Pearson (n 112).
120 See Donald (n 112); Davies, Walpole and Pearson (n 112) 336–40.

61. ASIC became responsible for the consumer protection provisions that were inserted into the *Australian Securities and Investments Commission Act 1989* (Cth) as Part 2 Div 2 of that Act.[121] The *Trade Practices Act 1974* (Cth) was amended to provide that the cognate consumer protection provisions it contained did not apply to a 'financial product' or 'financial service' within the meaning of the *Australian Securities and Investments Commission Act 1989* (Cth).[122]

62. The consumer protection provisions inserted into the *Australian Securities and Investments Commission Act 1989* (Cth) were carried over into Part 2 Div 2 of the *Australian and Investments Commission Act 2001* (Cth) ('*ASIC Act*') when it was enacted, and the provisions excluding financial products and services from the *Trade Practices Act 1974* (Cth) have been carried over into the *Australian Consumer Law*, contained in Schedule 2 to the *Competition and Consumer Act 2010* (Cth).[123]

Proposals for financial product and services regulatory reform — CLERP6

CLERP6 Proposals Paper

63. Following the Wallis Inquiry, CLERP was tasked with dealing with the Wallis Inquiry's recommendations relating to the substantive law governing the regulation of financial products and services.[124] In December 1997, CLERP released a Proposals Paper that aimed to 'identify the objectives of financial market regulation and propose a flexible, forward looking regulatory regime to satisfy those objectives'.[125]

64. In the Proposals Paper, CLERP observed that the 'current regulatory framework has been criticised for failing to keep pace with market developments and modern commercial practices'.[126] It also noted the change that had occurred in the financial system since the Corporations Law framework was developed, due to technological developments, globalisation, increased competition, and increased retail investment.[127]

65. CLERP indicated that its proposed new regulatory regime was based upon:

- providing comparable regulation of all financial products, including securities, derivatives, superannuation, life and general insurance and bank-deposit products;
- licensing financial markets and providing consistent and comparable regulation for similar financial products;
- licensing all financial intermediaries and imposing harmonised statutory obligations designed to protect retail investors; and
- ensuring that 'promoters' or issuers of financial products provide comprehensible disclosure documents which assist investors to make informed decisions.[128]

66. The Proposals Paper made nine proposals, including for the:

- introduction of a uniform and integrated regulatory framework for financial instruments to provide 'consistent regulation of functionally similar markets and products';[129]

121 Those provisions were inserted by the *Financial Sector Reform (Consequential Amendments) Act 1998* (Cth) sch 2.
122 Ibid sch 2 pt 2 items 26, 27.
123 *Competition and Consumer Act 2010* (Cth) s 131A.
124 Department of the Treasury (Cth) (n 80) 8.
125 Ibid.
126 Ibid 7.
127 Ibid.
128 Ibid 10.
129 Ibid Proposal 1.

- introduction of a new regulatory framework under which persons would be 'prohibited from conducting a market in financial instruments or providing financial intermediary services unless they hold an appropriately endorsed financial markets licence';[130]
- introduction of a requirement to hold a licence to operate a market;[131]
- introduction of a requirement to hold a licence to 'operate a clearing and settlement facility where the clearing and settlement services are not conducted by a licensed market operator';[132]
- introduction of a single licensing regime for 'financial market dealers and advisers';[133]
- imposition of statutory obligations on 'intermediaries in relation to their dealings with retail investors', including requirements relating to risks and benefits disclosure, pressure sales, and complaints and dispute resolution;[134]
- development of a 'consistent and comparable disclosure regime for all financial instruments';[135]
- harmonisation of the market misconduct provisions of the Corporations Law, including those relating to insider trading and market manipulation, together with harmonisation of the rules relating to misconduct by financial advisers and dealers;[136] and
- division of responsibility for components of the new regulatory regime between the Treasurer and the corporations and markets regulator (for which it provided two options).[137]

CLERP6 Consultation Paper

67. In March 1999, CLERP released a Consultation Paper that built upon the Proposals Paper from 1997, in preparation for the intended release of draft legislation in mid-1999.[138] The Consultation Paper addressed the uniform regulation of financial products, licensing of financial service providers, financial service provider conduct and disclosure, financial product disclosure, codes of conduct, licensing of financial product markets, licensing of clearing and settlement facilities, compensation arrangements, transfer of securities, and misconduct.[139]

68. Black and Hanrahan have identified 'two particular significant matters' addressed in the Consultation Paper:

> First, it proposed a broad, functional definition of 'financial product'. Second, it extended the reach of the reform proposals specifically into wholesale markets.[140]

69. The definition of 'financial product' that was put forward in the Consultation Paper involved a '[b]road functional definition outlining the key features of all financial products',

130 Ibid Proposal 2.
131 Ibid Proposal 3.
132 Ibid Proposal 4.
133 Ibid Proposal 5.
134 Ibid Proposal 6.
135 Ibid Proposal 7.
136 Ibid Proposal 8.
137 Ibid Proposal 9.
138 Department of the Treasury (Cth), *Financial Products, Service Providers and Markets — An Integrated Framework* (Corporate Law Economic Reform Program, Implementing CLERP 6: Consultation Paper, 1999) 1.
139 Ibid 3–7.
140 Black and Hanrahan (n 33) [1.58].

together with lists of specific inclusions and exclusions, and a power to include and exclude particular products by regulation.[141]

Corporate law reform — CLERP Act 1999 (Cth)

70. CLERP was far from limited to reform of the legislative framework for financial product and services regulation. It also sought to reform corporate regulation, resulting in the *Corporate Law Economic Reform Program Act 1999* (Cth) ('*CLERP Act*').[142] Austin has explained that:

> The CLERP Act restated and purportedly simplified the statutory provisions regarding the duties of directors and officers, related party transactions, oppression and derivative actions, takeovers, prospectuses and civil liability. The changes were substantive, particularly in the takeovers and prospectus areas. They were important particularly because, although there have been further statutory amendments, the shape of our modern statutory corporate law in these areas was basically settled by the CLERP Act.[143]

Constitutional impediments to federalisation

71. While significant reform to both corporate and financial regulation and the regulators had taken place over the course of the 1990s, the underlying framework remained that of the Corporations Law. This included the purported cross-vesting of state jurisdiction in the Federal Court.

72. Following nearly a century of steps designed to overcome constitutional limitations in order to achieve federalisation of corporations and financial services regulation, and with significant reforms to financial services regulation on the horizon, the question of the constitutionality of the Corporations Law once again came to the fore. As can be seen from the timeline set out in Appendix A, these constitutional issues arose during, and temporarily stalled, the reform process initiated by the Wallis Inquiry.

Constitutional challenges

Re Wakim

73. In an appeal arising from a bankruptcy matter, a majority of the High Court in *Re Wakim; Ex parte McNally*[144] ('*Re Wakim*') in June 1999 held that the *Australian Constitution* prohibited the conferral of state jurisdiction on a federal court. This brought about a 'demolition'[145] of this critical part of the cross-vesting scheme. The cross-vesting scheme upon which the Corporations Law relied was invalid.

R v Hughes

74. After *Re Wakim*, further 'constitutional uncertainty dogged' the Corporations Law.[146] R v *Hughes*, which was decided by the High Court in May 2000, concerned a challenge to whether it was constitutionally permissible for the Commonwealth Director of Public Prosecutions ('CDPP') to prosecute a person for an offence against the *Corporations Law*

141 Department of the Treasury (Cth) (n 138) 10.
142 For a summary of the changes made by the 'CLERP Act', see HAJ Ford, RP Austin and IM Ramsay, *An Introduction to the CLERP Act 1999: Australia's New Company Law* (Butterworths, 2000) [1.2].
143 Austin (n 31) 16.
144 *Re Wakim; Ex parte McNally* (1999) 198 CLR 511.
145 See The Hon Chief Justice JLB Allsop AO, *The Role and Future of the Federal Court within the Australian Judicial System* (Paper, 40th Anniversary of the Federal Court of Australia Conference, Sydney, 8 September 2017).
146 LexisNexis, *Australian Corporations Law Legislation*, 'Introduction to the 2001 National Corporations Legislation' [1.030].

(WA) in relation to offering overseas investment prescribed interests.[147] While the High Court upheld the federal law permitting the CDPP to perform functions conferred under West Australian law on the basis that it was supported by the trade and commerce and external affairs powers in ss 51(i) and (xxix) of the *Australian Constitution*,[148] there was resultant uncertainty as to the power of ASIC and the CDPP to exercise other powers under the Corporations Law enacted by each state.

75. Justice Kirby observed that:

> The accused's arguments thus present a challenge to the scheme adopted for the regulation of corporations in Australia, of which the *Corporations Law* is the centrepiece. Unless the offences provided in the *Corporations Law* are valid and may be the subject of prosecution in Western Australia by the Commonwealth DPP, the legislative and administrative scheme for the regulation of corporations in Australia would collapse. Without enforceability, the *Corporations Law* would be no more than a pious aspiration.[149]

76. Justice Kirby emphasised the 'national importance of the legislation under scrutiny'[150] and how the *Incorporation Case* had resulted in 'the grotesque complications that exist in the regulation of corporations under Australian law'.[151] His Honour also hoped that the High Court's decisions 'together with the great national importance of the subject matter of the legislation [would] encourage its early reconsideration and the adoption of a simpler constitutional foundation'.[152]

State referrals as a solution

77. Following *Re Wakim* and *R v Hughes*, the 'uncertainty over the constitutional validity of the Corporations Law was a matter of significant concern for the Australian business community'.[153]

78. Although the High Court decisions did not themselves invalidate the Corporations Law, many thought they raised sufficient doubt about its validity, such that a more certain constitutional footing was required.[154] Several options were put forward to address the uncertainty, including:

- constitutional amendment by way of a referendum to grant the Commonwealth the necessary power to legislate;
- the unilateral enactment of a Commonwealth corporations law in reliance on the Commonwealth's existing power; or
- a referral of 'matters' from the states to the Commonwealth pursuant to s 51(xxxvii) of the *Australian Constitution*, granting the Commonwealth power to legislate in relation to those matters.[155]

147 *R v Hughes* (2000) 202 CLR 535.
148 Ibid [42] (Gleeson CJ, Gaudron, McHugh, Gummow, Hayne and Callinan JJ).
149 Ibid [51] (Kirby J).
150 Ibid [53].
151 Ibid [58].
152 *R v Hughes* (n 147) [60].
153 Black and Hanrahan (n 33) [1.50].
154 Ian Govey and Hilary Manson, 'Measures to Address Wakim and Hughes: How the Reference of Powers Will Work' (2001) 12(4) *Public Law Review* 254, 257–8.
155 For a discussion of the relative merits of each of these options, see ibid 258–60.

79. On 25 August 2000, the states unanimously agreed to the Commonwealth's preferred option of a referral pursuant to s 51 (xxxvii) of the *Australian Constitution*.[156] Section 51(xxxvii) provides that the Commonwealth Parliament may legislate with respect to

> matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law…

80. The current constitutional framework produced by s 51(xxxvii) of the *Australian Constitution* and the state referrals, and the implications of that framework for potential reform of the corporations and financial services legislation, are discussed further below.[157]

The legislative framework for corporations and financial services

81. Following the state referrals, the *Corporations Act* and *ASIC Act* were enacted by the Commonwealth Parliament and assented to on 28 June 2001. They commenced operation on 15 July 2001. The *Corporations Act* therefore became the latest of several attempts to provide for uniform, national regulation of corporations by the Commonwealth.

82. Section 3 of the *Corporations Act* sets out the constitutional basis for the operation of the Act, which in summary is based on the matters referred by the states pursuant to s 51(xxxvii) of the *Australian Constitution* and any other power that the Commonwealth Parliament has under s 51 of the *Australian Constitution*. Section 4 of the *ASIC Act* performs the same role as s 3 of the *Corporations Act*.

Financial Services Reform Act 2001 (Cth)

83. Following the release of the CLERP6 Consultation Paper in March 1999,[158] an Exposure Draft of the Financial Services Reform Bill 2000 (Cth) ('FSR Bill') was released in February 2000. This was after *Re Wakim* but prior to the handing down of the decision in *R v Hughes*, the subsequent state referrals, and the passage of the *Corporations Act.*

84. The FSR Bill largely implemented the recommendations of the Wallis Inquiry and the proposals of CLERP6. While originally intended to amend the Corporations Law and the *Australian Securities and Investments Commission Act 1989* (Cth), the government subsequently delayed its introduction to Parliament as it considered the implications of *Re Wakim* and *R v Hughes*.[159]

156 The Hon Joe Hockey MP and Hon Daryl Williams MP, *Historic Agreement on Corporations Law* (Media Release, 25 August 2000).
157 See [106]–[181] below.
158 See [67] above.
159 Department of the Parliamentary Library (Cth), *Bills Digest* (Digest No 26 of 2001–02, 21 August 2001) 3; Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.22].

85. The Revised Explanatory Memorandum to the FSR Bill observed that it was 'the culmination of an extensive reform program examining current regulatory requirements applying to the financial services industry'.[160] The FSR Bill would implement the recommendations of the Wallis Inquiry and would

> put in place a competitively neutral regulatory system which benefits participants in the industry by providing more uniform regulation, reducing administrative and compliance costs, and removing unnecessary distinctions between products. In addition, it will give consumers a more consistent framework of consumer protection in which to make their financial decisions. The Bill will therefore facilitate innovation and promote business, while at the same time ensuring adequate levels of consumer protection and market integrity.[161]

86. The FSR Bill was ultimately enacted by the Commonwealth and was assented to on 27 September 2001. It took effect from 11 March 2002 as the *FSR Act*. The *FSR Act* introduced the current Chapter 7 regime into the *Corporations Act* and amended Part 2 Div 2 of the *ASIC Act* to, among other things, amend the defined terms 'financial product' and 'financial service'.

The current framework for financial services regulation

87. The current framework in Chapter 7 of the *Corporations Act* remains that introduced by the *FSR Act* in 2001. That said, Chapter 7 has evolved significantly over the past 20 years. Commonwealth regulation for consumer credit has also subsequently been introduced, as is discussed below.[162]

88. There have also been a number of significant inquiries that have influenced subsequent amendments to the legislative framework for the regulation of corporations and financial services in Australia. These include the work of the Ripoll Committee following the Global Financial Crisis,[163] the Murray Inquiry in 2014,[164] the ASIC Enforcement Review in 2017,[165] and, perhaps most significantly, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. One of the more significant regulatory developments arising out of that Royal Commission has been the changes to the regulation of superannuation.[166]

The (mostly) separate regulation of 'credit'

89. Statutory regulation of the provision of credit has existed for centuries.[167] Despite, or perhaps because of, this history of statutory regulation, credit in Australia has generally been regulated separately from other regulated products.

160 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) (n 149) [1.1].
161 Ibid [1.5].
162 See [96]–[99].
163 The Ripoll Report led to the introduction of the *Future of Financial Advice Reforms*: see Samuel Walpole, M Scott Donald and Rosemary Teele Langford, 'Regulating for Loyalty in the Financial Services Industry' (2021) 38(5) *Company and Securities Law Journal* 355, 362–4.
164 See Black and Hanrahan (n 33) [1.65].
165 See Ibid [1.66].
166 See Donald (n 112); Davies, Walpole and Pearson (n 112).
167 For discussion see, eg, The Hon Justice PDT Applegarth AM, *Credit and Unconscionability — The Rise and Fall of Statutes* (WA Lee Equity Lecture, 19 November 2020).

Uniform Consumer Credit Code

90. For most of the twentieth century, consumer credit regulation was subject to separate regulatory frameworks in each of the states and territories.[168] On 30 July 1993, the Australian states and territories agreed to implement uniform regulation of consumer credit.[169] This was given effect by each state and territory adopting, or enacting equivalent legislation, to the *Consumer Credit Act 1994* (Qld). This Act contained a code which was adopted nationally in 1994 as the Uniform Consumer Credit Code ('UCCC').[170] The UCCC commenced in all states and territories on 1 November 1996, with the exception of Tasmania where some providers were not regulated by the UCCC until March 1997.[171]

91. In 1997, the Wallis Inquiry considered whether responsibility for credit regulation, like other areas of financial services, should be transferred to the Commonwealth. The Wallis Inquiry noted its 'sympathy with calls to shift the jurisdiction of credit laws to the Commonwealth'[172] but, given the UCCC had only been in operation for five months, recommended that:

> The States and Territories should retain responsibility for the *Uniform Consumer Credit Code* (UCCC) and related laws and focus efforts on improving its cost effectiveness and nationwide uniformity. After it has operated for two years, the UCCC should be subject to a comprehensive and independent review to consider what improvements are necessary and whether a transfer to the Commonwealth would be appropriate.[173]

The exclusion of 'credit' from Chapter 7 of the Corporations Act

92. As discussed above,[174] in 1999, the CLERP6 Consultation Paper proposed a 'functional definition' of the term 'financial product'.[175] The definition it proposed included 'a facility or arrangement through which a person … obtains credit'.[176] The Consultation Paper noted that while that aspect of the definition would capture one-off credit arrangements, 'the licensing and conduct and disclosure provisions will not apply to such arrangements unless the service provider is in the business of providing, or advising on, credit'.[177]

93. In line with Recommendation 6 of the Wallis Inquiry, consumer credit covered by the UCCC was to be excluded from the definition of financial product and the regime outlined in the CLERP6 Consultation Paper.[178] While the UCCC only applied to credit for private, domestic or household purposes, the regime proposed in the CLERP6 Consultation Paper would capture all other credit, including credit provided for investment purposes.[179] A number of perceived advantages to bringing credit within the framework of the proposed regime for financial products and services were also set out in the CLERP6 Consultation Paper.[180]

168 Wallis et al (n 1) 254.
169 See Australian Uniform Credit Laws Agreement (30 July 1993).
170 *Consumer Credit Act 1995* (ACT); *Consumer Credit (New South Wales) Act 1995* (NSW); *Consumer Credit (Northern Territory) Act 1995* (NT); *Consumer Credit (South Australia) Act 1995* (SA); *Consumer Credit (Tasmania) Act 1996* (Tas); *Consumer Credit (Victoria) Act 1995* (Vic); *Consumer Credit (Western Australia) Act 1995* (WA).
171 Wallis et al (n 1) 254.
172 Ibid 257.
173 Ibid rec 6.
174 See [68]–[69] above.
175 Department of the Treasury (Cth) (n 138) 10.
176 Ibid.
177 Ibid 12.
178 Ibid.
179 Department of the Treasury (Cth) (n 138).
180 Ibid 126.

94. Ultimately, this approach was not adopted when the *FSR Act* was enacted in 2001. Credit was excluded from the definition of 'financial product' inserted by the *FSR Act* for the purposes of Chapter 7 of the *Corporations Act*. According to the Treasury in 2000, credit was excluded from the *Corporations Act* definition of 'financial product' in light of concerns that:

- during consultation, submissions 'suggested that a compelling case had not been established' and opposed the application of the regime to non-UCCC credit; and
- creating a Commonwealth regime that regulated non-consumer credit alongside the state-based UCCC regime for consumer credit 'would create complexity and opportunities for regulatory arbitrage'.[181]

95. On the other hand, credit continued to be included within the definition of 'financial product' in the *ASIC Act.*[182] This meant that while credit products and related services were excluded from the licensing, conduct and disclosure regime contained in Chapter 7 of the *Corporations Act*, credit was subject to the consumer protection provisions in Part 2 Div 2 of the *ASIC Act*.

Enactment of the National Consumer Credit Protection Act 2009 (Cth)

96. Like the Uniform Companies Acts earlier in the century,[183] the UCCC ultimately came to be criticised for non-uniformity: 'Despite the purpose of the UCCC being to ensure consistent regulation across borders, there was, in reality, no guaranteed consistency between jurisdictions'.[184] This risk had been adverted to by the Wallis Inquiry.[185]

97. In May 2008, a Productivity Commission report recommended that regulatory responsibility for consumer credit should be transferred to the Commonwealth.[186] On 3 June 2008, the Treasury released a Green Paper that recorded that the Council of Australian Governments (COAG) had 'agreed in principle to the Commonwealth assuming responsibility for regulating mortgage credit and advice, including persons and corporations engaged in mortgage broking activities, for the purpose of protecting consumers.'[187] The Green Paper noted that the Commonwealth's 'preferred implementation strategy' was to 'examine whether it had constitutional power to regulate comprehensively in the area of mortgage credit and advice' and that if there were doubt, the Commonwealth would 'explore a referral of power to cover the shortfall in power.'[188]

98. On 3 July 2008, COAG agreed that the Commonwealth would take over responsibility for regulating, among other things, mortgage broking, margin lending, and non-deposit lending institutions and consumer credit.[189] It was anticipated that the new regime would 'introduce licensing, conduct, advice and disclosure requirements'.[190]

181 Department of the Treasury (Cth), *Financial Services Reform Bill: Commentary on the Draft Provisions* (Corporate Law Economic Reform Program, 2000) [1.26].
182 *Australian Securities and Investments Commission Act 2001* (Cth) ss 12BAA, 12BAB.
183 See [16]–[20] above.
184 Department of Parliamentary Services (Cth), *Bills Digest* (Digest No 30 of 2009–10, 15 September 2009) 3.
185 Wallis et al (n 1) 254–5.
186 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Inquiry Report No 45, 2008) rec 5.2.
187 Department of the Treasury (Cth), *Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation* (Green Paper, 2008) 1.
188 Ibid 16.
189 Council of Australian Governments, *Communique 3 July 2008* (Attorney-General's Department (Cth)) 3.
190 Ibid.

99. The Commonwealth Parliament subsequently enacted the *National Consumer Credit Protection Act 2009* (Cth) ('*NCCP Act*'), which was assented to on 15 December 2009. Like the *Corporations Act*, the enactment of the *NCCP Act* depended on a referral of matters from the states to the Commonwealth, discussed in greater detail below.[191]

The continued separation of 'credit'

100. The enactment of the *NCCP Act* reflected a continued legislative preference for the separation of consumer credit regulation from the regulation of other financial products and services.

101. Although it was not canvassed as an option in the Green Paper, it is apparent that the Commonwealth considered incorporating credit regulation into the existing Chapter 7 regime in the *Corporations Act*.[192] From a Regulatory Impact Statement prepared in September 2008 and attached to the Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 (Cth), it appears that incorporating credit into the Chapter 7 regime was at that time the option recommended to the Australian Government.[193] Some consultees also appeared to favour amalgamating credit regulation with the existing Chapter 7 regime. For example, MinterEllison, in a submission to the Senate Economics Legislation Committee's Inquiry into the National Consumer Credit Protection Bill 2009 (Cth), commented that:

> we are not convinced that there is sufficient justification to establish a separate licensing regime under a separate statute. Given the nature of the proposed credit licensing regime, there does not seem any reason not to regulate credit through the Australian financial services licence (AFSL) regime in Chapter 7 of the *Corporations Act 2001* (FSR).[194]

102. The *NCCP Act* is the product of the approach ultimately adopted by the Commonwealth. It does contain a number of provisions bespoke to consumer credit, such as the responsible lending laws. However, the overall structural similarity between the separate financial services and credit licensing regimes, despite some differences in obligations, has continued to be identified.[195] At the same time, other obligations that arise under the *NCCP Act*, such as the best interests obligations of mortgage brokers, appear similar to those of financial advisers under the financial services licensing regime but may be quite different in their actual content.[196]

Exceptions to separation

103. While the enactment of the *NCCP Act* maintained the separation of credit from the Chapter 7 regime, there have been exceptions.

104. The first exception relates to margin lending, which was brought within Chapter 7 of the *Corporations Act* with the enactment of the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* (Cth), pursuant to the COAG Agreement

191 See [117]–[125] below.
192 Department of the Treasury (Cth), Submission No 56 to Senate Economics Legislation Committee, Parliament of Australia, *National Consumer Credit Protection Bill 2009 and Related Bills* (2009) 13; Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) [9.94]–[9.114].
193 Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth)' (n 205) 322 and 390–391.
194 MinterEllison, Submission No 10 to Senate Economics Legislation Committee, Parliament of Australia, *National Consumer Credit Protection Bill 2009 and Related Bills* (17 July 2009) 1.
195 See Davies, Walpole and Pearson (n 112).
196 Walpole, Donald and Teele Langford (n 163) 366–70.

that also led to the enactment of the *NCCP Act*. Prior to this reform, margin lending was not a 'financial product' within the meaning of Chapter 7, and was not subject to ASIC supervision under that regime.[197] Nor was margin lending within the scope of the UCCC, although the consumer protection provisions of the *ASIC Act* did apply to it.[198] It was considered appropriate to bring margin lending within Chapter 7 as 'margin loans are a form of credit widely used to finance acquisitions of investment-related financial products'.[199]

105. The second exception relates to the design and distribution obligations that were inserted into the *Corporations Act* as Part 7.8A in April 2019, and product intervention powers granted to ASIC in Part 7.9A at the same time.[200] Both of these Parts apply to a 'financial product' within the meaning of Part 2 Div 2 of the *ASIC Act* (rather than Part 7.1 Div 3 of the *Corporations Act*), thus encompassing credit products. [201]

The current constitutional framework

106. As discussed above,[202] two decisions of the High Court raised issues that questioned the constitutional foundation of the national Corporations Law scheme.[203] To resolve this uncertainty, the states made a referral of matters to the Commonwealth pursuant to s 51(xxxvii) of the *Australian Constitution*. This section discusses that referral, the subsequent 'credit' referral in 2009–2010, and their implications.

107. When making a reference to the Commonwealth, the states refer 'matters' over which they have legislative capacity, and not state legislative power itself.[204] A state's parliament must pass legislation in order to refer matters to the Commonwealth.[205] A state may also 'adopt' a law pursuant to s 51(xxxvii) after a Commonwealth law has been passed.[206]

The corporations and financial services referral

108. The corporations and financial services referral was given effect by uniform legislation passed by each state parliament that commenced on various dates in 2001, collectively described as the 'Corporations Referral Legislation'.[207] Each state's legislation remains in force and each state is a 'referring State' as that term is defined in s 4 of the *Corporations Act*.

109. The operative provisions of the Corporations Referral Legislation make two references of matters to the Commonwealth. These are defined as the 'initial reference' and the 'amendment reference'.

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197 Department of the Treasury (Cth), Supplementary Submission No 56 to Senate Economics Legislation Committee, Parliament of Australia *National Consumer Credit Protection Bill 2009 and Related Bills* (2009) 2.
198 Ibid.
199 Ibid 3.
200 See *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth).
201 *Corporations Act 2001* (Cth) ss 994A, 1023B.
202 See [73]–[76] above.
203 Govey and Manson (n 154) 255.
204 Andrew Lynch, 'After a Referral: The Amendment and Termination of Commonwealth Laws Relying on s 51(xxxvii)' (2010) 32(3) *Sydney Law Review* 363, 371.
205 *R v Public Vehicles Licensing Appeal Tribunal (Tas); Ex parte Australian National Airways Pty Ltd* (1964) 113 CLR 207, 226.
206 Lynch (n 216) 371.
207 *Corporations (Commonwealth Powers Act) 2001* (NSW); *Corporations (Commonwealth Powers Act) 2001* (Qld); *Corporations (Commonwealth Powers Act) 2001* (SA); *Corporations (Commonwealth Powers Act) 2001* (Tas); *Corporations (Commonwealth Powers Act) 2001* (Vic); *Corporations (Commonwealth Powers Act) 2001* (WA).

110. Under the initial reference, the following matters are referred to the Parliament of the Commonwealth (defined terms in **bold**):

> the matters to which the **referred provisions** relate, but only to the extent of making laws with respect to those matters by including the **referred provisions** in Acts enacted in the terms, or substantially in the terms, of the **tabled text** (including laws containing provisions that authorise the making of **Corporations instruments** that affect the operation of the **Corporations legislation**, otherwise than by **express amendment**).[208]

111. Under the amendment reference, the following matters are referred to the Parliament of the Commonwealth (defined terms in **bold**):

> the matters of the formation of corporations, corporate regulation and the regulation of financial products and services, but only to the extent of the making of laws with respect to those matters by making **express amendments** of the **Corporations legislation** (including laws inserting or amending provisions that authorise the making of **Corporations instruments** that affect the operation of the **Corporations legislation**, otherwise than by **express amendment**).[209]

112. The 'tabled text' upon which the references were premised was the text of the Corporations Bill 2001 (Cth) and Australian Securities and Investments Commission Bill 2001 (Cth) as tabled in the Legislative Assembly of New South Wales.

