

# **THE POLITICAL ECONOMY OF LEGAL COMPLEXITY: IMPLICATIONS OF THE MARKET BUILDING STATE**

**NICHOLAS SIMOES DA SILVA  
BALLIOL COLLEGE  
UNIVERSITY OF OXFORD**

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# **ABSTRACT**

## **THE POLITICAL ECONOMY OF LEGAL COMPLEXITY: IMPLICATIONS OF THE MARKET BUILDING STATE**

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This dissertation investigates the causes of increasing legal complexity in modern legal systems. Specifically, it asks how changing relationships between states and markets produce changes in legal complexity. Legal complexity is increasing in many modern legal systems, with consequences for the rule of law. Laws have become more ambitious in the conduct they govern, while regulating conduct in more detail and greater technicality than ever before. Legal complexity makes it harder for citizens to understand and comply with the law, undermines access to justice as litigation becomes costlier, reduces competition in regulated industries by increasing barriers to entry, and increases the risk of errors in application of norms by citizens, administrators, and judges.

This research builds on and challenges existing accounts of legal complexity and advances what I call the ‘market building’ theory of legal complexity. As a result of changing political economies since the 1980s, markets and market relations have gained in importance in modern economies. Markets are constituted by law, and they generate substantial and accretive legal complexity as a side-effect. This results principally from the way the profit motive creates powerful incentives that produce or exacerbate market deficiencies. Governments use law to manage incentives and market dynamics to address these deficiencies but are faced with the strength and resilience of profit-related incentives. Moreover, governments now use law to encourage or mandate participation in markets and often have abandoned non-regulatory means for reshaping market dynamics. Finally, I highlight that state provision of goods and services can be expected to produce less legal complexity than market provision.

The dissertation develops its case through two case studies of the development of private pensions law in the UK and Australia that clearly demonstrate the nexus between market building and legal complexity.

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## Table of Abbreviations

ACTU	Australian Council of Trade Unions
AIRC	Australian Industrial Relations Commission
ALP	Australian Labor Party
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Tax Office
BSP	British state pension
CCPs	Central counterparties
CDC schemes	Collective defined contribution schemes
CPPIB	Canada Pension Plan Investment Board
GFC	Global Financial Crisis
GMP	Guaranteed minimum pension’
GRB	Graduated retirement benefit

LNP	Liberal-National Party
NEST	National Employment Savings Trust
NI	National insurance
NPSS	National Pensions Saving Scheme
OECD	Organisation for Economic Co-operation and Development
RSAs	retirement savings accounts
RSEs	registrable superannuation entities
S2P	State second pension
SERPS	State earnings-related pension scheme
SGC	Superannuation guarantee charge
SIPPs	Self-invested personal pensions
UK	United Kingdom
US	United States of America

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## **Introduction**

This dissertation investigates the causes of increasing legal complexity in modern legal systems. Specifically, I ask how changing relationships between states and markets produce changes in legal complexity. I define legal complexity with reference to the density and technicality of legal rules and the pace of their evolution over time. There is substantial evidence that legal complexity is increasing in many modern legal systems, with consequences for the rule of law. Laws have become far more encompassing of the conduct they regulate, while regulating conduct in more detail and with greater technicality than ever before. The thesis develops the premise that legal complexity makes it harder for citizens to understand and comply with the law, undermines access to justice as litigation becomes costlier, reduces competition in regulated industries by increasing barriers to entry, and increases the risk of errors in application of norms by citizens, administrators, and judges.

