This research was supported by the Centre for International Finance and Regulation, which is funded by the Commonwealth and NSW Governments and supported by other Consortium members.
It has been said that the intellectual origins of the global financial crisis (GFC) can be traced back to “blind spots” in traditional financial theory, which obscured complexity and financial innovation in contemporary markets.¹ There has been growing recognition that changes to the modern market, including the effects of globalisation, extreme mobility of capital and technological advances,² require corresponding changes in regulatory approach and structure.³ The crisis highlighted the need for specific regulation to enhance financial market stability,⁴ and the importance of ensuring that such regulation is both informed and effective.⁵

This paper discusses key regulatory issues and developments emerging from the GFC in relation to three distinct areas - financial market regulation; taxation; and banking and finance. The paper analyses the adequacy and efficacy of Australia’s legal infrastructure in these three areas from a comparative perspective.

³ Id, xii.
1. **FINANCIAL MARKET REGULATION**

1.1 **Introduction**

Financial market regulators in different countries have varied regulatory and governance structures. Although there has been intense corporate governance discussion about the role and structure of corporate boards over the last two decades, virtually no attention has been given to these issues in relation to regulators.

The GFC shifted the spotlight onto financial market regulators. The crisis raised interesting questions about what makes an effective, efficient and accountable financial market regulator, and how this may be affected by the regulator’s governance structure.\(^6\)

The crisis also prompted major changes to regulatory architecture in many jurisdictions. Australia, too, is now undertaking its own “once-in-a-generation”,\(^7\) “root and branch” examination of the financial services sector under the Financial System Inquiry.\(^8\)

1.2 **International Regulatory Architecture and the Global Financial Crisis**

The regulatory architecture of some countries stood up to the GFC far better than others. Although Australia’s corporate and financial services regulatory regime shares many features with other common law jurisdictions,\(^9\) there were also important structural differences. Australia's “twin peaks” model was one of the regulatory winners. It appeared to withstand

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\(^7\) Eyers and Patten, "Murray’s Moment", *Australian Financial Review*, 17 February 2014, 44.


the crisis far better than either the US or UK systems,\textsuperscript{10} and has subsequently served as the blueprint for a number of jurisdictions, including the United Kingdom, which adopted a “twin peaks” model following the GFC.

Under Australia's version of the "twin peaks" model,\textsuperscript{11} which was introduced on the recommendation of the 1997 Wallis Report,\textsuperscript{12} regulatory responsibility is split between the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).\textsuperscript{13} APRA supervises deposit-taking, general insurance, life insurance and superannuation institutions,\textsuperscript{14} and ASIC is responsible for business conduct and consumer protection.\textsuperscript{15} The Reserve Bank of Australia (RBA), which effectively represents a third peak,\textsuperscript{16} controls monetary policy, systemic stability and payments systems.\textsuperscript{17} Finally, the Council of Financial Regulators acts as the main regulatory coordination body.\textsuperscript{18}

Australia's regulatory architecture withstood the GFC particularly well compared to the systems in the United States and the United Kingdom at that time. There were clear benefits


\textsuperscript{13} For background on the restructure, see also HIH Royal Commission, The Failure of HIH Insurance: Volume III: The Failure of HIH: Reasons, Circumstances and Responsibilities (Commonwealth of Australia, April 2003), [24.1.1] – [24.1.2].

\textsuperscript{14} Institutions over which APRA has supervisory responsibility currently hold approximately $4.5 trillion in assets. See “About APRA”, APRA webpage at http://www.apra.gov.au/AboutAPRA/Pages/Default.aspx.

\textsuperscript{15} Although APRA has responsibility for prudential supervision of financial services entities, these entities will, in other respects, be subject to regulation by ASIC. See Corporations and Markets Advisory Committee (CAMAC), Guidance for Directors, April 2010, 25.


\textsuperscript{17} See generally Reserve Bank of Australia Annual Report, 2013, 3. See also s 10(2) of the Reserve Bank Act 1959 (Cth), which sets out the RBA’s functions.

in the Wallis Report’s decision to combine prudential oversight in a single regulator.\textsuperscript{19} This approach departed from the more common "specialised regulatory agency" paradigm adopted by jurisdictions such as the United States. The Wallis Report, however, warned that a specialised regulatory agency model was inconsistent with financial market innovation, and could result in regulatory gaps and ineffectiveness.\textsuperscript{20}

The Wallis Report appears to have been remarkably prescient in its decision to jettison the specialised regulatory agency model, since the precise dangers identified in the report were replicated in the United States during the GFC.\textsuperscript{21} There were over 115 US federal and state agencies involved in some aspect of America’s financial services regulation in the lead up to the crisis.\textsuperscript{22} Within this fragmented, silo-like environment, regulatory arbitrage was commonplace and there developed a “race to the weakest supervisor”.\textsuperscript{23}

The United Kingdom, on the other hand, combined prudential oversight and business conduct regulatory functions in a single monolithic regulator, the Financial Services Authority (FSA) prior to the GFC. This model received strong criticism following the 2007 collapse of Northern Rock plc (“Northern Rock”), which was treated as a case study in flawed and deficient supervision.\textsuperscript{24} Northern Rock’s collapse seriously damaged the FSA’s reputation as a successful regulator, as well as casting doubt on its light touch regulatory style, which had previously been greatly admired.\textsuperscript{25}


\textsuperscript{24} See Financial Services Authority (UK), The Supervision of Northern Rock: A Lessons Learned Review, 2008, 2-9.

There was also consensus in the UK that the actual regulatory framework had proven to be a failure during the crisis.\textsuperscript{26} This led the United Kingdom to overhaul its regulatory structure, and to introduce a “twin peaks” model under the \textit{Financial Services Act} 2012.\textsuperscript{27} The “twin peaks” of the new UK system are the Prudential Regulation Authority (PRA), which is part of the Bank of England, and the Financial Conduct Authority (FCA).

The Bank of England had, in fact, been the primary UK financial market regulator up until 1997, when New Labour announced that, if it won the imminent election, it would strip the Bank of England of its supervisory powers, and create the FSA to replace it.\textsuperscript{28} Against this historical background, one commentator described the UK’s post-GFC regulatory restructure as "a dramatic fall from grace for the FSA and a remarkable phoenix-like re-emergence for the Bank [of England] as a financial supervisor".\textsuperscript{29}

Although Australia’s regulatory system served as a blueprint for the UK reforms, there are interesting differences in the two models. One of the major differences is the role of the central bank in the regulatory architecture. The Bank of England once again occupies a pivotal position in the UK financial market regulatory system, and there was concern in the

\begin{itemize}
\item \textsuperscript{27} See \textit{Financial Services Act} 2012 (UK) (available at http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted). The reforms established new “centres of regulatory excellence”:
\begin{itemize}
\item[(i)] Financial Policy Committee (FPC) (macroprudential responsibility) (see http://www.bankofengland.co.uk/financialstability/pages/fpc/default.aspx);
\item[(ii)] Prudential Regulation Authority (PRA) (microprudential supervisor) (see http://www.bankofengland.co.uk/pra/pages/default.aspx);
\item[(iii)] Financial Conduct Authority (FCA) (conduct of business and consumer protection regulator) (see http://www.fca.org.uk/about).
\end{itemize}
\end{itemize}


\item \textit{Id}, 456.
lead-up to the reforms that they would give the bank “unprecedented new powers”. The main statutory objectives of the PRA, which regulates approximately 1,700 financial firms, are (i) to promote the safety and soundness of these firms and (ii) to contribute to the protection of insurance policyholders. Another of PRA’s objectives is to facilitate competition. It is worth noting, however, that facilitating competition is secondary and subordinate to the authority’s two main protective objectives.

The Australian system of financial market regulation deliberately separates prudential regulation from the RBA. The Wallis Report considered that this separation was critical to differentiate clearly the roles of the prudential regulator and the central bank, and ensuring that prudential regulation was carried out efficiently and flexibly across a variety of specialised financial products. According to the Wallis Report, this structural separation also sent a vital message to the marketplace - namely that, although the central bank had an important role in supporting and maintaining financial stability, “there was no implied or automatic guarantee of any financial institution or its promises in the event of insolvency”. It is interesting to note that the question of whether the RBA should be involved in prudential regulation has reemerged in the current Australian Financial System Inquiry. Issues relating to the appropriate balance between competition/economic performance and system stability are also central features of the current inquiry.

1.3 The Role, Effectiveness and Structure of Regulators


Ibid. See also Financial Services and Markets Act 2000 (UK), s 2H.


Ibid.

See, for example, ANZ, Submission to the Financial System Inquiry, 31 March 2014, pp. 46-48.

Ibid. See, for example, Financial System Inquiry, The Inquiry’s Terms of Reference, [2.1], [2.3], [4.1] (available at http://fsi.gov.au/terms-of-reference/).
The Financial System Inquiry’s Terms of Reference comprise, inter alia, reassessing "the role, objectives, funding and performance of financial regulators including an international comparison".37

Central to this inquiry is an assessment of what makes an effective regulator, and how regulatory structure contributes to the effectiveness of financial supervisory agencies. In considering what makes an effective regulator, it is perhaps useful to examine first what makes an ineffective one.

The GFC provided numerous examples of supervisory agencies whose performance fell short of expectations. In the United Kingdom, sharp criticism was directed at the FSA for the collapse of Northern Rock in 2007 and failure of Royal Bank of Scotland (RBS) in 2008. In relation to Northern Rock collapse, critical flaws attributed to the FSA’s regulatory performance included weaknesses in the flow of intelligence and information, inadequate regulatory engagement, oversight and risk assessment, together with inadequate supervisory resources.38

The RBS failure imposed huge costs on the taxpayer, in view of the fact that the UK government injected £45.5 billion of equity capital,39 and the failure was closely linked to the UK recession that followed.40 A report by the FSA on the RBS failure identified a number of key regulatory deficiencies. First, the report claimed that the FSA (and many other international supervisory agencies during this period) had applied prudential regulations and capital rules that were "dangerously inadequate". The FSA had failed to supervise liquidity appropriately, allowing the RBS to operate with excessively high leverage. The report also faulted the FSA’s regulatory "philosophy and approach" at the time. It claimed that FSA’s “light touch” style of regulation, which was encouraged by the British government at the time

37 Id, [2.5].
39 By December 2011, however, the value of this equity had more than halved to around £20 billion. Financial Services Authority, The Failure of the Royal Bank of Scotland, Financial Services Authority Board Report, December 2011, 6.
40 Ibid.
and based on the assumption that markets were efficient, led the agency to provide insufficient challenge to poor decision-making by the management of RBS.41

In the United States, the US Senate Permanent Subcommittee on Investigations released a report in 2011 entitled *Wall Street and the Financial Crisis: Anatomy of a Financial Crisis* (Levin and Coburn Report).42 The Office of Thrift Supervision (OTS), which had regulated American International Group, Inc. (AIG)43 in the lead up to the financial crisis, was the subject of particular criticism in this report. The OTS was also one of several federal bank regulators that oversaw Washington Mutual Bank (Washington Mutual). This bank collapsed in September 2008, following a liquidity crisis caused by depositor withdrawals of more than $26 billion between 2007 and 2008. At the time of its collapse, Washington Mutual had $300 billion in assets, $188 billion in deposits, 2,300 branches in 15 states and 43,000 employees. According to the report, it represented "one of the most spectacular failures of federal bank regulators in recent history".44

Detection was not the problem when it came to the OTS’s supervision of Washington Mutual - rather it was enforcement. Over a five-year period, OTS examiners identified more than 500 serious defects relating to the bank’s lending practices, risk management and asset quality.45 Although the OTS requested Washington Mutual to take corrective action, the bank failed to do so. The OTS also failed to instigate any public enforcement action, yet continued to give Washington Mutual positive safety and soundness ratings.46 In particular, the regulator failed to rein in the bank’s escalating use of high risk lending practices and low quality home loans.