113. Other key terms in bold are defined as follows:

- 'referred provisions' means 'the tabled text to the extent to which that text deals with matters that are included in the legislative powers of the Parliament of the State';
- 'Corporations legislation' means 'Commonwealth Acts enacted in the terms, or substantially in the terms, of the tabled text as in force from time to time'; and
- 'express amendment' means:

> the direct amendment of the text of the Corporations legislation (whether by insertion, omission, repeal, substitution or relocation of words or matter) by Commonwealth Acts, but does not include the enactment by a Commonwealth Act of a provision that has or will have substantive effect otherwise than as part of the text of the Corporations legislation.[210]

114. Both the initial reference and the amendment reference contemplate that delegated legislation ('Corporations instruments') may affect the operation of the referred Acts 'otherwise than by express amendment'. The phrase 'otherwise than by express amendment' recognises that delegated legislation may, for example, exempt persons from the operation of the legislation (or particular provisions of it) and 'notionally amend' the legislation so as to change its operation. The role of delegated legislation made under the *Corporations Act*, and in particular 'notional amendments' by delegated legislation, will be discussed in Interim Report A.

208 *Corporations (Commonwealth Powers Act) 2001* (NSW) s 4(1)(a); *Corporations (Commonwealth Powers Act) 2001* (Qld) s 4(1)(a); *Corporations (Commonwealth Powers Act) 2001* (SA) s 4(1)(a); *Corporations (Commonwealth Powers Act) 2001* (Tas) s 5(1)(a); *Corporations (Commonwealth Powers Act) 2001* (Vic) s 4(1)(a); *Corporations (Commonwealth Powers Act) 2001* (WA) s 4(1)(a).

209 *Corporations (Commonwealth Powers Act) 2001* (NSW) s 4(1)(b); *Corporations (Commonwealth Powers Act) 2001* (Qld) s 4(1)(b); *Corporations (Commonwealth Powers Act) 2001* (SA) s 4(1)(b); *Corporations (Commonwealth Powers Act) 2001* (Tas) s 5(1)(b); *Corporations (Commonwealth Powers Act) 2001* (Vic) s 4(1)(b); *Corporations (Commonwealth Powers Act) 2001* (WA) s 4(1)(b).

210 *Corporations (Commonwealth Powers Act) 2001* (NSW) s 3; *Corporations (Commonwealth Powers Act) 2001* (Qld) s 3; *Corporations (Commonwealth Powers Act) 2001* (SA) s 3; *Corporations (Commonwealth Powers Act) 2001* (Tas) s 4; *Corporations (Commonwealth Powers Act) 2001* (Vic) s 3; *Corporations (Commonwealth Powers Act) 2001* (WA) s 3.

115. On 6 December 2002, the Commonwealth, states and Northern Territory entered into the Corporations Agreement 2002, which provides a framework for cooperation between the parties about the amendment and administration of the corporations and financial services legislation.[211]

116. The Corporations Agreement provides, for example, that the Commonwealth will not introduce a Bill to repeal or amend the *Corporations Act* (or other specified Acts, including the *ASIC Act*) without first consulting, and obtaining the approval of, the forum established under the Corporations Agreement. Clause 507 of the Corporations Agreement, however, sets out several broad exemptions to the consultation and approval processes, including amendments in respect of 'financial products and services' and any other subject-matters agreed by the forum. The Commonwealth is also required to release exposure draft legislation[212] and notify the forum about other legislation that would 'alter the effect, scope or operation' of the relevant Acts.[213]

The credit referral

117. The Commonwealth's legislative competence to enact the *NCCP Act* came about by a referral of power from the states and territories, similar to what had occurred before the *Corporations Act* was passed.

118. On 7 December 2009, the Commonwealth, states and territories entered into the National Credit Law Agreement 2009. Like the Corporations Agreement, the National Credit Law Agreement provides a framework for cooperation between the Commonwealth, states and territories for the enactment and administration of credit legislation.

119. Tasmania was the first state to pass legislation referring credit regulation to the Commonwealth, with the *Credit (Commonwealth Powers) Act 2009* (Tas) commencing on 17 November 2009. Tasmania's legislation referred the draft text of what was to become the *NCCP Act* and the ability to amend that text. Other states, however, sought a differently scoped amendment reference to that agreed by Tasmania and to instead 'adopt' the *NCCP Act*.[214]

120. Section 4(1) of the *Credit (Commonwealth Powers) Act 2009* (Tas) provides as follows (defined terms in **bold**):

> (1) The following matters are referred to the Parliament of the Commonwealth:
>
> (a) the matters to which the **initial referred provisions** relate, but only to the extent of the making of laws with respect to those matters by including the initial referred provisions in Acts enacted in the terms, or substantially in the terms, of the **tabled text**;
>
> (b) any **referred credit matter**, but only to the extent of the making of laws with respect to such a matter by making **express amendments** of the **National Credit Legislation**.

211 See Bradley Selway, 'Hughes Case and the Referral of Powers' (2001) 12(4) *Public Law Review* 288 for an account of the negotiations between the Commonwealth and States that led to the agreement. The Australian Capital Territory became a party to the agreement on 13 October 2005.

212 The Corporations Agreement 2002 (Compilation as at July 2017 prepared by the Department of the Treasury (Cth)) cl 509.

213 Ibid cl 516.

214 Explanatory Memorandum, National Consumer Credit Protection Amendment Bill 2010 (Cth) 6.

121. The key terms in bold are defined as follows:

- 'tabled text' means the text of the National Consumer Credit Protection Bill 2009 and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 as tabled in the Tasmanian House of Assembly;
- 'initial referred provisions' means 'the tabled text to the extent to which that text deals with matters that are included in the legislative powers of the Parliament of the State';
- 'National Credit legislation' means 'Commonwealth Acts enacted in the terms, or substantially in the terms, of the tabled text …';
- 'referred credit matter' means a matter relating to either of:

  (a) credit, being credit the provision of which would be covered by the expression 'provision of credit to which this Code applies' in the initial National Credit Code;

  (b) consumer leases, being consumer leases each of which would be covered by the expression 'consumer lease to which Part 11 applies' in the initial National Credit Code;

- 'express amendment' means:

  the direct amendment of the text of the National Credit legislation (whether by insertion, omission, repeal, substitution or relocation of words or matter) by another Commonwealth Act or by an instrument under a Commonwealth Act, but does not include the enactment by a Commonwealth Act of a provision that has or will have substantive effect otherwise than as part of the text of the National Credit legislation.

122. To accommodate the difference in referral legislation between Tasmania and other states, the *NCCP Act* was amended in minor respects by the *National Consumer Credit Protection Amendment Act 2010* (Cth), which commenced on 3 March 2010.

123. Other states' referral legislation uniformly commenced on 1 July 2010 and, most relevantly, provides as follows (defined terms highlighted bold):

> 4 Adoption of **National Credit legislation**
>
> The **relevant version of the National Credit legislation** is adopted within the meaning of section 51(xxxvii) of the Constitution of the Commonwealth. …
>
> 6 Reference of matters
>
> (1) Subject to section 7, any **referred credit matter** is referred to the Parliament of the Commonwealth but only to the extent of the making of laws with respect to such a matter by making **express amendments** of the National Credit legislation …
>
> 7 Matters excluded from reference
>
> (1) A matter referred by section 6(1) does not include—
>
> (a) the matter of making provision with respect to the imposition or payment of State taxes, duties, charges or other imposts, however described; or
>
> (b) the matter of making provision with respect to the general system for the recording of estates or interests in land and related information; or
>
> (c) the matter of providing for the priority of interests in real property; or

(d) the matter of making a law that excludes or limits the operation of a **State law**, to the extent that State law makes provision with respect to the creation, holding, transfer, assignment, disposal or **forfeiture** of a **State statutory right**. …[215]

124. Key terms in bold are:

- 'National Credit legislation', which refers to the *NCCP Act* and the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* (Cth) as in force from time to time;
- 'relevant version of the National Credit legislation', which refers to the *NCCP Act* as originally enacted and as amended by the *National Consumer Credit Protection Amendment Act 2010* (Cth);
- 'referred credit matter', which is defined in substantively the same terms as the Tasmanian legislation; and
- 'express amendment', which has the same meaning as in the Tasmanian legislation.

125. These Acts are collectively described as the 'Credit Referral Legislation'. The evident intention behind the differences in referral legislation as between the *Corporations Act* and the *NCCP Act* is to attempt to limit the scope of the Commonwealth's ability to amend the *NCCP Act* by expressly stipulating (in s 7 quoted above) matters that the referral does not cover. These were described as 'carve outs' from the amendment reference.[216]

The different framework underpinning the Australian Consumer Law

126. Like the *Corporations Act*, *ASIC Act* and *NCCP Act*, the *Australian Consumer Law* is a product of cooperation between the states, territories and Commonwealth. The *Australian Consumer Law* is also subject to an intergovernmental agreement, first entered into on 2 July 2009 and replaced by the second Intergovernmental Agreement for the Australian Consumer Law dated 30 August 2019. The constitutional framework underpinning the *Australian Consumer Law*, however, is different from that supporting the *Corporations Act* and *ASIC Act*.

127. The *Australian Consumer Law* is described as an 'application law, which is applied and enforced as a law of each jurisdiction in Australia'.[217] This means that although the *Australian Consumer Law* is contained in a Commonwealth Act, each jurisdiction (including the Commonwealth) has passed legislation to apply the law as a law of that jurisdiction.[218] This is similar to the co-operative scheme that underpinned the Corporations Law, discussed above.[219]

128. As an application law, the *Australian Consumer Law* differs from the *Corporations Act* and *ASIC Act* (which are supported by a referral of matters) in two main respects. First, as a law of the Commonwealth, the *Australian Consumer Law* applies to the conduct of corporations and those associated with them, and as a law of each state and territory,

215 *Credit (Commonwealth Powers) Act 2010* (NSW); *Credit (Commonwealth Powers) Act 2010* (Qld); *Credit (Commonwealth Powers) Act 2010* (SA); *Credit (Commonwealth Powers) Act 2010* (Vic); *Credit (Commonwealth Powers) Act 2010* (WA).

216 Explanatory Memorandum, National Consumer Credit Protection Amendment Bill 2010 (Cth) [1.7]; *Commonwealth, Parliamentary Debates*, House of Representatives, 10 February 2010, 927 (The Hon Chris Bowen MP).

217 Australian Government, *The Australian Consumer Law: A Framework Overview* (2013) 10.

218 *Competition and Consumer Act 2010* (Cth) pt XI; *Fair Trading (Australian Consumer Law) Act 1992* (ACT); *Fair Trading Act 1987* (NSW); *Consumer Affairs and Fair Trading Act 1990* (NT); *Fair Trading Act 1989* (Qld); *Fair Trading Act 1987* (SA); *Australian Consumer Law (Tasmania) Act 2010* (Tas); *Australian Consumer Law and Fair Trading Act 2012* (Vic); *Fair Trading Act 2010* (WA).

219 See [25] above.

the *Australian Consumer Law* applies to the conduct of corporations *and* individuals.[220] In contrast, the *Corporations Act* and *ASIC Act* are solely laws of the Commonwealth. Secondly, the *Australian Consumer Law* is jointly administered by the ACCC (a Commonwealth agency) and each of the state and territory consumer agencies.[221] The *Corporations Act* and *ASIC Act* are administered only by ASIC.

129. The reasons for the different legislative framework and administrative approach to the *Australian Consumer Law* are not immediately apparent, and are not recorded in available explanatory materials. Three factors may partly explain differences between the *Australian Consumer Law* and the corporations and financial services legislation.

130. First, as discussed above, the *Corporations Act* was the latest of several attempts to implement national, uniform regulation of corporations over several decades. Over that time, significant administrative duties had shifted from state-based agencies to the NCSC and subsequently the ASC (succeeded by ASIC) as the sole regulatory body. This meant that each state's capacity to administer the law had diminished, reducing the impetus for shared regulatory responsibility. A similar history did not precede the introduction of the *Australian Consumer Law*.

131. Secondly, given regulatory responsibility was to be divided between Commonwealth, state, and territory agencies, the *Australian Consumer Law* is not susceptible to the same uncertainty that arose in respect of the Corporations Law following *R v Hughes.* This is so because the ACCC need not enforce (or exercise powers under) state laws, with those laws being enforced by the respective state agencies.

132. Thirdly, the *Australian Consumer Law* Intergovernmental Agreement contains more significant limitations on the Commonwealth's ability to amend the *Australian Consumer Law* than the *Corporations Act* under the Corporations Agreement 2002. As discussed above, the Corporations Agreement contains processes for approval by the states and territories, but also contains significant carve-outs from the need for approval. The *Australian Consumer Law* Intergovernmental Agreement, however, contains (both in its first and second iterations) only a limited ability for the Commonwealth to make 'minor or inconsequential amendments' (as defined) to the *Australian Consumer Law* without agreement from at least four other parties to the agreement.[222] This is further limited by giving the parties to the agreement the ability to object to amendments being 'minor or inconsequential', thereby triggering the approval process.[223]

133. Though it is not entirely clear, these different approval mechanisms may also be relevant to why the states did not make a referral of matters to the Commonwealth in the case of the *Australian Consumer Law*. This is because in *Thomas v Mowbray* (decided in 2007, and discussed further below), both Kirby and Hayne JJ would have invalidated a provision of the Act in question that purported to prevent the Commonwealth from amending the Act without the approval of a majority of states and territories, including at least four states.[224] That requirement was in similar terms to the requirement contained in the *Australian Consumer Law* Intergovernmental Agreement.

220 Australian Government (n 217) 10.
221 Ibid 12.
222 Intergovernmental Agreement for the Australian Consumer Law (Compilation as at 30 August 2019) cll 14–19.
223 Ibid cl 14.
224 *Thomas v Mowbray* (2007) 233 CLR 307 [211]–[214] (Kirby J), [456]–[457] (Hayne J). See also Lynch (n 204) 381.

Determining the ‘scope’ of matters referred by a state

134. For a Commonwealth law that relies on a referral of matters under s 51(xxxvii) of the *Australian Constitution* to be valid, that law and subsequent amendments must necessarily be within the scope of the matters referred (or, in the terms used by the *Australian Constitution*, a law ‘with respect to [the] matters referred’).[225]

135. Generally speaking, referrals by states have fallen into one of two categories:

- a ‘subject matter’ referral, by which state legislation describes the matters that it refers to the Commonwealth; or
- a ‘text-based’ referral, by which state legislation ‘refers’ the matters addressed by draft Commonwealth legislation which may be annexed to the state legislation or identified by being tabled in a state parliament, accompanied by a further reference permitting the Commonwealth to amend that identified text.[226]

136. Both Professor Lynch and Greg Calcutt SC have noted a trend on the part of the states to prefer text-based referrals, and have observed that the drafting of the amendment reference has been the most challenging issue in each case.[227] Lynch has noted:

> The central – but by no means exclusive – puzzle is how the referral can be made in such a way that the Commonwealth enjoys the necessary capacity to maintain and enhance the law’s operation through amendment without this flexibility being exploited to the detriment of state power.[228]

137. Put slightly differently, the question is how a state can, by the terms of its referral legislation, constrain the Commonwealth’s power to amend legislation after a referral is made.

138. To date, the interpretation of legislation that refers matters to the Commonwealth has received little judicial attention. In *Thomas v Mowbray*,[229] Kirby J and Hayne J provided contrasting approaches to interpreting an amendment reference in almost identical terms to that granted to the Commonwealth under the Corporations Referral Legislation.

139. *Thomas v Mowbray* concerned challenges to the validity of Part 5.3 Div 104 of the Schedule to the *Criminal Code Act 1995* (Cth) (‘*Criminal Code*’). Most relevantly for present purposes, the plaintiff argued that Div 104 was invalid because it was not supported by the Commonwealth’s power in s 51(xxxvii) of the *Australian Constitution* and the relevant state referral legislation.

140. The referral legislation passed by each state uniformly contained a ‘text-based’ referral and amendment reference relating to acts of terrorism. One of the questions in *Thomas v Mowbray*, considered only by Kirby J and Hayne J, was therefore whether the amending legislation that introduced Div 104 into Part 5.3 of the *Criminal Code* was within the scope of the amendment reference under the *Terrorism (Commonwealth Powers) Act 2003* (Vic) (‘Referring Act’).

225 *Thomas v Mowbray* (n 224) [447].
226 Treasury (Cth), Submission No 56 to Senate Economics Legislation Committee, *National Consumer Credit Protection Bill 2009 and Related Bills (Cth)* (n 192) 11; Lynch (n 204) 369.
227 Lynch (n 204) 364; Greg Calcutt, ‘A Commentary on the Mechanics of Referring Matters under s 51(xxxvii) of the Constitution’ (2011) 6(1) *Public Policy* 89, 91.
228 Lynch (n 204) 372.
229 *Thomas v Mowbray* (n 224).

141. Section 4 of the Referring Act provides:

> (1) The following matters are referred to the Parliament of the Commonwealth:
>
> (a) the matters to which the referred provisions relate, but only to the extent of the making of laws with respect to those matters by including the referred provisions in the terms, or substantially in the terms, of the text set out in Schedule 1; and
>
> (b) the matter of terrorist acts, and actions relating to terrorist acts, but only to the extent of the making of laws with respect to that matter by making express amendments of the terrorism legislation or the criminal responsibility legislation.

142. Like the equivalent Corporations Referral Legislation, s 4(3) of the Referring Act provides that 'the operation of each paragraph in subsection (1) is not affected by the other paragraph' and subsection (4) notes that the Commonwealth may amend the legislation in reliance on any of its other legislative powers.

143. The definition of 'express amendment' in the Referring Act is substantively the same as in the Corporations Referral Legislation:

> *express amendment* of the terrorism legislation or the criminal responsibility legislation means the direct amendment of the text of the legislation (whether by insertion, omission, repeal, substitution or relocation of words or matter) by Commonwealth Acts, but does not include the enactment by a Commonwealth Act of a provision that has or will have substantive effect otherwise than as part of the text of the legislation.[230]

144. The plaintiff in *Thomas v Mowbray* argued that Part 5.3 Div 104 of the *Criminal Code*, which related to what were known as 'control orders', introduced 'an entirely new regime' into the *Criminal Code* and was not an 'express amendment' within the terms of the Referring Act.[231] The Commonwealth, by contrast, submitted that s 4(1)(b) of the Referring Act enabled the Commonwealth to 'make laws with respect to a defined subject matter', but that power

> was qualified by the requirement that the law had to be enacted in a particular form – as part of the original Act identified as the provisions whose text was set out in Sch 1 to the Referring Act.[232]

Justice Kirby in Thomas v Mowbray

145. In Kirby J's view, context was important when interpreting the Referring Act. Justice Kirby expressly distinguished the Victorian Corporations Referral Legislation from the Referring Act on the basis that the text of the referred legislation was 'contained within' the Referring Act as a schedule, whereas the Corporations Referral Legislation 'referred to' text that had been tabled in the New South Wales Parliament.[233]

146. The form of the referred text was relevant, according to Kirby J, because the defined term 'terrorism legislation' was used in both the amendment reference and in the definition of 'express amendment'. In Kirby J's view, the phrase 'express amendment' is qualified 'not only by *matters* referred in s 4(1)(b) but also by the form of the *legislation* defined

230 Ibid [187].
231 Ibid [449].
232 Ibid [448].
233 Ibid [190]–[197].

in s 4(1)(b), by reference to which only express amendments may be made'.[234] As a result, the words of the amendment reference took on 'a more confined meaning' in the Referring Act than in the Corporations Referral Legislation.[235]

147. Lynch notes that Kirby J also appeared to favour a narrow construction of referrals under s 51(xxxvii) of the *Australian Constitution* because they necessarily enlarge Commonwealth powers and diminish state power, in contrast to how the scope of the enumerated powers in s 51 are viewed by the Court.[236] Justice Kirby also cited the interpretative 'principle of legality' since the terrorism legislation arguably curtailed fundamental rights. In Kirby J's view, this further justified a narrow reading of the referral legislation underpinning the terrorism legislation.[237]

148. The context surrounding the Referring Act and Part 5.3 of the *Criminal Code* meant that an express amendment, according to Kirby J,

> must be a 'direct amendment' of the 'terrorism legislation' as so defined. Although this may include the 'insertion' of text, that term should be construed ejusdem generis with the preceding words 'direct amendment', read together with the requirement that the amendment be to the 'terrorism legislation'. This requires that a more restrictive meaning be given to the term 'insertion'.[238]

149. Ultimately, Kirby J concluded that the impugned amendments 'did not amount to a direct amendment' but rather 'an addition to the scope and function of Pt 5.3 of the [*Criminal Code*] by federal law alone'.[239] As a result, Div 104 of Part 5.3 of the *Criminal Code* went beyond the Commonwealth's power and was invalid.

150. Lynch has commented that:

> While [Kirby J's] narrow reading of the power to 'amend' might be seen as convincing on a contextual level, it clearly suffers from a near fatal weakness. It constrains the Commonwealth's power to amend, but does so without a referable standard. Giving the power to insert 'words or matter' into referred text a 'more restrictive meaning', leaves us with uncertainty as to the scope of the amending reference with all the potential this carries for legislative paralysis and instability.[240]

151. Before considering Hayne J's approach, it can be observed here that each state's Corporations Referral Legislation referred to the text as tabled in the New South Wales Parliament. While Kirby J's primary focus appeared to be on the difference between referring to a separate text versus appending that text in a schedule, his Honour's reasons also suggest that the fact text was 'tabled in the Parliament of another State' was relevant.[241] Justice Kirby stated that the 'context in which' the Referring Act was enacted

> is decidedly different from that which existed when the Corporations Referral was enacted. In the latter case, the Victorian Parliament was content to define 'Corporations Legislation' by reference to provisions that were tabled in the Parliament of another State. By way of contrast, the present Referring Act specifically included the 'terrorism legislation' as a Schedule to the Act. It could not have been more particular or more explicit. …

234 Ibid [196] (original emphasis).
235 Ibid [196].
236 Lynch (n 204) 374; *Thomas v Mowbray* (n 224) [206].
237 *Thomas v Mowbray* (n 224) [199].
238 Ibid [204].
239 Ibid [205].
240 Lynch (n 204) 377.
241 *Thomas v Mowbray* (n 224) [195].

> In a constitutional referral of powers in the Australian federation, it is one thing to provide for the making of 'express amendments' to identified legislation contained in the Schedule to the enactment constituting that referral. It is another thing altogether to provide in the referral for the making of 'express amendments' to legislation not contained in the enactment constituting the referral, but rather, in documents tabled in another Parliament at some other time.[242]

152. In other words, according to Kirby J, the meaning of referral legislation can vary according to the mechanism by which a specific referred text is identified in that legislation. On this reasoning, it is possible that the scope of the five other states' Corporations Referral Legislation differs from that of New South Wales, being the only State in whose parliament the referred text was tabled.

Justice Hayne in Thomas v Mowbray

153. In contrast to Kirby J, Hayne J took the view that the Referring Act contained 'two distinct and different references of power: one made by s 4(1)(a) by reference to the scheduled text; the other made by s 4(1)(b)'.[243] This reading, according to Hayne J, is consistent with s 4(3), which provides that the operation of each of paragraphs (a) and (b) is not affected by the other.

154. Justice Hayne noted that the two parts of the definition of 'express amendment' appeared to be 'contradictory':

> The first part contemplates direct amendment by insertion, omission, repeal, substitution or relocation of words or matter; the second part limits that by excluding enactment of a provision that has or will have 'substantive effect otherwise than as part of the text of the legislation'.[244]

155. Unlike Kirby J, Hayne J accepted the Commonwealth's submission that so long as an insertion to the legislation could be described as a law with respect to the matter referred, and that law was enacted in the form of the scheduled text, then the 'contrariety' could be resolved. Justice Hayne observed that

> By contrast, if the plaintiff is right to submit that no change may be made to legislation enacted in the form of the scheduled text if that change introduces a new provision having 'substantive effect', the definition of express amendment cannot be given sensible meaning. On the hypothesis advanced by the plaintiff, the qualification to the definition of express amendment [being the requirement that it not have 'substantive effect otherwise than as part of the text of the legislation'] would swallow the body of the definition and, no less importantly, s 4(1)(b) would not constitute the reference of a second, and separate subject matter.[245]

156. Put differently, accepting the plaintiff's argument would render the amendment reference inoperable, and be contrary to s 4(3) which provided that each of s 4(1)(a) (the initial reference) and s 4(1)(b) (the amendment reference) were not affected by the other.

242 Ibid [195], [197].
243 Ibid [451].
244 Ibid [453].
245 Ibid [454].

157. Lynch has commented that while Hayne J's approach removes the contrariety, 'one may be forgiven for finding it a strangely formalistic result',[246] but that the 'strong appeal of the more literal interpretation of Hayne J' is the avoidance of the uncertainty produced by Kirby J's interpretation.[247] The result is 'formalistic', according to Lynch, because

> the Referring Act firstly provides a set text of provisions which the referred power is to support as a Commonwealth enactment, before proceeding to grant an unlimited discretion to otherwise legislate on the 'matter of terrorist acts' accompanied by a requirement only that this must occur 'as part of the text' specifically referred.[248]

158. Justice Hayne's interpretation may also be seen as a pragmatic view that gives the definition sensible meaning while imposing, as recognised by Lynch, a 'manner and form' requirement that amendments be made to the particular piece of legislation as enacted in reliance on the referral.

Implications for reform

159. The constitutional arrangements underpinning the corporations and financial services legislation have both historical and practical significance when it comes to reform of that legislation.

160. The Terms of Reference for this Inquiry ask the ALRC to consider how the provisions contained in Chapter 7 of the *Corporations Act* could be reframed or restructured. There may be limits on how the Commonwealth could presently amend or re-enact Chapter 7 of the *Corporations Act*, and potentially integrate parts of the *ASIC Act* and parts (or the whole) of the *NCCP Act*, in reliance on the current referrals under s 51(xxxvii) of the *Australian Constitution*. Some potential ways that the current law could be restructured, and challenges presented by the current constitutional framework, are discussed under the headings below.

161. As the judgments of Kirby J and Hayne J in *Thomas v Mowbray* demonstrate, there is considerable scope for uncertainty when interpreting state referral legislation and much may turn on the precise nature of any amendments.

162. It should be noted that both the Corporations Agreement 2002 and the National Credit Law Agreement 2009 provide mechanisms for consultation and cooperation between the Commonwealth, states, and territories about legislative change. Following these mechanisms to effect any reforms would not, however, guarantee the constitutional validity of those reforms because it is the agreement of a state's parliament by enacting legislation, and not merely agreement by a state's executive, that is required for the purposes of s 51(xxxvii) of the *Australian Constitution*.[249]

246 Lynch (n 204) 376.
247 Ibid 377.
248 Ibid 376.
249 *R v Public Vehicles Licensing Appeal Tribunal (Tas); Ex Parte Australian National Airways Pty Ltd* (n 205) 226.

Repeal and partial repeal by the Commonwealth

163. According to Lynch, it seems clear that the Commonwealth has the power to repeal any law enacted by it in reliance on a state referral.[250] Any referral that purported to prevent the Commonwealth from repealing a law would invalidly curtail the Commonwealth's legislative power.[251]

164. The extent to which the Commonwealth may partially repeal legislation enacted in reliance on a referral is less clear. Lynch notes that partial repeal may result in legislation that is outside the scope of the text referred by a state, given that a reference usually refers to legislation being in 'the terms, or substantially in the terms' of the referred text.[252] So although the Commonwealth must retain the power to repeal a law, according to Lynch,

> qualms may legitimately exist were it to act selectively through partial repeal so as to produce a law substantially distinct from that to which the states gave their initial imprimatur.[253]

Could Chapter 7 of the Corporations Act be integrated with Part 2 Division 2 of the ASIC Act? Or vice versa?

165. The *FSR Act* was enacted by the Commonwealth, at least in part, in reliance on the amendment reference contained in the Corporations Referral Legislation. The amendment reference referred 'the matters of the formation of corporations, corporate regulation and the regulation of financial products and services' so long as only the text of the *Corporations Act* or the *ASIC Act* was altered by 'express amendment' (as defined in the referral legislation).[254]

166. The *FSR Act* both introduced Chapter 7 into the *Corporations Act* and amended Part 2 Div 2 of the *ASIC Act*. Repealing part of the *ASIC Act*, and re-enacting it in substantially the same form within the *Corporations Act* may satisfy the definition of 'express amendment'. One potential issue may be the extent to which the amendments produced legislation that deviated from the initial text of the *Corporations Act* referred by the states. Of course, given the extensive amendments to the *Corporations Act* and *ASIC Act* since 2001, it may be arguable that the text already is substantially different and, to date, no issue has been taken. Nevertheless, a reformed constitutional framework may usefully provide greater certainty for future amendments.