My research builds on and challenges existing accounts of legal complexity, notably the two most common theories. The ‘law reflects reality’ thesis argues that increasing legal complexity is an inevitable side-effect of societies growing more complex, particularly through the emergence of new technologies and social and economic relationships. The ‘self-interest’ thesis argues that groups such as lawyers, bureaucrats, and certain litigants thrive on greater legal complexity and advocate to increase it. I advance here what I call the ‘market building’ theory of legal complexity. As a result of changing political economies since the 1980s, markets and market relations have gained increasing importance in modern

economies. This matters for legal complexity because markets are constituted by law, and they generate substantial and accretive legal complexity as a side-effect. This results principally from the way the profit motive creates powerful incentives that produce or exacerbate market deficiencies. Governments use law to manage incentives and market dynamics to address these deficiencies, but the strength of profit-related incentives make this process challenging. I also observe two related trends driving market-related legal complexity. Governments now use law to encourage or mandate participation in markets. Furthermore, they have often abandoned non-regulatory means for reshaping market incentives and outcomes. Finally, I observe that state provision of goods and services can be expected to produce less legal complexity than market provision.

This dissertation makes its case with recourse to two case studies of the development of private pensions law in the UK and Australia that demonstrate the nexus between market building and legal complexity. UK and Australian private pensions laws are infamously complex,<sup>1</sup> subject to dense and highly technical rules spanning thousands of pages of primary and delegated legislation and case law. The case studies allow scrutiny of the mechanisms through which these private pensions markets generated specific instances of legal complexity. They offer evidence for the market building theory and the impact of changing state-market relationships on legal complexity. They also enrich understandings of how

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<sup>1</sup> Pension Law Review Committee, 'Pension Law Reform: Volume I' (1993) CM 2342-I [4.1.6]; Productivity Commission, 'Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation' (2001) Inquiry Report 18 xx, ch 3.

private pensions law has developed in the UK and Australia, especially the role of law in their growth and in the regulation of prudential issues, fees, and performance.

The dissertation does not seek to argue that legal complexity is always bad, particularly in the context of private pensions law. Yet, by arguing for greater awareness and indeed scrutiny of legal complexity produced through the nexus of governments and market provision, the thesis does challenge the over-reliance by governments on legal intervention and on reactive or remedial market building work that overlooks the possibility of more radical reconceptualization of the provision of goods and services such as pensions. The project is impelled by the view that governments must ensure that the making of laws, particularly of regulation, remains attentive to the democratic rights of individuals to understand the law, both to comply with it and critique it.

## **1 Explaining legal complexity**

Legal complexity refers to the density and technicality of legal rules as well as their evolution over time. Density denotes the number and scope of rules, such as the range of conduct covered and the level of detail at which the conduct is regulated. Technicality draws attention to the level of ‘sophistication or expertise’ required to understand a rule, such as related to its terminology.<sup>2</sup> Generally, the emergence and growth of legal rules in relation to conduct or subject matter will create greater

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<sup>2</sup> This definition draws Peter H Schuck, ‘Legal Complexity: Some Causes, Consequences, and Cures’ (1992) 42 Duke Law Journal 1, 3–4.

legal complexity for those subject to the rules. Similarly, more frequent and substantial legal change is, all else being equal, likely to increase the complexity faced by persons subject to the law. Legal complexity encompasses the complexity of rules in both legislation and case law, the latter of which is crucial in determining disputes over the meaning of legislative rules. The focus on the *density* of legal rules reflects my view that legal complexity is more than technical complexity in the drafting and communication of law. Legal complexity is principally found in the creation of new obligations and prohibitions,<sup>3</sup> rather than in the drafting and design of specific legislative rules.<sup>4</sup> Finally, legislation refers here to primary and delegated legislation, the former comprising Acts made by the legislature, the latter made by the executive under powers contained in primary legislation.

## **1.1 Why investigate legal complexity?**

There is widespread recognition that legal complexity is increasing and that its modern scale is potentially troublesome.<sup>5</sup> The crude metrics of the volume of

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<sup>3</sup> For a similar view, see Adam I Muchmore, 'Uncertainty, Complexity, and Regulatory Design' (2016) 53 *Houston Law Review* 1321, 1335–1336.