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41 *Id.*, 10. The Northern Rock collapse has also been used to argue that the FSA was “philosophically disinclined” to question the bank’s business plans and risk models: Brooke Masters, “Northern Rock Exposed Regulatory Failings”, *Financial Times* (online), 12 September 2012.


45 *Id.*, 161-162.

46 *Id.*, 161.
According to the Levin and Coburn Report, part of the explanation for this was the fact that, under its regulatory culture, the OTS treated the institutions under its supervision as "constituents", which could be relied upon to correct problems once identified. The report noted that in taking such a hands-off approach, the OTS had displayed "an unusual amount of deference" to the bank's management.47 Indeed, the OTS even impeded calls for stronger enforcement against Washington Mutual by another key US banking regulator, the Federal Deposit Insurance Corporation (FDIC).48 This resulted in a full-scale regulatory turf war between these two regulatory agencies.49

The OTS was ultimately abolished by the Dodd-Frank Act 2010, and its powers were redistributed between other authorities.50 This, however, constituted no more than minor tinkering with the US financial market regulatory structure, which remains both fragmented and byzantine. Also, some commentators, such as Professor John Coffee have adopted a pessimistic approach to reforms actually introduced in legislation such as the Dodd-Frank Act 2010, arguing that there is often a rapid subsequent erosion of regulation as a result of lobbying by powerful interest groups.51 He has coined this phenomenon the “Regulatory Sine Curve”.52

Australian regulatory agencies largely escaped the kind of opprobrium for regulatory failure during the GFC that was directed against many international regulators.53 Nonetheless,
APRA experienced analogous censure almost a decade earlier, when the HIH Royal Commission examined its role in the 2001 failure of HIH Insurance (HIH).

The HIH Royal Commission, under Owen J., ultimately concluded that APRA did not contribute to HIH’s collapse, stressing that regulators cannot provide a fail-safe guarantee that no company under their supervision will ever fail.\(^{54}\) Nonetheless, the Commission considered that APRA, which was a relatively new regulator at the time of HIH’s collapse,\(^{55}\) had not performed its regulatory role at a standard that the public was entitled to expect.\(^{56}\) According to Owen J., APRA had ignored many red flags, been slow to act and made numerous errors of judgment.\(^{57}\) The Royal Commission also considered that APRA’s board had underestimated the challenges inherent in moving to an integrated regulatory model.\(^{58}\)

Unlike in the United Kingdom, where the FSA’s flawed performance during the GFC led to an overhaul of the entire UK regulatory architecture, the post-HIH regulatory response in Australia introduced targeted changes to APRA to improve its regulatory performance. Of the total of 61 recommendations made by the HIH Royal Commission, many related specifically

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55 APRA was created in July 1998 (see [http://www.apra.gov.au/Pages/default.aspx](http://www.apra.gov.au/Pages/default.aspx)).


57 *Ibid*.

58 *Id.*, 210.
to APRA. These recommendations predominantly comprised changes to APRA’s operational structures and basic approach to prudential supervision.

The HIH Royal Commission’s specific recommendations for structural reform of APRA included the following:- Recommendation 18 proposed replacing APRA’s non-executive board with a full-time executive group comprising a CEO and 2-3 commissioners. Recommendation 19 provided that the chief executive should have power to establish an advisory board. Recommendation 20 suggested discontinuing any direct involvement by representatives of ASIC or the RBA in APRA’s governance structure. Finally, Recommendation 21 proposed an urgent review of APRA’s organizational structure, to ensure effective supervision.

An important theme underlying many of the HIH Royal Commission’s recommendations was that of regulatory culture. The report recommended for example, that APRA develop “a more sceptical, questioning and, where necessary, aggressive approach” approach to prudential supervision, and adopt systems that encouraged its employees to adopt a sceptical and challenging approach to the solvency and viability of regulated entities. The Australian Government subsequently introduced legislation implementing Owen J.’s


60 Id, liv.


63 Id, 210-11.

64 Eg Recommendations 26-28, id, 220-221.

65 See Recommendation 26, id, 220.

66 See Recommendation 28, id,221.
recommendations in the HIH Royal Commission concerning APRA, including the restructuring of its board.

1.4 Regulatory Deficiencies and the Link Between the Governance Structure of Regulators and their Performance

Some of the HIH Royal Commission’s recommendations relating to APRA’s governance structure were clearly premised on the view that there is a link between the governance structure of regulators and their performance. Although this is a familiar contemporary theme in relation to boards of directors, it is a far less commonly discussed topic in the context of regulators.

A financial crisis is usually followed by a change in regulation and/or regulatory architecture, and the global financial crisis proved no exception in this regard. Many of these reforms responded to regulatory deficiencies highlighted by the GFC, including:

- misconceived role by regulators;
- ignorance and informational defects;
- detection problems;
- enforcement problems;
- lack of independence;
- regulatory capture by government;
- regulatory capture by industry;

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• blurred lines of regulatory responsibility (potentially resulting in "turf warfare" on the part of the regulators and arbitrage on the part of those subject to regulation);
• inadequate funding for regulators.

Regulatory independence was an intriguing aspect of the GFC. From the early 1990s, independence, particularly independence from political interference, was seen as a crucial feature of effective, accountable financial market regulators. During this period, most Western jurisdictions followed the United States in strengthening the independence of their financial regulators. This was also encouraged by key international organisations, such as the Basel Committee and the International Monitoring Fund (IMF). It has been argued, however, that this independent agency paradigm came under attack in the GFC, when international policy makers sought to provide greater supervision of financial institutions, and to enable governmental intervention in situations of financial emergency.

There were a number of cases during the GFC when supposedly independent regulatory agencies both permitted, and welcomed, political intervention. For example, in the United States, Treasury Secretary Paulson was a central participant in all bail-out decisions, and worked closely with the Federal Deposit Insurance Corporation (FDIC). In the United Kingdom, Prime Minister Gordon Brown was personally involved in the decision to nationalise Northern Rock. In Europe, the potential failure of the bank, Fortis, led to collaborative action between the Belgian and Dutch governments, together with national regulators to try to take over Fortis. Australia, however, arguably provides a counter example to this trend. There is some evidence to suggest that the Australian government disagreed strongly with, but failed to succeed in overturning, the RBA’s decision to stagger rate reductions across several months during the crisis. If this is correct, it indicates a high level of independence for Australia’s central bank.

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73 Id, 332.
74 Id, 351-353.
75 Ibid.
1.5 Governance Paradigms for Regulators

A range of different possible regulatory arrangements exist around the world, in relation to governance structure, size and level of independence from political forces and market participants. It is worth considering the extent to which particular governance structures can affect the performance of financial market regulators, in terms of their efficiency, accountability and capacity to avoid the regulatory pitfalls discussed above.

Dominant governance paradigms around the world include the following:-

(i) **Governing board with a majority of independent non-executive directors**

This paradigm, which operates, for example, in the United Kingdom, New Zealand and Hong Kong, essentially mimics the governance model developed for public companies, including splitting the role of CEO and chair.

This governance structure has, however, sometimes been criticised (both in relation to companies, and regulators), on the basis that it may increase the risk of regulatory capture. It was said, for example, that in the lead-up to the global financial crisis, the FSA was primarily interested in maintaining market confidence and that its regulatory function was compromised due to the fact that a majority of its board’s non-executive representatives came from the financial services community. Although the composition of the UK’s new regulatory bodies have a similar structure in terms of non-executive members, they have less involvement from members of the finance industry.

(ii) **Governing board comprising of full-time executives**

The second regulatory paradigm of a governing board with full-time executives rejects any parallels between the optimal governance structure of financial market regulators and the

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77 Namely, the FPC, PRA and FCA.
public companies under their supervision. This paradigm is adopted in several jurisdictions, including Australia, the United States and Ontario.

The governing bodies of both ASIC and APRA comprise full-time executives. They also avoid separating the role of CEO and chairman, which is viewed as a critical governance technique for public companies in the United Kingdom and Australia. The changes to APRA’s regulatory structure implemented on the recommendation of the HIH Royal Commission effectively took APRA out of paradigm category (i), and placed it in category (ii). As a result of the reforms introduced after the HIH Royal Commission, APRA went from having non-executive board to a three member Executive Group.

The HIH Royal Commission considered that APRA’s initial non-executive board structure reflected a “governance board”, rather than an “advisory board”, as envisaged by the Wallis Report. The Commission definitively rejected the part-time non-executive board paradigm for Australia’s key regulators. It took the view that such a structure was inappropriate for a prudential regulator because, unlike the board of a public company, the regulator’s board would have no power to remove the chief executive officer (CEO). Under the circumstances, Owen J. believed that interposing a non-executive board structure between the Treasurer, and the CEO had the potential to “cloud the line of accountability”. This was an issue, given that it is the regulator’s board, rather than the Treasurer that sets the CEO’s duties, yet, unlike the position in a public company, the board does not appoint the CEO.

According to Owen J:

“The chief executive is answerable to the board – although it does not appoint him or her – as well as to the Treasurer. At the same time, the board carries responsibility of the performance of APRA but does not appoint the person who runs the organisation on its behalf.

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79 Id, 770.

80 See Financial Reporting Council (FRC), the UK Corporate Governance Code, September 2012, A.2.1.

While individuals of the kind who were appointed to APRA’s board would no doubt be able to play a valuable advisory role – including acting as a commercial sounding board – there is a question as to the utility of non-executive board input into how a regulatory body such as APRA carries out statutory role.\textsuperscript{82}

The HIH Royal Commission also disapproved of the fact that under APRA’s original governance structure, representatives of the central bank and corporate regulator sat on the prudential regulator’s board. The Commission considered that this practice could, in fact, undermine regulatory cooperation, which was better located in the Council of Financial Regulators.\textsuperscript{83}

Another influential Australian report to explore the connection between the governance structure of financial market regulators and their performance was the 2003 Uhrig \textit{Review of the Corporate Governance of Statutory Authorities and Office Holders} ("Uhrig Report").\textsuperscript{84} The Uhrig Report considered that adoption of unsuitable governance structures by a statutory authority would inevitably have a negative impact on that authority's performance.\textsuperscript{85} The report contemplated, but firmly rejected, a public company-style board model for Australian regulators.\textsuperscript{86} It highlighted the fact that the role and powers of corporate boards and the boards of regulators were fundamentally different.