167. Another way of achieving some level of integration and implementing a new structure may be the use of a schedule to either the *Corporations Act* or *ASIC Act* containing (for example) the 'financial services laws', in a similar way to the *Australian Consumer Law*. Even assuming that this would be possible within the terms of the current referral,

250 Lynch (n 204) 381.
251 Ibid.
252 Ibid.
253 Ibid.
254 It should be noted here that the amendment reference and the definition of 'express amendment' would not appear to prevent the use of legislative instruments that 'notionally amend' the text of the legislation. The amendment reference expressly permits 'provisions that authorise the making of [legislative instruments] that affect the operation of the Corporations legislation, otherwise than by express amendments'. This is essentially reiterated, for the avoidance of doubt, in s 4(4)(b) of the Corporations Referral Legislation. A legislative instrument does not fall within the definition of 'express amendment', which only contemplates amendment by Commonwealth Acts. Legislative instruments have force by virtue of the instrument and only for so long as the instrument is in force, and do not have effect as an amendment to legislative text. Therefore a 'notional amendment' only ever 'affects the operation' of the law and does not amend the legislative text.

enacting only one part of the law in a schedule would risk compromising the intelligibility (and navigability) of the legislation.

Could Chapter 7 of the Corporations Act and Part 2 Division 2 of the ASIC Act be integrated in new, standalone legislation?

168. Given the qualified definition of 'express amendment', which requires that any amendment be made only to the text of the *Corporations Act* and *ASIC Act*, it would not seem possible for the Commonwealth to enact new, standalone legislation in reliance on s 51(xxxvii) of the *Australian Constitution* and the Corporations Referral Legislation. Another way to achieve a similar outcome may be by way of a schedule to the *Corporations Act* or *ASIC Act*, as noted above.

Could part, or the whole, of the NCCP Act be integrated with Chapter 7 of the Corporations Act?

169. Three main issues arise when considering whether the *NCCP Act* could be integrated with the *Corporations Act* or *ASIC Act* in reliance on the current referrals to the Commonwealth.

170. First, given the qualified definition of 'express amendment' in both the Corporations Referral Legislation and the Credit Referral Legislation, it would not seem possible to enact standalone legislation to integrate the three Acts.

171. To the extent there is overlap between the subject matters of the corporations and credit referrals, some level of consolidation may be achieved by re-enacting Chapter 7 of the *Corporations Act* (or parts of it) and incorporating parts of the *ASIC Act* and *NCCP Act* in the *Corporations Act* or *ASIC Act*.

172. Second, while the Corporations Referral Legislation has been relied on to legislate with respect to 'credit' products and services as in the *ASIC Act*, it is less clear that the terms of the referral would capture all matters currently regulated by the *NCCP Act*. As noted above, the Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 suggests that Government contemplated that consumer credit regulation might be incorporated within Chapter 7 of the *Corporations Act.* Explanatory materials do not, however, contain any commentary about the Constitutional basis for doing so without a specific referral in respect of credit.

173. Further, the *NCCP Act* regulates consumer leases, which form a distinct category within the definition of 'referred credit matter' in the Credit Referral Legislation. This suggests that consumer leases may not meet a natural description of 'credit' within the first limb of the credit referral. On the other hand, it could also be argued that some of the matters included within the definition of 'credit facility' in the *ASIC Act*, such as taking a lease over real or personal property, also may not meet a natural description of 'credit' but are nonetheless regulated in that way.[255]

255 *Australian Securities and Investments Commission Act* (n 182) s 12BAA(7)(k); *Australian Securities and Investments Commission Regulations 2001* (Cth) reg 2B.

174. Third, if the *NCCP Act* were only partially repealed in order to be re-enacted within the *Corporations Act* or *ASIC Act*, then a question may arise as to whether the partially repealed *NCCP Act* was 'substantially in the terms' of the initial text referred by Tasmania and adopted by the other states (as discussed above).

Could the Commonwealth rely on its legislative powers in s 51 of the Australian Constitution, other than s 51(xxxvii), to reform the corporations and financial services legislation?

175. As each of the *Corporations Act*, *ASIC Act*, and *NCCP Act* specifies, the application of those Acts is based upon *both* the Commonwealth's legislative powers in s 51 of the *Australian Constitution* (other than its power under s 51(xxxvii)), and the legislative power the Commonwealth has because of a reference or an adoption under s 51(xxxvii) of the *Australian Constitution*.[256] The question remains whether the Commonwealth could legislate comprehensively in relation to corporations and financial services without relying on any referral.

176. Since the *Incorporation Case*[257] in 1990, the Commonwealth's corporations power in s 51(xx) of the *Australian Constitution* has been held not to include a power to enact legislation concerning the formation of corporations. The decision in the *Work Choices Case*[258] raises the possibility that the Commonwealth's corporations power may be interpreted much more broadly today, though it does not suggest that the power would extend as far as regulating the formation of corporations. Even if the corporations power could support parts of the corporations and financial services laws, it may not be a complete solution as much of the present law is directed to both individuals and corporations.

177. In a 2018 paper, the Hon Robert French AC (formerly Chief Justice of the High Court) raised the question as to whether the Commonwealth may seek to

> enact legislation pursuant to an intergovernmental agreement on a topic outside any of the subject-matter heads of legislative power, outside the ambulatory referral provision and outside the framework of the conditional financial assistance power.[259]

178. To do so, according to French, the Commonwealth 'would have to resort to the incidental power'.[260] The incidental power is contained in s 51(xxxix) of the *Australian Constitution*, and may be used to legislate 'in aid of an exercise of the executive power' in s 61 of the *Australian Constitution*.[261]

179. Putting the question slightly differently, French also asked:

> is an intergovernmental agreement made in pursuance of a national objective able to be implemented absent any other power, in reliance upon the incidental power?[262]

256 *Corporations Act* (n 201) s 3; *Australian Securities and Investments Commission Act* (n 182) s 4; *National Consumer Credit Protection Act 2009* (Cth) s 18.
257 *New South Wales v Commonwealth* (n 17).
258 *New South Wales v Commonwealth* (n 21).
259 Robert French, 'Executive and Legislative Power in the Implementation of Intergovernmental Agreements' (2018) 41 *Melbourne University Law Review* 1383, 1393.
260 Ibid.
261 *R v Hughes* (2000) 202 CLR 535 [39].
262 French AC (n 259) 1398.

180. An affirmative answer to that question, according to French, is supported by the High Court's decision in *R v Hughes*[263] and a negative answer is not required by three other more recent decisions.[264] French appears to suggest that the nationhood aspect of the Commonwealth's executive power, combined with the incidental power in s 51(xxxix), may permit the Commonwealth to legislate on matters the subject of intergovernmental agreements with the states. French concluded, however, that the incidental power's 'relationship in this connection to the implementation of intergovernmental agreements remains to be explored'.[265] Further, it is apparent from French CJ's own reasons in *Pape v Federal Commissioner of Taxation* that there are limits, as yet clearly defined, on the incidental power in s 51(xxxix) of the *Australian Constitution*.[266]

181. Any attempt by the Commonwealth to legislate on the basis of intergovernmental agreements that relate to a specific referral of matters, but in reliance on the incidental power, may be seen as a transparent attempt to circumvent the mechanism provided by s 51(xxxvii) of the *Australian Constitution*. Justice Kirby perhaps contemplated this possibility when in *Thomas v Mowbray* he declined

> to interpret the provisions of s 51(xxxvii) of the *Constitution* to permit the parliamentary reference of constitutional power to be achieved without any relevant parliamentary involvement, as by the use of communiqués by heads of government alone.[267]

'Freezing' of the Acts Interpretation Act

182. The *Acts Interpretation Act* applies to the interpretation of Commonwealth legislation generally. In the case of the *Corporations Act* and *ASIC Act*, a point-in-time version of the *Acts Interpretation Act* applies as though it were 'frozen' on 1 January 2005. This 'freezing' is apparently a consequence of the state referrals outlined above. However, for the reasons outlined below, the stated rationale does not convincingly justify why the *Acts Interpretation Act* should be 'frozen' at a point in time for those Acts.

The 'freezing' provisions

183. Upon commencement, s 5C of the *Corporations Act* and s 5A of the *ASIC Act* both provided:

> (1) The *Acts Interpretation Act 1901* as in force on 1 November 2000 applies to this Act.
>
> (2) Amendments of the *Acts Interpretation Act 1901* made after 1 November 2000 do not apply to this Act.

184. Section 5C of the *Corporations Act* and s 5A of the *ASIC Act* were repealed and the following wording, which remains in force, was substituted by the *Legislative Instruments (Transitional Provisions and Consequential Amendments) Act 2003* (Cth):

> (1) Until the date of commencement of section 4 of the Legislative Instruments (Transitional and Consequential Amendments) Act 2003 (the **Legislative Instruments**

263 *R v Hughes* (n 261).
264 French AC (n 259) 1398 citing *Pape v Federal Commissioner of Taxation* (2009) 238 CLR 1, *Williams v Commonwealth* (2012) 248 CLR 156 and *Williams v Commonwealth* (2014) 252 CLR 416.
265 Ibid 1400.
266 *Pape v Federal Commissioner of Taxation* (2009) 238 CLR 1 [9]–[10]. See also Cheryl Saunders, 'Intergovernmental Agreements and the Executive Power' (2005) 16 *Public Law Review* 294.
267 *Thomas v Mowbray* (n 224) [215].

commencement day), the Acts Interpretation Act 1901 as in force on 1 November 2000 applies to this Act.

(2) On and after the Legislative Instruments commencement day, the Acts Interpretation Act 1901 as in force on that day applies to this Act.

(3) Amendments of the Acts Interpretation Act 1901 made after the Legislative Instruments commencement day do not apply to this Act.

185. The 'Legislative Instruments commencement day' was 1 January 2005. Therefore, the *Acts Interpretation Act* as in force on 1 January 2005 applies to the *Corporations Act*.[268]

186. The Explanatory Memorandum to the Corporations Bill 2001 (Cth) stated:

> The scope of what is referred by a State Parliament is determined by that Parliament. As the scope of the matters referred is in part determined by reference to a particular text, Bill clause 5C provides that the text referred is to be interpreted in accordance with the Acts Interpretation Act 1901 of the Commonwealth as in force on 1 November 2000. This is intended to preclude any argument that the matters referred differ from State to State (as a result of differences in the relevant interpretation legislation) or that the scope of the reference may change as a result of amendments of the Acts Interpretation Act 1901. While the Bill applies the Acts Interpretation Act 1901 as at 1 November 2000, it is envisaged that changes to that Act could be applied to the interpretation of the legislation by an appropriate amendment of clause 5C in reliance on the amendment reference…[269]

187. The 2003 legislation amending s 5C of the *Corporations Act* was explained as follows:

> This item repeals section 5C of the Corporations Act 2001, which freezes the Acts Interpretation Act in its application to the Corporations Act as at 1 November 2000. This was needed to prevent any unintended amendments to the Corporations Act (brought about by changes to the Acts Interpretation Act) in recognition of the agreement between the States and the Commonwealth in relation to the Corporations Act.[270]
>
> The proposed amendment will insert a new section 5C in the Corporations Act to provide that the Acts Interpretation Act as amended by this Bill will apply to the Corporations Act as at the date of commencement of this Bill, but any later amendments to the Acts Interpretation Act will not apply.[271]

188. Those amendments accommodated the introduction of the *Legislative Instruments Act 2003* (Cth) (now the *Legislation Act 2003* (Cth)), which reformed the framework governing Commonwealth legislative instruments and, together with related legislation, made consequential amendments to the *Acts Interpretation Act*.

189. Excluding amendments made to the *Acts Interpretation Act* by the 2003 legislation, only two other minor amendments to the *Acts Interpretation Act* took effect between 1 November 2000 (the initial 'freezing' date for the purposes of the *Corporations Act* and

268 *Legislative Instruments (Transitional Provisions and Consequently Amendments) Act 2003* (Cth) s 2.
269 Explanatory Memorandum, Corporations Bill 2001 (Cth) [5.47].
270 It is not entirely clear what is meant by the phrase 'in recognition of the agreement between the States and the Commonwealth in relation to the Corporations Act'. While the Corporations Agreement 2002 contains provisions that require some level of cooperation and consultation between the Commonwealth, States and Territories when amending the corporations legislation, it does not directly touch upon matters of interpretation.
271 Explanatory Memorandum, Legislative Instruments (Transitional Provisions and Consequential Amendments) Bill 2003 (Cth) 9. The amendment to s 5A of the *ASIC Act* was explained in identical terms.

ASIC Act) and 1 January 2005.[272] It appears, therefore, that changing the effective date in s 5C of the *Corporations Act* and s 5A of the *ASIC Act* to 1 January 2005 did not frustrate the apparent purpose behind those sections as introduced.

Apparent rationale for 'freezing' the Acts Interpretation Act

190. The apparent rationale for 'freezing' the *Acts Interpretation Act* for the purposes of the *Corporations Act* and *ASIC Act* could be questioned for three reasons.

191. First, ensuring that the interpretation of the referred text would not differ between states does not require that the *Acts Interpretation Act* be 'frozen', only that the *Acts Interpretation Act* uniformly apply, which would be the position in any event.

192. Second, it is unclear how the Commonwealth *Acts Interpretation Act* would be relevant to interpreting the matters referred by the state referral legislation, which presumably would be subject to each state's own interpretation legislation. While the matters referred are repeated in the *Corporations Act* itself (which is subject to the *Acts Interpretation Act*), it is the state legislation that effects the referral and is relevant to determining the scope of that referral (as illustrated by *Thomas v Mowbray*). Likewise, the predecessor national Corporations Law scheme applied as state law and would therefore have been subject to state interpretation legislation. National uniformity of interpretation was achieved by inserting an extensive number of interpretation provisions into the *Corporations Law* itself, replicating much of the *Acts Interpretation Act*.[273]

193. Third, while it makes sense that the states would wish to be certain that the text initially enacted by the Commonwealth had the same meaning as the text referred by them, this is achieved by the 'substantially in the same form' requirement. Once enacted, the 'initial reference' is essentially spent (at least on Hayne J's approach in *Thomas v Mowbray*), and any amendments rely on the 'amendment reference'. The only possible relevance is if, as Kirby J suggested in *Thomas v Mowbray*, the 'initial reference' has implications for the 'amendment reference' and regard needs to be had to the text as referred by the states. But even that does not seem to require that the *Acts Interpretation Act* be frozen (for the ongoing purpose of interpreting the *Corporations Act*) because the text referred by the states would be interpreted as at the time they referred it, which would not be informed by later changes to the Commonwealth *Acts Interpretation Act* — only the enacted legislation itself would be informed by later changes to the Commonwealth *Acts Interpretation Act*.

194. As discussed in the next section, the *Corporations Act* and *ASIC Act* are not the only Commonwealth legislation subject to a 'frozen' *Acts Interpretation Act*. The analysis below suggests that 'freezing' is related to the form of referral made for the purposes of s 51(xxxvii) of the *Australian Constitution*, specifically whether the referral is text-based. In the case of the *Corporations Act*, 'freezing' was thought necessary to ensure a uniform approach to interpreting each state's referral legislation and to preserve the meaning of the text as referred by the states.[274] However, it was nonetheless acknowledged that the 'freezing' provision could itself be amended, as occurred in 2003.

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272 These were the correction of a typographical error in subsection 4(6) by the *Statute Law Revision Act 2002* (Cth) and the addition of s 27A relating to documents used to commence proceedings, which took effect in relation to proceedings commenced after 7 July 2003.

273 See, *Corporations Law 1989* (Cth), ss 109A–109Z.

274 See [186]–[187].

195. In contrast to the *Corporations Act* and *ASIC Act*, the *NCCP Act* does not contain a provision 'freezing' the *Acts Interpretation Act*. This might be explained on the basis that five of the six states 'adopted' the Commonwealth legislation and granted a limited amendment reference. This does not, however, explain why a provision 'freezing' the *Acts Interpretation Act* was unnecessary at least when the *NCCP Act* was first passed, given Tasmania's referral was 'text-based' and the Explanatory Memorandum expressly contemplated referrals from all states without comment on their form.

Other Commonwealth legislation

196. In addition to the *Corporations Act* and *ASIC Act*, six other in force Commonwealth Acts contain provisions that have the effect of 'freezing' the *Acts Interpretation Act* at a point in time. Each of these are founded, at least in part, on a referral of matters under s 51(xxxvii) of the *Australian Constitution.* The table in Appendix B contains a list of those Acts and the relevant provisions.

197. There are currently seven Commonwealth Acts in force that are supported, at least in part, by a referral of matters under s 51(xxxvii) of the *Australian Constitution* but are *not* subject to a 'frozen' *Acts Interpretation Act*. The table in Appendix C contains a list of those Acts.

198. To summarise:

- there are currently 15 Commonwealth Acts underpinned by a referral from one or more states;
- six entire Commonwealth Acts (including the *Corporations Act* and *ASIC Act*) are subject to five different point-in-time versions of the *Acts Interpretation Act*;
- the *Water Act 2007* (Cth) is subject to a point-in-time version of the *Acts Interpretation Act* for specified parts, and the rest of the Act is subject to the current *Acts Interpretation Act*;
- Part 5.3 of the *Criminal Code* is subject to a point-in-time version of the *Acts Interpretation Act,* with the exception of ss 2D, 2E and 2F of the *Acts Interpretation Act* which apply to Part 5.3 as per the current *Acts Interpretation Act*. The rest of the *Criminal Code* (that is, excluding Part 5.3) is subject to the current *Acts Interpretation Act*; and
- the state referral legislation underlying these eight Acts all employ 'text-based' referrals.

199. Of the seven Commonwealth Acts in force that are supported by a referral but *not* subject to a 'frozen' *Acts Interpretation Act*, two are based on subject matter referrals, four are text-based referrals, and one (the *NCCP Act*) is text-based in the case of Tasmania and 'adopted' by all other states.

200. The provisions 'freezing' the *Acts Interpretation Act* for the purposes of the *Water Act 2007* (Cth) and the *Criminal Code* are explained in similar terms to the *Corporations Act*. The Revised Explanatory Memorandum to the Water Amendment Bill 2008 (Cth), which introduced the current s 5 of the *Water Act 2007* (Cth), stated:

> New section 5 provides that the text referred is to be interpreted in accordance with the *Acts Interpretation Act 1901* of the Commonwealth as in force on the day on which Schedule 1 to the *Water Amendment Act 2008* commences. This is intended to preclude any possible

> argument that the scope of the reference may change as a result of amendments to the *Acts Interpretation Act 1901*.[275]

201. Similarly, the Explanatory Memorandum to the Criminal Code (Terrorism) Amendment Bill 2002 (Cth) explained s 100.5 in almost identical terms to the Explanatory Memorandum for the Corporations Bill 2001:

> The scope of what is referred by a State Parliament is determined by that Parliament. As the scope of the matters referred is in part determined by reference to a particular text, proposed section 100.5 provides that the text referred is to be interpreted in accordance with the *Acts Interpretation Act 1901* of the Commonwealth as in force on the day on which Schedule 1 of the Bill commences. This is intended to preclude any argument that the matters referred differ from State to State (as a result of differences in the local interpretation legislation) or that the scope of the reference may change as a result of amendments of the *Acts Interpretation Act 1901*. While the Bill applies the *Acts Interpretation Act 1901* as at the date of commencement of Schedule 1, it is envisaged that changes to that Act could be applied to the interpretation of the legislation by an appropriate amendment of section 100.5 in reliance on the amendment reference.[276]

Implications and potential for reform

202. The absence of commentary, both by the academy and in case law, on s 5C of the *Corporations Act* and its equivalent in s 5A of the *ASIC Act*, may suggest that the provisions have not led to any substantive problems in interpreting or applying the law. This is not to say, however, that it is desirable to retain the provisions, which clearly complicate the process of interpreting the legislation, by requiring a reader to identify that the legislation is *not*, as would ordinarily be the case, governed by the current *Acts Interpretation Act* and then, if necessary, to locate and have regard to the applicable point-in-time version.

203. Several other potential complications are caused by 'freezing' the *Acts Interpretation Act*.

204. First, it is not entirely clear whether legislative instruments made by ASIC under the *Corporations Act* should be interpreted in accordance with the *Acts Interpretation Act* as in force on 1 January 2005 or the *Acts Interpretation Act* as in force at a later time. Section 5C of the *Corporations Act* and s 5A of the *ASIC Act* provide that the 'frozen' *Acts Interpretation Act* applies to 'this Act'. 'This Act' is defined:

- for the purposes of the *ASIC Act*, as including regulations made under the *ASIC Act*;[277] and
- for the purposes of the *Corporations Act*, as including regulations made under the *Corporations Act*, the Insolvency Practice Rules and the Passport Rules. Both the Insolvency Practice Rules and the Passport Rules are legislative instruments made by the Minister.[278]

205. It therefore seems clear that the *Corporations Act*, *ASIC Act*, regulations under those Acts, and at least the Insolvency Practice Rules and Passport Rules (which are legislative instruments), would be subject to the 'frozen' *Acts Interpretation Act* because they are expressly included within the definition of 'this Act'. The position is less clear, however,

275 Revised Explanatory Memorandum, Water Amendment Bill 2008 (Cth) [173].
276 Explanatory Memorandum, Criminal Code Amendment (Terrorism) Bill 2003 (Cth) [10].
277 *Australian Securities and Investments Commission Act* (n 182) s 5.
278 *Corporations Act* (n 201) s1211, sch 2 s 105–1.

in relation to other legislative instruments made by ASIC (including those that ‘notionally amend’ the Act). Section 13 of the *Legislation Act 2003* (Cth) provides that ‘unless the contrary intention appears’:

- the *Acts Interpretation Act* applies to instruments made under an Act as though each provision were a section of an Act;
- expressions used in instruments have the same meaning as in the enabling legislation; and
- any instrument is to be read and construed subject to the enabling legislation and so as not to exceed the person’s power to make the instrument.

206. The *Corporations Act* does not expressly displace s 13 of the *Legislation Act 2003* (Cth).

207. Arguably, s 5C of the *Corporations Act* and the inclusive definition of ‘this Act’ may demonstrate an intention to displace s 13 of the *Legislation Act 2003* (Cth). This argument would proceed on the basis that the inclusive definition of ‘this Act’ enlarges the term’s ordinary meaning and does so in a non-exhaustive way, with the result that legislative instruments made under the *Corporations Act* fall within the meaning of ‘this Act’. This would mean that the *Acts Interpretation Act* as currently in force would not apply to legislative instruments made under the *Corporations Act*, and such legislative instruments would instead be subject to the ‘frozen’ *Acts Interpretation Act*. This result would also be consistent with the requirement that an instrument be read and construed subject to the enabling legislation and so as not to exceed the power to make the instrument, because construing an instrument in accordance with the current *Acts Interpretation Act* may take it ‘outside of power’.

208. On the other hand, however, while some types of legislative instruments have been included within the definition of ‘this Act’ in the *Corporations Act*, the more general category of ‘legislative instruments’ (as defined by s 8 of the *Legislation Act 2003* (Cth)) has not been. Further, legislative instruments are separate from the Act under which they are made, and although the power to make them derives from the Act, the instruments themselves take effect independently of the empowering Act. This means that legislative instruments may not fit comfortably within the ordinary meaning of ‘this Act’ in the *Corporations Act*.

209. Secondly, ASIC is empowered by s 102 of the *ASIC Act* and other provisions to delegate its functions and powers by writing under its common seal. ASIC relies heavily on delegations in order to ensure that its staff (or others) can perform functions and exercise powers that are vested in ASIC. The *Acts Interpretation Act* was amended, with effect from 27 December 2011, to include s 34AB which provides, in effect, that where an Act confers power on a person or body to delegate a function, duty or power, and the functions, duties or powers of that person or body are added to or amended, then the delegation in force immediately before the addition or amendment is taken to incorporate those changes and remain in effect.[279] ASIC is unable to rely on s 34AB of the *Acts Interpretation Act* because s 34AB was not included in the *Acts Interpretation Act* as at 1 January 2005, with the result that ASIC is required to amend its delegations each time any functions or powers of ASIC are added to or amended.

279 Section 34AB was introduced by the *Acts Interpretation Amendment Act 2011* (Cth).

210. Thirdly, where a term is defined in both the *Acts Interpretation Act* and the *Corporations Act,* amendments to both Acts are needed to achieve consistency. For example, in 2011 the definition of 'document' in the *Acts Interpretation Act* was amended so as to remove an apparent inconsistency in its drafting and to make it 'consistent with more modern Interpretation Acts, for example, section 38 of the Victorian *Interpretation of Legislation Act 1984*.'[280] Until that amendment, the definition of 'document' in the *Corporations Act* was the same as the *Acts Interpretation Act* definition. It was not until 16 December 2020, however, that the definition of 'document' in the *Corporations Act* was amended by the *Corporations Amendment (Corporate Insolvency Reforms) Act 2020* (Cth) and is now identical to the *Acts Interpretation Act* definition introduced in 2011. In the context of other insolvency reforms and the COVID-19 pandemic, this amendment was made 'to ensure that the reforms apply to all information, including information that is not in a paper or material form'.[281]

211. By way of further example, the definition of 'de facto partner' was first introduced into the *Acts Interpretation Act* with effect from 4 December 2008.[282] The *Corporations Act* was also amended, with effect from 10 December 2008, to repeal the definition of 'de facto spouse,' amend certain other definitions and to define the term 'spouse' to include 'a de facto partner … within the meaning of the *Acts Interpretation Act 1901*'.[283]

212. These examples further illustrate that, regardless of the 'freezing' provisions, the Commonwealth Parliament can make changes to the *Corporations Act* equivalent to any changes made to the *Acts Interpretation Act*. The Commonwealth's ability to do so appears to undermine any purpose behind 'freezing' the *Acts Interpretation Act*. The only apparent practical difference between amending the *Corporations Act* and amending the *Acts Interpretation Act* is that amendments to the *Corporations Act* are subject to the requirements of the intergovernmental Corporations Agreement 2002, whereas amendments to the *Acts Interpretation Act* more generally are not. As discussed above, clause 506 of the Corporations Agreement provides that the Commonwealth will not introduce a Bill to repeal or amend the *Corporations Act* (or other specified Acts, including the *ASIC Act*) without first consulting, and obtaining the approval of, the forum established under the Agreement. The Commonwealth is also required to release exposure draft legislation[284] and notify the forum about other legislation that would 'alter the effect, scope or operation' of the relevant Acts.[285] Clause 507 of the Corporations Agreement also sets out several broad exemptions from the consultation and approval processes in clause 506, including matters relating to 'financial products and services' and any other subject-matters agreed by the forum.

213. Fourthly, s 15AD of the *Acts Interpretation Act* provides that examples of a provision's operation are not exhaustive and, since 2011, has provided that examples may extend the operation of the provision. By contrast, s 15AD as in force on 1 January 2005, and therefore applicable to the *Corporations Act* and *ASIC Act*,[286] provided that if an

280 Explanatory Memorandum, Acts Interpretation Amendment Bill 2011 (Cth) 5.
281 Explanatory Memorandum, Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth) [5.6].
282 *Same-Sex Relationships (Equal Treatment in Commonwealth Laws—Superannuation) Act 2008* (Cth) sch 2 pt 1.
283 Ibid sch 14 pt 3.
284 The Corporations Agreement 2002 (Compilation as at July 2017 prepared by the Department of the Treasury (Cth)) cl 509.
285 Ibid cl 516.
286 *Corporations Act* (n 201) s 5C; *Australian Securities and Investments Commission Act* (n 182) s 5A.

example was inconsistent with a provision, then the provision prevailed. The Explanatory Memorandum explained the amendment of s 15AD as follows:

> If Parliament has enacted an example in a Commonwealth Act, this shows an intention that the example should be covered whether or not it strictly falls within the scope of the provision. However, the amended provision [s 15AD] will state that the example 'may extend the operation of the provision' so that a court can assess whether this is in fact appropriate when interpreting a particular provision that includes an example.[287]

214. More generally, the Explanatory Memorandum to the Acts Interpretation Amendment Bill 2011 (Cth) notes that although the *Acts Interpretation Act* had been amended numerous times since its introduction in 1901, the 2011 amendments were 'the first time the Act ha[d] been comprehensively amended to address concerns regarding its structure, application to modern technology and language'.[288] These same perceived benefits do not, however, automatically apply for readers of the *Corporations Act* and *ASIC Act*.

215. Fifthly, legislative drafters and the members of the Treasury responsible for administering the *Corporations Act* and *ASIC Act* must also have regard to the 'frozen' *Acts Interpretation Act* when considering amendments. This arguably adds unnecessary complication to what is already a complex task.