<sup>4</sup> David M Driesen, 'Complexity and Simplicity in Law: A Review Essay (Cass R. Sunstein, *Simpler: The Future of Government* (2013))' (2015) 45 *Environmental Law* 181, 184; Schuck (n 2) 4; Australian Law Reform Commission, 'Complexity and Legislative Design' (2021) FSL2 2–16.

<sup>5</sup> Prasanna Gai and others, 'Regulatory Complexity and the Quest for Robust Regulation' (European Systemic Risk Board 2019) 8 5; Daniel Greenberg, 'The Volume and Complexity of United Kingdom Legislation Today' in Simon Hetherington (ed), *Halsbury's Laws of England Centenary Essays* (Butterworths Law 2007) 68; Lord Justice Haddon-Cave, 'English Law and Descent into Complexity' (2021) 26 *Judicial Review* 227.

legislation are illuminating, as Figure 1 highlights.<sup>6</sup> In Australia, the number of pages of acts and regulations made yearly has risen rapidly since the 1970s, and more federal primary legislation was enacted between 2000 and 2022 than in the entire 20<sup>th</sup> century.<sup>7</sup> Today, Australian federal lawmakers enact over 35,000 pages of legislation each year. Similar trajectories have been observed in the UK and US.<sup>8</sup> Private pensions law now accounts for thousands of pages of legislation and court judgments, the vast majority of which has emerged since the 1980s.

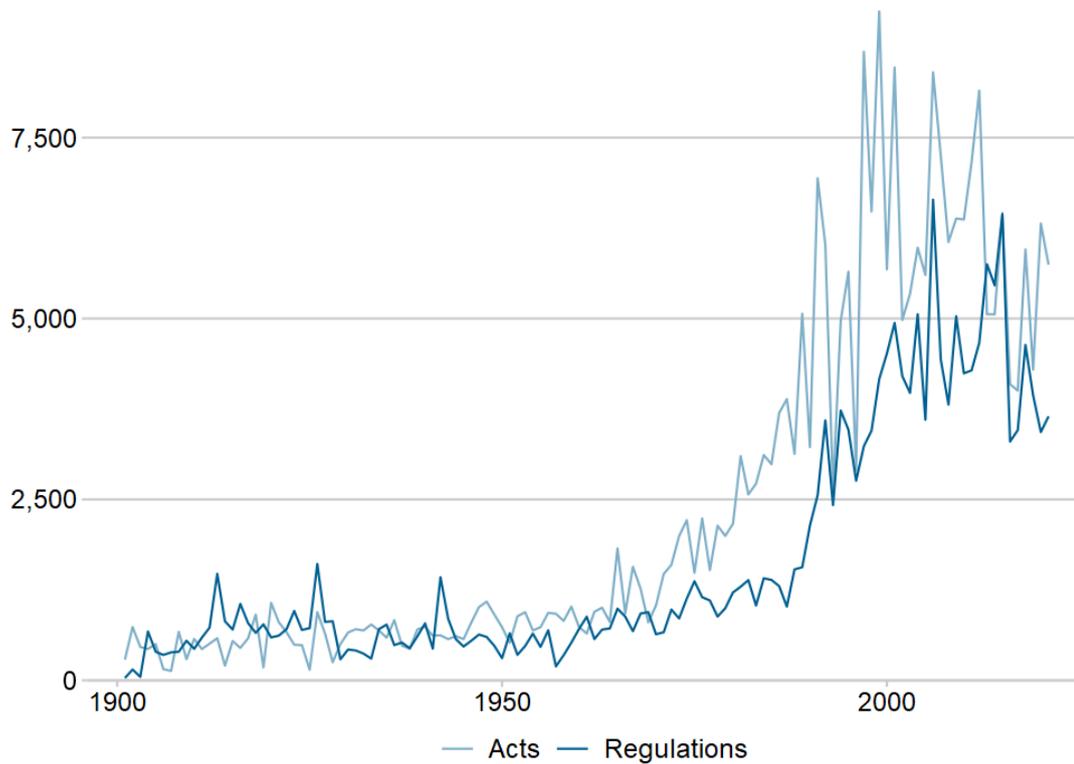
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<sup>6</sup> Figure 1 is taken from Australian Law Reform Commission, 'A Short History of a Long Statute Book' (12 December 2022) <<https://www.alrc.gov.au/datahub/the-commonwealth-statute-book/a-short-history-of-a-long-statute-book/>> accessed 24 July 2024.