According to the Uhrig Report, boards of public companies operate as effective governance mechanisms, precisely because such boards are delegated full power to act, including the power to:

\begin{itemize}
  \item \textsuperscript{82} HIH Royal Commission, \textit{The Failure of HIH Insurance: Volume 1: A Corporate Collapse and Its Lessons} (Commonwealth of Australia, April 2003), p. 207-210 [8.5.1].
  \item \textsuperscript{83} \textit{Id}, 209-10.
  \item \textsuperscript{85} Uhrig Report, 65.
  \item \textsuperscript{86} See generally Bird, “Regulating the Regulators: Accountability of Australian Regulators” (2011) 35 \textit{Melbourne Law Review} 739, 770-771.
\end{itemize}
• appoint and remove the CEO;
• appoint the chairman and new directors;\(^{87}\)
• finalise and approved strategy;
• define the company’s values and culture;
• provide a constraint on management; and
• give final approval in relation to the sale/purchase of significant assets.\(^{88}\)

However, the Uhrig Report noted the government often retains power over many of these functions with respect to regulatory authorities. Where this occurs, the report considered that a public company-style board would constitute "an unnecessary layer in the accountability framework" and fail to deliver optimal performance.\(^{89}\) It also concluded that a public company-style board could complicate accountability in the regulatory context and lead to board capture by the CEO. This was on the basis that boards without full powers might tend to become an ally of the CEO, rather than act as a check on managerial power.\(^{90}\) Finally, the report suggested that that use of a board structure without full powers could result in misconceived roles by the regulatory authority.\(^{91}\)

In spite of the misgivings expressed by both the HIH Royal Commission and Uhrig Report about use of public company governance systems for Australian regulators, as Joanna Bird has noted,\(^{92}\) this seem to work well for a number of highly regarded foreign regulators, including the Hong Kong Securities and Futures Commission.\(^{93}\) Indeed, it has been said that, in some situations, where governments might have too much power over formally

\(^{87}\) Subject generally to confirmation by shareholders at the following annual general meeting in accordance with the Corporations Act 2001 (Cth).

\(^{88}\) Uhrig Report, 65.

\(^{89}\) Id, 66.

\(^{90}\) Id, 66.

\(^{91}\) The Uhrig Report states that, in these circumstances, the board of the statutory authority may wrongly believe that its role relates to providing consultancy or entrepreneurial services, rather than governance. Ibid.


\(^{93}\) The Hong Kong Securities and Futures Commission comprises a non-executive Chairman, CEO, 5 executive directors and 7 non-executive directors (see http://www.sfc.hk/web/EN/about-the-sfc/organisational-chart/board-of-directors/).
independent regulators, internal governance control mechanisms paralleling those used in public companies could have a salutary effect in bolstering regulatory independence and ensuring that the interests of the public remain paramount.\textsuperscript{94}

(iii) A governing board, where most members are government appointees

Another possible paradigm is a regulatory authority with a governing board, where most members are government appointees. Singapore is a good example of this paradigm in operation. Little attempt has been made to ensure that Singapore’s main financial services regulator and central bank, the Monetary Authority of Singapore (MAS), is independent of government, however, the Singaporean government has gone to some lengths to avoid the pitfalls of regulatory capture by industry participants, which was perceived as one of the failings of the FSA in the UK.

1.6 Financial Market Regulation - Conclusion

Australia's regulatory architecture held up remarkably well during the GFC, and the twin peaks model now serves as a regulatory blueprint for a number of countries around the world, which have reformed their financial market regulatory framework in the wake of the crisis. Australia's financial market regulatory structure was clearly superior to the systems in the United States and the United Kingdom in addressing the problems that arose during the GFC. Although there have been some calls for increased involvement by the RBA in prudential regulation in response to the Australian Financial System Inquiry,\textsuperscript{95} the Wallis Report considered that there were clear benefits in combining prudential oversight in a single regulator,\textsuperscript{96} APRA, and the GFC seems to have confirmed the wisdom of that decision.


\textsuperscript{95} See, for example, ANZ, Submission to the Financial System Inquiry, 31 March 2014, pp. 46-48.

In terms of the governance structure of particular regulators, Australia's key financial market regulators, ASIC and APRA adopt a governing board comprising of full-time executives. This paradigm received strong support from both the HIH Royal Commission and the Uhrig Report. In spite of this, a number of international regulators adopt a public company-style governance system, which in many cases appears to work equally well.\(^{97}\) Whichever governance structure is adopted, however, factors, such as corporate culture, independence (from government and industry) and adequate funding, are also critical in determining a regulator’s ultimate effectiveness.

Australia’s regulatory system proved robust during the GFC and is highly regarded around the world. There are many opportunities for Australian law and regulatory structure to be influential going forward, particularly in Asia, where US and UK law has lost some of its cachet since the crisis.

2. **Taxation**

2.1 **Introduction**

The GFC has had a considerable impact on the area of taxation in Australia and globally, the two best-known examples being the various initiatives in international transparency (particularly the effective abolition of bank secrecy in taxation) and the attack on corporate tax avoidance through the OECD and G20 project on Base Erosion and Profit Shifting (BEPS) following revelations of the low effective tax rates paid by companies in the digital economy. Yet the Australian and global response to the GFC in the tax area stands in stark contrast to that in the financial regulation area in a number of ways.

Rather than question the effectiveness of the regulator (in this case the Australian Taxation Office or ATO) and the structure of regulation through detailed examination of regulatory

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failures – because there were not the same obvious failures as in the financial regulation area – the response has been more of the same, more transparency and more attacks on tax avoidance without any significant weighing of the benefits and costs, including diversion from other important policy initiatives, or serious examination of the underlying policies involved. Further the response has been much more a coordinated top-down international effort through the G20 and the OECD using treaty mechanisms, rather than a bottom-up approach through domestic law. Although the G20 has also been very influential in the financial regulation area, the necessary implementation mechanism is generally domestic law, rather than treaties or other international instruments; the most significant change to international instruments promoted by the G20 has been an increase in the IMF’s resources which was an early G20 initiative in response to the GFC but to date has not occurred.

The tax part of this paper examines these developments out of, and responses to, the GFC under two main themes: tax transparency and the taxation of capital income. In relation to the former we examine developments in exchange of information with tax havens, automatic exchange of information driven by the US Foreign Account Tax Compliance Act 2010 (FATCA) and country-by-country reporting of profits by multinational enterprises (MNEs), including to what extent there have been changes in the structure and operation of the regulator. In relation to the latter we consider briefly the underlying policy of taxation of income from capital at the individual and corporate level, and the marked failure to deliver a long promised tax reform policy designed to make Australia an Asian financial hub in the area of collective investment.

2.2 Transparency

Income tax revenue collections naturally fall during an economic downturn as employment and corporate profits decline. Rather than being viewed as a problem, this feature is generally regarded as an advantage of an income tax which operates as an automatic economic stabiliser. During the GFC the need to prop up failed or failing financial institutions and to pump large amounts of cash into the economy to ameliorate a severe recession or depression lead to significant fiscal deficits and potentially unsustainable government borrowing, and hence the need to increase revenue for many governments. This need coincided with work
that was already occurring in relation to hidden offshore bank accounts and it was easy politically for everyone to agree that such tax evaders should be made to contribute to government revenue needs.

The OECD began its work on exchange of information with tax havens and the abolition of bank secrecy in the late 1990s and by 2002 had secured the necessary internal consensus and international instruments for the purpose, but in the following years very little happened, including in Australia which was a very strong supporter of the process. At the G20 Heads of Government meeting in London in April 2009, the G20 became involved in the push for tax transparency through endorsement of the OECD work, and at this point international cooperation in the area, which had already been growing, took off as the following graph indicates.

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100 The G20 agreed, “to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information.,” see [http://www.g20.utoronto.ca/2009/2009communique0402.html](http://www.g20.utoronto.ca/2009/2009communique0402.html).

Australia now has signed 36 Tax Information Exchange Agreements (TIEAs) of which all but three are in force.\textsuperscript{102} While the push to have tax havens enter into TIEAs has been successful, the agreements provide only for exchange of information on request and have to be individually negotiated and put into effect. Research seems to indicate that they have not yet had a significant impact on money in tax havens or tax revenues.\textsuperscript{103} The notorious examples of offshore bank accounts such as UBS’s promotion of tax evading Swiss bank accounts in the US and the uncovering of offshore money held by Australians through Project Wickenby were not revealed through the operation of information exchange agreements but came about through other processes.\textsuperscript{104} What is probably most

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{TIEAs_signed_annually.png}
\caption{TIEAs signed annually}
\end{figure}

\textsuperscript{102} See \url{http://www.treasury.gov.au/Policy-Topics/Taxation/Tax-Treaties/HTML/TIEA}.
significant about the TIEA story is the creation of an international peer review process for evaluating individual country’s practices in transparency through the Global Forum.  

As a way of obviating the need for bilateral negotiation of TIEAs and for permitting more rapid evolution in the international consensus in exchange of information, the Global Forum promoted the multilateral Convention on Mutual Administrative Assistance in Tax Matters which had originally been devised by the OECD and the Council of Europe and opened for signature in 1988. The requisite five signatories for it to come in operation were only achieved in 1995 and thereafter the list of signatories grew slowly. In 2010 the OECD was successful in negotiating a protocol which brought the convention into line with the “international standard” on exchange of information and by November 2011 all G20 members had agreed to sign the treaty (Australia being one of the last to agree to do so, having declined to sign the Convention in 1988). The UK as part of hosting the G8 in 2013 required that its dependencies (a significant number of which are tax havens) become parties through extension of the UK’s adherence to the treaty and there are now over 60 signatories and 10 extensions, including Switzerland which signed in October 2013 and many tax havens.

The multilateral Convention also provides for automatic exchange of information as well as exchange on request and since late 2012 when the G20 decided to move the international standard for exchange of information to the next level of automatic exchange, the multilateral Convention became the preferred vehicle for achieving this change. At the same time the US was proceeding with the implementation of FATCA

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107 For the Swiss effort to fend off exchange of information by agreements on anonymous withholding taxes commonly called Rubik agreements, which seems to have been now overtaken, see Cavelti, “Automatic Information Exchange versus the Withholding Tax Regime: Globalization and Increasing Sovereignty Conflicts in International Taxation” (2013) 5 World Tax Journal 172.
which requires disclosure by financial institutions outside the US of accounts and similar investments held by US citizens and residents to the US Internal Revenue Service (IRS). The compliance costs of this measure were potentially huge for financial institutions and likely to put them in breach of the law in countries where they operated so the US and several European countries developed Model Inter-Governmental Agreements (IGAs) to allow financial institutions in countries that enter into IGAs with the US to provide the information to their local tax administration which then automatically exchanges that information with the IRS under exchange of information treaties permitting this form of exchange already in existence between the US and the other country.108

The OECD facilitated the development of IGAs and in the process brought FATCA, IGAs and the multilateral Convention together as the means for implementing automatic exchange of information on a global basis. The Common Reporting Standard for this purpose was released in early 2014 and works by closely following IGAs but generalising them to apply to agreements not involving the US.109 Australia has very recently signed an IGA with the US but is not among the self-identified early-adopters group of the Common Reporting Standard.110 Australian banks have indicated that the start-up costs for the FATCA IGA will be substantial even though it seems unlikely that foreign tax evaders will maintain accounts or similar investments in Australia.111

108 There are many articles tracing this process which are rapidly outdated by the speed of developments; for a recent discussion see Grinberg, “Taxing Capital Income in Emerging Countries: Will FACTA Open the Door?” (2013) 5 World Tax Journal 325.