216. These observations also serve to highlight the anomaly that two of the three key pieces of legislation administered by ASIC are subject to a 'frozen' *Acts Interpretation Act*, while the *NCCP Act* is not. Similarly, although the *ASIC Act* contains consumer protection provisions that are intended to mirror provisions contained in the *Australian Consumer Law*, the former is subject to a 'frozen' *Acts Interpretation Act* while the latter is not.

217. In *Thomas v Mowbray*, though Kirby J and Hayne J were focused on interpreting the amendment reference as opposed to the initial reference, neither felt it necessary to refer expressly to the *Acts Interpretation Act* as 'frozen' for the purposes of that Commonwealth legislation. Furthermore, Kirby J's approach suggests that minor differences in state referral legislation may produce different interpretations of state referral legislation, regardless of the interpretive provisions that may apply. This casts further doubt on the apparent rationale for 'freezing' the *Acts Interpretation Act*.

218. The ALRC's Interim Report A will discuss the potential for reforming s 5C of the *Corporations Act* and s 5A of the *ASIC Act*.

287 Explanatory Memorandum, Acts Interpretation Amendment Bill 2011 (Cth) 19.
288 Ibid 1.

Appendices

Appendix A: Timeline of key events

1989
Corporations Act 1989 (Cth)

8 February 1990
NSW v Commonwealth ('*The Incorporation Case*') (1990) 169 CLR 482

1 January 1991
National Corporations Law uniform scheme commenced

March 1997
Final Report of the Wallis Inquiry

December 1997
CLERP 6 Proposals Paper released

1 July 1998
ASC Act 1989 renamed *ASIC Act 1989* and financial product/service first defined

March 1999
CLERP 6 Consultation Paper released

17 June 1999
Re Wakim; Ex parte McNally (1999) 198 CLR 511

February 2000
Draft Financial Services Reform Bill and Treasury Commentary published

3 May 2000
R v Hughes (2000) 202 CLR 535

25 August 2000
States and Commonwealth agreed on a referral to the Commonwealth

4 April 2001
Corporations (Commonwealth Powers) Act 2001 (NSW) commenced

21 June 2001
All other States' Corporations referral legislation commenced

15 July 2001
Corporations Act 2001 and *ASIC Act 2001* commenced

27 September 2001
FSR Act received Royal Assent

11 March 2002
Amendments introduced by the *FSR Act commenced*

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Appendix B: Commonwealth Acts subject to a 'frozen' Acts Interpretation Act

	Commonwealth Act and provision	Summary of 'freezing' provision	Example state referral Act
1.	*Mutual Recognition Act 1992* s 4(2)	The *Acts Interpretation Act* as in force at the date on which this Act received the Royal Assent (21 December 1992) applies to this Act.	*Mutual Recognition (Victoria) Act 1993* (Vic)
2.	*Trans-Tasman Mutual Recognition Act 1997* S 4(5)	The *Acts Interpretation Act* as in force at the date on which this Act received the Royal Assent (7 December 1997) applies to this Act.	*Trans-Tasman Mutual Recognition (Victoria) Act 1998* (Vic)
3.	*Criminal Code Act 1995* s 100.5	For the purposes of Part 5.3, the *Acts Interpretation Act* applies as in force on the day on which Schedule 1 to the *Criminal Code Amendment (Terrorism) Act 2003* commenced (29 May 2003). Despite that, ss 2D, 2E and 2F *Acts Interpretation Act* apply to Part 5.3 (see s 100.5(3), added after commencement).	*Terrorism (Commonwealth Powers) Act 2003* (Vic)
4.	*Water Act 2007* s 5	The *Acts Interpretation Act* as in force on the day on which Schedule 1 to the *Water Amendment Act 2008* commenced (15 December 2008) applies to Parts 1A, 2A, 4, 4A, 10A and 11A.	*Water (Commonwealth Powers) Act 2008* (Vic)
5.	*Fair Work Act 2009* s 40A	The *Acts Interpretation Act* as in force on 25 June 2009 applies to this Act.	*Fair Work (Commonwealth Powers) Act 2009* (Vic)
6.	*Personal Property Securities Act 2009* s 11	The *Acts Interpretation Act* as in force at the start of the day on which this Act received the Royal Assent (14 December 2009) applies to this Act.	*Personal Property Securities (Commonwealth Powers) Act 2009* (Vic)

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Appendix C: Commonwealth Acts supported by a referral but not subject to a 'frozen' Acts Interpretation Act

	Commonwealth Act	Type of referral: subject matter, text-based or 'adoption'?	Example state referral Act
1.	*Australian National Airlines Act 1945*	Subject matter	*Commonwealth Powers (Air Transport) Act 1950* (Qld) *Commonwealth Powers (Air Transport) Act 1952* (Tas) • Only Queensland and Tasmania have passed referral legislation
2.	*Family Law Act 1975*	Subject matter	*Commonwealth Powers (De Facto Relationships) Act 2004* (Vic) *Commonwealth Powers (Family Law-Children) Act 1986* (Vic)
3.	*Proceeds of Crime Act 2002*	Text-based in the case of NSW Adopted by South Australia	*Unexplained Wealth (Commonwealth Powers) Act 2018* (NSW) *Unexplained Wealth (Commonwealth Powers) Act 2021* (SA) • NSW and South Australia have passed referral legislation
4.	*National Consumer Credit Protection Act 2009*	Text-based in the case of Tasmania Adopted by other States	*Credit (Commonwealth Powers) Act 2009* (Tas) *Credit (Commonwealth Powers) Act 2010* (NSW)
5.	*National Vocational Education and Training Regulator Act 2011*	Text-based	*Vocational Education and Training (Commonwealth Powers) Act 2010* (NSW)
6.	*Business Names Registration Act 2011*	Text-based	*Business Names (Commonwealth Powers) Act 2011* (NSW)
7.	*National Redress Scheme for Institutional Child Sexual Abuse Act 2018*	Text-based	*National Redress Scheme for Institutional Child Sexual Abuse (Commonwealth Powers) Act 2018* (NSW)

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Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL5

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Risk and Reform in Australian Financial Services Law

March 2022

This discussion of the role of risk in reform of Australian financial services law is the fifth in a series of background papers to be released by the Australian Law Reform Commission as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish three Interim Reports during the Inquiry, and these Reports will include specific questions and proposals for public comment. A formal call for submissions will be made on the release of each Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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Introduction

1. The concept of risk occupies a central position in societies, economies, financial systems, and markets, as well as in financial regulation and regulation more broadly. Taking risks and managing risks is a part of human existence: and as Bernstein notes, advances in our 'capacity to manage risk, and with it the appetite to take risk and make forward-looking choices, are key elements of the energy that drives the economic system forward'.[1] In particular, present in much thinking about risk is the trade-off between risk and return. In financial markets, a greater willingness to bear risks is often associated with the potential for larger rewards.

2. This Background Paper examines changing approaches to risk in Australian financial services regulation and the extent to which regulation has not adapted to take account of these new approaches. Chapter 7 of the *Corporations Act 2001* (Cth) ('*Corporations Act*'), and other financial services laws, offer a tapestry that tell the story of how different regulatory approaches to risk have evolved over the past twenty years.

3. The Paper suggests that this tapestry, and the regulatory philosophies that have woven it, have evolved in response to new understandings of risk: how and to what extent regulators should manage it; how consumers understand it; and the increasing extent to which consumers are exposed to it. Behavioural economics, financialisation, the 'risk-shift' to individuals in areas such as superannuation, and international developments such as the Global Financial Crisis, have all informed new understandings of and approaches to risk. In particular, this Paper considers how shifting approaches to product risks, conduct risks, and institutional and systemic risks, have shaped Australian financial regulation.

The key finding: the legislative architecture matters

4. The central finding of the Paper is that the legislative architecture for regulating product risks and conduct risks in financial services legislation has struggled to adapt to, and facilitate, changes in regulatory philosophies. As Parts Two (product risks) and Three (conduct risks) demonstrate, disclosure- and conduct-focused financial services legislation has been subject to dramatic reform over the past thirty years. These have often been driven by efforts to implement shifting regulatory philosophies, notably towards risk.

5. As the history of changing approaches to product and conduct risks illustrates, financial services regulation in Chapter 7 of the *Corporations Act* lacks an architecture that can adapt to and support changes in regulatory philosophies without generating significant complexity. Instead, reform of financial services law (particularly Chapter 7) has occurred through a complex mix of exemptions, conditions, notional amendments, obligations, and prohibitions, contained in regulations, ASIC or ministerial legislative instruments, as well as amendments to the *Corporations Act* itself. This has been driven, in large part, by the inconsistent legislative hierarchy in Chapter 7, which, for example, sees both principled and prescriptive obligations across various types of legislation: in the Act, regulations, and hundreds of ASIC instruments. Regulatory philosophies have been built upon one another through new initiatives, usually without much change to the law that came before. More interventionist philosophies towards risk, manifested in laws such as those regulating responsible lending, MySuper, or design and distribution obligations, have simply been built atop the pre-existing disclosure-focused architecture. Duplication and redundancy are by-products of the ad-hoc way in which the existing law has developed.

6. The Chapter 7 reform process can be contrasted with the way in which reforms concerning institutional and systemic risks have been incorporated in legislation administered by the Australian Prudential Regulation Authority ('APRA'). As Part Four of the Paper shows, prudential regulation

1 Peter L Bernstein, *Against the Gods* (John Wiley & Sons, 1998) 3.

has also seen significant changes in regulatory philosophies towards risk. The framework for regulating those risks, however, is embedded in legislation that can support evolving regulatory philosophies without the degree of complexity seen in Chapter 7. The framework is underpinned by a clear legislative hierarchy and functionally focused Acts for different activities (such as life insurance and banking). Acts establish the regulatory architecture, covering higher-level topics such as the establishment of prudentially-regulated institutions and the powers of APRA. Acts empower APRA to make prudential and reporting standards (as legislative instruments) that cover the detailed obligations to which an entity is subject and which can evolve as needed, often following long periods of highly technical consultation. This legislative framework creates a clear allocation of responsibilities between Parliament, the Treasury, ministers, and APRA, which has proven important in reforms to prudential regulation. Unlike Chapter 7 of the *Corporations Act*, where there are overlapping responsibilities in many areas, the clear allocation of responsibilities has minimised duplication and complexity. Whether or not one agrees with the particular design choices underlying the APRA model of regulation, it has the key attribute of consistency: a regulated entity generally knows who will make the rules that affect it, the manner in which they will be made, and where those rules are located.

Policy and legislative complexity

7. The architecture of Chapter 7 of the *Corporations Act* has struggled to adapt to new policy positions rooted in shifting regulatory philosophies. However, as the accretion of law over the past twenty years illustrates, this Paper finds that policymakers have rarely been willing to undertake the difficult task of reviewing and revising earlier policies and regulatory philosophies. Instead, new law has been built upon the old. This has been a significant source of legislative complexity — and one which, under the current legislative architecture, drafters alone can do little to reduce.

8. For example, despite an increasing shift away from disclosure as the foundational regulatory tool, the vast majority of disclosure-related law remains unchanged. The continuing footprint of disclosure-related law in the *Corporations Act*, regulations, and ASIC legislative instruments, testifies to the reluctance of policymakers to review and simplify the fundamentals of existing legislation. This is despite disclosure having arguably been displaced or made less central by more interventionist policies, such as design and distribution obligations, bans on conflicted remuneration, and product intervention powers. The role of disclosure is ripe for simplification, both in terms of policy and legislative design. This Background Paper highlights the limits to legislative simplification that will exist unless there is a readiness to rationalise the policies and regulatory philosophies underlying the law and update the law and its architecture accordingly.

The Paper and the ALRC's Inquiry

9. The analysis in this paper has informed the ALRC's design of a legislative architecture that ensures that legislative complexity can be appropriately managed over time, while maintaining regulatory flexibility.[2] Overall, this Paper underlines the importance of: a clear and consistent legislative hierarchy that can facilitate reform with minimal complexity; regular review of existing provisions rooted in older regulatory philosophies; and a recognition that the policy positions of today may not be the policy positions of tomorrow. Designing a legal architecture that recognises these three elements would make for simpler and more adaptive financial services legislation.

2 Australian Law Reform Commission, 'Terms of Reference', *Review of the Legislative Framework for Corporations and Financial Services Regulation* (11 September 2020) <www.alrc.gov.au/inquiry/review-of-the-legislative-framework-for-corporations-and-financial-services-regulation/terms-of-reference/>.

Part One: Introducing risk

10. This Background Paper defines risk as 'the uncertainty about the outcome or payoff of an investment in the future'.[3] This definition is one quite specific to financial markets and services, and can be contrasted to the more colloquial definition of risk: 'the possibility of loss, injury, or other adverse or unwelcome circumstance; a chance or situation involving such a possibility'.[4] Far from being unwelcome, risk is an inevitable and, indeed, desirable feature of financial markets. The colloquial definition remains relevant, however, because it often the risk of financial loss that drives consumer decision making and to which regulation responds. But the first, more technical definition reflects the fact that particular risks are not inherently positive or negative, and must be understood in relation to the 'payoff' or return for bearing the particular risk.

Risk as a part of the financial system

11. Risk sits at the heart of the financial system. All financial products and services 'incorporate risk', and '[i]dentifying, allocating and pricing risk is a key role of the financial system'.[5] Some financial products, such as warranties and insurance, allow consumers to protect against risks of loss (but carry risks of their own). These products will often be priced for the risk the insurer is taking on from the consumers. Smokers and young drivers, for example, may pay more for life or car insurance. Other financial products require consumers to assume risks through an investment, such as by purchasing shares in a company, or through an investment vehicle (such as a superannuation fund). In making investment decisions, consumers have to balance 'the chance of positive returns against the risk of loss'.[6] In theory, this requires an investor to make judgements about a range of other risks, such as inflation, foreign currency, or liquidity risks. For example, investments in a fund that holds mostly European shares may fall in value if the value of the Australian dollar increases relative to the Euro (assuming the fund's returns are denominated in Euros, which are now worth less in Australian dollars). The inverse is also true: if the Australian dollar falls, some investments will become more valuable. Acquiring credit, such as residential loans, credit cards, or buy now pay later, carries the risks of 'indebtedness and/or interest rate increases'.[7]

3 Ronald W Melicher and Edgar A Norton, *Introduction to Finance: Markets, Investments, and Financial Management* (John Wiley & Sons, 16th ed, 2016) 8.

4 *Oxford English Dictionary* (online at 1 July 2021) 'risk, *n.*' (def 1). See also *Macquarie Dictionary* (online at 1 July 2021) 'risk' (def 1): 'exposure to the chance of injury or loss; a hazard or dangerous chance'. The ALRC acknowledges that this is a colloquial understanding of risk. In mathematics and economics, the concepts of risk and uncertainty have been the subject of continuous and ongoing debate as to their contours: John Maynard Keynes, 'The General Theory of Employment' (1937) 51(2) *The Quarterly Journal of Economics* 209, 214; Frank H Knight, *Risk, Uncertainty and Profit* (Riverside Press, 1921); Niall Ferguson, *The Ascent of Money: A Financial History of the World* (Penguin, 2008) 342–4; Mervyn King and John Kay, *Radical Uncertainty: Decision-Making for an Unknowable Future* (The Bridge Street Press, 2020); Peter L Bernstein, *Capital Ideas Evolving* (Wiley, 2009). In this literature, risk is inherently linked to probability theory. Risk is quantifiable, as in there being a 20% chance of rain tomorrow or a 1 in 8 million chance of a shark killing a swimmer. Risks can be contrasted to 'uncertainties', a point made by the economists Frank Knight in 1921 and John Maynard Keynes in 1937. Knight noted that '[u]ncertainty must be taken in a sense radically distinct from the familiar notion of Risk, from which it has never been properly separated … A measurable uncertainty, or "risk" proper… is so far different from an unmeasurable one that it is not in effect an uncertainty at all.' But scholars have disagreed on where risk ends and uncertainty or unknowability begins. Given this, we use the more colloquial understanding of risk in which 'possibility' is the focus, thus reducing the theoretical difference between 'uncertainties' and 'risk'.

5 Stan Wallis et al, *Financial System Inquiry* (Final Report, March 1997) 179.

6 Australian Securities and Investments Commission and Dutch Authority for the Financial Markets, *Disclosure: Why It Shouldn't Be the Default* (Joint Report No 632, October 2019) 10.

7 Ibid.

12. The financial system also exposes its participants to other types of risks. For example, every financial transaction is accompanied by 'counterparty risk'. This refers to the potential that the firm with which a customer is dealing may not be able to meet some or all of its obligations towards the customer. For instance, insurance held with an insolvent insurer will not protect the customer against the insured risks. Counterparty risk is among the most prevalent risks because anyone holding a financial product — even something as basic as a bank account — is exposed to the possibility that the product provider will go bankrupt, or fail to perform its side of the bargain for some other reason. Prudential regulation — which is discussed in Part Four of this Paper — is squarely aimed at managing, in some parts of the financial system, the institutional and systemic risks that increase counterparty risk.

Accepting risk

13. As noted, a degree of risk is unavoidable and, indeed, desirable in financial markets and services.[8] Risk is also constantly evolving with the development of new financial products and services, and the increasing complexity of existing products. Recent examples include a range of derivative products such as contracts for difference ('CFDs') that are linked to cryptocurrencies or other crypto-assets. Financial markets also see the emergence of new risks or risks that gain greater prominence. Examples of such risks include climate risk and environmental, social, and governance risks.

14. The existence and acceptance of risk in financial markets makes financial services regulation fundamentally different from other areas of regulation that seek to eliminate risk to a greater extent, such as consumer goods safety regulation.[9]

Risk and return

15. Historically, since at least the Campbell Inquiry and the deregulation of financial markets in the 1980s, the regulatory philosophy for financial services has not focused on significantly reducing the risks faced by consumers.[10] This has been justified on the basis that risk is not only an inevitable part of financial markets, but a desirable feature. The Campbell Inquiry emphasised the importance of a 'reasonably full spectrum of risk/return combinations' being 'available to investors'.[11] The Inquiry noted that excessive government regulation 'might create a "gap" in the investment risk spectrum'.[12] Risk gaps would mean that 'investors … do not have available to them an asset which involves a moderate degree of risk'.[13] The need for a risk spectrum that includes higher risk products is based in part on the view that higher risk investments can be good for the economy — 'a necessary part of innovation and competition'.[14] Individuals, as illustrated by the Campbell Inquiry's views, also need access to products that incorporate a spectrum of risks, based on their risk tolerance and capacity (see Figure 1).

8 Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (LexisNexis Butterworths, 10th ed, 2021) 5.
9 Wallis et al (n 5) 189–190.
10 There are important exceptions to this general approach in prudentially regulated institutions and products, where a willingness to intensively regulate financial promises and the ability to meet them was accepted. See Part Four of this Background Paper.
11 JK Campbell et al, *Australian Financial System: Final Report* (Final Report, September 1981) 286.
12 Ibid 327.
13 Ibid 4. Campbell also noted the importance of risk-free assets, which could be provided by 'indexed government securities': 743.
14 Productivity Commission, Australian Government, *Competition in the Australian Financial System* (Inquiry Report No 89, June 2018) 16.

Figure 1: Risk tolerance and capacity

Risk tolerance refers to the willingness of a person to bear the likelihood of an adverse financial event or the general uncertainty or volatility that accompanies investments. This may be affected by a person's characteristics, such as age, employment status, experience, and wealth. Younger people may be more tolerant of risk because they have time to make up for losses through years of future employment. Alternatively, they may be less tolerant of risk as a result of the need to save for a home deposit or to generate income to service a mortgage. People with a higher risk tolerance may prefer shares in companies with more speculative growth prospects, or be willing to experiment with high-risk cryptocurrencies, while those with a lower risk tolerance may prefer to keep more of their wealth in bonds, term deposits, cash, or the equity in their homes. People with more financial experience may be willing to engage in higher-risk investing strategies, such as by using leverage (ie borrowing money to invest).

Risk capacity refers to someone's ability, as distinct from willingness, to bear the consequences of, and absorb any losses arising from, a financial investment. People with more wealth are more likely to be able to endure a soured financial investment, assuming they have diversified and not exposed all of their wealth to the same risk.

16. The risk spectrum only makes sense because individuals and organisations who bear risks are willing to do so in return for the possibility of being rewarded. This is the allocative function of financial markets — risks can be shifted from those less willing and able to bear them to those more willing and able to bear them. In the market economy, these risks are allocated for a price.

17. This illustrates the concept of the 'risk/return' relationship, which is fundamental to the pricing of financial products and services. The Campbell Inquiry noted that 'investments which offer equal risk/return combinations are priced equally and borrowers with equal risk are offered similar terms and conditions'.[15] Likewise, the Wallis Inquiry considered that risk, 'in an efficient system, is priced to reward those who bear it'.[16]

18. At the core of the risk and return relationship is a trade-off: people who are willing to bear more risk generally stand to gain higher returns. For example, investors in the stock market generally receive an equity risk premium relative to persons holding less risky assets, such as bonds.[17] Banks who lend to high-risk borrowers will demand a higher interest rate, and life insurers will charge higher premiums to cigarette smokers. The willingness to carry risks brings with it the possibility of greater reward.

15 Campbell et al (n 11) 1.
16 Wallis et al (n 5) 299.
17 Ferguson (n 4) 125–6. Bondholders enjoy priority over shareholders in bankruptcy proceedings.

19. A range of financial instruments and intermediaries have been developed to allocate and carry risks in the financial system. For example, the Wallis Inquiry identified financial products including ‘swaps, futures, options and forward contracts’ as managing risks ‘such as movements in currencies and interest rates, share prices and commodities’.[18] Airlines often buy oil futures contracts, a type of derivative, to manage their exposure to commodity risks (ie the risk of the price of oil increasing).[19] If the price of oil rises, the airline can offset the higher costs with profits derived from its futures contracts. The other party in the transaction, perhaps a hedge fund, is paid for their willingness to bear the risk of oil prices falling. If the fund considers the likelihood of oil prices falling is high, it will demand a higher risk premium (ie a higher price for taking the risk).

Risk and regulation

20. While not a focus of this Background Paper, it is useful to recognise the increasing role that risk has played in the methodologies underlying regulation. Risk-based regulation has become increasingly embedded in the practices of regulators since the early 2000s, and this has shaped their approaches in financial services. The ALRC outlined risk-based regulation in Interim Report A of the Financial Services Inquiry.[20]

A changing Australian financial system

21. Before considering the changes that have occurred in the regulation of risk in Australia’s financial system, it is necessary to understand two aspects of the broader context. Two significant and related consumer-facing changes have formed the backdrop to these changes: the ‘risk shift’ from government and employers to individuals that has occurred over the past thirty years, and the accelerated financialisation that has accompanied this development.[21] These trends were apparent at the time of the 1996 Wallis Inquiry, but their development and impact have increased significantly since then. These consumer-facing trends have also been accompanied by changes in regulatory theory, including the development of the field of behavioural economics.

Risk shift

22. The ‘risk shift’ refers to the increasing risks individuals have taken on, as opposed to employers or governments.[22] Some of these risks have resulted from deregulation. For example, the movement away from interest rate controls, in conjunction with a lack of long-term fixed-rate residential mortgages such as those in the US,[23] has meant that households bear the risk of interest rate movements on their home loans. Likewise, as Wallis observed in 1996, ‘governments have sought, through superannuation initiatives, to encourage reduced dependence by retirees on the age pension’.[24] Subject to the age pension, which provides a floor to retirement incomes, this has shifted the risk of having sufficient funds to support people in retirement from governments to the individual. There has also been a move away from defined-benefit retirement savings products, whether provided by employers or super funds, and towards accumulation funds.[25] Accumulation funds, as opposed to defined-benefit funds, mean that individuals directly bear market performance risks and face a variable rate of return, and therefore a variable income stream in retirement (unless an individual acquires an annuity).

18 Wallis et al (n 5) 166.
19 Tanya Powley, ‘Ryanair Hit by Wrong Way Bet on Fuel’, *Financial Times* (online, 3 April 2020) <www.ft.com/content/8f6ec56a-accc-4b51-96ff-89f32ed5a7bc>.
20 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, November 2021) 81–2.
21 These changes are in addition to other developments, such as the internationalisation and deregulation of Australian financial markets.
22 John Quiggin, ‘Risk Shifts in Australia: Implications of the Financial Crisis’ in Greg Marston, Jeremy Moss and John Quiggin (eds), *Risk, Welfare and Work* (Melbourne University Press, 2010) 3–23.
23 C Breidbach et al, *FinFuture: The Future of Personal Finance in Australia* (University of Melbourne, 2019) 5.
24 Wallis et al (n 5) 81.
25 Breidbach et al (n 23) 5.

Financialisation

23. Increased individual exposure to risk has been accompanied by increasing exposure to financial assets and markets in particular, and the overall growth of the financial sector relative to the real economy. Scholars commonly refer to these trends as ‘financialisation’.[26] Financialisation has meant that the overall size of the financial sector has grown enormously, while the proportion of financial wealth has increased relative to non-financial wealth (such as net equity in real-estate).[27] Within financial wealth, there has been a move to market-linked investments, such as publicly-listed shares held within a superannuation fund.[28] As Wallis noted, ‘Australian households now rely more on the financial system and have greater exposures to particular financial service providers and to the financial system generally’.[29]

24. As at March 2021, every percentage point increase in the proportion of household wealth held in financial assets is equivalent to an increase of $152 billion. The 5 percentage point increase from 1988 to 2021 therefore means that individuals have $760 billion more in financial assets than would have been the case if the proportions remained as they were in 1988. The 11 percentage point increase since 1980 is equivalent to $1.67 trillion in March 2021 dollars.[30]

25. Financialisation has accompanied massive increases in the value of financial markets and financial assets. Based on ABS data,[31] the total financial assets of Australian households were valued at over $478 billion in June 1988. In March 2001, near the introduction of the Corporations Bill into the Commonwealth Parliament, this had increased to $1.3 trillion. By March 2021, the total wealth of Australian households in financial assets was $6.24 trillion — an increase of more than 450% in 20 years. All figures above and below are unadjusted for inflation.

26. Increases in household financial wealth are tied to increases in the size and diversity of Australian financial markets. The total size of financial markets,[32] as measured by the ABS’s Australian National Accounts, increased from $1.3 trillion in June 1988, to $4.3 trillion in March 2001, and to $19.5 trillion in March 2021. To put this in context, Australia’s annual GDP was $345 billion in 1988, $730 billion in 2001 and just under $2 trillion in the 2020-21 financial year.[33] Particular financial markets have also exploded in size. The market for derivatives and employee share schemes increased from $120 billion in March 2001 to over $720 billion in March 2021, down from $1.2 trillion in March 2020.

27. The increasing size of financial markets and their increased importance to the economy and households — and the risks that this brings for household wealth — have provided a critical backdrop to regulatory developments for at least the past twenty years. The Wallis Inquiry argued that these trends highlight ‘the importance of the overall efficiency and safety of the financial

26 Natascha van der Zwan, ‘Making Sense of Financialization’ (2014) 12(1) *Socio-Economic Review* 99; Jeffrey M Chwieroth and Andrew Walter, ‘Financialization, Wealth and the Changing Political Aftermaths of Banking Crises’ (2020) *Socio-Economic Review* (Forthcoming); Gerald A Epstein, ‘Introduction: Financialization and the World Economy’ in Gerald A Epstein (ed), *Financialization and the World Economy* (Edward Elgar, 2005).

27 Financialisation has seen household wealth in financial markets increase from 30% of total assets in 1980 to 36% in September 1988, to 38.80% in March 2001, and to 40.99% in March 2021: Australian Law Reform Commission, ‘Interim Report A: Financial Services Legislation’ (n 20) 107.

28 Wallis et al (n 5) 81. Almost all the increased exposure to financial markets has been due to increased exposure to market-linked investments. The proportion of household wealth in superannuation, shares, and other market-linked assets increased from 21% in September 1988 to 30% in March 2021: Australian Law Reform Commission, ‘Interim Report A: Financial Services Legislation’ (n 20) 107.

29 Wallis et al (n 5) 86.

30 Figures calculated from ABS data by the ALRC based on the overall value of household wealth in March 2021: Australian Bureau of Statistics, ‘Australian National Accounts: Finance and Wealth’, *National Accounts* (24 June 2021) Table 35 <www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-finance-and-wealth/mar-2021>.

31 Ibid.

32 This refers to the sum of total assets outstanding at end of period for various financial instruments. See Tables 39–49 of the Australian Bureau of Statistics (n 30).