<sup>7</sup> Analysis of Australian Law Reform Commission, 'As Made Commonwealth Legislation' <<https://www.alrc.gov.au/datahub/download-the-data>> accessed 23 July 2024.

<sup>8</sup> Patrick M Vollmer and Alison Creagh, 'Volume of Legislation' (House of Lords Library 2011) LLN 2011/028 3–4; William P Li and others, 'Law Is Code: A Software Engineering Approach to Analyzing the United States Code' (2014) 10 *Journal of Business & Technology Law* 297, 320.

**Figure 1: Enacted pages of federal acts and regulations in Australia**



The rule of law requires clear, accessible and comprehensible laws.<sup>9</sup> These values are threatened by excessive and ever rising levels of legal complexity that undermine the law's 'moral clarity'<sup>10</sup> and make it harder for citizens to understand and comply with the law.<sup>11</sup> Frequent amendments lead to unstable legal rules and reduce the ability of citizens to 'orient' their conduct.<sup>12</sup> As it grows, legal complexity

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<sup>9</sup> Tom Bingham, 'The Rule of Law' (2007) 66 *Cambridge Law Journal* 67, 69; Lon L Fuller, *The Morality of Law* (Yale University Press 1964) 39.

<sup>10</sup> Robert French, 'Law — Complexity and Moral Clarity', *North West Law Association and Murray Mallee Community Legal Service* (2013) 1.

<sup>11</sup> Bingham (n 9) 70; Office of the Parliamentary Counsel (UK), 'When Laws Become Too Complex: A Review into the Causes of Complex Legislation' (2013) 29.

<sup>12</sup> Fuller (n 9) 39. See also, AV Dicey, *Introduction to the Study of the Law of the Constitution* (Macmillan 1897) 179–80; Joseph Raz, 'The Law's Own Virtue' (2019) 39 *Oxford Journal of Legal Studies* 1, 2.

increases the costs of understanding the law and undermines access to justice as litigation becomes more resource-intensive. Costly, specialised lawyers become key for navigating legal rights and duties, and for enforcing them. Consequently, promises of consumer protections can become hollow. Legal complexity also increases business compliance costs and thereby reduces competition in regulated industries.<sup>13</sup> It acts as a barrier to entry for new firms and rewards large firms able to assume the potentially enormous costs of its implementation.<sup>14</sup> Finally, legal complexity increases the risk of errors in the application of norms and rules by citizens, administrators, and judges. Multiple government reports have linked legal complexity to mistakes in the administration of the law.<sup>15</sup> There is broad consensus in government and academia that excessive legal complexity threatens the rule of law and other crucial values,<sup>16</sup> such as the democratic legitimacy of laws.<sup>17</sup>

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<sup>13</sup> Ian Ramsay, 'Corporate Law in the Age of Statutes' (1992) 14 Sydney Law Review 474, 478–9.

<sup>14</sup> Australian Law Reform Commission, 'Confronting Complexity: Reforming Corporations and Financial Services Legislation' (2023) Report 141 [2.53]–[2.57].

<sup>15</sup> Law Commission of England and Wales, 'Simplification of the Immigration Rules' (2019) Report [1.10]; Australian Law Reform Commission, 'Interim Report C: Financial Services Legislation' (2023) Report 140 [4.7], [9.25]–[9.26].