110 See http://www.treasury.gov.au/Policy-Topics/Taxation/Tax-Treaties/HTML/Intergovernmental-Agreement for the IGA with the US signed on 28 April 2014. The FATCA and associated IGA systems commence on 1 July 2014 with the various reporting and other obligations then being rolled out progressively over succeeding years. For the early adopters of the OECD Common Reporting Standard, see http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf. Early adoption will commence on 1 January 2016 with the first exchange of information in September 2017.

111 Australian bank representatives have indicated costs of more than A$500 million for Australian banks to implement the FATCA IGA at various public events (and the same again for the Common Reporting Standard); some larger foreign banks indicate similar figures for a single bank.
The final transparency issue that will be covered here is the most recent development of country-by-country reporting by MNEs of various financial data and tax payments, driven by concerns about tax avoidance by MNEs especially in the digital economy. This possibility again had been actively investigated by the OECD for some years mainly arising out of concerns about developing countries’ difficulties in taxing MNEs. The GFC also made it an issue for developed countries and produced action in 2013 when country-by-country reporting was included in the OECD BEPS Action Plan endorsed by the G20. The inclusion of this initiative as part of MNEs transfer pricing documentation means that it is much more limited than sought by many proponents (especially from civil society) who wished the information to relate more broadly to tax avoidance issues, not just transfer pricing, and to be made public rather than only reported to tax authorities.

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Australia’s domestic response in this area was to pass legislation in 2013 requiring the ATO to publish income tax payment information obtained from the tax returns of corporate tax entities that have an annual total income of $100 million or more. The problem with this approach is that it only requires information to be published on companies which lodge tax returns in Australia and report gross income of $100 million or more. In the case of foreign MNEs which operate in Australia via subsidiaries, the information requirement will only apply to the subsidiaries and they will often fall below the disclosure threshold; hence to what extent the measure will have much effect on tax avoidance behaviour of MNEs is unclear. Similarly the compliance costs of global country-by-country reporting for MNEs are claimed to be large and its effectiveness on a cost-benefit analysis has been called into question in the academic literature.

From this account of developments in relation to tax transparency as a result of the GFC, it will be clear that the main drive has come from the OECD and G20 and that domestic law changes have played a very subsidiary role. Although significant progress has been made, the cost-benefit and revenue effectiveness of increased transparency are still to be demonstrated. It is unlikely, however, that some of the benefits, such as maintenance of respect for the tax system, which underpins voluntary compliance with tax laws, can ever effectively be measured.

What is noteworthy in comparison with other areas of financial regulation is that there has been little public questioning of the effectiveness of the regulator or of the underlying tax policy. With regard to the regulator, the ATO is often proclaimed to be a model tax administration, sometimes to the point of complacency and self-congratulation. It is


true that the ATO has been at the forefront of many tax administration developments in dealing with international tax avoidance and evasion\(^{120}\) and is the subject of intense scrutiny from several different oversight mechanisms.\(^{121}\) On the other hand it is viewed by corporate taxpayers as an extremely aggressive regulator,\(^{122}\) producing among the highest tax compliance costs in the world.\(^{123}\) The ATO may be about to undergo a quiet revolution as a regulator with the appointment of an outside Commissioner who has begun to bring in other senior officials from the private sector and commenced a program of cultural change in the ATO.\(^{124}\)

2.3 Tax Policy in relation to Income from Capital

The underlying policy assumption of all the transparency initiatives arising from the GFC outlined above has been that income from capital should be subject to tax at the individual and corporate level. Yet there has been a long held view in the economic literature that taxation of income from capital (and particularly the corporate income tax) is inefficient and should be replaced by taxes on more efficient bases such as consumption and land. This literature underpinned the “root and branch” review of the Australian tax system commonly

\(^{120}\) This is evident in a number of OECD publications on tax administration, including promoting the model used by the ATO for Project Wickenby, see OECD, *Effective Inter-Agency Co-Operation in Fighting Tax Crimes and Other Financial Crimes* (1st ed, 2012, 2nd ed, 2013). See also Dirkis and Bondfield, “Striking gold offshore with Australia's tax information gathering powers: alchemy or evolution?” (2013) 14 *Journal of Australian Taxation* 41.

\(^{121}\) The oversight bodies are the ANAO, the Inspector-General of Taxation, the Ombudsman (which has a specialist tax oversight section) and Parliamentary committees. The tax role of the Ombusdman is proposed in the 2014 Budget to be absorbed by the Inspector-General of Taxation.

\(^{122}\) For example, in relation to transfer pricing, see Walpole and Riedel, *The Role Of Tax In Choice Of Location Of Intellectual Property: Report for the Oxford University Centre for Business Taxation* (2011), pp. 12-13

\(^{123}\) Most of the work in Australia on compliance costs (including by the ATO) dates from the 1990s and early 2000s at which time even the ATO work indicated extremely high compliance costs in Australia; recently there has been a resurgence of interest in the topic, see Lignier and Evans, “The rise and rise of tax compliance costs for the small business sector in Australia” (2012) 27 *Australian Tax Forum* 615, Evans, Tran-Nam and Lignier, “Personal taxpayer compliance costs: Recent evidence from Australia” (2014) 29 *Australian Tax Forum* (available online at www.taxinstitute.com.au).

called the Henry Review, which, although it reported in 2009, was effectively based on the
pre-GFC view of the world.\footnote{125}

Hence there is a fundamental tax policy dissonance between the economic literature and the
post-GFC tax transparency initiatives. In this section we suggest that the transparency (and
other) initiatives are based on the correct policy approach and that the prevailing economic
view has been destroyed by the GFC, which involved catastrophic capital market failures
whereas the economic literature assumes perfect capital markets, perfect mobility of capital
and perfect immobility of labour. Whichever view is correct, what is noticeable in relation to
the GFC is the general failure to appreciate its significance as a test of tax policy
prescriptions, in contrast to corporate and financial regulation.

At the individual level there has long been an argument in the economic literature that a
consumption tax is superior to an income tax, the major difference being that a consumption
tax effectively exempts income from capital from tax. That argument is based on an
economic model with highly unrealistic and limited assumptions; when the assumptions are
made more realistic, the exact opposite view emerges – that income from capital of
individuals should be taxed.\footnote{126}

\footnote{125} Australia’s Future Tax System, Report to the Treasurer (2009), available at
http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm; to similar effect see
President’s Advisory Panel on Tax Reform, Simple, Fair, and Pro-Growth, Proposals to Fix America’s
Tax System (2005), available at http://govinfo.library.unt.edu/taxreformpanel/, Institute for Fiscal
Studies Mirrlees’ Review, Tax by Design (Oxford University Press, 2011) available at
http://www.ifs.org.uk/mirrleesReview.

\footnote{126} Two of the assumptions are that all households consist of a single person and not a family unit and that
time is divided between market work and leisure, that is, there is no household production. Apps and
Rees have been in the forefront of showing that when realistic households of families involving
household production (especially childcare) are modelled the results get turned on their head, Apps and
Rees, Public Economics and the Household (Cambridge University Press, 2009), Apps and Rees
McMahon, eds, The Proper Tax Base: Structural Fairness from an International and Comparative
Perspective – Essays in Honor of Paul McDaniel (2012) 87; see also Diamond and Saez, “The Case for
Perspectives 165.
In relation to corporate taxation the story is similar. The tax competition literature which underlies the story of the corporate tax being inefficient is based on perfect capital markets as well as other even more restrictive assumptions such as the marginal investor being a non-resident and being tax exempt in their home country. The OECD has been arguing this view for many years but the BEPS project goes in the opposite direction with 15 actions designed to shore up the corporate income tax base in relation to corporate tax avoidance particularly in the digital economy but also more generally.\(^{127}\) Again when those assumptions are made more realistic, the standard economic results from these models of tax competition defeating the corporate tax do not hold; in this case the economic literature on taxation simply fails to face up to the capital market failures of the GFC, as now seems to be recognised by the Australian Treasury.\(^{128}\)

Australia has been backing the BEPS project strongly both internationally and through domestic law changes (with most of the international anti-avoidance tax changes announced in 2013 and 2014 being subsumed under the BEPS rubric).\(^{129}\) Partly as a result of this focus (but also partly of the political contest on the carbon tax and the Minerals Resource Rent Tax (MRRT)) other tax policy changes that make eminent sense and that are likely to have positive economic benefits for Australia have languished.\(^{130}\) The most notable policy relevant


\(^{130}\) The federal Liberal-National government elected in 2013 was faced with about 90 unenacted tax policy announcements when it came to power, including several tracing back to the Howard government. It abandoned about half of these and committed for the rest to enacting “the bulk of legislation” in 2014, see Sinondinos, “Integrity restored to Australia’s tax system” Press Release 14 December 2013, available at http://axs.ministers.treasury.gov.au/media-release/008-2013/. Based on the current rate of progress, it is highly unlikely that this commitment will be anywhere near fulfilled.
to the current discussion is in relation to the taxation of collective investment vehicles (CIVs).

The main tax policy that the Labor opposition carried to the 2007 federal election was to make Australia a financial services hub in the Asian region by leveraging the strengths of Australia’s already internationally significant CIV industry built on the back of Australia’s unique private superannuation arrangements. While some changes were quickly made to this end, the main endeavour of rebuilding the Australian tax system for collective investment, which was the subject of several independent reviews sponsored by the Labor government, has so far come to nothing, even though it has been embraced by the current federal government.131 The OECD was also working in the CIV area in the period. One of its projects of making tax treaties work appropriately for CIVs, which involved suggesting special tax treaty provisions for CIVs, was completed in 2010. The following project for developing practical systems for carrying out the 2010 proposals, which is referred to as TRACE (Treaty Relief and Compliance Enhancement) is still on foot but it has effectively been stalled by the recent OECD work on transparency and BEPS.132

The combined effect of this national and international slowdown is that Australia has probably lost a significant opportunity to taking a leading role in the CIV industry in Asia (being effectively overtaken by Hong Kong and Singapore) and the OECD has lost the opportunity to overcome significant international problems in ensuring a smooth operation of CIVs internationally in a tax sense. Both were essentially technical projects on which there was widespread policy agreement that income from capital was taxable and that internationally the policy underlying national CIV regimes of taxing the investor in a CIV as near as possible the same as if holding the investments of the CIV directly rather than indirectly through the CIV should apply.

131 Vann, “Never-ending tax reform and financial services” (2011) 14 Tax Specialist 186. Nothing of significance on the legislative front has occurred since that paper was written other than fixing past problems.
In other words an uncontroversial project where it seemed agreed that the cost of compliance would be far outweighed by the benefits of facilitating international portfolio investment has been significantly delayed by other more controversial, but politically appealing, projects where the cost-benefit balance is more contested. It is to be hoped that the international taxation of income from capital will be enhanced by the other projects and that the policy work to support such an approach will be developed though it is unfortunate that the implementation has preceded the policy justification and that resources have been denied as a result to a project with more immediately obvious benefits.