33 Federal Reserve Bank of St. Louis, ‘Current Price Gross Domestic Product in Australia’, *FRED* <fred.stlouisfed.org/series/AUSGDPNADSMEI>. These figures are not seasonally adjusted or inflation adjusted.

system'.[34] CLERP 6 emphasised that 'the increasing exposure of household investment to market risk underscores the importance of effective regulation of Australian financial markets'.[35] More recently, the Productivity Commission noted in 2018 that the

> vital importance of financial services to the ongoing operation and the growth prospects of the economy, as well as the extent of information asymmetry, build a strong case for a high level of regulatory intervention. The objective of intervention is to reduce risk, generally.[36]

28. As this Background Paper will demonstrate throughout, the increased exposure of consumers to financial markets, the 'risk shift' identified above, and the dramatic increases in the scale and complexity of such markets, has provided the backdrop to enhanced regulatory interventions.

Part Two: Product risks

29. In Australia, financial regulation designed to protect consumers has historically focused on ensuring that 'adequate information [is] available to assist investors in assessing the risks and expected returns attached to various financial assets'.[37] Efficient financial markets, in which products are priced according to their expected risks and returns, are thought to require the reduction of information asymmetries (that is, the discordance between information known by the buyers and sellers of products). Reducing asymmetries requires disclosure of information to persons deciding whether to buy particular financial products, including information that will enable those buyers to assess the potential risk/return trade-off (such as the product's features, estimated return, duration etc) and make an informed decision as to whether to buy the product.[38] Disclosure rules seek to ensure that market participants can understand, measure, and manage the various risks to which they are or may be exposed.[39] This Part considers how this philosophy has been implemented, and explores how shifts in understandings of risk have led to legislative reforms that incorporate more prescriptive and interventionist regulatory philosophies. This Part demonstrates the key themes of this paper: the legislative architecture has shaped how reforms to manage product risk have occurred, and reforms have been accompanied by an unwillingness to revisit existing regulation embedded in older regulatory philosophies.

The Wallis Inquiry and financial services reform

30. The Wallis Inquiry situated disclosure 'at the core of any scheme to protect consumers as it allows them to exercise informed choice'.[40] Product disclosure, the Inquiry recommended, should be consistent across similar products, as well as 'comprehensible and sufficient to enable a consumer to make an informed decision relating to the financial product'.[41] The Department of the Treasury's CLERP 6 reforms required disclosure of 'the fundamental terms and obligations attaching to a financial product as well as the risks involved with the product'.[42] The regulatory philosophy underlying these reforms was one of contractual freedom.[43] Consumers were assumed

34 Wallis et al (n 5) 86.
35 Department of the Treasury (Cth), *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment* (Corporate Law Economic Reform Program, Proposals for Reform: Paper No 6, 1997) 17.
36 Productivity Commission, Australian Government (n 14) 14.
37 Campbell et al (n 11) 3.
38 Ibid.
39 However, regulation has never meant perfect information: '[a]mong the risks that investors may be rewarded for bearing are those deriving from imperfect information': Wallis et al (n 5) 251. This means that people will always have an imperfect understanding of the risks they face, such as the likelihood of a company going bankrupt, a financial promise not being kept, an economic downturn, or interest rates rising.
40 Ibid 261.
41 Ibid 264. The Inquiry also proposed a range of reforms to disclosure in relation to the offers of securities, though these will not be further considered in this section.
42 Department of the Treasury (Cth), *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment* (n 35) 4.
43 'In a market economy, consumers are assumed, for the most part, to be the best judges of their own interests': Wallis et al (n 5) 191.

to be broadly capable of making decisions about the right financial products to acquire, and to understand the risks associated with their acquisition. This decision-making process was to be supported by disclosure requirements, and reinforced by obligations regulating the conduct of financial product providers in the sale of their products. Those obligations include prohibitions on misleading and deceptive conduct and representations, and against unconscionable conduct.[44]

31. The Wallis Inquiry and CLERP 6 eventually saw the introduction of a new Part 7.9 in the *Corporations Act 2001* as part of broader amendments in the *Financial Services Reform Act 2001* (‘*FSR Act*’).[45] Part 7.9 introduced the product disclosure statement (‘PDS’) as the standard disclosure document for most financial products. Section 1013D of the Act outlines the required content of a PDS.[46] This includes ‘information about any significant risks associated with holding the product’.[47] Various other information must also be contained in a PDS, in part to assist consumers in assessing (and comparing) risks. For example, s 1013D mandates disclosure of ‘information about any significant benefits to which a holder of the product will or may become entitled, the circumstances in which and times at which those benefits will or may be provided, and the way in which those benefits will or may be provided’.[48] Such information allows consumers to consider the product’s benefits and the way in which they are provided, and to consider those benefits against the risk of not receiving them (or experiencing losses). The information in a PDS is key to a consumer’s assessment of a product’s ‘risk/return’ trade-off. Further, where a product has an investment component, the Act requires disclosure of ‘the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment’.[49] This information allows consumers to assess what are commonly known as ‘ESG’ (environmental, social, and governance) risks.

32. PDSs are therefore designed to function as the means by which consumers assess the risks and benefits of a product, and decide whether they should acquire the product in light of that assessment. Disclosure is intended to allow consumers to make informed decisions as to a product’s risk/return trade-off and whether this is appropriate for them in light of their risk tolerance and capacity. As such, disclosure has been understood as being at the core of financial product regulation.

Making disclosure work better

33. Almost as soon as it was passed, the disclosure provisions in the *Corporations Act* began to evolve. Much of the 2000s and the early 2010s were spent trying to make PDSs, and other disclosure regimes, work better for consumers. This occurred in the context of a growing body of research highlighting the limitations of standardised disclosure and the ability of consumers to process information. The focus of policy-makers shifted to ‘good’ or ‘effective’ disclosure, including disclosure that was tailored to particular products and circumstances. Good disclosure, it was hoped, would better assist consumers in assessing the risks and benefits of financial products. Policy-makers also understood that excessive standardised disclosure was difficult for consumers to understand, and expensive for businesses to produce.

34. Even before the passage of the PDS regime in 2001, it was understood that disclosure had its limitations — hence the need for general conduct obligations (such as those against misleading or unconscionable conduct). Experimental research as early as the 1940s and 1950s had highlighted the limitations of theories that assumed the rationality of human decision-making,

44 *Australian Securities and Investments Commission Act 2001* (Cth) ss 12DA, 12DB, 12DC; *Corporations Act 2001* (Cth) ss 908DB, 1041E.
45 A range of other disclosure reforms were included in the *FSR Act*. See, for example, the introduction of Financial Services Guides in Part 7.7.
46 The information in s 1013D is not required in certain circumstances: s 1013F.
47 *Corporations Act 2001* (Cth) s 1013D(1)(c).
48 Ibid s 1013D(1)(b).
49 Ibid s 1013D(1)(l).

on which much standardised disclosure was premised. Allais, for example, found that ‘in a context of risky outcomes, the key factor for the decision-maker is the risk level of the selected option’ in an absolute sense — which was prioritised over consideration of the likelihood of financial loss and return.[50] Research into human decision-making further accelerated with the work of Daniel Kahneman and Amos Tversky, which challenged assumptions about how humans understand and cope with risk, probabilities, and uncertainties.[51] Behavioural economics, as this field of study would become known, garnered popular awareness in the 2000s, most notably as a result of the book *Nudge* by Richard Thaler and Cass Sunstein.[52]

Precursors to better disclosure

35. More prescriptive intervention in consumer decision-making — as represented by ‘good’ or ‘effective’ disclosure and ‘nudges’ — was not without precedent in Australian law. The *Insurance Contracts Act 1984*, from its inception, prescribed a ‘standard cover regime’ for certain insurance contracts. This regime included minimum claim amounts and cover, as provided in the *Insurance Contracts Regulations*. Insurers could opt out of the minimum standard cover provided that they ‘clearly informed the insured in writing … or the insured knew, or a reasonable person in the circumstances could be expected to have known,’ that they were not covered by the standard cover.[53] Insurers were also required to notify insureds of any contractual provision ‘of a kind that is not usually included in contracts of insurance that provide similar insurance cover’.[54] Notification could occur by giving the insured a copy of the insurance policy or by demonstrating that the insurer ‘clearly informed the insured in writing of the effect of the provision’.[55] Both these steps were early examples of ‘nudges’, and the ALRC pointed to the potential for information asymmetries and information overload from disclosure when it recommended such a regime in 1982.[56]

36. The enhanced disclosure for unusual contract terms recognised that consumers were unlikely to fully understand the risks covered by the insurance, based on the general description of the product.[57] While insurers could derogate from the standard cover, consumers were ‘nudged’ to consider whether they were happy with this reduced cover. Tailored and enhanced disclosure is therefore nothing new in Australian law. Nonetheless, the scope of reforms made to the PDS and other disclosure regimes in the 2000s and 2010s is notable, and reflects the development of behavioural economics and an appreciation of the increased risks consumers have borne with the financialisation of the Australian economy.

Legislating for better disclosure

37. Reforms to disclosure introduced immediately after the commencement of the *Corporations Act* were aimed at reducing the volume of information provided to consumers, or tailoring how or when it would be provided. Tailoring initially occurred through regulations such as reg 7.9.02A,[58] which allowed PDSs to be given in certain ways so long as the consumer agreed. Likewise, reg 7.9.07B adapted standard disclosure provisions for certain market-traded derivatives.[59] Tailoring regulation to reflect the degree of risk was also reflected in the definition of ‘retail client’ in new regulations. These regulations sought to exclude persons who were ‘better able to assess the

50 Anne-Francoise Lefevre and Michael Chapman, Behavioural Economics and Financial Consumer Protection (OECD Working Papers on Finance, Insurance and Private Pensions No 42, 2017) 5.
51 Daniel Kahneman and Amos Tversky, ‘Prospect Theory: An Analysis of Decision under Risk’ (1979) 47(2) *Econometrica* 263.
52 Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Yale University Press, 2008). For a discussion of these developments, see Lefevre and Chapman (n 50) 6.
53 *Insurance Contracts Act 1984* (Cth) s 35.
54 Ibid s 37.
55 Ibid.
56 Australian Law Reform Commission, *Insurance Contracts* (Report No 20, 1982) xxvi. The ALRC’s report also underlines how far disclosure has come in the past forty years: the ALRC suggested in the 1981 review that ‘there should be no requirement that an insurer should, in every case, provide the insured with a copy of his contract’: Ibid xxiv.
57 Australian Law Reform Commission, ‘Insurance Contracts’ (n 56) 30, 44.
58 *Corporations Amendment Regulations 2002 (No. 2)* (Cth).
59 Ibid.

risks involved in financial transactions' from the definition of retail client,[60] which meant they did not receive various mandated disclosure. ASIC also made a number of legislative instruments that reduced disclosure requirements for some lower-risk products.[61]

38. Further amendments in 2001 sought to tailor PDS requirements for different products and circumstances. For example, reg 7.9.15 required enhanced disclosure in relation to insurance products issued by unauthorised foreign insurers, because such products were regarded as carrying greater risks for consumers. Superannuation and retirement saving account products were also subject to more detailed disclosure requirements. However, disclosure for capital guaranteed superannuation products and retirement savings account products were 'subject to differing requirements from other regulated superannuation products due to their lower risk-return nature'.[62] Good disclosure also came with an understanding that the way information is provided to consumers is important, which was reflected in a range of reforms.[63]

39. Significant reforms to PDSs occurred in 2005 with new exemptions that sought to reduce the volume of redundant information given to consumers, and with a new 'short-form PDS' regime. For example, new regulations 'turned off' a range of disclosure provisions that applied to general insurance products.[64] Regulation 7.9.15D turned off the requirement that insurers disclose 'significant risks associated with holding the product' because government 'considered that insurers appropriately disclose risks' through other arrangements.[65] Regulation 7.9.15E required certain enhanced disclosure to draw terms and conditions to a consumer's attention. New regulations also exempted certain products from the PDS regime in particular circumstances, including for simple low-risk products like basic deposit products.[66]

40. It was the 'short-form PDS' regime that marked the first concerted effort to improve financial product disclosure. The Explanatory Statement accompanying the changes noted that

> PDSs have as a rule turned out to be complex and lengthy documents. Consumer feedback suggests that the average retail investor finds it difficult to absorb the large volume of information in some PDSs, and is therefore deterred from using the information to make investment decisions. …
>
> The overall intention is to give financial product providers the flexibility to create a document that is not only shorter, but also more tailored to the individual product, and that is written in a manner that is more appealing and informative for the retail client.[67]

41. The shift towards shorter disclosure documents was part of an international trend, and driven in significant part by findings from behavioural research.[68] In Australia, it also led to the shorter-

60 See *Corporations Amendment Regulations 2001 (No. 4)* (Cth) regs 7.1.11–7.1.28; Explanatory Statement, Corporations Amendment Regulations 2001 (No. 4) (Cth).

61 See, for example, *ASIC Class Order — Investor directed portfolio services* (CO 02/294) 296; *ASIC Class Order — Nominee and custody services* (CO 02/295) 296; *ASIC Class Order — Managed Discretionary Accounts* (CO 02/296) 296; *ASIC Class Order — Managed Discretionary Accounts* (CO 04/194) 194.

62 *Corporations Amendment Regulations 2001 (No. 4)* (Cth) reg 7.9.11, schs 10B, 10C; Explanatory Statement, Corporations Amendment Regulations 2001 (No. 4) (Cth).

63 The *Corporations Regulations* were amended four months after their Gazettal to provide that s 1015C of the *Corporations Act* was modified so that the Regulations could provide 'for the format of a Product Disclosure Statement, including the location of particular statements or information': *Corporations Amendment Regulations 2001 (No. 4)* (Cth) s 5.1. Section 1015C already provided that the regulations could mandate the 'presentation, structure and format for a Statement that is to be given in electronic form'.

64 *Corporations Amendment Regulations 2005 (No. 5)* (Cth) regs 7.9.15D, 7.9.15F.

65 Explanatory Statement, Corporations Amendment Regulations 2005 (No. 5) (Cth) 24.

66 *Corporations Amendment Regulations 2005 (No. 5)* (Cth) reg 7.9.07FA. In addition to their low-risk, the Explanatory Statement noted that providers of such products generally complied with ASIC's *Guide to Good Transaction Fee Disclosure for Bank, Building Society and Credit Union Deposit and Payments Products*, which 'contains principles for effective disclosure': Explanatory Statement, Corporations Amendment Regulations 2005 (No. 5) (Cth) 21.

67 Explanatory Statement, Corporations Amendment Regulations 2005 (No. 5) (Cth) 13.

68 Andrew Godwin and Ian Ramsay, 'Financial Products and Short-Form Disclosure Documents: A Comparative Analysis of Six Jurisdictions' (2015) 10(2) *Capital Markets Law Journal* 212, 213; Andrew Godwin and Ian Ramsay, 'Short-Form Disclosure Documents—An Empirical Survey of Six Jurisdictions' (2016) 11(2) *Capital Markets Law Journal* 296, 300.

PDS regime in respect of certain financial products. Research suggests that the Australian reforms have been notably unsuccessful in simplifying product disclosure.[69] Notably, these reforms, like many in this period, were introduced through notional amendments to the *Corporations Act*,[70] a particularly complex means of lawmaking.

42. Under the Australian reforms, short-form PDSs could be given to consumers instead of a PDS, but product issuers were still required to prepare a PDS and consumers were entitled to request one. The short-form PDS was required to contain 'a summary of defined core information relating to the product'.[71] This included information on significant risks associated with the product, and information required by s 1013D (that would allow consumers to assess the risk/return trade-off).[72] The principle that consumers were best placed to make decisions about their exposure to risk was core to all of these reforms. Regulation was adapted to suit products, and the risks of those products, but the ultimate responsibility still lay with the consumer, who it was assumed would consider the disclosures before making a decision. However, significant changes to this philosophy came in 2009 and 2010.

Disclosure and regulatory risks

43. Risks to consumers undoubtedly played an important role in shaping the design and reforms of the disclosure regime in the 2000s. However, the detailed disclosure provisions included in the *FSR Act*, and the move to make these more prescriptive in the subsequent decade, may also have been driven by financial services law seeking to reduce other types of risk: compliance and regulatory risks. It is possible that companies sought more detailed disclosure requirements in an effort to increase certainty as to their legal obligations, and thereby to address the regulatory or compliance risks that a more principled framework may be perceived to introduce. However, attempts to facilitate compliance through prescription has meant that the law may fail to achieve its more fundamental objective of consumer protection. This is because prescriptiveness can itself introduce risks of non-compliance by increasing the complexity and sheer scale of the legislation, thereby making it harder to understand and enforce.

44. There is also a more fundamental sense in which prescriptive disclosure can distract from broader obligations that licensees and other providers of financial products and services have in relation to consumers. Disclosure can be perceived as a risk shift — having informed a consumer of the risks in a product or service, a company may feel that it has executed its responsibilities.[73] This can detract from the broader conduct obligations that providers of financial products have to retail clients. In particular, an emphasis on prescriptive disclosure requirements, including as to the content and form of information, may focus compliance on black and white aspects of the law, rather than the more indeterminate requirements imposed by prohibitions such as that against misleading and deceptive conduct or the requirement that AFS licensees act efficiently, honestly, and fairly. Incidents such as the collapse of Storm Financial and examples from the Financial Services Royal Commission ('FSRC') also illustrate the way in which complying with disclosure provisions may create a sense of licence to disregard consumer interests or generally accepted norms of conduct, whether in the law or not. Prescriptive content and timing requirements, such as in relation to Statements of Advice for personal advice, may also simply reduce the time that can be given to actually providing advice, and add to the costs of such advice. The fundamental obligations of an advisor — to act in the best interests of the client — can be overwhelmed by the disclosure obligations to which an advisor is subject.

69 Australia's short-form PDSs are 'overwhelmingly considered to be the hardest to read' among comparable jurisdictions: Godwin and Ramsay, 'Short-Form Disclosure Documents—An Empirical Survey of Six Jurisdictions' (n 68) 297.
70 Largely contained in Schedule 10BA of the *Corporations Regulations 2001*.
71 Explanatory Statement, Corporations Amendment Regulations 2005 (No. 5) (Cth) 13.
72 See s 1017I, as notionally inserted by Schedule 10BA in *Corporations Amendment Regulations 2005 (No. 5)* (Cth).
73 There is evidence for this in relation to conflicts of interest, for example: Australian Securities and Investments Commission and Dutch Authority for the Financial Markets (n 6) 42.

Legislating to reduce product risks

45. The introduction of responsible lending requirements, provisions invalidating unfair contract terms, MySuper, and payday loan reforms, marked significant shifts in how regulation addressed risks facing consumers in the acquisition of financial products.[74] Both represented shifts from disclosure-led regulation to more interventionist forms of consumer protection. They also resulted from a more explicit focus on risks faced by consumers, which had been more implicit in the early- to mid-2000s.[75] However, in building new regulatory regimes, policymakers left the old disclosure regimes largely intact (and in some instances even increased their scale). This remains a persistent theme in financial services law: the slow accretion of laws and regulatory regimes reflecting new regulatory philosophies, with little desire to revisit or dismantle what came before.

Responsible lending

46. Disclosure was a central feature of consumer protection under each Australian state's Uniform Consumer Credit Code (UCCC).[76] Pre-contractual disclosure was based on the 'principle of truth-in-lending', which it was presumed would 'allow borrowers to make informed choices when purchasing credit'.[77] This reflected the objective of never 'restricting product flexibility and consumer choice'.[78] Any risks associated with a product, including affordability risks and the risk of non-payment, would be left to consumers.[79]

47. Responsible lending reforms were informed by two trends at the core of this Background Paper: increased engagement with behavioural economics, and accelerating financialisation. The Productivity Commission's 2008 work that led to responsible lending appears to have been heavily influenced by the growing body of research into human behaviour and decision-making.[80] The Commission observed that 'behavioural economists have drawn on longstanding insights into human behaviour to question whether consumers always behave in what standard economic analysis suggests is their best interests, even where they are adequately informed'.[81] While the Commission

> has often not explicitly separated behavioural rationales from other reasons for policy intervention, it sees the findings of behavioural economics as relevant to the design of consumer policies in a range of specific areas.[82]

48. Nonetheless, the contribution of behavioural economics 'lies in enriching existing analytical frameworks and improving the design and implementation of specific policies, rather than in providing a superior alternative framework'.[83] The attachment to the existing analytical framework explains the continued focus on disclosure in financial services regulation.[84]

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74 Responsible lending also reflected concerns as to the conduct of lenders and financial intermediaries. See [46]–[50] for discussion of responsible lending in this context.
75 Gail Pearson, 'Risk and the Consumer in Australian Financial Services Reform' (2006) 28 *Sydney Law Review* 99, 100.
76 See, for example, *Consumer Credit (New South Wales) Act 1995* (NSW) Consumer Credit Code ss 14–15.
77 Explanatory Note, Consumer Credit (New South Wales) Bill 1995 (NSW) 1.
78 Ibid 1–2.
79 Effective prudential regulation theoretically means that no lender should be able to systematically engage in irresponsible lending. However, such regulation is not aimed at ensuring the provision of appropriate credit to any particular consumer. See also Explanatory Memorandum, National Consumer Credit Protection Bill 2009, 3.15: the state regimes do not 'comprehensively address the appropriateness of the initial provision of the credit to the consumer'.
80 An entire appendix was given over to behavioural economics: Productivity Commission, Australian Government, *Review of Australia's Consumer Policy Framework* (Report No 45, Vol 2, April 2008) Appendix B.
81 Ibid 32.
82 Ibid 12.
83 Ibid 8.
84 See [55]–[57].

Figure 2: Examples of observed behavioural patterns[85]

Under-estimating low probabilities: A study of horseracing showed that punters generally over-bet on longshots. For example, horses with 2 per cent of the total money bet on them win only about 1 per cent of the time**.**

Overconfidence: A study showed that 80 per cent of respondents rated themselves in the top 30 per cent of drivers.

49. The Productivity Commission observed that rapid increases in the size of Australian consumer credit markets 'may well mean that modifications or augmentations to the regulatory regime are warranted'.[86] This financialisation, which had seen the real value of consumer loans grow at an annualised rate of 5 per cent since 1988, meant that household debt levels were 'at historically high levels'.[87] The risks to consumers had grown accordingly, and could affect 'household financial capacity and ability to respond to changing circumstances such as interest rate increases, a slowdown in economic conditions or rising unemployment'.[88] Responsible lending, in requiring that lenders, lessors, and intermediaries provide credit that is not 'unsuitable', responded to changes in how regulation understands consumer behaviour, and to the increased risks consumers faced as a result of their increased exposure to financial markets. In a legislative intervention that would likely have been regarded as objectionable by the Wallis Inquiry, lenders were required to refuse credit where 'the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship'.[89] They also had to refuse credit where it would not meet a 'consumer's requirements or objectives'.[90] These obligations marked a considerable departure from a regulatory philosophy that positioned disclosure as the principal means of consumer protection.

50. The mixture of regulatory philosophies implicit in the Productivity Commission's report was evident in the responsible lending reforms. The *National Consumer Credit Protection Act 2009* includes prescriptive and detailed disclosure requirements in the form of credit guides,[91] serving a similar purpose to PDSs for non-credit financial products. The late 2000s therefore mark the beginning of a shift in financial regulation to a more mixed regulatory philosophy. The Productivity Commission's report made clear that consumers still bore responsibility for their decisions, but that consumers could no longer be presumed to be the best guardians of their own interests (including in relation to the risks they assumed in financial markets).

Unfair contract terms

51. The introduction of unfair contract term ('UCT') provisions in the *ASIC Act* and the Australian Consumer Law was also the result of the Productivity Commission's Review of Australia's Consumer Policy Framework.[92] The Commission's proposed ban on UCTs sought to address the fact 'that consumers may underestimate certain risks'.[93] While the Review gave consideration to enhanced disclosure of unfair terms and mandatory cooling-off periods, the Commission concluded that consumers would be unlikely to genuinely engage with such disclosure or consider the risks and

85 Productivity Commission, Australian Government (n 80) 380.
86 Ibid 446.
87 Ibid 444.
88 Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) [3.8].
89 *National Consumer Credit Protection Act 2009* (Cth) s 131(2)(a).
90 Ibid s 131(2)(b).
91 Ibid pt 3-2, div 2.
92 The Ministerial Council on Consumer Affairs had considered a uniform ban in state legislation since August 2002 and Victoria had introduced a ban on UCTs in 2003: Productivity Commission, Australian Government (n 80) 56, 59.
93 Ibid 422.

benefits of an unfair term.[94] The reforms were calibrated to balance consumer and seller interests. The upfront price in a contract, for example, would not be an unfair term under the reforms, because these 'cannot legitimately be seen as surprises veiled by a complex contract'.[95] Likewise, the Commission proposed a model that did not allow regulators to 'pre-emptively rule out unfair terms that could cause (future) detriment to consumers'.[96] Instead, it would be necessary to show that actual contracts were entered into and that consumer detriment flowed from the inclusion of an unfair term.[97] UCTs were part of a new regulatory philosophy in which it was presumed that consumers would not consider all the risks and benefits involved in acquiring a product.

MySuper

52. The introduction of the MySuper suite of reforms was, like responsible lending, a response to the recognised flaws of human decision-making and the increased exposure of consumers to risks in financial markets. Superannuation carried with it the expectation that consumers would effectively manage financial risks to maximise their retirement income and achieve a better outcome than the age pension would allow. MySuper defaulted people into super products with a 'single diversified investment strategy'.[98] A person could choose to leave this default option and select another product or investment strategy, but would have to actively make this choice. The Super System Review (2009–10), which recommended MySuper, endorsed the 'nudge'-based language of 'choice architecture' in proposing a system that was designed,[99] by default, against 'investment choice'.[100] This system rejected the idea that consumers should be expected to assess investment risks and select the appropriate product or strategy for their circumstances. The Review pointed to 'inadequate levels of financial literacy and appreciation of risk' and 'complex disclosure needed to understand' the available options in rejecting the expectation of decision-making by consumers.[101] The Review also justified the reforms in the context of financialisation, with 'the superannuation system … expected to grow to $6.1' trillion by 2035.[102] According to the Review, this context necessitated a new regulatory architecture.

53. Disclosure still occupies a place of 'paramount importance' in the new architecture.[103] Those who decide to leave the default MySuper options 'bear substantial responsibility for the investment choices or fund choices that they made', albeit 'with trustee responsibility for reasonable due diligence on investment options offered'.[104] MySuper, in seeking to preserve consumer choice while ensuring a reasonable default option for disengaged consumers, was a manifestation of behavioural economics in policy and law design. It was a 'nudge' embedded in law.[105] The reforms marked yet another shift in the regulatory philosophy underpinning financial services law — one in which the role of choice by consumers was increasingly circumscribed.

94 Ibid 157.
95 Ibid 162.
96 Ibid 165.
97 Ibid 166.
98 *Superannuation Industry (Supervision) Act 1993* (Cth) s 29TC.
99 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department, *Super System Review* (Final Report, Part 1, June 2010) 9.
100 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department, *MySuper: Optimising Australian Superannuation* (Second Phase One — Preliminary Report, April 2020) 4.
101 Ibid.
102 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department, 'Super System Review' (n 99) 5.
103 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department, *Super System Review* (Final Report, Part 2, June 2010) 8.
104 Ibid.
105 Thaler and Sunstein's book of the same name appeared in the second footnote of Part 2 of the Super System Review's *Final Report*.

Payday loan and other 2012 credit reforms

54. A more interventionist regulatory philosophy was also reflected in 2012 reforms to the cost of small amount credit. These reforms sought to 'address particular risks identified' in relation to small amount credit contracts, as well as consumer leases and reverse mortgages.[106] The reforms included a cap on the cost that lenders could charge for some small amount credit contracts (being contracts for credit of $2,000 or less). The reforms also imposed a 'more restrictive cap on all other credit contracts'.[107] The reforms were aimed at reducing risks to consumers: the caps, for example, addressed 'specific risks of financial detriment or harm to consumers'.[108] The reforms were, in part, a response to the increased understanding that consumers — particularly those in financial distress — may not make informed decisions about the financial risks of taking on high-cost credit. Reforms relating to reverse mortgages also sought to limit consumer exposure to risk, particularly the potential that people could borrow so much as to eventually have negative equity in their houses (where the amount of the loan exceeds the value of the house).[109] The Explanatory Memorandum emphasises the particular 'difficulty in managing the risk of negative equity'.[110] Again, however, these reforms reflected the mixture of more interventionist consumer protections with a regulatory philosophy based on disclosure. A range of new disclosure requirements were mandated in the reform Bill (and the content of two disclosures regimes prescribed in the regulations),[111] reflecting a continued shift towards tailored and behaviourally informed disclosure obligations.