<sup>16</sup> Office of the Parliamentary Counsel (UK) (n 11) 1; Lisa B Crawford, 'The Rule of Law in the Age of Statutes' (2020) 48 Federal Law Review 159, 161.

<sup>17</sup> French (n 10) 12.

## 1.2 Existing explanations of legal complexity

Advocates of the ‘law reflects reality’ thesis posit that legal complexity is inevitable as societies grow more complex,<sup>18</sup> such as through technology and changes in economic and social relations. New information asymmetries have emerged in modern economies, notably with respect to the purchase of novel, non-standard, and increasingly complex services.<sup>19</sup> New technologies generate products and services that create new markets or transform existing ones. The internet too has produced new economic relations and seen the creation of numerous new markets. The market building framework I develop here challenges this theory by identifying dynamics that created legal complexity separate from the emergence of new technologies and economic relationships. Specifically, by explaining how markets generate legal complexity and the role of state involvement in market development, I foreground changes in political economy that have increased market relations as an important driver of legal complexity.

I also seek to challenge the ‘self-interest’ thesis, propounded by scholars in the law and economics tradition.<sup>20</sup> In this account, individuals have ‘preferences’ for complexity,<sup>21</sup> with ‘dominant producers and rationalizers of law’ motivated to

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<sup>18</sup> Greenberg (n 5) 57; Sir Anthony Mason, ‘Corporate Law: The Challenge of Complexity’ (1992) 2 *Australian Journal of Corporate Law* 1, 2; Ramsay (n 13) 479; Eric W Orts, ‘The Complexity and Legitimacy of Corporate Law’ (1993) 50 *Washington and Lee Law Review* 1565, 1612–13; Vito Tanzi, *Termites of the State: Why Complexity Leads to Inequality* (Cambridge University Press 2017) 279.

<sup>19</sup> Tanzi (n 18) 93.

<sup>20</sup> Schuck (n 2).

<sup>21</sup> Michelle J White, ‘Legal Complexity and Lawyers’ Benefit from Litigation’ (1992) 12 *International Review of Law and Economics* 381.

increase legal complexity.<sup>22</sup> Self-interest accounts have been offered to explain why a range of groups, such as lawyers and compliance firms, benefit from higher levels of complexity and may work with political entrepreneurs and bureaucrats to drive greater complexity.<sup>23</sup> The market building model posits that while self-interest drives some legal complexity, this is not a direct result of people seeking greater legal complexity as such.

### **1.3 Market building and legal complexity**

Since the 1980s, there has been a ‘secular expansion of market relations’ across the world,<sup>24</sup> for reasons outside the scope of this dissertation. Here, I focus on one consequence of this development, outlining a framework for explaining how rising market relations have contributed to mounting levels of legal complexity. The first step in understanding this relationship is to observe that markets are generally constituted, at least in part, by law. The state and the economy ‘co-evolve’ so that ‘[m]arkets and other identifiably capitalistic patterns of behavior are creatures of law.’<sup>25</sup> As Commons observed in 1924, the law transforms intangible assets from a ‘valueless personal right into a valuable property right’.<sup>26</sup> Similarly, Vogel has

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<sup>22</sup> Schuck (n 2) 7.

<sup>23</sup> Andreas Horsch and Jacob Kleinow, ‘The Challenge of Regulatory Complexity’ (2022) 33 *European Business Law Review* 421, 429.

<sup>24</sup> Wolfgang Streeck and Kathleen Ann Thelen, ‘Introduction: Institutional Change in Advanced Political Economies’ in Wolfgang Streeck and Kathleen Ann Thelen (eds), *Beyond continuity: institutional change in advanced political economies* (Oxford University Press 2005) 2.

<sup>25</sup> Jeff E Biddle and Warren J Samuels, ‘Introduction’ in John R Commons, *Legal Foundations of Capitalism* (Routledge Taylor & Francis Group 2017) xxx–xxxi.