2.4 Taxation – Conclusion

In the wake of the GFC the structure of regulation in the taxation context and the effectiveness of the regulator (the Australian Taxation Office (ATO)) have not been subject to extensive examination. This maybe explained in part as there were not the same obvious failures as in the financial regulation area. That said the response has been focused of the two areas, which were the focus of the study, international transparency (particularly the effective abolition of bank secrecy in taxation) and the attack on corporate tax avoidance (Base Erosion and Profit Shifting (BEPS) project). As noted above, these responses have occurred without any significant weighing of the benefits and costs, including diversion from other important policy initiatives, or serious examination of the underlying policies involved. They have been a coordinated top-down international effort through the G20 and the OECD rather than rather than a bottom-up approach through domestic law. Much of the reform has been driven through the use of a treaty mechanism. This is unlike the approach adopted in the financial regulation area where the necessary implementation mechanism is generally domestic law influence by the G20.

In the context of transparency, although significant progress has been made through multilateral treaties and an agreed standard for automatic exchange of information, the cost-benefit and revenue effectiveness of increased transparency are still to be demonstrated. Similarly, Australia has been backing the BEPS project strongly internationally, but the
domestic policy response and law changes has been much needed international anti-
avoidance tax changes, which have been subsumed under the BEPS rubric. Other tax policy
changes that make eminent sense and that are likely to have positive economic benefits for
Australia have languished. Unlike financial regulation, the one gap in post GFC regulatory
review still remains the effectiveness of the regulator or of the underlying tax policy. As
suggested above, that may occur internally given the recruitment and appointment to key
positions (the Commissioner, a Second Commissioner and Chief Tax Council) persons with
extensive experience from the private sector.

3. BANKING AND FINANCE: TITLE TRANSFER AND COLLATERALISATION ARRANGEMENTS

3.1 Introduction

In this section, the focus of the paper is on private law. As leading English commentators have
recently argued:133

Regulation may well have been at the centre of the financial debate over the last four years,
but….a full appreciation of the lessons of the crisis also requires account to be taken of
private law.

Private law encompasses a diverse range of legal rules, including property law which is itself a critical
building block of banking and finance law. 134 Efficient and smooth conduct of financial market
transactions involving dealings with securities depends substantially on principles of property law.
These principles were radically reshaped in Australia through the enactment of the Personal Property
Securities Act 2009 (Cth) (PPSA), which came into force on 30th January 2012. While the legislation
is intended to bring certainty and predictability to Australia’s secured transactions regime under which
interests in property are offered as security for performance of obligations, the first few years of its
operation have inevitably raised questions as to its potential scope. This paper explores uncertainty in
the context of title transfer collateralisation arrangements, in particular certain types of repurchase
agreements (repos) and securities lending arrangements. The analysis is focused on those

133 Bridge and Braithwaite, “Private Law and Financial Crises” (2013) 13 Journal of Corporate Law
Studie 361, 361.

134 See generally McCracken, Bird, John Stumbles and Tolhurst, Everett & McCracken’s Banking and
arrangements whose economic purpose is to replicate a loan secured by the grant of a property interest; namely, those arrangements which arise in the “cash driven market” rather than those taking place in the ‘securities driven market’.  

While the enactment of the PPSA was not itself a direct result of the global financial crisis, the collapse in its wake of brokers such as Opes Prime Stockbroking Ltd appears to have prompted the drafters of the PPSA to bring title transfer collateralisation transactions within its scope, while at the same time attempt to accommodate financial market expectations that many of the arrangements conducted in the markets should nonetheless fall beyond its scope. Prior to the implementation of the PPSA, such arrangements were regarded at common law in Australia as involving outright transfers of the underlying securities and as outside the then secured transactions regime. Characterisation of these arrangements as a security interest within the scope of the PPSA would impact on their structuring as well as on their operation, potentially constraining the ability of market participants to deal with the underlying securities and exposing those participants to risk. The paper thus focuses on two major legal issues: the extent to which such arrangements might now amount to a “security interest” within the definition of PPSA s 12, discussed at [3.2] and the effectiveness of the current statutory exclusions of specific interests in s 8 from this definition, examined at [3.3].

A conclusion that the arrangements may indeed fall within the definition of a security interest under PPSA s 12 provides an alternative view to that expressed recently by some other commentators on the PPSA.  

If tenable, it would point to a key difference in approach under Australian law from that followed in other common law countries, including the United Kingdom, which do not have similar personal property securities (PPS) legislation. These jurisdictions rely on the form of the arrangements as the critical feature precluding them from classification as security interests. More surprisingly, such a conclusion would also highlight a potential and significant difference in approach to the United States where Article 9 of the Uniform Commercial Code (from which the PPSA is ultimately derived) is typically, though by no means unanimously, interpreted as also precluding

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135 See Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Ltd [2008] FCA 594, [5] (Beconwood), where the Court described the borrower in the securities driven market as ‘seek[ing] access to specific securities, usually to cover exposure to a short position.’


138 Replacement Explanatory Memorandum to the Personal Property Securities Bill 2009 (Cth) (“REM”).

139 See, for example, White and Summers, Uniform Commercial Code Practitioner Treatise Series Vol 4 (6th ed) 2010 p 13 who state: “repos are in Article 9 for attachment, perfection and priority but outside
the arrangements from being characterised as a security interest. The conclusion would not, however, mean that the arrangements would necessarily be regulated by PPSA but would rather direct the focus of attention to the operation of the statutory exclusions. It is only if there are ambiguities in their formulation that such a risk would eventuate.

In discussing possible interpretations of the Australian legislation, reference is made to other jurisdictions whose legislation bears a strong resemblance to the PPSA, in particular Canada and New Zealand. There would appear to be no specific case law addressing these particular financial arrangements in either Canada, which has had legislation in place in various provinces as from the late 1960s\(^\text{140}\) or New Zealand which implemented the legislation in 2002.\(^\text{141}\) The absence of judicial authority on the legal status of these arrangements underlines the importance of determining the Australian position. In this respect the Australian approach has the potential to offer a legal model for analysing title transfer collateralisation arrangements in international markets regulated by this style of legislation.\(^\text{142}\)

3.2 Title Transfer Collateralisation Arrangements as Security Interests

When structured as a transfer of title to securities in return for cash, followed by redelivery by the original transferee of equivalent securities and cash payment by the original transferor, an arrangement may be used *functionally* as an alternative to borrowing. This was recognised by the Federal Court of Australia in the leading Australian decision of *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Ltd* ("*Beconwood*")\(^\text{143}\), which was decided in 2008 prior to the enactment of the PPSA. The Court observed\(^\text{144}\) that a borrowing of money secured by a common law mortgage and this type of securities lending arrangement are “different means of for rights on default”. See also Harris and Mooney, *Security Interests in Personal Property Cases, Problems and Materials*, Foundation Press (5th ed) 2011, p 87 note 29 who describe the characterisation as unclear.


\(^{142}\) Nonetheless it is important to acknowledge that there are significant differences of detail in the legislation in each jurisdiction which necessarily impact on the construction of the legislation and which may legitimately result in differing interpretations.

\(^{143}\) *Beconwood* [2008] FCA 594, [53].

\(^{144}\) *Ibid*, [53].
achieving a similar result’, concluding that ‘while the economic substance of the transactions (mortgage and securities lending) may be similar, the legal mechanism by which they are effected is fundamentally different.’

In contrast, the definition of a security interest in PPSA s 12(1) now encompasses an ‘interest in personal property provided for by a transaction that, in substance secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property). (Emphasis added.) Hence this section explores the application of the definition to the arrangements and the extent to which support for their characterisation as a security interest can be drawn from the examples of transactions constituting security interests listed in PPSA s 12(2). It also considers two contrary arguments commonly raised in the United States based on the intention of the parties and the lack of an equity of redemption on the part of the grantor, neither of which appears directly applicable to the PPSA.

(i) Application of statutory definition

There are three key elements to the statutory definition:

- A transaction which
- provides for an interest in personal property that
- in substance, secures payment or performance.

The first two elements can be readily acknowledged as satisfied. As consensual, valid and enforceable contracts, the arrangements represent “transactions”. The securities are “personal property”. Irrespective of whether particular securities take the form of bonds, units, shares, fractional co-ownership interests or trust interests, they are nonetheless “personal property” for the purposes of

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145 The drafting is ambiguous. Logically, it is the “interest” which must secure the payment or performance of an obligation rather than the transaction. Although PPSA s12(2) does refer explicitly to the transaction securing payment or performance, it is left to a court to infer that it is the secured party’s interest that is the relevant interest. PPSA s 12(3) also refers to a transaction potentially securing payment or performance but singles out specific interests as a security interest.

146 There is no definition of “transaction” in PPSA s 10 “Dictionary”. See generally McCracken, Bird, Stumbles and Tolhurst, Everett & McCracken’s Banking and Financial Institutions Law, Thomson Reuters (8th ed) 2013, [13.100].

147 The legal nature of particular securities such as shares is not free from controversy and may be explained in various ways: see generally Bridge, Gullifer, McMeel and Worthington, The Law of
the PPSA; “personal property” being defined\textsuperscript{148} to refer to property other than land and certain statutory rights expressly declared not to be personal property. The relevant “interest” in the personal property is that of ownership – in legal terminology, “title”. The fact that the title to the securities is transferred by way of sale and not within a recognised form of security at common law is of no relevance, given the specific statutory direction contained in PPSA s 12(1) to ignore the form of the transaction in determining the existence of a security interest.

What therefore becomes critical is the third element. Given the acknowledgement that these title transfer collateralisation arrangements have commercially long been recognised as functionally equivalent to secured loans at common law and that PPSA s 12(1) now explicitly directs a court to that very economic substance, it seems clear as a matter of construction that the arrangements potentially fall within the definition. Rules of statutory interpretation emphasise that the starting point in approaching a statute is the text, taking into account its context and purpose: “The touchstone”, said Chief Justice French of the High Court of Australia recently, ‘remains always, text, context and statutory purpose’.\textsuperscript{149} In substance, the transfer of the ownership of the securities under the first limb of the arrangements secures the obligation of the original transferor to transfer cash under the second limb of the arrangements.

\textit{(ii) Support from PPSA s 12(2) examples of transactions}

PPSA 12(2) provides examples of transactions potentially amounting to a security interest. Two of these transactions are of particular interest for the purposes of this discussion– an “assignment” (s 12(2)(j)) and “a transfer of title” (s 12(2)(k)).

\textsuperscript{148} PPSA s 10 “personal property”.

\textsuperscript{149} Chief Justice French AC, “Bending Words: The Fine Art of Interpretation”, University of Western Australia, Faculty of Law, Guest Lecture Series Perth, 20 March 2014, p 10, available at \url{www.hcourt.gov.au} under “Publications”, “Speeches”.

The term “assignment” is well established. It has long been understood as meaning “the immediate transfer of an existing proprietary right”.\textsuperscript{150} It would appear necessarily to encompass the term “transfer of title”. The additional inclusion of “transfer of title” is thus puzzling. Interestingly, it is not found in the equivalent lists of either the New Zealand or Canadian legislation. The phrase appears unique to the Australian legislation, raising a question as to the rationale for its inclusion. It was not contained in the Consultation Draft of the Bill, which was issued on 16 May 2008.\textsuperscript{151} Indeed the Commentary to the Bill released in May 2008 by the Australian Attorney-General’s Department indicated that title transfer arrangements concerning securities would be specifically excluded.\textsuperscript{152} That suggests concern had already been expressed that arrangements of this kind might indeed fall within the scope of the legislation. The phrase “transfer of title” appeared first in the Exposure Draft released in November 2008\textsuperscript{153} and subsequently in the 2009 bill,\textsuperscript{154} which became the current Act.