Disclosure is dead. Long live disclosure.

55. In the course of the 2000s and early 2010s, behaviourally informed disclosure, and disclosure adapted to particular products and circumstances, increasingly replaced the standardised disclosure regimes of the Wallis Inquiry and the *FSR Act*. In 2009, the Commonwealth took over the regulation of margin loans, which received a tailored disclosure regime.[112] Pursuant to the shorter-PDS regime as previously noted, certain superannuation products and simple managed investment schemes were also subject to highly prescriptive regimes governing the content, manner, and form of their product disclosure statements.[113] The Regulation Impact Statement for these reforms acknowledged that 'there has been considerable discussion about the overall effectiveness of current PDSs', and noted that the length of PDSs varied 'between 46 and 154 pages for superannuation products, and 32 and 124 pages for MIS [Managed Investment Scheme] products'.[114] It was recognised that the ability of consumers to assess the 'inherent risks associated with certain types of financial products' was undermined by complex disclosure documents.[115]

56. Outside the *Corporations Act*, enhanced and simplified disclosures — in the form of Key Fact Sheets ('KFS') — were introduced for a range of financial products. Home loans and credit

106 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) [1.5].
107 Ibid [1.14].
108 Ibid [5.6]
109 Ibid [3.1]. Reverse mortgages allow a person to borrow money from a financial institution while using the person's home as security for the loan. As long as the person continues to live in the home they do not need to make repayments on the loan. The interest payable on the loan compounds and increases the total amount repayable, and which is secured against the home. The loan is repaid when the person dies or sells the property. Depending on the size of the loan and the age of the borrower, interest can significantly increase the total amount repayable.
110 Ibid [10.14].
111 See the reverse mortgage information statement (ss 5(1), 133DB(1)(d)) and website requirements for small amount credit providers (s 124B). Other disclosure requirements included a lessor's obligation to account (sch 1, pt 11, div 5) and a requirement to give projections of equity in relation to reverse mortgages (s 133DB(1)(a)). These provisions were inserted into the *National Consumer Credit Protection Act 2009* (Cth) in the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth).
112 *Corporations Regulations 2001* (Cth) Schedule 10C. See also the various other amendments made by *Corporations Amendment Regulations 2010 (No. 5)* (Cth), including to Schedule 10A.
113 Ibid schs 10D, 10E.
114 Regulation Impact Statement, Corporations Amendment Regulations 2010 (No. 5) (Cth) [8].
115 Ibid [13].

cards became subject to a KFS regime in 2011. The Explanatory Memorandum emphasised the benefits of KFS over longer-form disclosure, suggesting that research from the UK 'found that consumers are using the KFI [the UK equivalent] to better understand the risks and features of the mortgages they take out, including the affordability risks'.[116] KFSs were also introduced for certain types of insurance policies in 2012 following devastating natural disasters in several states.[117] In endorsing KFSs for home insurance, the Natural Disaster Insurance Review found that the existing disclosure regime had 'failed to sufficiently inform consumers' of the risks covered by their insurance policies, including whether the policies covered flood risks.[118]

57. The accumulation of these reforms meant that, by 2013, the standard financial product disclosure regime in Part 7.9 of the *Corporations Act* had been so completely modified as to be unrecognisable.[119] It had also ceased to be 'standard' given how many products were subject to tailored regulatory regimes. The vast majority of the disclosure provisions introduced in the *FSR Act* and in the course of the 2000s remained in the *Corporations Act*, despite a recognition that the 'legislation surrounding disclosure is very complex'.[120] Writing in 2021, Tapley and Godwin suggested that there 'is good reason to question whether the current disclosure regime is coherent and achieves the outcomes it is designed to achieve'.[121] The regulatory philosophies underpinning the law had evolved, but the reforms had simply added to its volume and complexity.

Evolution or revolution? DDOs and PIOs

58. The Murray Inquiry published its final report in November 2014. While both the Wallis Inquiry and the Murray Inquiry were referred to as a 'Financial System Inquiry', they each surveyed very different regulatory and legislative landscapes. The Murray Inquiry represented an effort to reconcile the regulatory and legislative architecture of the 1996 Wallis Inquiry with the changes in financial markets and regulatory expectations that had occurred since 1996. Whereas Wallis spoke of 'fair and efficient markets',[122] Murray spoke of markets 'characterised by the fair treatment of users'.[123] A weakness of the current regulatory settings, Murray suggested, was that 'unfair consumer outcomes remain prevalent'.[124] This focus on consumer outcomes, rather than a more systemic focus on market outcomes,[125] underlined the fact that the Murray Inquiry embodied a different regulatory philosophy from that of the Wallis Inquiry. Concerns about how consumers engage with risk sat at the heart of many of the Murray Inquiry's recommendations:

> Consumers should have the freedom to take financial risks and bear the consequences of these risks. However, the Inquiry is concerned that consumers are taking risks they might not have taken if they were well informed or better advised.[126]

59. The focus of the Wallis Inquiry was on creating a fair playing ground on which consumers could transact. Regulation in the post-Wallis period was characterised by a focus on 'the three

116 Revised Explanatory Memorandum, National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 (Cth) [5.55].

117 Revised Explanatory Memorandum, Insurance Contracts Amendment Bill 2012 (Cth) [2.2].

118 Department of the Treasury (Cth), *Natural Disaster Insurance Review: Inquiry into Flood Insurance and Related Matters* (Final Report, September 2011) 103.

119 ASIC legislative instruments that imposed tailored product disclosure requirements include *ASIC Class Order — Investor Directed Portfolio Services Provided Through a Registered Managed Investment Scheme* (CO 13/762); *ASIC Class Order — Investor Directed Portfolio Services* (CO 13/763); *ASIC Class Order — Managed Discretionary Accounts* (CO 04/194). For a discussion of the extensive role of delegated legislation in financial product disclosure, see Phoebe Tapley and Andrew Godwin, 'Disclosure (Dis)Content: Regulating Disclosure in Prospectuses and Product Disclosure Statements' (2021) 38 *Company & Securities Law Journal* 315, 328–30.

120 Regulation Impact Statement, Corporations Amendment Regulations 2010 (No. 5) (Cth) [13].

121 Tapley and Godwin (n 119) 330.

122 Wallis et al (n 5) 178.

123 David Murray et al, *Financial System Inquiry* (Final Report, November 2014) xiii.

124 Ibid.

125 The chapter in the Wallis Inquiry report devoted to the philosophy of financial regulation made reference only to 'market outcomes' and 'efficient markets'.

126 Murray et al (n 123) 28.

building blocks of disclosure, education and advice'.[127] Disclosure and general protections against, for example, insider trading and misleading conduct, would seek to guarantee a fair market. But there was no particular emphasis on whether any particular consumer or class of consumers would in fact achieve good outcomes. The years between Wallis and Murray had seen this regulatory philosophy challenged by changed understandings of consumer behaviour and increased financialisation.[128] Legislative interventions such as those described in the preceding paragraphs had increasingly sought to protect consumers from risks in financial markets by imposing significant conduct obligations on firms. The Murray Inquiry concluded that new understandings of the financial system had 'reduced the Inquiry's confidence in the inherent efficiency and stability of financial markets'.[129] Nonetheless, the Murray Inquiry did not seek to completely abandon the regulatory philosophy of the Wallis Inquiry. In summarising general principles for policymakers, Murray suggested that

> Consumers should generally bear responsibility for their financial decisions, but should be able to expect financial products and services to perform in the way they are led to believe they will.[130]

60. In at least two of its recommendations, however, the Murray Inquiry underlined just how much this principle was subject to the caveat that consumers should 'generally' be responsible for their decisions.

Design and distribution obligations

61. Design and distribution obligations ('DDOs') marked a significant shift in the regulation of financial products in Australia. These obligations reflect a regulatory philosophy in which sellers of financial products — and not simply consumers — bear responsibility for ensuring that the products are suitable for their end-users. In doing so, DDOs strengthen 'product issuer and distributor accountability'.[131] At the core of DDOs is the requirement on financial firms to identify a 'target market' for a financial product, and then to develop product distribution processes that ensure sales of the product are directed only to consumers within that target market. The Murray Inquiry, which recommended the reforms, indicated that the 'risk/return profile' of a product was a central consideration in identifying a target market.[132] In other words, consumers should not be expected, based only on product disclosures, to determine whether a product is appropriate for them. Product issuers and distributors would also be expected to periodically review whether a product's 'risk profile is consistent with its distribution' to the target market.[133] For example, a target market may need to be narrower if an issuer determines that the product is higher risk than expected. Murray considered that DDOs would reduce the incidence of calamities like Storm Financial,

> where margin lending products did not suit consumer risk profiles, such as those approaching retirement who could only cover significant losses by selling the family home. Close to 2,800 consumers faced around $500 million net losses.[134]

127 Kevin Davis, 'The Australian Financial System in the 2000s: Dodging the Bullet' in Hugo Gerard and Jonathan Kearns (eds), *The Australian Economy in the 2000s: Proceedings of a Conference* (Reserve Bank of Australia, 2011) 313.

128 Murray et al (n 123) 8–9. On page 28, the Inquiry also pointed to consumer losses as a basis for the need to intervene: 'Previous collapses involving poor advice, information imbalances and exploitation of consumer behavioural biases have affected more than 80,000 consumers, with losses totalling more than $5 billion, or $4 billion after compensation and liquidator recoveries'. Financialisation had made the scale of these losses greater, and increased the number of consumers exposed to failures.

129 Ibid 8.

130 Ibid 12.

131 Ibid 198.

132 Ibid.

133 Ibid.

134 Ibid 202.

62. DDOs were designed to 'assist consumers to obtain appropriate financial products'.[135] While exemptions from the obligations exist for some financial products (such as certain superannuation interests), the vast majority of financial products provided to retail clients are subject to DDOs.

63. In other ways, DDOs embed the language of risk in consumer financial regulation. As the Explanatory Memorandum explains, DDOs require issuers and distributors to use risk management approaches in taking 'reasonable steps' to ensure products are distributed consistently with the target market determination.[136] The legislation also encourages a risk management approach in determining a 'reasonable review period' for target market determinations.[137]

64. A notable feature of DDOs that sets them apart from many previous reforms is the complete lack of a disclosure element. Interventions such as MySuper, caps on the cost of credit, and responsible lending, were accompanied by disclosure reforms. Disclosure was considered integral to the objectives of each new reform. Even UCT provisions required courts to have regard to the extent to which unfair terms were 'transparent' to a consumer (including the extent to which they were disclosed).[138] DDOs reflected a shift towards a regulatory philosophy in which disclosure was important but no longer understood as necessary to achieving fairer outcomes for consumers.

Product intervention powers

65. Product intervention powers ('PIPs'), in particular, are a departure from a regulatory philosophy of 'buyer beware'. Another recommendation of the Murray Inquiry, PIPs allow ASIC to make product intervention orders that ban the sale of a financial product to retail clients, or impose conditions on the sale of such products. The fact that PIPs sit uncomfortably with the regulatory philosophy of pre-existing law was underlined by the range of limitations and safeguards recommended by the Murray Inquiry.[139] PIPs can only be made where ASIC is satisfied that a financial product is creating the risk of significant consumer detriment to retail clients, and Murray recommended they be limited to only 12 months in duration (which became 18 months in the final law). After this, the Minister would have to approve an extension or the order would lapse. ASIC would need to consult APRA where APRA-regulated firms were affected, and Murray emphasised that the exercise of the power would be subject to judicial review.[140]

66. PIPs are an anomaly in financial regulation because they run completely contrary to the principle expressed in the Murray Inquiry that consumers 'should have the freedom to take financial risks and bear the consequences of these risks'.[141] Using PIPs, ASIC has the power to prohibit the sale of financial products — thereby completely depriving consumers of the ability to take on certain risks — or to impose conditions on a product that limit the risks a consumer can take. ASIC has used the power to make three product intervention orders since 2019. These ban the sale of binary options to retail clients;[142] limit the leverage retail clients can use on contracts for difference;[143] and cap the charges a consumer can pay on certain short-term credit.[144]

Binary options

67. The ban on binary options is an example of ASIC removing the ability of consumers to take certain financial risks. Binary options are a type of derivative 'that allow clients to make "all-or-

135 Revised Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 (Cth) [1.5].
136 Ibid [1.95].
137 Ibid [1.65].
138 *Australian Securities and Investments Commission Act 2001* (Cth) s 12BG(2)–(3).
139 Murray et al (n 123) 206.
140 Ibid.
141 Ibid 28.
142 *ASIC Corporations (Product Intervention Order—Binary Options) Instrument 2021/240*.
143 *ASIC Corporations (Product Intervention Order—Contracts for Differences) Instrument 2020/986* (Cth).
144 *ASIC Corporations (Product Intervention Order – Short Term Credit) Instrument 2019/917* (Cth).

nothing" bets on the occurrence or non-occurrence of a specified event in a defined timeframe (e.g. the price of gold increasing in 30 seconds)'.[145] ASIC concluded that binary options posed an unacceptable risk to retail clients. ASIC suggested that

> we have found that disclosure alone is ineffective in helping retail clients to understand these risks because humans' ability to accurately assess abstract matters such as risk and probability is innately constrained, and these products are highly complex.[146]

68. ASIC's decision to ban binary options highlights the broader shift in regulatory philosophy that PIPs heralded. An observation that 'disclosure alone is ineffective' might previously have triggered a push for additional consumer protections, such as caps on trading amounts accompanied by enhanced or tailored disclosure. In contrast, ASIC simply banned the issue of binary options to retail clients. ASIC's conclusion that 'binary options provide no meaningful investment or economic utility' ran completely contrary to the principle that consumers should be able to look after their own interests and select their own financial risks.[147] ASIC's intervention shut down a market worth $490 million in 2018, in which 80% of clients lost money.[148]

Contracts for difference (CFDs)

69. ASIC's product intervention order in relation to contracts for difference ('CFDs') did not prevent consumers from acquiring such contracts. Instead, it imposed a range of conditions on issuers of CFDs that limited the risks retail clients could expose themselves to. CFDs are, like binary options, derivatives. They are leveraged[149] and 'allow clients to speculate on the change in the value of an underlying asset' such as a commodity, cryptocurrency, or other financial product.[150] They are often used to speculate on currency pairs (such as GBP/EUR). ASIC found that most clients lose money trading CFDs.[151]

70. ASIC's intervention, amongst other things, imposed limits on how much leverage retail clients could use, and required CFD issuers to limit client losses to the amount in the client's trading account. Retail clients would also have their positions closed if the 'funds in their CFD trading account' fell 'to less than 50% of the total initial margin required for all of their open CFD positions on that account'.[152] The leverage requirements and the margin close-out protection significantly reduced the risks retail clients could take on. Whereas a client could previously trade crypto-assets with as much as 500:1 leverage (putting up $1 for $500 worth of exposure), ASIC's intervention limited them to leverage of 2:1.[153] Nonetheless, in a sign that disclosure was still regarded as an essential regulatory tool, ASIC's consultation paper proposed new risk warnings and ongoing disclosure.[154] These did not make it into the final order because ASIC concluded that the other conditions would achieve the objectives of the order.[155] ASIC also suggested that 'consideration of academic research and anecdotal evidence' shows 'that risk warnings and disclosure can be less effective than expected or ineffective'.[156] In making an order that relied

145 Australian Securities and Investments Commission, *Product Intervention: OTC Binary Options and CFDs* (Consultation Paper No 322, August 2019) [5].
146 Ibid [83].
147 Ibid [145].
148 Ibid [68], [70].
149 This means that clients 'use a small initial investment (known as 'margin') to gain exposure to an asset for a proportion of that asset's value. For example, for a CFD contract with a leverage ratio of 200:1, a client would only have to deposit an initial margin of $5,000 to gain economic exposure of $1 million to the performance of the underlying asset': Ibid [39].
150 Ibid [36].
151 Ibid [89].
152 Ibid 46.
153 Leverage limits vary by asset type: ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986 (Cth) s 7.
154 These were proposed conditions 5–8: Australian Securities and Investments Commission, *Product Intervention: OTC Binary Options and CFDs* (n 145) 46–7.
155 Explanatory Statement, ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986 (Cth) [66(e)].
156 Ibid.

solely on new conduct obligations on the product issuer, and which quite dramatically reduced the risks retail clients could take, ASIC's CFD intervention was yet another example of the changing regulatory philosophy underpinning financial product regulation.

The retail client in Australian regulatory philosophy

71. Despite the shifting regulatory philosophies of the past 20 years, one constant has generally remained: reforms aimed at protecting against product risks have principally affected products issued to retail clients. The only significant shift in this regard has been to extend protections to small businesses. Small businesses first received protections under the *Trade Practices Act* in 1998. Subsequently, the Financial Services Reform Bill 2001 included the objective of ensuring that small businesses 'receive protection as retail clients under the regime'.[157] The Australian Consumer Law applied Unfair Contract Terms ('UCT') protections to small businesses in 2009.[158] Since then, UCT provisions have been extended to small businesses in the *ASIC Act*,[159] and it has been agreed these should be enhanced.[160]

72. Nonetheless, the definition of 'retail client', and terms that serve a similar purpose in legislation such as the *ASIC Act* ('consumer' — see s 12BC) and the *NCCP Act* ('provision of credit to which this Code applies' see *National Credit Code* s 5(1)(b)), have evolved at a glacial pace, if at all. In this way, they have been a notable source of continuity in the regulatory philosophy as to who should be protected.

Product risk: evolution and revolution

73. The 2017 FSRC marked the latest step in the development of financial services regulation. It recommended a number of reforms to protect consumers from product risks. This included the extension of UCT provisions to insurance contracts, and limits on the charging of default interest for agricultural loans. The FSRC also endorsed the Productivity Commission's earlier recommendation of a deferred-sales model for add-on insurance. As implemented in the *ASIC Act*, this prohibits the sale of certain insurance products sold with other goods or services for a period of four days after the good or service is acquired. Commissioner Hayne endorsed ASIC's justification for a deferred sales model, which was that it 'would give consumers additional time to navigate the complexities of add-on products and facilitate improved decision making'.[161] Nonetheless, most FSRC reforms related to the conduct of sellers and intermediaries, rather than the exposure of consumers to risks inherent in financial products.

74. So, in relation to how Australia regulates consumer engagement with financial product risks, have we seen a revolution or an evolution? The best answer is that we have seen a mix of the two, with a general evolution over the past twenty years in the use of disclosure and targeted consumer interventions. These have been interspersed with reforms that are arguably revolutionary in how they depart from previously existing regulatory philosophies on risk. Such revolutions include responsible lending, MySuper, DDOs, and PIPs. The Murray Inquiry suggested that the Stronger Super reforms, of which MySuper was an element, and the consumer credit reforms that included responsible lending, represented 'fundamental changes in the domestic regulatory framework'.[162]

75. But it is harder to conclude that a revolution has occurred in the regulatory philosophies that underpin how we regulate product risks and the consumer. A revolution suggests a break with

157 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.28].
158 *Trade Practices Amendment (Australian Consumer Law) Act 2009* (Cth).
159 *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth).
160 'Meeting of Ministers for Consumer Affairs Friday 6 November 2020', *Australian Consumer Law* (6 November 2020) <https://consumer.gov.au/consumer-affairs-forum/communiques/meeting-12-0>.
161 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Volume 1, February 2019) 289.
162 Murray et al (n 123) 29.

the past. Such a break with the past is not apparent in most of Chapter 7 of the *Corporations Act* and other financial services legislation. Instead, the development of financial services consumer protection over the past twenty years is arguably a result of decreased confidence in disclosure being sufficient to ameliorate risks. This reflected the development of behavioural economics and a growing body of literature suggesting that individuals understand risk poorly and

> that the effectiveness of many traditional consumer protection approaches is diminished once you can no longer assume that consumers will seek out and understand all relevant information before purchasing a financial product.[163]

76. But disclosure has never lost its place at the heart of financial product regulation. Financial product regulation has instead evolved, rather than been revolutionised, by the gradual accretion of additional laws and regulatory regimes. This accretion, emerging from a mix of regulatory philosophies and contexts and inconstantly spread across dozens of Acts, regulations and ASIC legislative instruments, is the basis of much of the legislative and regulatory complexity present in the law today. The failure to comprehensively review and simplify this law, to date, means that there are many 'easy wins' available to simplify the *Corporations Act* and financial product regulation. Such easy wins include consolidation of notional amendments and removal of the duplication, redundancy, and unnecessary prescription that has crept into the legislation over many years. However, more fundamental simplification will likely also require shifts in the law's underlying policy, and the development of a more consistent regulatory philosophy for regulating financial products and the risks they pose.

Part Three: Conduct risk

77. A similar story to that told above for product risks can be told for how Australia regulates conduct risks. Conduct risk relates to the conduct of a product issuer or intermediary, such as the potential for conflicts of interest or misconduct in selling a financial product. Conduct risks to which consumers are exposed may or may not be prohibited by law, but they all pose the risk of consumer detriment. The law seeks to reduce or eliminate many conduct risks, such as through prohibitions on misleading or deceptive conduct and unconscionable conduct. However, the extent to which the law intervenes to address conduct risks facing consumers has grown significantly over the past twenty years. Increases in the intensity of that regulation have been accompanied by changes in how the law intervenes. Shifting regulatory philosophies underlie these changes. This section considers how these trends have affected two key sources of conduct risk facing consumers: conflicts of interest and sales conduct.

Conflicts of interest

78. The Wallis Inquiry was aware of the risks posed to consumers by conflicts of interest, particularly in relation to intermediaries such as financial advisors. The Inquiry, however, embedded proposals to address conflicts in the philosophy that consumers were the best guardians of their interests. Sufficiently informed of any conflicts of interest, a consumer would be able to weigh up the quality of the advice and any risk it was inappropriate. This had been the approach under earlier regulation of investment advisers, life agents, and brokers.[164] In proposing standardised disclosure for retail financial products, the Inquiry noted its belief

> that consumers need information about fees, commissions (including trailing commissions) and

163 Productivity Commission, Australian Government (n 14) 87. For a review of this literature, see Lefevre and Chapman n 50). See also Geraint Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32(3) *Journal of Law and Society* 349; Kristy Johnston, Christine Tether and Ashley Tomlinson, 'Financial Product Disclosure: Insights from Behavioural Economics' (Occasional Paper No 15/01, Ministry of Business, Innovation and Employment (NZ), February 2015); Russell Korobkin, 'Bounded Rationality, Standard Form Contracts, and Unconscionability' (2003) 70 *University of Chicago Law Review* 1203.

164 Wallis et al (n 5) 263.

the remuneration paid to their financial advisers or brokers so that they can determine whether a recommendation is skewed in favour of a particular product.[165]

79. The Inquiry recommended that such disclosures occur for all products where 'commissions are deducted from the consumer's investment', which marked an extension of disclosure obligations from previous regulations.[166] The CLERP 6 process endorsed the Wallis Inquiry's approach, explicitly linking benefits to intermediaries and conflicts of interest.[167] Disclosure, CLERP 6 concluded, would assist clients 'in assessing the merits of a product recommendation' and would reduce 'the opportunity for advisers to act in self interest to the disadvantage of the client'.[168]

The Financial Services Reform Act 2001

80. The disclosure-based approach to conflicts of interest in the distribution of retail financial products was embedded in the *FSR Act*. Financial Services Guides ('FSGs') and Statements of Advice ('SOAs'), both implemented by the *FSR Act*, include a range of disclosures about remuneration and on whose behalf the provider of a financial service or product is acting.[169] The high-level obligations in the *Corporations Act* to disclose information that allows consumers to identify potential conflicts of interest were complemented by extensive and prescriptive regulations. As with disclosure for product risks, the regulations quickly became a vehicle for tailored disclosure regimes in relation to remuneration and other potential conflicts of interest. From 15 October 2001, almost immediately after passage of the *FSR Act*, additional regulations mandated 'more detailed statements in relation to the remuneration (including commission) and other benefits' in FSGs.[170] Similar regulations applied to SOAs.[171] The Explanatory Statement accompanying these changes emphasised that the SOA remuneration disclosures would assist consumers to compare 'similar products or services offered by other providers'.[172]

81. The *FSR Act* also introduced restrictions on use of the words 'independent', 'impartial', 'unbiased', or any similar terms where a financial services provider did not meet certain criteria. These could only be used where a person did not accept commissions, volume-based remuneration, or other gifts or benefits from an issuer of a financial product that may reasonably be expected to influence the person.[173] Use of the terms also required avoiding conflicts of interest that may 'arise from their associations or relationships with issuers of financial products' and 'reasonably be expected to influence the person in carrying on the business or providing the services'.[174] While more interventionist than disclosure, this restriction was consistent with a regulatory philosophy that sought to maintain a fair market by eliminating potentially misleading conduct. The overall philosophy underlying the FSG and SOA disclosure reforms was that consumers can, and should, make decisions about the risks of conflicts of interest, and the risks of potential harm that conflicts may create.

Initial reforms

82. Regulatory philosophies are apt to need revision as soon as they are implemented. The principal focus on disclosure-based regulation of conflicts of interest began to evolve in 2004. Events in Australia and internationally put a new focus on the importance of intermediary independence.

165 Ibid.
166 Ibid.
167 Department of the Treasury (Cth), *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment* (n 35) 102.
168 Ibid.
169 *Corporations Act 2001* (Cth) ss 947B(2)(d)–(e) , 942B(2)(d)–(f).
170 *Corporations Amendment Regulations 2001 (No. 4)* (Cth) regs 7.7.04, 7.7.07.
171 Ibid regs 7.7.11–7.7.12.
172 Explanatory Statement, Corporations Amendment Regulations 2001 (No. 4) (Cth).
173 *Corporations Act 2001* (Cth) s 923A.
174 Ibid 923A(2)(e).

A number of corporate failures had drawn attention to issues in auditor independence.[175] The independence of financial analysts also became a cause for concern in Australia and the United States,[176] with ASIC publishing a report suggesting that existing regulation was insufficient.[177] Under the regulations at the time, there was 'no explicit duty in relation to the management of conflicts of interest'.[178] The 2004 reforms prioritised auditor independence, but also saw the introduction of a new duty on all financial services licensees to

> have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.[179]

83. The Explanatory Memorandum to the reform Bill emphasised that this was not an effort to replace existing approaches to conflicts of interest. The reforms relied on ASIC guidance about 'the level and manner of disclosure of conflicts'.[180] Guidance would ensure that consumers 'could benefit from more transparent disclosure of conflicts'.[181] Overall, the initiative would 'deliver a market-based solution for managing conflicts of interest'.[182] While the 2004 reforms represented a shift in the regulation of conflicts of interest, it was a minor one. Self-regulation supported by ASIC guidance and improved disclosure, both voluntary and mandated, remained the core of the regulatory philosophy. However, the explicit focus on conflicts of interest was an early sign of potential changes ahead. It would be some time, nonetheless, before any significant changes occurred.

The Big Bang: FOFA

84. Few reforms to financial services law have been as significant as the 2012 Future of Financial Advice ('FOFA') reforms. In its two core reforms — a best interests duty for financial advisors, and a ban on conflicted remuneration relating to most financial product advice — FOFA represented a remarkable break from previous regulatory philosophies in how it addressed conflict of interest risks. What set FOFA apart from previous reforms were two underlying observations, in part influenced by behavioural economics.