<sup>26</sup> John R Commons, *Legal Foundations of Capitalism* (Routledge 2017) 269.

explored the role of state regulation in creating ‘freer’ markets.<sup>27</sup> Polanyi and various other scholars have made similar points about the role of state law in constituting markets.<sup>28</sup> Indeed, even the metaphor of ‘market building’ has been used before,<sup>29</sup> though without the conceptual apparatus I erect around the term. The ‘market-institutional’ school recognises that markets are ‘actively constructed’ through a range of institutions,<sup>30</sup> including the state and its instrumentalities. The importance of law to market development has also been observed by law and finance scholars.<sup>31</sup> They have shown that tough regulation fostered the development of securities markets in Poland, while its lack in the Czech Republic produced a failing securities market.<sup>32</sup> Finally, governments often justify legal interventions as necessary for market functioning. Thus, the European Union’s new regulation on crypto assets seeks to address a potential ‘lack of user confidence in those assets, which could significantly hinder the development of a

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<sup>27</sup> Stephen K Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Cornell University Press 1996) 3.

<sup>28</sup> Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Beacon Press 2001) 145.

<sup>29</sup> Michelle Egan, *Constructing a European Market: Standards, Regulation, and Governance* (Oxford University Press 2001) 6, 9; Jacob Soll, *Free Market: The History of an Idea* (Basic Books 2022).

<sup>30</sup> Naazneen H Barma and Steven K Vogel, *The Political Economy Reader: Contending Perspectives and Contemporary Debates* (2nd edn, Routledge 2021) 1.

<sup>31</sup> Rafael La Porta and others, ‘Law and Finance’ (1998) 106 *Journal of Political Economy* 1113.

<sup>32</sup> Edward Glaeser, Simon Johnson and Andrei Shleifer, ‘Coase Versus the Coasians’ (2001) 116 *The Quarterly Journal of Economics* 853, 855–856.

market in those assets’.<sup>33</sup> An original objective of the Financial Services and Markets Act 2000 (UK), repealed in 2012, was ‘maintaining confidence in the financial system’.<sup>34</sup> The constitutive character of law has been challenged by some, such as Marxists and some laissez-faire free marketers,<sup>35</sup> and there is evidence for the emergence and growth of markets without legal norms.<sup>36</sup> However, substantial evidence remains that law is crucial for constituting markets, and the private pensions case studies I examine underline this relationship.

### **1.3.1 Market deficiencies and legal complexity**

Yet, beyond the basic rules that constitute market relations — such as rules of contract and property — how do markets generate legal complexity, particularly greater complexity than would be expected from the development of new technologies and economic relationships? Markets are highly heterogeneous, with a wide range of participants pursuing different interests, including, crucially, profit. Although the profit motive contributes to socially beneficial outcomes, such as innovation, it also drives the emergence of market deficiencies that produce public pressure for law reform aimed at correcting deficiencies and their causes. I use ‘market deficiencies’ to broaden understanding of the basis of government

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<sup>33</sup> Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (Text with EEA relevance) [2023] OJ L 150, [5].

<sup>34</sup> Financial Services and Markets Act 2000 (UK) s 3.

<sup>35</sup> Geoffrey M Hodgson, *The Wealth of a Nation: Institutional Foundations of English Capitalism* (Princeton University Press 2023) 47.

<sup>36</sup> Eric A Posner, *Law and Social Norms* (Harvard University Press 2000) ch 2.

intervention beyond ‘market failures’, generally used to justify government intervention in markets. Market failures represent only one basis for legal change, with ‘other defects in market ordering’ often driving interventions.<sup>37</sup> These include perceived maldistributions, market outcomes inconsistent with ‘collective desires and aspirations’, and practices that produce ‘social subordination’ of groups.<sup>38</sup> Law reform that addresses perceived market deficiencies may be used to tackle fraud, reduce information asymmetries, ensure prudent management of a business, and otherwise shape outcomes for market participants and achieve social objectives.