It seems not unreasonable to surmise that the motive for its inclusion was the decision of the Federal Court of Australia in \textit{Beconwood} in May 2008.\textsuperscript{155} That decision, which at the time attracted significant media and market attention, offered confirmation in the context of financial market transactions that at common law a structuring of an arrangement as a sale generally precluded characterisation as a security interest. Although the term “assignment”, which had been used in the Consultation Draft and which reflected typical usage in Canadian and New Zealand PPS legislation, should have been sufficient to catch outright transfers, the additional and deliberate inclusion of the phrase “transfer of title” infers an intention to target outright transfers of title.\textsuperscript{156} Such a surmise is strengthened by the fact that the Exposure Draft also included for the first time certain express

\begin{itemize}
  \item \textsuperscript{151} See Australian Government Attorney-General’s Department, Personal Property Securities Reform Personal Property Securities Bill 2008 Consultation Draft May 2008, section 21(2), which refers simply to an assignment.
  \item \textsuperscript{152} Australian Government Attorney-General’s Department, Personal Property Securities Bill 2008 Commentary May 2008, \[3.10\]: “It is likely that the regulations would exclude lending arrangements in relation to investment instruments from the definition of security interest”.
  \item \textsuperscript{153} Commonwealth of Australia, Exposure Draft Personal Property Securities Bill 2008, clause 28(2)(k).
  \item \textsuperscript{154} Personal Property Securities Bill 2009, section 12(2)(k).
  \item \textsuperscript{155} \textit{Beconwood} [2008] FCA 594.
  \item \textsuperscript{156} For speculation in a different context - that of a transfer of an account “as a deemed security interest under PPSA s 12(3) - that the use of the term “transfer” is intended to emphasise “the unqualified nature of the assignment”, see Stumbles, “The Impact of the \textit{Personal Property Securities Act} on Assignments of Accounts” (2013) 37 \textit{Melbourne University Law Review} 415, 425-426. It is noted, however, that the term “transfer” in that context is also found in New Zealand legislation and, in modified form in Canadian legislation: \textit{ibid}, 425.
\end{itemize}
exclusions seemingly addressed to repos and securities lending arrangements insofar as they involved transfers of fungible property.\footnote{157}

(iii) Irrelevance of intention as a determining factor

In the leading 1986 United States decision of \textit{In the matter of Bevill, Bresler & Schulman Asset Management Corporation (“Bevill”)}, \footnote{158} the court took the view that economic substance was not the only factor to be taken into account in determining whether an arrangement was a security interest. Rather, the agreements had “to be construed in accordance with the probable common intent of the parties”. The presence of certain terms in the arrangements which would be absent in a simple “one-way purchase and sale transaction” was found by the court to ‘raise sufficient doubts as to the intent of the parties to justify examination of extrinsic evidence of intent’.\footnote{159} The court described itself as gleaning that intent ‘from the express terms employed in the transaction documents as well as relevant extrinsic evidence of intent, including trade custom and usage, market realities and the parties’ course of conduct and performance.’\footnote{160}

The court further observed:

\begin{quote}
There is an ever present need for certainty and predictability in commercial transactions of any sort. To ignore the voluntary decision of contracting parties to structure their transactions in a particular manner, and to disregard widely recognized and accepted industry practices would only foster confusion within the repurchase market over the legal consequences of engaging in repo and reverse repo transactions.
\end{quote}

It therefore held that the repos were contracts for “the sale of securities and their resale back to the original seller at a future date”, and should be given legal effect as such.

\begin{flushleft}
\footnote{157} See text in following section.  
\footnote{158} \textit{In the matter of Bevill, Bresler & Schulman Asset Management Corporation (“Bevill”) (1986) 67 BR 557, 586.}  
\footnote{159} \textit{Bevill, (1986) 67 BR 557, 590.}  
\footnote{160} \textit{Ibid, 597.}
\end{flushleft}
The reference to intent in *Bevill* is in part explicable by the fact that the then section 9-102 (now section 9-109) of the Uniform Commercial Code applied “only to a transaction which is intended to create a security interest in personal property”. The reference to intent was removed by amendments made in 1999. *Bevill* would in any event appear to be only of limited use in considering the Australian position, given the text of the PPSA and the primacy that is likely to be given to that text by an Australian court as a matter of statutory interpretation. Interestingly, the United Kingdom Law Commission commented in 2004, that it too found that *Bevill* did ‘not put the matter beyond doubt’. It was rather of the view that under its proposed (albeit never enacted) PPS-style scheme repos with a security function would indeed fall within the scheme and therefore asked the question whether such repos should be exempted or whether modifications to the scheme should be made. It noted that opinions from experts in the UK over Article 9 were conflicting.

A further argument based on parties’ intentions as evidenced by structuring the arrangement as a sale is difficult to develop under the PPSA in light of the express inclusion of the seemingly unqualified “transfer of title” example in s 12(2) (as discussed in (ii)).

***(iv) Impact of a grantor’s lack of property interest***

The common law notion that there cannot be a security interest unless the grantor retains some interest is a notion that has also been put forward in the United States in support of the view that repos fall outside the scope of Article 9. It is evident that the markets do not wish them to be characterised as security interests. In 2002 Professor Schroeder had described the effects of such characterisation as ‘disastrous’. She sought to treat repos as ‘sui generis transactions that do not fit comfortably into the traditional categories of sales and security interests’. She in fact advocated a ‘presumption that a transaction structured as a repo is not a secured transaction.’

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162 *Ibid*, [5.133].


In *Beconwood* the Federal Court of Australia referred to the work of Professor Schroeder, and in particular to an article she published in 1996 entitled ‘Repo Madness: The Characterization of Repurchase Agreements under the Bankruptcy Code and the UCC’. In her introduction she acknowledged:

It is generally recognised that it is crucial to the continued existence of the repo market that repos be treated as sales and purchases of securities, rather than as secured loans.

Professor Schroeder also acknowledged that ‘Repos are obviously equivalent to secured loans for *economic* purposes.’ Although agreeing with the outcome of decisions indicating that the transactions were sales and not security interests, she appeared keen to avoid the justification that it was the intent of the parties that precluded the arrangements from being security interests, which in her view ‘flout [ed] the spirit of Article 9’. Accordingly, she approached the question by comparing the property interests that were obtained by the buyer under a repo with those obtained by a secured party under a security interest. She identified the “free right of disposition of the underlying security” as a critical distinguishing element, reiterating that view in her later article in 2002 where she described that element as ‘fundamentally inconsistent with the minimum elements of a security interest.’

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168 Ibid,1004.

169 Ibid,1006.

170 Ibid,1015.

171 Ibid,1013. She pointed out that it should not be the subjective intent of the parties, but rather an intent as to “whether the parties intended to enter into a transaction which has the substantive characteristics of a secured transaction”.

172 Ibid,1017.

173 Ibid,1022.

174 See the conclusion (ibid,1049-1050): “I suggest that a repo is a genuine sale and not a security interest if the repo seller loses all of its property interest in the security when it is sold to the repo buyer. This should be evidenced not by self-serving subjective statements of the repo parties, but by the objective evidence of the contractual terms. Specifically, if the repo buyer has the right to sell the repo security and merely sell a substitute security back to the repo seller, the repo should be recognized as a true sale”.

175 Schroeder, “A Repo Opera: How Cripri Mae got Repos Backwards” (2002) 76 American Bankruptcy Law Journal 565, 567. See also at 584-585: “if there is no understanding between the two parties that the repo security (or its proceeds) should be maintained in order to secure an obligation of the repo seller to the repo buyer, then there is no intent to create a transaction that has the substantive indicia of
It is submitted that in light of the explicit inclusion in PPSA of the phrase “transfer of title”, the release of the original property interest by the grantor does not of itself appear sufficient under the PPSA to exclude the repo arrangement from characterisation as a security interest. As contended above, the transfer of ownership gives the secured party an interest in property which secures the repurchase obligation. Furthermore, although the grantor generally has a statutory right to redeem under PPSA s 142, the grantor is nonetheless permitted in a commercial context to contract out of this statutory right. This suggests that the grantor’s ability to call for the property to be re-transferred is no longer a critical element under the new statutory regime.

The ability to contract out of statutory enforcement provisions in PPS-style legislation, including the statutory right to redeem, has been criticised by some commentators. A leading text in Australia argues that freedom of contract considerations that have seemingly motivated the Australian approach to contracting-out generally cannot justify the ability to contract out of the right of redemption in the security agreement. The commentators refer in support to the common law’s recognition of a mortgagor’s equity of redemption as “a central feature of pre-PPSA mortgage law”, observing that contracting out is a “denial of history” and represents a “significant departure from pre-PPSA law”. Yet in light of the express inclusion of “transfer of title” as an example of a transaction giving rise to a secured transaction”. See also Johansson, Property Rights in Investment Securities and the Doctrine of Specificity, Springer 2009, pp 152-153, who follows Schroeder’s analysis.

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176 PPSA s 115(1)(q). Section 115 (1) permits parties to a security agreement to contract out of specified provisions where the collateral is not “used predominantly for personal domestic or household purposes”. A grantor can also agree after default not to exercise the right: s 142(2).

177 This provision has been included in the Australian legislation from the outset: see Australian Government Attorney-General’s Department, Personal Property Securities Bill 2008 Consultation Draft, May 2008 section 163(1)(p). Interestingly, that draft did not include the current PPSA s 115(3) providing that on a contracting out of the right of redemption, the provision which continues the excluded provision in respect of third party rights (current PPSA s 115(2); section 163(2) under the Consultation Draft) does not ‘give any person (whether or not the person is a party to the agreement) a right to redeem collateral under s 142.

178 Duggan and Brown, Australian Personal Property Securities Law, LexisNexis Butterworths 2012, [12.15]-[12.16]

179 Replacement Explanatory Memorandum to the Personal Property Securities Bill 2009

180 Duggan and Brown, Australian Personal Property Securities Law, LexisNexis Butterworths 2012, [12.16].

181 Ibid, [12.16]. At [17.1] they note the contracting out of the right of redemption as a problematic issue and list it in their helpful table of matters that should be reviewed under the statutory review of the legislation which is required by s 343 to be completed by January 2015. The review and its terms of reference were announced by the Attorney-General in April 2014, see www.ag.gov.au.
a security interest and indeed other major changes introduced by the PPSA which constitute a significant departure from common law, such an argument becomes difficult to sustain.

The Australian approach is undoubtedly different to that in the United States and Canada. The Australian Personal Property Security Act 1993 initially precludes any waiver of a debtor’s right to redeem collateral under Section 9-623, although that provision is made subject to Section 9-624(c) which allows a debtor in a non-consumer goods transaction to waive the right to redeem by agreement after default. The Saskatchewan legislation appears to have followed suit. Professors Cuming, Walsh and Wood have noted that a waiver in the security agreement pre-default would not be effective. While New Zealand originally also permitted parties to contract out of the statutory right of redemption, the position was changed in 2007.