85. The first observation related to consumers. Disclosure, the FOFA Explanatory Memorandum indicated, is simply incapable of sufficiently informing consumers as to the risks of conflicts of interest, and consumers are 'unable to assess the impact of the conflict on the advice received'.[183] Consumers trust their advisors too much to be able to make such assessments. In the end, disclosure could not eliminate the difficulty consumers have 'understanding the impact of the remuneration on advice'.[184] The second observation related to advisors and financial services firms. It was, the Bill concluded, impossible to 'manage' the risk of conflicts of interest created by certain remuneration arrangements. Despite obligations to manage conflicts, 'commission-based remuneration arrangements, sales and volume incentives and the use of asset based fees' had

175 Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [4.8].
176 Ibid [4.155].
177 Ibid [4.156].
178 Ibid [4.152].
179 *Corporations Act 2001* (Cth) s 912A(1)(aa).
180 Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (Cth) [4.158], [4.169].
181 Ibid [4.159].
182 Ibid [4.169].
183 Revised Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) [3.69].
184 Ibid [3.72].

continued to result in a range of problems.[185] In the end, 'the inherent sales versus advice conflict may continue to misalign the interests of the consumer and adviser'.[186]

86. Financialisation had increased the exposure of individuals to financial risks, and thereby made the consequences of conflicts of interest more politically and economically salient. The Explanatory Memorandum cited ASIC's view that the collapse of Storm Financial during the Global Financial Crisis 'may be an example of the potential impact on clients of failure to manage conflicts of interest created by commissions and remuneration based on funds under advice'.[187] The 2009 Ripoll Inquiry considered the Storm Financial collapse in depth,[188] concluding that

> disclosure documents are too long and confusing for conflicts of interest caused by commission-based remuneration and vertical ownership structures to be properly understood by consumers. The documents are so inaccessible that they are probably not read at all by most people. There are also limits as to the usefulness of disclosure, however clear and concise, in an environment where clients have already committed in their mind to their trusted adviser's chosen strategy.[189]

87. The insufficiency of disclosure and the impossibility of appropriately managing some conflicts of interest justified the shift to eliminating some of their sources. The ban on conflicted remuneration for financial products (other than insurance) represented the principal means of targeting these risks. The ban covered monetary and non-monetary benefits, and applied to both general advice and personal advice. In its scope, the ban was sweeping (with notable exceptions for general and life insurance,[190] and a more targeted exemption for basic banking products).[191] It was accompanied by specific bans on volume-based shelf-space fees (from asset managers or product issuers to platform operators), and asset-based fees on borrowed amounts.[192]

88. FOFA's attempt to eliminate conflict of interest risks was accompanied by obligations that sought to more intensively manage remaining conflicts, such as those based on ownership. FOFA introduced a best interests duty for providers of personal financial product advice.[193] The Bill also introduced a requirement that such providers give priority to their client's interests.[194]

89. Disclosure had its place in these reforms. Ongoing fee disclosures were targeted at the risk of 'disengaged clients … paying ongoing financial advice fees where they are receiving little or no service'.[195] The Bill assumed that financial advisors would not necessarily act to notify or engage with such clients. Disclosure of an ongoing fee relating to a period longer than 12 months, it was hoped, would nudge a consumer to consider whether the ongoing fees were worthwhile, and ongoing fees that went for longer than 24 months required a fee disclosure statement and a renewal notice to the client.[196] Moreover, the disclosure provisions that had been introduced in the *FSR Act* (and tweaked through changes to the Act and regulations in the 2000s) remained largely intact. Regulatory interventions were built on top of regulatory interventions, but little thought was given to repealing or simplifying the older provisions.

185 Ibid [3.23].
186 Ibid [3.69].
187 Ibid [3.44].
188 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (Report, November 2009) Chapter 3.
189 Ibid 87.
190 *Corporations Act 2001* (Cth) ss 963B(1)(a)–(b).
191 Ibid s 963D.
192 Ibid ss 964–964H.
193 Ibid s 961B.
194 Ibid s 961J.
195 Revised Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) [1.5].
196 Ibid [1.7].

Building on FOFA

90. A number of reforms were made to the FOFA regime between 2014 and 2016.[197] In particular, reforms to address conflicts of interest and other conduct risks in financial advice were made following the Murray Inquiry and an inquiry by the Parliamentary Joint Committee on Corporations and Financial Services,[198] both in 2014. Despite earlier reforms, the Murray Inquiry had identified ongoing problems among financial advisors 'relating to shortcomings in disclosure and financial advice, and an over-reliance on financial literacy'.[199] Two Acts in 2017 made reforms aimed at improving standards for financial advice. The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* imposed more prescriptive training requirements and a new mandatory Code of Ethics. The Code of Ethics, which was finalised in 2019, had a clear focus on addressing conflicts of interest. Three of the 11 standards in the Code addressed these goals:

> Standard 2: You must act with integrity and in the best interests of each of your clients.
>
> Standard 3: You must not advise, refer or act in any other manner where you have a conflict of interest or duty.
>
> Standard 5: All advice and financial product recommendations that you give to a client must be in the best interests of the client and appropriate to the client's individual circumstances.[200]

91. The new Code of Ethics went further than the existing obligations in the *Corporations Act*. It was not, for example, subject to safe harbours in relation to its best interests duty. Likewise, the *Corporations Act,* in its exemptions for certain types of conflicted remuneration, permitted potential conflicts of interest, which in the Code were prohibited under Standard 3. The professional standards reforms marked a further shift away from regulation that assumed consumers could assess the risks associated with conflicts of interest in relation to their financial advisors.

92. Broader reform came with the *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017*, which affected both personal and general advice. This Act sought to limit the scope of the exemption for life insurance conflicted remuneration by granting ASIC the power to impose limits on the levels and types of remuneration. The amendments came in response to evidence that life insurance remuneration structures were incentivising poor advice and advisors acting in their own interests.[201] The Act (and associated ASIC legislative instrument) had the aim of better aligning 'the interests of consumers and those providing life insurance advice'.[202] ASIC's instrument imposed caps on the level of commissions,[203] and required scaled 'clawback' arrangements under which commissions needed to be repaid where a consumer cancelled or did not renew a product within particular periods.[204] The life insurance remuneration reforms represented the continued implementation of a philosophy that conflicts of interest needed to be eliminated, rather than simply managed. Disclosure played no role in either the professional standards or life insurance remuneration reforms. Neither reform expected consumers to better understand or manage the conflicts of interest to which they were exposed.

197 See, for example, *Corporations Amendment (Statements of Advice) Regulation 2014* (Cth); *Corporations Amendment (Revising Future of Financial Advice) Regulation 2014* (Cth); *Corporations Amendment (Financial Advice) Regulation 2015* (Cth) 201; *Corporations Amendment (Financial Advice Measures) Act 2016* (Cth).

198 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Proposals to Lift the Professional, Ethical and Education Standards in the Financial Services Industry* (Report, December 2014).

199 Explanatory Memorandum, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 (Cth) [7.12].

200 *Financial Planners and Advisers Code of Ethics 2019* (Cth) s 5.

201 Australian Securities and Investments Commission, *Review of Retail Life Insurance Advice* (Report No 413, October 2014) [157]–[167].

202 Explanatory Statement, ASIC Corporations (Life Insurance Commissions) Instrument 2017/510 (Cth) 2.

203 *ASIC Corporations (Life Insurance Commissions) Instrument 2017/510* (Cth) s 5.

204 Ibid s 6.

The Financial Services Royal Commission

93. The FSRC, and the reforms implemented in its wake, represent the most significant effort to target conflicts of interest since the FOFA reforms. Commissioner Hayne's articulated regulatory philosophy marked a departure from that in the Wallis Inquiry. While the Wallis Inquiry considered that disclosure of conflicts of interest was key, Commissioner Hayne considered that

> [w]here possible, conflicts of interest and conflicts between duty and interest should be removed. There must be recognition that conflicts of interest and conflicts between duty and interest should be eliminated rather than 'managed'.[205]

94. Nine of the 76 FSRC recommendations related to conflicts of interests.[206] Just one of these recommendations (2.2 — financial advisers disclosing any lack of independence) principally involved disclosure. Other recommendations were to impose conduct obligations on financial services licensees or advisors that sought to eliminate sources of conflict risks, or to more intensively manage them through best interest duties.

95. In relation to conflicted remuneration, the FSRC recommended that

a. conflicted remuneration for mortgage brokers should be banned (Recommendation 1.3);

b. grandfathered commissions which had been exempt from the FOFA reforms should be eliminated (Recommendation 2.4);

c. unless ASIC concluded there were compelling justifications to retain them, the cap on conflicted remuneration for life risk insurance products should eventually be set at zero (Recommendation 2.5);

d. the review of measures to improve the quality of advice (Recommendation 2.3) should consider whether key exemptions from the bans on conflicted remuneration remained justified, notably for general insurance products and consumer credit insurance products (Recommendation 2.6); and

e. ASIC should be given the power to impose caps on the commissions payable in relation to add-on insurance products (Recommendation 4.4).

96. Commissioner Hayne also recommended the imposition of a best interests duty for mortgage brokers (Recommendation 1.2). These recommendations reflected a continued evolution of the regulatory philosophy underlying the regulation of conduct risks.

97. The legislation implementing several of these reforms involved a compromise between the evolving regulatory philosophy and the perceived impact of bans on conflicted remuneration on the cost of advice. Instead of banning conflicted remuneration for mortgage brokers, the eventual reforms to the *NCCP Act* and regulations restricted the conflicted remuneration payable to brokers.[207] The permitted monetary benefits were 'directed at ensuring the benefits are transparent and do not negatively impact consumers',[208] and there were a limited number of exemptions for non-monetary benefits.[209] The best interests duty, however, was implemented through a broad obligation on brokers,[210] which lacked the safe harbours available under the FOFA reforms. The

205 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 161) 45.

206 Ibid.

207 Reforms were implemented through amendments in the *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Act 2020* (Cth) and the *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers) (Mortgage Brokers) Regulations 2020* (Cth).

208 Replacement Explanatory Statement, Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers) (Mortgage Brokers) Regulations 2020 (Cth) 1.

209 Ibid.

210 *National Consumer Credit Protection Act 2009* (Cth) s 158LA. There is also an obligation to, in the event of a conflict, give priority to the interests of a consumer over the interests of the brokers: s 158LB.

ban on grandfathered commissions was also implemented,[211] and ASIC now has the power to cap commissions in relation to add-on insurance for motor vehicles.[212] The review of conflicted remuneration for life insurance, general insurance, and consumer credit insurance, will form part of Treasury's Quality of Advice Review, the terms of reference for which were released in March 2022.

Twenty years of change

98. The regulation of conflicts of interest risks facing consumers has undergone a dramatic evolution over the past twenty years. Today, there is broad agreement — reflected in the *Corporations Act* and the *NCCP Act* — that disclosure is not a particularly effective way to address conflict risks. Consumers cannot generally be expected to identify conflict risks and take steps to ameliorate them. Bans and restrictions on conflicted remuneration have instead reduced or eliminated sources of conflict risks across most financial services, and best interests duties for financial advisors and brokers have sought to more intensively manage remaining conflicts where they are most likely to affect consumers.

99. Despite the shift in regulatory philosophies these reforms represented, the disclosure architecture of the 2001 *FSR Act* remains untouched, with extensive prescription in relation to the disclosure of remuneration and conflicts in FSGs and SOAs. In addition to the disclosure provisions in the Act, a range of regulations and ASIC legislative instruments affect the operation of the conflicts disclosure regime.[213] In leaving the older regimes intact, this history underscores the fact that the complexity of the legislative regime broadly reflects the accretion of regulatory philosophies without a broader architecture for managing change. Little thought appears to have been given to how disclosure could be simplified given the changed risks to consumers resulting from reforms to eliminate and reduce conflicts of interest. This is in part because the policy in relation to conflict risks remains an agglomeration of regulatory philosophies. Conflicts and conflicted remuneration have not been eliminated in areas such as personal advice and the distribution of financial products, and disclosure therefore remains necessary, despite the imposition of a range of new conduct obligations. The mixture of regulatory philosophies will remain a source of inevitable complexity, necessitating exemptions and tailored regulatory regimes. Nonetheless, there remains the potential to rationalise the provisions without changing the policy settings through reliance on more principled obligations for disclosure and removing much of the prescription that has evolved but been made less relevant with the introduction of new conduct obligations. The adoption of a consistent legislative hierarchy, as discussed below in relation to systemic risk in Part Four, may reduce the complexity of the exiting legislation. Regardless, reviewing the approach to conflicts risk underlines the extent to which Australian financial services regulation has been driven by shifting approaches to risk, informed at various points by factors such as developments in behavioural economics, increasing financialisation, and amplified consumer exposure to risks.

211 *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019* (Cth).

212 *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) sch 4. ASIC has not exercised the power.

213 *Corporations Regulations 2001* (Cth) regs 7.7.04–7.7.04AB, 7.7.05C, 7.7.07–7.7.07A, 7.7.10A, 7.7.11–7.7.13B; *ASIC Corporations (Disclosure in Dollars) Instrument 2016/767* (Cth).

Sales conduct

100. Increasingly interventionist approaches have characterised the regulation of risks relating to sales conduct. The Wallis Inquiry said little about sales conduct, and the CLERP 6 process emphasised only a need to address risks of pressure selling in some contexts.[214] When it was passed, the *ASIC Act 2001* contained a number of general protections relating to the sale of financial products. These included prohibitions on misleading or deceptive conduct, unconscionable conduct, harassment and coercion, and pyramid-selling of securities. The Act also included restrictions on offering gifts and prizes, bait advertising, referral selling, and unsolicited debit cards. The *FSR Act* also introduced a number of prohibitions relating to the hawking of financial products.[215] These applied in relation to certain financial products when offered to retail clients. The hawking prohibition in s 992A, however, had a major exemption in subsection (3), which significantly reduced the scope of the ban by exempting cold calling by sellers of financial products in certain situations. Retail clients also had a right to a cooling-off period in relation to a limited number of financial products,[216] which it was thought would act as a safeguard where misconduct occurred at the point of sale (such as pressure selling). There was also the general obligation on financial services licensees that they behave 'efficiently, honestly and fairly',[217] though a breach of this requirement was neither a civil penalty nor an offence at the time of the *FSR Act* in 2001.

A long intermission

101. Unlike the law in relation to product risks, the regulation of sales conduct risks saw few reforms between the enactment of the *FSR Act* and the FSRC. This reflected a more sustained willingness to rely on general consumer protections and extensive (and growing) disclosure provisions. Some of the reforms in relation to product risks and conflict of interest risks also had intended or unintended effects on sales conduct. Responsible lending, for example, arguably reduced the scope of pressure selling, given lenders were required to assess the 'unsuitability' of the credit. Caps on the cost of credit likewise restricted the ability of sellers to push consumers to accept very high-cost credit. Reforms to the regulation of conflicts of interest clearly had an impact on the motivations that might lead an intermediary to engage in inappropriate sales conduct. But interventions that more directly regulated sales conduct, including the manner in which products could be sold, were absent.

The Financial Services Royal Commission

102. Sales conduct became a central focus of the FSRC. Commissioner Hayne concluded that, in the lead up the FSRC, '[s]ales became all important', relegating '[p]roviding a service to customers … to second place'.[218] As discussed in relation to conflict of interest risks, the FSRC considered that remuneration and incentives were key causes of conduct that did not meet community expectations. However, several recommendations sought to address sales conduct risks without necessarily affecting remuneration practices. Three examples are notable, all of which fell under the heading of '[m]anner of sale and types of product sold'.[219]

103. The first was the ban on hawking financial products. The earlier ban introduced by the *FSR Act* proved to be flawed because of its exemption for unsolicited sales calls (provided certain criteria were met). The exemption resulted in extensive cold calling, causing a range of poor

214 Department of the Treasury (Cth), *Financial Products, Service Providers and Markets – An Integrated Framework: Implementing CLERP 6* (Consultation Paper, March 1999) 48–50.
215 *Corporations Act 2001* (Cth) ss 992A, 992AA. Section 736 already prohibited hawking of securities.
216 Ibid pt 7.9, div 5.
217 Ibid s 912A(1)(a).
218 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 161) 2.
219 Ibid 278.

consumer outcomes.[220] Hawking of financial products, the FSRC concluded, gave significant advantages to salespeople. In receiving an unsolicited call, consumers were

> unlikely to be armed with the information that they needed to allow them to assess critically the features of the (usually complex) product that was being offered. Without this information, the potential acquirer did not know what questions they needed to ask to test the truth of what was being said or to request the details necessary to assess the suitability of the product for their circumstances.[221]

104. Commissioner Hayne recommended a complete ban on the hawking of financial products.[222] Those prohibitions thereby addressed a range of sales misconduct identified in earlier ASIC investigations.[223]

105. The second notable intervention in sales processes is the deferred sales model for add-on insurance (discussed also in relation to product risks). In addition to assisting consumers to better understand financial products and the risks associated with them, deferred sales models have been justified on the basis that they help address 'the risk that a consumer will feel pressured to purchase [a financial product]', or that they might purchase a '[financial product] that does not meet their needs'.[224] The Deferred Sales Model ('DSM') ensures that sales conduct risks are reduced in relation to add-on insurance because a consumer has to take steps to either re-initiate contact with the seller or conclude the sale. Pressure selling at the point of sale, which ASIC had particularly identified in relation to insurance sold with motor vehicles (and to which the FSRC also referred),[225] was significantly less effective given the sale of the insurance had to occur at least four days after sale of the principal product (such as the motor vehicle). The DSM marked a major intervention in how and when certain financial products can be sold.

106. The final notable intervention into the manner in which products could be sold came through the removal of the exemption for funeral expenses policies. Commissioner Hayne emphasised that the existing exemption from regulation by Chapter 7 of the *Corporations Act* had a number of important implications, such as on licensing and general obligations. However, he particularly emphasised the impact the exemption had on sales, because it meant that funeral expenses policies could be hawked. ASIC had previously identified problems with 'the design, marketing and sales of funeral insurance', including funeral expenses policies.[226] In extending Chapter 7 to funeral expenses policies, this change brought with it various consumer protections, aimed at least in part at addressing sales conduct risks.

Sales conduct risks

107. Overall, the regulation of sales conduct risks has seen far more stability than in other areas of financial services regulation. This is in part because the general consumer protections were largely in place in 2001 and have generally proven satisfactory, even if sometimes honoured in the breach. But the targeted interventions in sales conduct recommended by the FSRC, notably in the DSM — as well as ASIC's potential to intervene in sales processes through its product intervention powers — suggest a greater willingness to regulate how financial products are sold so as to address sales conduct risks, rather than only regulating risks inherent in a product.

220 Ibid 280–2.
221 Ibid 280.
222 The ban was implemented through *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) sch 5.
223 Australian Securities and Investments Commission, *The Sale of Direct Life Insurance* (Report No 587, August 2018) 58–60.
224 ASIC, '17-255MR Banks to overhaul consumer credit insurance sales processes' (Media Release, 1 August 2017).
225 Australian Securities and Investments Commission, *Buying Add-on Insurance in Car Yards: Why It Can Be Hard to Say No* (Report No 470, February 2016) 9; Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 161) 288–9.
226 ASIC, '15-315MR ASIC report on funeral insurance highlights increasing premiums and high cancellation rates' (Media Release, 29 October 2015).

Part Four: Institutional and systemic risks

108. Australia's approach to institutional and systemic risks has changed significantly over the past twenty years. In particular, there has been a gradual increase in the intensity and sophistication of prudential regulation to reduce institutional and systemic risk, and in regulation that seeks to protect consumers from the consequences of institutional and systemic risks.

- Institutional risk refers to the risk of an individual firm failing to meet some or all of its obligations.
- Systemic risk refers to the 'risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy'.[227]

109. Systemic and institutional risks are closely linked, though not all institutional risks pose systemic risk. As Caruna observes, if

> a bank loses money from a risky investment, that is not systemic. But institutional failure, market seizure, infrastructure breakdown or even a sharp rise in the cost of financial services can have serious adverse implications for many other market participants. In these cases, there is a systemic dimension. It is such negative externalities and the significant spillovers to the real economy that are the essence of systemic risk and which make a case for policy intervention.[228]

110. Risk and risk management, more so than in any other area of financial regulation, sit at the heart of prudential regulation.

111. The Wallis Inquiry considered that prudential regulation was justified where information asymmetries could not be overcome. In these cases,

> it may be desirable to substitute the opinion of a third party for that of consumers themselves. In effect, the third party is expected to behave paternalistically, looking out for the best interests of consumers when they are considered incapable of doing so alone. To some extent, such third parties can be supplied by markets (such as the role played by rating agencies). However, for many years the practice in all countries has been for government prudential regulators to take on much of this role.[229]

112. As this Part demonstrates, the period from the Wallis Inquiry to the late-2010s saw significant change in the exposure of consumers to institutional and systemic risks. The Wallis Inquiry had expected consumers to take on some degree of exposure to the risk of failure by a financial institution with whom they dealt. Two trends in the past twenty years have reduced individuals' exposure to institutional risk, and the expectation that consumers will manage this risk: first, more intensive and expansive prudential regulation; and second, the introduction of financial claims schemes. These changes in regulatory philosophy have been facilitated by a more deliberately designed legislative architecture put in place following the Wallis Inquiry, characterised by a clear and consistent legislative hierarchy and demarcated regulatory responsibilities.

227 Financial Stability Board, International Monetary Fund and Bank for International Settlements, *Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations* (Report to the G-20 Finance Ministers and Central Bank Governors, October 2009) 2.

228 Jamie Caruana, 'Systemic Risk: How to Deal with It?', *Bank for International Settlements* (12 February 2010) <https://www.bis.org/publ/othp08.htm>.

229 Wallis et al (n 5) 191–2.

Early prudential regulation

113. Prudential regulation has historically focused on the financial soundness of banks, given the exposure of individual depositors to the risk of bank failure, and the role of banks in the payments system. The original *Banking Act 1945* included a regime administered by the Commonwealth Bank for the 'protection of depositors'. This allowed the Bank to exercise a range of supervisory powers over other banks.[230] These responsibilities were transferred to the newly created Reserve Bank of Australia ('RBA') in the *Banking Act 1959.* However, scholars have argued that monetary policy, rather than prudential regulation, was the principal focus of this regime. As Hogan and Sharpe observe, most Commonwealth 'depositor or investor protection was implemented through a complex set of direct controls over bank activities' rather than through what is today regarded as prudential regulation.[231] By 'excluding banks from potential high risk exposures in domestic and foreign financial markets, the need for systematic appraisal and supervision of each bank's activities did not really arise'.[232]

The challenge of non-bank financial institutions

114. The approach of the *Banking Act 1959* was institutional, focusing on the particular type of entity providing the financial service (namely an entity authorised by the *Banking Act 1959*). Non-bank financial institutions ('NBFIs') were not subject to the *Banking Act* and did not face the same regulation when they took savings, including deposits, from consumers. A patchwork of state legislation regulated building societies and credit unions, despite these institutions offering functionally similar services to banks.[233] These state regimes were generally more favourable to the NBFIs than Commonwealth regulation in respect of banks, and the 1960s and 1970s saw significant growth in NBFIs relative to banks. Commonwealth efforts to reduce these regulatory asymmetries stalled in the 1970s.[234] The growth of banks overtook that of NBFIs in the 1980s and 1990s as bank deregulation reduced the benefits of being an NBFI.[235] This deregulation followed the Campbell Inquiry in 1981, which recommended 'immediate or ultimate abandonment of a wide range of direct controls and a shift to almost total reliance on open market methods of intervention in domestic financial markets'.[236] The Inquiry identified that institutional groups

> which were of little significance forty years ago have since developed into positions of considerable importance (e.g. building societies, finance companies, credit unions and superannuation funds), whilst important new financial institutions have emerged (e.g. private savings banks, merchant banks, authorised short-term money market dealers, unit trusts and special purpose banks).[237]

115. The development of these institutions, and the different prudential regulation they faced, led the Campbell Inquiry to recommend

> a functional approach — a group of intermediaries performing a particular activity (e.g. competing for household deposits) should generally be subject to comparable monetary controls and prudential regulation, having regard to the differing characteristics of their assets and general perceptions of risk.[238]

230 *Banking Act 1945* (Cth) pt II div 2.
231 WP Hogan and Ian G Sharpe, 'Prudential Supervision of Australian Banks' (1990) 66(2) *Economic Record* 127, 128.
232 Ibid.
233 Di Thomson and Malcolm Abbott, 'Australian Financial Prudential Supervision: An Historical View' (2000) 59(2) *Australian Journal of Public Administration* 75, 81–2.
234 Part IV of the *Financial Corporations Act 1974*, regulating 'financial corporations', never commenced.
235 Thomson and Abbott (n 233) 83.
236 Campbell et al (n 11) xxviii.
237 Ibid xxv.
238 Ibid [130].

116. Despite the Campbell Inquiry's recommendation, the institutional approach to prudential regulation persisted into the 1990s. The RBA remained reluctant to regulate NBFIs and 'cited a lack of supervisory resources, fear of a "contagion effect", and a need to maintain risk spectrum within the financial markets'.[239] The 1991 Martin Inquiry noted that the Commonwealth Government 'was not prepared to be involved in the supervision of these institutions, that they were a state responsibility and under no circumstances would it legislate to supervise these institutions'.[240] Nonetheless, in 1992, the Australian Financial Institutions Commission was created to 'develop a common regulatory standard to which individual jurisdictions would voluntarily conform' in relation to deposit-taking institutions.[241] This still left a large number of institutions facing inconsistent prudential regulation across jurisdictions, which would only be resolved following the 1996 Wallis Inquiry. This period also saw the creation of the Council of Financial Supervisors, established following a recommendation from the Martin Inquiry. Its broad objective was to 'improve communication and co-ordination among the main agencies responsible for regulation and prudential supervision in the financial system'.[242]

International developments: Basel I

117. The late-1980s saw significant developments in international cooperation on prudential regulation, with a focus on managing systemic risk as it affected the international financial system. In Australia, these changes marked the culmination of a shift away from direct controls on financial markets and banks, and a move to market-oriented and more indirect forms of prudential regulation. While aimed at systemic risk, these changes fundamentally changed the regulation of individual institutions and therefore the regulatory approach to institutional risks. This was embedded in a regulatory philosophy that did not necessarily seek to significantly reduce or eliminate risk-taking, but in which institutions were sufficiently able to manage the risks to which they were exposed.

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239 Thomson and Abbott (n 233) 85.

240 Standing Committee on Finance and Public Administration, Parliament of Australia, *A Pocket Full of Change: Banking and Deregulation* (Parliamentary Paper No 290, November 1991) 229.

241 Peter Docherty et al, Australian Prudential Regulation Before and After the Global Financial Crisis (Centre for Applied Macroeconomic Analysis Working Paper No 49/2016, August 2016) 19.

242 Graeme Thompson, *The Role of the Council of Financial Supervisors* (Speech, AFMA National Convention, Sydney, 14–15 September 1995) <https://www.rba.gov.au/speeches/1995/sp-dg-150995.html>.

Figure 3: Key concepts in modern prudential regulation

Capital adequacy requirements or standards: A bank's *capital* can be viewed in two ways, each of which is mathematically and conceptually equivalent from a balance sheet perspective: (1) the excess of its assets over its liabilities; or, (2) the amount invested by shareholders of the bank, plus its accumulated retained profits.[243] A bank's *capital ratio* refers to the ratio of its capital to its risk-weighted assets. A bank with liabilities of $92 and assets of $100 has a capital of $8 and a capital ratio of 8% ($8 ÷ $100). Capital ratios are generally risk-weighted. This means the bank or a regulator gives each asset type a risk-weighting for the purposes of determining how much capital a bank must hold against them. For example, Australian government securities are risk-weighted at 0%, and so do not count towards the bank's risk-weighted assets for the purposes of calculating the capital ratio. The risk-weighted asset value of a housing loan is 35% of its face value (eg $35 for every $100 of a housing loan), while that for a business loan is 100%.[244] Complex mathematical models are used to develop risk-weighted capital ratios, such as those prescribed by Basel III (an internationally recognised model of prudential regulation).[245] Under the Basel III requirements, the minimum total capital ratio for banks is 8%.

Liquidity requirements: A bank's liquidity refers to its stock of liquid assets. Liquid assets are those considered easy to trade or sell, particularly during periods of economic instability. Cash is the most liquid asset, followed generally by government bonds. Liquidity frameworks will designate assets that are considered liquid. For example, Basel III has a definition of a 'high-quality liquid asset' for the purposes of calculating liquidity requirements.[246]

118. As early as 1981, the Campbell Inquiry had proposed that the RBA set capital adequacy requirements for Australian banks,[247] in addition to the liquidity requirements it effectively imposed through the requirement to hold reserves with the RBA.[248] No legislative amendments were enacted to implement this recommendation, but the RBA was able to informally implement capital ratios of between 6 and 6.5 per cent through a mix of authorisation conditions and cooperation with individual institutions.[249] Capital adequacy requirements, unlike direct controls, did not necessarily seek to prevent high-risk financial activities. Instead, the requirements sought to ensure that prudentially regulated institutions, which could be sources of systemic risk, were appropriately able to manage their exposure to risk and absorb any unexpected losses.

119. Building this acceptance of risk into prudential regulation became a feature of risk-weighted capital adequacy requirements. These gained international endorsement in 1988 in the Capital Accord (Basel I). This agreement provided for a complex series of risk-weighted capital requirements for large international banks. In theory, this meant that banks held capital proportionate to the risks they were bearing. However, the regime was subject to a range of exceptions and flaws which became evident in the Global Financial Crisis. Regardless, the idea of risk-weighted capital adequacy requirements became an essential part of the prudential toolkit in Australia and internationally.

243 Australian Prudential Regulation Authority, 'Capital Explained', *APRA Insight 2020 Issue One* (2020) <www.apra.gov.au/capital-explained>.