Markets are prone to producing deficiencies because maximising profit provides the principal incentive for actions. For example, individuals and firms tend to take advantage of information asymmetries and consumer apathy. They often will seek to charge the highest possible price while reducing the quality of goods to their lowest acceptable level. Law is an instrument for changing or managing the incentives produced by the profit motive and to correct market deficiencies. Product safety rules, mandatory warranties, and marketing laws emerged to address information asymmetries between customers, who may know little about the quality of the products or services they are acquiring, and sellers, who possess that knowledge and may be incentivised to produce low quality goods and services and to misrepresent their quality. Law is a ‘counteracting institution’ for addressing

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<sup>37</sup> Cass R Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (Harvard University Press 1993) 47.

<sup>38</sup> *ibid* 55–69.

such market deficiencies.<sup>39</sup> Legal interventions can result from scandals or crises caused by market deficiencies.<sup>40</sup> They can also occur outside of times of crisis as governments seek to address deficiencies affecting their voters or potentially threatening their goals. For example, Australian legislation voids terrorism exclusions in specified insurance contracts, thereby requiring insurers to cover terrorist-related losses in property and business interruption insurance and addressing perceived failures in market functioning.<sup>41</sup>

The strength of the incentives produced by the profit motive, however, make addressing market deficiencies through law challenging. Individuals and firms may seek to avoid legal rules and to lobby for favourable ones. Perceived attempts to bypass rules can lead to dense and technical rules that more closely control the conduct of regulated persons. Thus, market actors may be tempted to interpret principles-based legislation in self-serving ways, and generally have the resources to acquire legal advice that defends their desired interpretation. This can drive ever more prescriptive and technical legislation as government seeks more closely to control their behaviour, with simpler principles replaced by complex rules.<sup>42</sup>

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<sup>39</sup> George A Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *The Quarterly Journal of Economics* 488, 499–500; Rory Van Loo, 'Broadening Consumer Law: Competition, Protection, and Distribution' (2019) 95 *Notre Dame Law Review* 49.

<sup>40</sup> Roberta Romano, 'The Sarbanes-Oxley Act and the Making of Quack Corporate Governance' (2005) 114 *Yale Law Journal* 1521, 1526–7; John C Coffee, Jr, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated' (2012) 97 *Cornell Law Review* 1019.

<sup>41</sup> *Terrorism and Cyclone Insurance Act 2003 (Cth)* ss 7–8.

<sup>42</sup> For examples of how principles can substitute for rules, see Julia Black, Martyn Hopper and Christa Band, 'Making a Success of Principles-Based Regulation' (2007) 1 *Law and Financial*

The potential for regulatory arbitrage can also see greater delegation of lawmaking power to specialised government agencies rather than elected lawmakers. Such agencies may be more likely to produce highly technical rules that change more often, as delegated rulemaking is generally easier to undertake than enactment of primary legislation. Successful attempts to avoid rules and the difficulty of addressing the causes of market deficiencies in heterogeneous and evolving markets can leave those deficiencies unresolved, meaning that further reform is often required in an iterative process in which complex legal interventions build upon earlier reforms.

Lobbying, too, can leave market deficiencies unaddressed, driving the need for future law reforms. Firms and other market actors can often prevent the introduction of structural interventions aimed at addressing deficiencies. Structural approaches can be relatively legally simple, such as through prohibitions on certain remuneration or ownership structures. An emblematic case study in this respect is the post-GFC regulation of central counterparties (CCPs). CCPs play a central role in the functioning of financial markets by acting as intermediaries between the seller and buyer of an equity or derivative. CCPs thence purport to reduce counterparty risks such as credit risk.<sup>43</sup> After the GFC, the government moved to mandate the clearing of certain derivatives through CCPs to

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Markets Review 191, 194. However, they argue that principles can be harder to ‘creatively comply’ with (i.e. avoid) than rules.