In any event, PPSA Chapter 4 which contains the statutory right to redeem is actually excluded for the most part where security interests in investment instruments and intermediated securities are perfected by possession or control. Possession and control would often, albeit not necessarily always, be the means for perfecting security interests arising out of transfer title collateralisation arrangements involving securities. Hence the fact that parties to a security agreement have purported to confer particular rights such as the right of free disposal does not of itself under the PPSA seemingly preclude the characterisation of the arrangement as a security interest. Nonetheless it should be acknowledged that the fact that a repo might give a secured party ownership has troubled some

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182 See Duggan and Brown, Australian Personal Property Securities Law, LexisNexis Butterworths 2012, [12.56].


185 PPSA NZ s 107(2)(j) was repealed in 2007, thereby excluding the power to contract out of the statutory right to redeem: Property Law Act 2007 (NZ) s 364, effective as from 1 January 2008. See generally Barry Allan, Personal Property Securities Act 1999, Act and Analysis, Thomson Reuters 2010, 403.

186 PPSA s 109(3) continues sections 110, 111, 113 and 140.

187 Where the security interests were not perfected by control or possession but by registration, restrictions on the exercise of ownership rights that would flow from the application of Chapter 4 would be no different to those restrictions imposed on secured parties who are lessors under a finance lease and who are no longer able to rely on their ownership in the event of a default by the debtor but must rather proceed to enforce their security through Chapter 4 or through any contractual rights in relation to a default contained in the security agreement (see PPSA s 110).
commentators on the Australian legislation. Professors Duggan and Brown, for example, view the transfer of title as the key factor precluding a repo from being a security interest.\textsuperscript{188}

The critical difference…is that in the case of a security interest, the secured party obtains only a limited interest in the collateral and title remains with the grantor. Performance of the secured obligation terminates the security interest and gives the grantor clear title. Correspondingly, the secured party may sell the collateral, but only if the grantor defaults, and the secured party must account to the grantor for any surplus following the sale. By contrast, in the case of a repo, the transferee (B) typically acquires title to the securities and is free to deal with them regardless of whether the transferor (A) is in default. Correspondingly, A retains no interest in the securities following the transfer and it has no more than a contractual right to purchase equivalent securities from B on the settlement date. For these reasons, the typical repo is not a transaction that in substance secures payment or performance of an obligation and so the PPSA does not apply.

This analysis, which also requires the commentators to regard title to the collateral under a mortgage governed by the PPSA as still residing in the grantor,\textsuperscript{189} appears predicated on the assumption that the PPSA security interest must take the form of an encumbrance. An alternative view is that the concept of a unitary security interest under the PPSA rather simply demands that all interests falling within the definition of a security interest be subject to the rules of the PPSA and that different types of interests including ownership may legitimately be characterised as a security interest.\textsuperscript{190}

Finally, there is one further alternative argument that does not appear as yet to have been discussed in the literature on the PPSA; namely, whether equity might intervene to recognise an equity of redemption simply on the ground that the absolute transfer amounts to a security interest under the PPSA. If so, that would provide an alternative basis for addressing the argument that no property interest remains with the grantor, although it may give rise to difficulties when considering the further question of the secured party’s ability to deal with the securities.\textsuperscript{191}

\textsuperscript{188} Duggan and Brown, \textit{Australian Personal Property Securities Law}, LexisNexis Butterworths 2012, [3.18]. They draw in support on the arguments of Professor Schroeder, discussed above.

\textsuperscript{189} Duggan and Brown, \textit{Australian Personal Property Securities Law}, LexisNexis Butterworths 2012, [3.4].


\textsuperscript{191} See \textit{Lift Capital Partners Pty Ltd v Merrill Lynch International} [2009] NSWSC 7.
There is no doubt that equitable principles potentially operate in the context of the PPSA. Section 254 expressly states:

This Act is not intended to exclude or limit the operation of [certain laws] to the extent that the law is capable of operating concurrently with this Act.

Those laws include “the general law”, which is defined to include principles of equity.192

An equity of redemption is now generally said to be animated by equity looking to the intent of a transaction rather than to its form.193 Hence an argument for recognition of an equity of redemption derives from the PPSA’s expanded definition of security interest. The expanded definition suggests that the equitable principle is now capable of applying by analogy to a wider range of transactions than was the case prior to the commencement of the PPSA. If that is correct, the result is that a transaction on its face documented as an unqualified transfer of property to a secured party and constituting a PPSA security interest may still enable a grantor to reclaim the property at general law on payment of all secured liabilities.194

Furthermore, any such equitable right to reclaim the property would appear capable of existing even if the statutory right to redeem the security interest has been expressly excluded. The equitable jurisdiction is distinct from the statutory regime and hence dealings with the statutory right should not

192 PPSA s10.

193 Originally, the equitable jurisdiction was explained on the basis that it would be unconscientious for a secured party to refuse to re-transfer the secured party to the grantor following the grantor’s satisfaction of all liabilities secured by the security. Subsequently, and contemporaneously with the development of equity’s jurisdiction to relieve against penal bonds, the jurisdiction was also exercised where a mortgagor’s failure to comply with the mortgage arose from circumstances amounting to fraud, mistake or accident. The jurisdiction further evolved to the stage that now, and irrespective of the circumstances which brought about the default, a defaulting mortgagor is granted relief from losing secured property provided all liabilities outstanding under the security are duly satisfied at any time prior to the secured party exercising its remedies under the security. See further Sykes and Walker, The Law of Securities, LawBook Co (5th ed) 1993, 50-52; Waldock, The Law of Mortgages, Stevens (2nd ed) 1950, 172-173.

194 While the term “equity of redemption” is sometimes used in the context of a mortgage by way of statutory charge over real property regulated by real property (Torrens) legislation, the mortgagor’s right to have the mortgage removed from the register on satisfaction of the obligation is based on the mortgagor’s legal title as registered proprietor: Latec Investments Ltd v Hotel Terrigal Pty Ltd (1965) 113 CLR 265, 275 per Kitto J; Figgins Holdings Pty Ltd v SEAA Enterprises Pty Ltd (1999) 196 CLR 245, 264 per Gaudron, Gummow and Callinan JJ. Hence it does not offer an appropriate analogy to the position under the PPSA.
as a matter of principle automatically exclude the equitable interest. Interestingly, the New Zealand High Court\(^{195}\) has acknowledged that a statutory right to redeem given by another statute, the *Property Law Act 2007* (NZ),\(^{196}\) exists independently of the statutory right to redeem under the *Personal Property Securities Act 1999* (NZ). The court described the regimes under the two statutes as “parallel and not inconsistent”.\(^{197}\)

### 3.3 Statutory Exclusions

It is clear from current market practice that the expectation in the Australian financial markets is that such arrangements are beyond the parameters of the PPSA. If the arrangements fall within the scope of PPSA s 12, the only basis on which this market expectation can be justified is that the interest to which they give rise – ownership- is an interest that is expressly excluded by the PPSA under s 8. This section examines the use of exclusions as a means whereby interests may be protected from the impact of the PPSA, identifying some measure of ambiguity in their application.

#### (i) Development of exclusions relating to title transfer collateralisation arrangements

Australia appears unique among United States, Canadian and New Zealand jurisdictions in attempting to deal with exclusions of interests arising under some title transfer collateralisation arrangements. These exclusions represent an acknowledgement of the debate which the treatment of securities lending and repos for the purposes of the Uniform Commercial Code had by the mid-2000s generated in the United States and of the concerns reportedly expressed by Australian financial market participants.

### Specific exclusion

\(^{195}\) *Thorn v RFD Finance Ltd* [2012] NZHC 1959.

\(^{196}\) *Property Law Act 2007* (NZ) s 97.

\(^{197}\) *Thorn v RFD Finance Ltd* [2012] NZHC 1959, [32]. *Property Law Act 2007* (NZ) s 78 characterises the provisions in that Act applying to a mortgage that gives rise to a PPS security interest as “supplementary to the Personal Property Securities Act 1999”. It makes the PPS legislation prevail in the event of inconsistency.
The first, and most direct, attempt occurred in the Exposure Draft of the legislation released in November 2008. In the wake of Beconwood, that draft introduced “transfer of title” as a specific example of a transaction potentially creating a security interest in what is now PPSA s 12(2).\(^{198}\) In what might be labelled a quid pro quo, the Exposure Draft also however contained provisions which, while phrased in general terms of transfer title collateralisation arrangements, were nonetheless directed at excepting only those arrangements which involved fungible property and hence securities:\(^{199}\)

(i) a transfer of personal property (the original property) to a transferee, if the transferee is obliged to transfer to the transferor personal property that is fungible with the original property;

(x) if there is personal property that is fungible with a kind of personal property – a transfer of personal property (the original property) of that kind to a transferee, if the transferee is obliged to transfer to the transferor a cash equivalent of all of the original property, or a cash equivalent of part of the original property together with personal property that is fungible with the original property;…..

These provisions were however omitted from the subsequent bill and do not appear in the PPSA, despite submissions made by industry bodies such as the International Swaps and Derivatives Association (ISDA)\(^{200}\) and the Australian Financial Markets Association (AFMA).\(^{201}\) No formal reason was given for their omission.

The further attempt by drafters of the PPSA nonetheless to tackle the issue was less evident. It is in fact still not necessarily immediately obvious on first consideration of the list of exclusions in PPSA s 8. It lies in the exclusion relating to netting, and in particular close-out netting.\(^{202}\)

**Nutting exclusion**

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198 See text in previous section.

199 Exposure Draft, Personal Property Securities Act, clause 6. It should be noted that there is considerable academic debate as to whether shares are properly described as “fungible” in nature: see generally Bridge, Gullifer, McMeel and Worthington, The Law of Personal Property, Sweet & Maxwell 2013, [23.015]-[23.027].


202 While on first consideration the additional exclusion of “any right of set-off” appears relevant, the explicit restriction to the “right” results in the wording failing to address the ownership interest passing under a transfer of title.
It is true that an exclusion in relation to close-out netting was originally included in the Consultation Draft of May 2008, albeit in a somewhat different form. In introducing it, the Consultation Draft appears to have followed the New Zealand legislation then in force, although the wording was slightly different. The latter referred only to a “right of…netting”. By contrast, neither the Canadian legislation nor Article 9 specifically refers to “netting” in their equivalent lists of exclusions.

Unlike its New Zealand counterpart, the Australian reference was from the outset placed in a separate clause to the exclusion in respect of set-off. The draft Australian statute was stated not to apply to:

(d) any right held by a person under any of the following:

…..(iii) a close out netting contract;

as defined in section 5 of the Payment Systems and Netting Act 1998;…

This exclusion did not, however, at this initial stage appear directed at securities lending or repos. The Commentary to the Consultation Draft of May 2008 specifically stated that regulations were “likely” to exclude ‘lending arrangements in relation to investment instruments from the definition of security interest’.

By the time the Exposure Draft was issued some six months later in November 2008, the reference to netting had been expanded. It now referred not simply to a right held under a close out netting contract but also to an “interest” so held as well as to “any interest provided for by any transaction under”…. a close out netting contract. This expansion appears to have been prompted by a submission on the Consultation Draft made by ISDA in August 2008. ISDA had suggested inclusion of additional words on the basis that:

…the definition of security interest…refers to “interests” and “transactions”.

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203 Section 22 referred only to “any right held by a person” under the stated netting arrangements or contracts.