244 Australian Prudential Regulation Authority, 'APRA Explains: Risk-Weighted Assets', *APRA Insight Issue two - 2020* (2020) <www.apra.gov.au/apra-explains-risk-weighted-assets>.

245 See, eg, Basel Committee on Banking Supervision, Bank for International Settlements, *Minimum Capital Requirements for Market Risk* (January 2019).

246 Basel Committee on Banking Supervision, Bank for International Settlements, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (January 2013) [24].

247 Campbell et al (n 11) 300–2.

248 Ibid 306.

249 Hogan and Sharpe (n 231) 133.

120. The 1980s and early-1990s also saw the RBA introduce risk management guidelines for firms, leading to 'more differentiated capital requirements which better reflect the specific risks of individual institutions'.[250] This period saw capital adequacy requirements 'introduced and tightened for non-bank deposit taking institutions', as well as enhanced for life and general insurance companies.[251]

The Wallis Inquiry and the foundations of Australian prudential regulation

121. The Campbell Inquiry noted that the institutional approach to prudential regulation, and the differing prudential standards among Australian jurisdictions, resulted in an unequal regulatory environment for institutions offering functionally similar services (and therefore posing similar risks). This disparity continued into the 1990s, despite attempts at cooperation between Australian jurisdictions and regulators. The Wallis Inquiry set out to address this, and in so doing laid the foundations for how Australia regulates systemic and institutional risks. Its proposals occurred against the backdrop of a vast and growing financial system, and an economy that could be seriously affected by developments in financial markets.

The Wallis Inquiry's regulatory philosophy

122. The Wallis Inquiry sought to develop a clear and shared understanding of the purpose and scope of prudential regulation. The Inquiry emphasised that prudential regulation should be aimed at

> financial risks [that] cannot be adequately priced or managed by the market. Some financial promises have the combined characteristics of being onerous to honour, difficult to assess, and of major adverse consequence if breached — not only for the promisee, but for third parties as well. In addition to information asymmetry, of particular concern are threats to system stability. In these areas, the financial system should be subject to a higher intensity of regulation.[252]

123. The Wallis Inquiry also positioned systemic risk, which only entered public discourse in the early- to mid-1980s, as an important focus of Australian financial regulation. However, the Inquiry was clear that regulation needed to balance the reduction of systemic and institutional risk with the fact that risk is inherent in the financial sector. Central to the Wallis Inquiry's regulatory philosophy was the need to appropriately preserve risk in financial markets, including the risk of institutional failure:

> [Not] all financial services should be subject to financial safety regulation. If regulation is pursued to the point of ensuring that promises are kept under all circumstances, the burden of honour is effectively shifted from the promisor to the regulator. All promisors would become equally risky (or risk free) in the eyes of the investing public. Regulation at this intensity removes the natural spectrum of risk that is fundamental to financial markets. If it were extended widely, the community would be collectively underwriting all financial risks through the tax system, and markets would cease to work efficiently.[253]

124. Recommendation 34 of the Wallis Inquiry reflected the tension inherent in prudential regulation: the 'intensity of prudential regulation needs to balance financial safety and efficiency'.[254] The Inquiry argued that this 'balance should preserve a spectrum of market risk and return choices for retail investors, meeting their differing needs and preferences'.[255] Efforts to manage systemic risk and financial safety should also 'minimise the adverse effects on efficiency, competition, innovation and competitive neutrality'.[256] Regulation could achieve this through disclosure, which

250 Wallis et al (n 5) 645.
251 Ibid.
252 Ibid 299.
253 Ibid 192.
254 Ibid 320.
255 Ibid 321.
256 Ibid.

would be administered by the regulator that became ASIC. Disclosure would 'promote further transparency for markets in assessing the risks posed by financial institutions' activities'.[257] Prudential regulation was to be but one piece of the puzzle for managing institutional risk.

125. Prudential regulation was also to be reserved for only some activities. The Inquiry located systemic risk, and the need for prudential regulation against institutional risks, in particular sectors of the financial system. The intensity of regulation was to vary based not only on the institution but on the attributes or economic functions of its financial products; namely, 'the characteristics of the promises which they contain' and the 'the inherent risks of the product'.[258] Prudential regulation would therefore 'be expected to combine institutional and functional coverage'.[259]

126. In particular, the Inquiry noted that 'institutions offering payments services or conducting the general business of deposit taking — including retail banks, building societies and credit unions [were] clear candidates for prudential regulation'.[260] The Inquiry also identified 'a strong case for prudentially regulating: capital backed investment products offered by life insurers and friendly societies; and risk products, including term life and general insurance products'.[261] It considered entities and activities related to the settlement of securities and derivatives to be important sources of systemic risk.[262] Managed funds, where returns may vary and declines in value could result in hardship, would not be subject to prudential regulation because such loss was 'clearly a consequence of the risk accepted by the investor'.[263] An important exception to this principle was superannuation, where prudential regulation is justified 'even where investors have knowingly accepted market risk'.[264] The willingness to regulate superannuation reflected the fact that it was mandatory and that almost all Australians were exposed to the risks of institutional failure, which could have catastrophic consequences. Nonetheless, the focus on regulating for functions represented a shift in regulatory philosophy that offered a more consistent and sophisticated understanding of how best to regulate systemic and institutional risks.

Managing systemic risk

127. The Wallis Inquiry concluded that managing systemic risk required clearer regulatory responsibilities and a clear regulatory philosophy. The Inquiry also noted that there are two main approaches to managing systemic risk: preventative measures (including prudential regulation and sustainable macroeconomic policies) and reactive strategies (including liquidity support and, where appropriate, statements of support to assuage uncertain markets).[265] Prudential regulation was therefore only one means of managing systemic risk, though a significant one.

Regulatory responsibilities

128. Core to the reform of regulatory responsibilities was the consolidation of prudential regulation in a single regulator. This involved the consolidation of regulators at both the Commonwealth and state level, which each had responsibility for particular types of institutions.[266] The new regulator, which became the Australian Prudential Regulation Authority ('APRA'), would cover deposit-taking institutions, life and general insurers, friendly societies, and providers of superannuation products and retirement savings accounts.[267] The conduct and markets regulator, which would become ASIC, would remain responsible for regulating conduct and disclosure. The RBA would

257 Ibid 336.
258 Ibid 303–5.
259 Ibid 305.
260 Ibid 304.
261 Ibid.
262 Ibid 367–370.
263 Ibid 305.
264 Ibid.
265 Ibid 364–5.
266 Ibid 302.
267 Ibid 321–334.

be responsible for system stability as a whole,[268] managing sources of systemic risk through preventative and reactive measures described above. The RBA, as it long had, would also be the key anchor and regulator of the payments system. Along with new legislation,[269] a Payments System Board was formed in the RBA,[270] which has 'responsibility for determining the Reserve Bank's payments system policy' with particular regard to 'controlling risk in the financial system'.[271] APRA and ASIC would represent a 'twin peaks' approach to regulation,[272] with the RBA sitting at the heart of the financial system through its role in the payments system and its focus on systemic stability. Following a recommendation from the Murray Inquiry,[273] these regulators would cooperate through the reworked non-statutory Council of Financial Regulators, which since 2003 has included the Department of the Treasury (Cth).[274] This regulatory architecture has proven perhaps the most resilient of all the Wallis Inquiry's proposals.

Enhancements in prudential regulation

129. The institutional architecture of the Wallis Inquiry has continued to be the foundation of Australian prudential regulation to this day. However, the balance struck between financial safety and efficiency has shifted, with more institutions and financial products subject to a higher intensity of prudential regulation. Prudential regulation, particularly over the past 10 years, has also been used as a tool for managing macroeconomic conditions that may create systemic risks. A number of legislative and regulatory developments exemplify these changes. However, before considering the changing approaches to risk in the period, it is worth examining this legislative architecture. As will be seen, a notable feature of the legislative architecture is the extent to which it has been able to adapt to significant reforms (unlike the architecture of the *Corporations Act*, as discussed in previous sections of this Paper).

The original legislative architecture

130. Following the Wallis Inquiry, a range of financial services Acts were amended to create APRA and establish the architecture for effective prudential regulation. This architecture was based on primary legislation that contained high-level provisions regulating firms such as life insurers and authorised-deposit taking institutions ('ADIs'). Detailed prudential requirements for firms would then be prescribed by APRA through 'prudential standards'.[275] Immediately following the Wallis Inquiry, this architecture was adopted in the *Banking Act 1959* and the *Life Insurance Act 1995*.[276]

131. An analogous architecture was created for private health insurers in the *National Health Act 1953* in 1999,[277] under which solvency standards and capital adequacy standards could be made. However, this Act was administered by the Private Health Insurance Administration Council rather than APRA.[278]

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268 Ibid 538.
269 *Payment Systems (Regulation) Act 1998* (Cth).
270 Wallis et al (n 5) 362.
271 Reserve Bank of Australia, 'Payments System Board', *About Us* <https://www.rba.gov.au/about-rba/boards/psb-board.html>. See also the definition of 'public interest' in s 8 of the *Payment Systems (Regulation) Act 1998* (Cth), which requires the RBA 'have regard to the desirability of payment systems … not (in its opinion) materially causing or contributing to increased risk to the financial system'.
272 For a review of the global success of the 'twin peaks' model, see Andrew Godwin and Andrew Schmulow, *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021).
273 Murray et al (n 123) 543.
274 Treasury was included following the collapse of HIH Insurance: Council of Financial Regulators, 'History', *About* <https://www.cfr.gov.au/about/history.html>.
275 These have been classified as legislative instruments since the enactment of the *Legislative Instruments Act 2003* (Cth), renamed the *Legislation Act 2003* (Cth) in 2015.
276 Through amendments in the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth).
277 The architecture was created through amendments in the Schedule 2 of the *Health Legislation Amendment Act (No. 3) 1999*.
278 Consideration had been given to having APRA regulate private health insurers, but this was not 'considered immediately viable' because of 'the significant differences between the general insurance and private health insurance industries (i.e. the non-risk rated nature of health insurance)': Explanatory Memorandum, Health Legislation Amendment Bill (No. 3) 1999 (Cth) 6.

132. A critically important feature of this architecture was APRA itself, which replaced multiple earlier regulators. In doing so, the architecture ensured that just one regulatory philosophy would be determinative in prudential regulation: the philosophy of APRA. The establishment of one regulator sitting at the heart of a clear legislative architecture, and acting as the single lawmaker in prudential regulation, has been a notable feature of prudential regulation in Australia. APRA's position contrasts with that of ASIC in financial services regulation, where ASIC's lawmaking function overlaps with, rather than complements, that of the Minister, regulations, and Parliament.

Immediate reforms — General insurance and banking regulation

133. Amendments in 2001 extended the prudential standards model to general insurers regulated by the *Insurance Act 1973*.[279] This Act had 'remained largely unchanged since its inception' nearly 30 years prior and was 'widely perceived to be blunt and unresponsive in the face of market developments that [had] transformed the financial sector over recent years'.[280] The Explanatory Memorandum to the *General Insurance Reform Bill 2001* (Cth) noted that prudential 'standards would replace the current highly prescriptive prudential supervisory requirements set out in the Insurance Act with more flexible, tailored and risk specific requirements for insurers'.[281] The reforms embedded risk in the regulation of general insurers, recognising that different 'types of insurance business are riskier than others' by extending a capital adequacy standard to general insurers. Firms 'would be required to hold capital commensurate with the risk profile of the insurance business underwritten', meaning that higher 'risk insurers would be required to hold higher minimum capital relative to lower risk insurers'.[282] General insurers therefore became subject to the more intensive model of prudential regulation applicable to other important prudentially regulated firms.

134. The *Banking Act 1959* was also amended in 2000 to allow APRA to give directions to ADIs in the event APRA concluded an ADI was likely to breach a prudential regulation or standard and the breach posed a prudential risk. This was an extension on earlier APRA powers only exercisable where an actual breach of a prudential regulation or standard had occurred or depositors' interests were at risk.[283] APRA also received several other powers to enhance its prudential supervision of ADIs, such as improved information-gathering powers.

135. This period also saw the collapse of Australia's second largest insurer, HIH Insurance, in 2001.[284] In the first major departure from the Wallis Inquiry's prudential regulatory philosophy, the Government implemented the HIH Claims Support Scheme. This ad-hoc intervention provided up to $640 million in compensation for policyholders. The Wallis Inquiry had been clear in its view that the Government should not guarantee financial promises. The Government's intervention indicated its willingness to protect consumers from the risks of financial collapses. In doing so, the Government undermined the Wallis Inquiry's view that the community should not expect state intervention and fostered 'community expectations of implicit government guarantees of prudentially regulated institutions'.[285] Research after the intervention suggested that 60% of respondents thought the government 'would provide at least partial compensation in the event of a failed bank'.[286] The Government's intervention is consistent with academic research suggesting that financialisation increases electoral pressure to protect consumers from institutional or systemic failure in financial markets.[287]

279 *General Insurance Reform Act 2001* (Cth).
280 Explanatory Memorandum, General Insurance Reform Bill 2001 (Cth) [1.2].
281 Ibid [3.9].
282 Ibid.
283 Revised Explanatory Memorandum, Financial Sector Legislation Amendment Bill (No. 1) 2000 (Cth) [6.2].
284 The collapse of HIH also led to significant internal reform of APRA through the *Australian Prudential Regulation Authority Amendment Act 2003* (Cth).
285 Davis (n 127) 312.
286 Ibid.
287 Chwieroth and Walter (n 26).

Shifting regulatory philosophies

136. The 2000s saw two significant developments in regulatory philosophies towards institutional and systemic risks. These were reflected in the Basel II and III reforms, which built on the major shift in regulatory philosophy represented by Basel I. APRA and the legislative architecture for prudential regulation was able to implement these reforms without creating many of the sources of legislative complexity present in Chapter 7 of the *Corporations Act* and other financial services legislation. For example, notional amendments did not form a part of these reforms, nor were the reforms implemented through the inconsistent use of different types of legal instruments by Parliament, Ministers, and APRA. Instead, the changes were overwhelmingly implemented by APRA through a limited number of instruments (prudential standards accompanied by guidance, as well as reporting standards)[288] and following significant consultation. The reforms were also subject to ongoing regulatory review as APRA developed the standards. The legislative architecture therefore adapted to major shifts in regulatory philosophy, and the major changes in the law these brought, without creating significant legislative complexity.

Basel II

137. APRA undertook major reforms to its prudential standards for ADIs in 2007 following the Basel II process and ongoing work to enhance prudential regulation of conglomerates that included ADIs.[289] Basel I had been subject to a range of criticisms since its implementation in Australia and internationally, including that its rules were not sufficiently risk-sensitive or could actually encourage excessive risk-taking.[290] APRA also noted that there had 'been substantial change in global financial markets and developments in risk measurement and management techniques'.[291] The reforms were therefore in part the product of enhanced understanding of risk and increased financialisation, including the continued development of financial instruments through securitisation and greater use of derivatives. Their adoption in Australia reflected a willingness to align with international developments, as had been the case with Basel I, which Australia was among the first to adopt.[292]

138. The purpose of Basel II was to 'promote the adoption of stronger risk management practices by the banking industry'.[293] As the APRA Explanatory Statement to its new prudential standards explained, the Basel II reforms built on the regulatory philosophy of Basel I, which had been the 'first step in moving from a simple capital-to-assets ratio to a methodology whereby banks held capital that was better aligned to risk'.[294]

139. The Basel II reforms were built around three pillars: minimum capital requirements (Pillar One), the supervisory review process (Pillar Two), and increased disclosure requirements (Pillar Three). Pillars One and Two were aimed at more intensively and sensitively regulating prudential risk in firms, while Pillar Three sought to use enhanced disclosure to increase 'market discipline' in relation to prudential risks. Pillar One, for example, offered a spectrum of more sophisticated approaches to calculating risk weights for assets and the associated capital requirements.[295] A

288 Reporting standards are made under the *Financial Sector (Collection of Data) Act 2001* (Cth).
289 This package of reforms was comprised of 11 new prudential standards for ADIs: Explanatory Statement, Banking (prudential standard) determinations Nos. 3-4, 6-8, 10-11, 13-14, 16-17 of 2007 (Cth) 1–2. APRA's reforms applied to all ADIs, though specific prudential standards applied only to ADIs that were using advanced approaches for assessing risk, and some did not apply to foreign ADIs.
290 Docherty et al (n 241) 24.
291 Explanatory Statement, Banking (prudential standard) determinations Nos. 3-4, 6-8, 10-11, 13-14, 16-17 of 2007 (Cth) 13.
292 Ibid 12.
293 Basel Committee on Banking Supervision, Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (June 2004) [4].
294 Explanatory Statement, Banking (prudential standard) determinations Nos. 3-4, 6-8, 10-11, 13-14, 16-17 of 2007 (Cth) 12.
295 Basel Committee on Banking Supervision, Bank for International Settlements, 'International Convergence of Capital Measurement and Capital Standards: A Revised Framework' (n 293) [6]–[7].

new capital charge was also introduced for operational risk,[296] recognising an increasing range of risks to which banks were understood to be exposed. The Pillar Three disclosure obligations were 'intended to complement broader regulatory objectives in Basel II rather than to replace them'.[297]

Compensation arrangements and retail clients

140. This period also saw the introduction of enhanced compensation arrangements for financial services licensees that were regulated by the *Corporations Act*. Introduced on July 2007, reg 7.6.02AAA of the *Corporations Regulations* required that licensees obtain professional indemnity insurance to comply with s 912B of the *Corporations Act*.[298] The regulation was intended to 'reduce the risk that compensation claims to retail clients cannot be met by the relevant licensees due to the lack of available financial resources'.[299] ASIC was clear that it would 'administer the compensation requirements to maximise their potential to reduce the risk that a retail client's losses (due to breaches by a licensee) cannot be compensated by the licensee due to the lack of financial resources, as far as this is practically possible'.[300] Again, a desire to manage risks to which consumers may be exposed, in this case counterparty risk, drove reforms in financial services regulation. However, the manner in which the reform occurred, through notional amendments to the Act to defer the commencement of s 912B and then regulations to prescribe the compensation requirements, with ASIC consulting on the administration of these requirements, presents a contrast to the way in which self-contained APRA-made prudential standards covering prescriptive matters could evolve. Legislative and broader regulatory complexity was one result of the manner in which the compensation requirements were introduced.

The Global Financial Crisis and Basel III

141. The story of the Global Financial Crisis ('GFC') has been told many times, and will not be considered extensively in this section. Suffice to say that it significantly changed regulatory philosophies towards systemic and institutional risks. A number of reports published in the immediate aftermath of the GFC identified poor risk management as a key cause of the crisis, as well as regulatory failures that resulted in, for example, insufficient bank capital and liquidity.[301] Basel III introduced 'much higher capital requirements and more risk sensitivity' for banks.[302] APRA began consulting on enhancing prudential standards in light of Basel III in 2011,[303] and APRA introduced 16 new prudential standards for banks in 2012, most of which replaced existing standards.

142. One of three objectives of APRA's reforms was to 'reduce the likelihood of the need for (and degree of) government intervention or support for ADIs in any future financial crisis',[304] reflecting APRA's intensified regulation of institutional and systemic risks and also the broadening of risk beyond financial risk to include risks such as conduct risk. The Basel III implementation process has been gradual, and APRA has been implementing different phases of the reforms (such as for disclosure and counterparty credit risks) for the past decade.[305]

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296 Docherty et al (n 241) 25.
297 Ibid 26.
298 Section 912B had been introduced in the *Financial Services Reform Act 2001* (Cth), but its commencement had been deferred to 1 July 2007.
299 Australian Government, *Compensation Arrangements for Financial Services Licensees* (Regulation Impact Statement, April 2007) 7.
300 Australian Securities and Investments Commission, *Compensation and Insurance Arrangements for AFS Licensees* (Consultation Paper No 87, July 2007) [6].
301 Docherty et al (n 241) 31–2.
302 Davis (n 127) 315.
303 Australian Prudential Regulation Authority, *Implementing Basel III Capital Reforms in Australia* (Discussion Paper, September 2011).
304 Explanatory Statement, Banking (prudential standard) determination No. 3 of 2012 (Cth).
305 See, eg, Australian Prudential Regulation Authority, 'Basel III Capital: Counterparty Credit Risk and Other Measures', *Consultations for Authorised deposit-taking institutions* (January 2013) <www.apra.gov.au/basel-iii-capital-counterparty-credit-risk-and-other-measures>; Australian Prudential Regulation Authority, 'Basel III Disclosure Requirements', *Consultations for*

143. The language surrounding these reforms underlines just how far the regulatory philosophy towards institutional and systemic risks has come. While the Wallis Inquiry considered it inevitable that some firms would fail, and thereby create systemic risks and potential consumer harm, the Murray Inquiry recommended that every effort should be made to reduce the likelihood of institutional failure, including through ‘unquestionably strong’ capital ratios for banks. APRA is today committed to an ‘unquestionably strong financial system in the years ahead’,[306] and recently consulted on reforms to create an ‘Unquestionably Strong Framework for Bank Capital’.[307] The legislative architecture for prudential regulation has facilitated the ongoing development of APRA’s approach to risk in banking, providing a tool in the form of prudential (and reporting) standards that has allowed for regulatory evolution without notable symptoms of legislative complexity. The consistency of the overall legislative architecture, as in the commitment to particular types of detail in prudential standards and higher-level provisions in the Act, underlines how adaptive the architecture is to the needs of the area of law (prudential regulation), as compared with the approach in respect of financial services as outlined in [148] below.

Financial Claims Scheme

144. Perhaps the biggest shift in how Australia manages systemic and institutional risk came from the introduction of the Financial Claims Scheme (‘FCS’) in 2008. Both the Campbell and Wallis Inquiries had resisted the introduction of government guarantees for depositors or insurance policyholders,[308] though in 1982 the ALRC suggested the introduction of a guarantee for general insurance policyholders.[309] The Wallis Inquiry was clear that the ‘assurance provided by prudential regulation should not extend to a government guarantee of any financial promises’.[310] While some considered that the *Banking Act 1959* included an implicit guarantee for banks, the RBA Governor sought to dispel this in 1985, suggesting that the

> legislation is less than a guarantee to depositors of full repayment and is no assurance of the solvency of an individual bank, nor of how the parties would emerge in the event of a winding-up.[311]

145. The government promptly ignored the Wallis Inquiry’s opposition to government guarantees with the launch in 2001 of the HIH Claims Support Scheme.[312] In the midst of the Global Financial Crisis, the Parliament formally abandoned the idea that the government was not in the business of guaranteeing any part of the financial system.[313] The FCS marked the first formal shift to eliminating, as opposed to managing, risk in prudential regulation. The FCS guarantees deposits of up to $250,000 per account holder per ADI.[314] It also covers claims of up to $5,000 for general insurance policyholders, and higher claims for eligible policyholders.[315] A separate regime also provides protection for private health insurance policyholders. These reforms reflect the reality that certain information asymmetries cannot be overcome (for example, relating to the prudential health of an institution) and changes in risk tolerance in depositor protections.

Sector-specific reforms in the 2010s

146. The 2010s saw a number of other reforms to prudential regulation that reflected, in part, the changing approaches to risks in financial markets. In particular, the period saw the extension of many of the regulatory standards first developed for banks to other sectors. For example, early in

uthorised deposit-taking institutions (May 2015) <www.apra.gov.au/basel-iii-disclosure-requirements>.

306 Australian Prudential Regulation Authority, *An Unquestionably Strong Framework for Bank Capital* (Information Paper, November 2021) 5.

307 Ibid.

308 Campbell et al (n 11) [20.11], [20.37]–[20.43]; Wallis et al (n 5) 193, 300.

309 Australian Law Reform Commission, ‘Insurance Contracts’ (n 56) [370].

310 Wallis et al (n 5) 175.

311 R A Johnston, ‘Prudential Supervision of Banks’ (1985) March *RBA Bulletin* 571, 572, cited in Hogan and Sharpe (n 231) 131.

312 See discussion at [135].

313 *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* (Cth).

314 *Banking Act 1959* (Cth) pt II, div 2AA; *Banking Regulation 2016* (Cth) reg 11.

315 *Insurance Act 1973* (Cth) s 62ZZF; *Insurance Regulations 2002* (Cth) pt 4A.

the decade, APRA enhanced and significantly standardised the prudential regulation of general and life insurers. These changes were aimed at reducing the risk of institutional failure and improving risk sensitivity in prudential standards.[316] In 2015, the prudential regulation of private health insurers was transferred to APRA under a new Act,[317] which also harmonised the legislative architecture with others administered by APRA.[318] APRA has subsequently begun consulting on enhancing capital requirements for private health insurers, using the standards for life and general insurers as a template.[319] Amendments in 2012 also extended the APRA-administered model of prudential standards to the *Superannuation Industry (Supervision) Act 1993*.[320] This followed recommendations in the Stronger Super Review.[321] Reforms in 2012 also enhanced the regulation of derivatives markets, which became subject to a mix of ASIC and ministerial powers to improve 'transparency' and 'risk management practices'.[322] A greater desire to manage risks in financial markets was a significant driver of these reforms.

Reflecting on the legislative architecture

147. Examining prudential regulation in Australia highlights the important role that shifting approaches to systemic and institutional risks have played in driving legislative change. The Basel II and III international agreements both marked gradual shifts in the intensity of regulation applied to banks, and the approach taken to managing the sources of systemic risks they posed. The desire to more intensively manage institutional and systemic risks saw the Basel regulatory tools — such as capital adequacy and liquidity standards — extended to other sectors of the financial system. An increasing desire to more intensively manage risk, and to do so through more sophisticated tools, has therefore driven prudential regulation.

148. Exploring the history of these reforms also highlights the resilience of the architecture for prudential regulation. Despite the significance of the changes to prudential regulation discussed above, the institutional and legislative architecture in which APRA operated coped relatively well in terms of maintaining an adaptive, efficient, and navigable legislative framework, and in reducing and managing complexity. The broad outlines of the regulatory framework, with prudential and reporting standards at the core, have remained relatively stable. Sources of complexity present in Chapter 7 of the *Corporations Act* — notional amendments, hundreds of narrowly focused legislative instruments, extensive and varied regulations, overlapping responsibilities between ministers, Parliament, and regulators — have not emerged in APRA-administered legislation. The distinctive architecture of APRA's model of prudential regulation has also made it relatively easy to extend to new sectors, such as general insurance, superannuation, and private health insurance.

149. The important role of prudential standards in facilitating changed approaches to regulation is unmistakable. APRA has been able to frequently update these instruments, often following years of consultation, in response to shifting approaches to risk, while maintaining the standards as largely self-contained statements of the law (noting the potential for APRA guidance and correspondence to shape the law's interpretation by firms). APRA's ability to update its standards, and its other powers to give directions to firms, have also meant that it has not always resorted to the law. Its interventions in the residential mortgage market, for example, have often been

316 Australian Government, *Life and General Insurance Capital Review* (Regulation Impact Statement, December 2011) 12.
317 *Private Health Insurance (Prudential Supervision) Act 2015* (Cth).
318 Explanatory Memorandum, Private Health Insurance (Prudential Supervision) Bill 2015 (Cth) [1.6].
319 Australian Prudential Regulation Authority, *Review of the Private Health Insurance Capital Framework* (Information Paper, December 2021) 3.
320 *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth).
321 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department, 'Super System Review' (n 99) 57 (rec 10.2).
322 Revised Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012 (Cth) [1.5].

implemented through letters to ADIs. This was the case for the introduction of caps on interest-only and investor loans,[323] which were aimed at systemic and institutional risks.[324]

150. The clear allocation of responsibilities between Parliament, the Treasury, ministers, and APRA, has also proven important in reforms to prudential regulation. Unlike Chapter 7 of the *Corporations Act*, where there are overlapping responsibilities in some areas, the clear allocation of responsibilities in the area of prudential regulation has minimised complexity. Whether or not one agrees with the particular design choices underlying the APRA model of regulation, it has the key attribute of consistency: a regulated entity generally knows who will make the rules that affect it, and where those rules are located.

323 Australian Prudential Regulation Authority, *Reinforcing Sound Residential Mortgage Lending Practices* (Letter to All Authorised Deposit-Taking Institutions, December 2014); Australian Prudential Regulation Authority, *Further Measures to Reinforce Sound Residential Mortgage Lending Practices* (Letter to All Authorised Deposit-Taking Institutions, March 2017).

324 In justifying its intervention in investor lending, APRA referred to the fact that '[f]ast or accelerating credit growth can also be a key indicator of a build-up in risk, both at an individual ADI and at an aggregate system level': Australian Prudential Regulation Authority, 'Reinforcing Sound Residential Mortgage Lending Practices' (n 323) 2.