204 Consultation Draft, section 22 (d).

205 Commentary to the Personal Property Securities Bill 2008, para [3.10].

206 Exposure Draft, clause 6(1), (e).

207 ISDA, “Personal Property Securities Bill 2008 – Consultation Draft”, letter to the Attorney-General’s Department, dated 15 August 2008 (available at www.isda.org ,”Regions”, “Asia Pacific”). In the same submission ISDA had also asked for the bill to make clear that the statute would be subject to the provisions of the Payment Systems and Netting Act 1998 (Cth) (“Netting Act”), to the extent of any inconsistency between the Netting Act and the PPSA. See Exposure Draft clause 18; now PPSA section 256. The rationale of the override is ensure that the protection given to close-out netting contracts under the Netting Act is in no way diminished by the PPSA and that both prior to and after insolvency such contracts operate in accordance with their terms.
Even in this expanded form, the clause in the Exposure Draft still did not appear directed at securities lending. In its August 2008 submission ISDA had treated the netting exclusion (and indeed that of set-off) separately from exclusions of absolute transfers of investment instruments. It had advocated a further exclusion for these latter transfers drafted on a general basis. It thus appears that the approach taken in the Exposure Draft, reflecting ISDA’s recommendations, was to direct set-off and netting exclusions to derivative arrangements generally and the transfer of fungible property exclusions to securities lending arrangements and repos. Nonetheless, all these arrangements involve a transfer of title and documentation that typically includes set-off and netting clauses. So, it may be further surmised that on making the decision subsequent to the Exposure Draft of November 2008 to drop the express exclusions for transfers of fungible property, a view was taken that the securities lending and repo arrangements were adequately addressed by the then draft exclusions for set-off and netting.

The exclusion for close-out netting appeared in the same substantive format in the Personal Property Securities Bill 2009 (Cth) and remains in that form under the current legislation. Interestingly, ISDA subsequently made a further submission in relation to the then draft regulations released in 2010 in favour, once again, of specifically excluding transactions under which property is transferred to a transferee whose corresponding obligation is limited to the transfer of equivalent property or the payment of money. No change however resulted, either in the regulations or in any subsequent amendments to the regulations and the legislation. All thus now turns on the content of the close-out netting exclusion.

(ii) Express exclusion of close-out netting

The exclusion for close-out netting is currently set-out in PPSA s 8(1)(e):

8. Interests to which this Act does not apply
   (1) This Act does not apply to any of the following interests (except as provided by subsection (2) or (3)):
   (e) any right or interest held by a person, or any interest provided for by any transaction, under any of the following (as defined in section 5 of the Payment Systems and Netting Act 1998):
      (i) an approved netting arrangement;
      (ii) a close-out netting contract;
      (iii) a market netting contract.”

In its submission ISDA referred to its own credit support documentation as adopting a similar “title-transfer” approach.

Importantly, the wording indicates that the exclusion is not limited only to the right to close-out and net obligations. Rather, it excludes:

- any right held by a person under a close-out netting contract; and
- any interest held by a person under a close-out netting contract; and
- any interest provided for by any transaction under a close-out netting contract.

Although the general term “netting” is not defined in the PPSA, the PPSA gives to a “close-out netting contract” a specific meaning by defining it by reference to Payment Systems and Netting Act 1998 (Cth) s 5. Hence the starting point for determining the limits of the exclusion is the definition of a “close-out netting contract” in section 5 of that Act. Section 5 states:

*close-out netting contract* means:

(a) a contract under which, if a particular event happens:

(i) particular obligations of the parties terminate or may be terminated; and
(ii) the termination values of the obligations are calculated or may be calculated; and
(iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable; or

(b) a contract declared by the regulations to be a close-out netting contract for the purposes of this Act;

A close-out netting contract thus contains three elements: the termination of obligations of each counterparty to the contract following the occurrence of a particular event; the calculation of the termination values of the terminated obligations; and the netting of the termination values so that only a net cash amount is payable. It would appear, however, that the definition only applies to that category of obligations the termination value of which constitutes elemental components in determining the net cash amount payable. It does not, for example, include dealings which secure payment of a net amount once it has been determined. Furthermore, the definition assumes the existence of unperformed executory obligations between the counterparties but does not make any reference to the anterior transactions which may have generated those obligations.

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210 Its meaning, like that of set-off, can be controversial. See generally McCracken, The Banker’s Remedy of Set-Off, Bloomsbury Professional (3rd ed) 2010, Chapter 1 “Problems of terminology”.

211 There are 3 specific exclusions to this definition in Payment Systems and Netting Act 1998 (Cth) s 5: “(c) a contract that constitutes, or is part of, an approved netting arrangement; or (d) a contract in relation to which a declaration under section 15 is in force; or (e) a contract declared by the regulations to not be a close-out netting contract for the purposes of this Act”. 
PPSA thus leaves open to interpretation what rights and interests may be held, and what transactions may be provided for, “under the close out netting contract.” Arguments that the ownership interest under repos and securities lending arrangements is excluded are most likely to focus on the broadest of these three heads; it being argued that ownership is an interest provided for by a transaction under the close out netting contract.

It is the qualifier that the transaction must be provided for “under the close out netting contract” that raises questions as to the coverage of the exclusion. Would, for example, a contract which contained a general security agreement (GSA) as well as, say, a netting clause arising out of a distinct arrangement be a close out netting contract sufficient to exclude the GSA from being characterised as a security interest? Such a wide reading would risk, on the one hand, frustrating the purpose of the PPSA whose definition of a security interest in s 12 clearly covers a GSA and, on the other hand, extending the close-out netting exclusion beyond its purpose of ensuring that certain netting arrangements survive the insolvency of a counterparty.

The historical development of the netting exclusion outlined above suggests that the transaction to which it would appear directed is a transfer of credit support under the ISDA Credit Support Annex. Accordingly, the issue is whether a court would interpret the phrase “transaction under the close-out netting contract” as now also covering the transfer of title to securities under repos and securities lending arrangements. The obligations to be netted under such arrangements are typically the promises to redeliver securities and to make payment. The netting of those obligations is preserved by the close out netting exclusion. The question is, however, whether the interest of ownership transferred under the original transfer of title is sufficiently connected to be part of the “transaction under the close out netting contract”. Problematic is the fact that the actual obligation to be netted is a further and distinct obligation to deliver equivalent securities. A view that the original transfer is an anterior transaction not taking place “under the close out netting contract”, albeit connected insofar as it provides a reference point for working out the valuation of the equivalent securities, would place in doubt the efficacy of the exclusion in relation to those repos and securities lending arrangements functioning as an alternative to a borrowing. In this regard, it is again

interesting to note that in 2010 both ISDA and AFMA made their representations in support of a specific exclusion despite the existence of the netting provision in its expanded form in the PPSA.213

3.4 Banking and Finance - Conclusion

Ultimately, it is a question of statutory interpretation for the courts whether an arrangement constituting a transfer of title of securities in the circumstances discussed in this paper does give rise to a security interest within PPSA s 12 and whether the statutory exclusion in PPSA s 8 is sufficient to exclude the interest from the reach of the PPSA. Ambiguity in either context, however, breeds legal and commercial uncertainty.

On the assumption that the prevailing policy view is, and continues to be, that repos and securities lending arrangements functioning as an equivalent to borrowing should enable the original transferee to hold absolute title to its securities and to be able to deal with them freely, it becomes critical to ensure that the original transfer of title is not a relevant transaction for the purposes of PPSA s 12 and/or that the ownership interest arising out of that transaction is excluded from the application of PPSA. The view that title transfer collateralisation arrangements are not within the definition of a security interest under PPSA s 12 risks challenge, due to the wording of the statutory text. This text may also preclude the success of arguments that have prevailed in other jurisdictions supporting the view that the arrangements are not security interests. Given the risk of characterisation as a security interest, an intention that such arrangements should nonetheless not be regulated by the PPSA should be clearly reflected in the legislation itself (or in regulations). The legal position should not be left open to unnecessary uncertainty provoked by arguments as to where the proverbial line in the sand should be drawn. It is to be hoped that the statutory review of the PPSA that is now in process and due for completion by January 2015 will take the opportunity to make the legal position clear.

4 General Conclusion

The GFC focused renewed attention on financial market regulation and regulators. Policy makers around the world have sought to find a regulatory framework and strategies that can adequately respond to changes in modern capital markets and provide protection against future crises. It has been said that “[t]rust is the lubrication that keeps the wheels of a market from grinding to a halt”,214 and the creation/ restoration of such trust is at the heart of many post-GFC initiatives. However, policy makers are still experimenting with the best way to achieve this, and important differences in regulatory approach have appeared across different legal fields and international jurisdictions in the post-GFC era.

This paper analyses a range of post-GFC regulatory issues in three specific legal areas – financial market regulation; taxation; and banking and finance. A key post-crisis issue in relation to financial market regulation relates what makes an effective regulator and how the structure of financial supervisory agencies may contribute to their effectiveness. These are also question under consideration in Australia’s current Financial System Inquiry.215 Although there may well be room for fine-tuning and improvement of Australia’s regulatory architecture in the light of the fundamental changes to capital markets that have occurred since the 1997 Wallis Report, Australia’s framework withstood the global financial crisis remarkably well in comparison with that in many international jurisdictions. Therefore, any major structural overhaul would seem to be unwarranted. Indeed, Australia’s “twin peaks” model has been used as the blueprint for a number of international regulatory reforms, and there is scope for it to become an influential paradigm in Asia.

Regulatory responses to the GFC in the taxation area provide a strong contrast to the global responses to financial market regulation. Rather than examining on the effectiveness of tax regulators, international policy developments in the taxation area have focused on the need to improve transparency and to prevent tax avoidance. This has also been the case in Australia. Yet the Government’s two focal points in the area of taxation regulation (international transparency and the attack on corporate tax avoidance via the BEPS project) post-GFC are yet to fully formulated in Australia, let alone implemented, and as a consequence the cost-


benefit and revenue effectiveness are still to be demonstrated. As they are both top down projects driven through international agreement, the outcomes for effective taxation regulation remain uncertain as is the internal operation of the ATO under its new private sector influenced management team. Further point in time research will be required to appreciate the impact of post-GFC regulation fully in this area.

The need for “well-founded market confidence”\textsuperscript{216} and trust between market participants is particularly important the area of banking and finance, and certainty is a critical factor in creating such trust. In the private law sphere, legislation expressed in ambiguous terms introduces uncertainty in the conduct of transactions. It risks unintentionally disrupting accepted market practice. In times of economic stress, let alone financial crisis, insolvency administrators will undoubtedly test its limits. Australia’s new secured transactions regime introduced by the PPSA will be no exception. On default by a counterparty, transactions will be subject to close scrutiny. The characterisation of title transfer collateralisation arrangements and indeed other financial market transactions will be examined by reference to the statutory text of the PPSA, bearing in mind its context and purpose. Legal reasons for reaching a conclusion that arrangements are beyond the scope of equivalent legislation in other jurisdictions do not necessarily apply to Australian legislation, not least because of differences in drafting. The concerns raised by the paper’s analysis of the arrangements illustrate the need for constant refining of legislation addressed to the conduct of transactions to reduce the likelihood of a mismatch between legal rules and commercial expectations.