<sup>43</sup> Darrell Duffie and Haoxiang Zhu, ‘Does a Central Clearing Counterparty Reduce Counterparty Risk?’ (2011) 1 Review of Asset Pricing Studies 74.

reduce systemic risk. The EU, Australia, and the US introduced extensive legislative schemes to regulate these CCPs.<sup>44</sup> Much of the regulation aimed to improve risk management and manage conflicts of interest inherent in the relationship between a for-profit CCP and the parties with which it is transacting. Yet much of this regulation could have been avoided, or minimised. The Bank of England argued in December 2010 that, '[u]ser-ownership and not-for-profit governance arrangements provide the strongest incentives for effective risk management, aligning CCPs' interests with suppliers of capital'.<sup>45</sup> This recommendation was not accepted, and CCPs remained private for-profit firms, with implications for legal complexity. Managing the consequences for systemic risk of the incentives created by CCP private ownership remains deeply challenging.<sup>46</sup>

Structural market interventions also offer opportunities for avoiding, or at least reducing, legal complexity. Again, following the GFC, Johnson and Kwak proposed structural financial interventions that included caps based on the size of financial institutions.<sup>47</sup> Martin Wolf also argued for the abandonment of fractional

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<sup>44</sup> Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance [2012] OJ L 201; Corporations Legislation Amendment (Derivative Transactions) Act 2012 (Cth); ASIC Derivative Transaction Rules (Clearing) 2015 (Cth); Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub L No 111–203) §§ 725, 726, 732.

<sup>45</sup> Bank of England, 'Financial Stability Report' (2010) Issue No. 28 10.

<sup>46</sup> Katrien Morbee, 'The Corporate Governance of Central Counterparties and Shareholder Primacy: A Re-Evaluation in the Presence of Systemic Risk' (2022) 15 *International and Comparative Corporate Law Journal* 35.

<sup>47</sup> Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (Vintage 2011).

reserve banking.<sup>48</sup> Adopting Johnson and Kwak’s proposal would eliminate the vast regulatory infrastructure around Systemically Important Financial Institutions, through a relatively simple legislative intervention. Adopting Wolf’s proposal would manage how private institutions in the financial system generate risk and make the central bank the sole generator of new money. It would not necessarily reduce systemic risk, as a government could still create an excessive money supply, but it would reduce the need for a vast system of prudential and financial market regulation.

Structural approaches do not necessarily guarantee simpler legal interventions. Structural interventions such as the Volcker Rule in the US, preventing proprietary trading by banks, and the UK’s introduction of rules ‘ring-fencing’ retail banking activities to certain entities have been described as ‘extremely complex’.<sup>49</sup> However, attempts to avoid and manipulate the structural separation rules may have been an important driver of complexity, particularly in the case law.<sup>50</sup>

The gradual accretion of laws aiming to address market deficiencies, but failing to do so satisfactorily, is a proximate cause of rising levels of legal complexity in modern economies. The profit motive, and the incentives that it generates among heterogeneous market actors, remain as a deeper cause of legal

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<sup>48</sup> Martin Wolf, *The Shifts and the Shocks: What We’ve Learned — and Have Still to Learn — from the Financial Crisis* (Penguin Books 2014).

<sup>49</sup> John Armour and others, *Principles of Financial Regulation* (Oxford University Press 2016) 745.

<sup>50</sup> *ibid* 755.

complexity. These dynamics play out regardless of whether new technologies and economic relationships emerge in specific markets, highlighting the limits of the law reflects reality thesis. Moreover, the expansion of market relations, in part a political choice, lays the foundation for these dynamics and the resulting legal complexity.

### **1.3.2 Actively constructing markets**

In addition to using law to manage market deficiencies, governments increasingly have used law to construct markets and expand participation therein. Complex legal interventions can result from these efforts. In seeking to expand markets, legislation may mandate or encourage participation in markets, and provide tax arrangements and corporate forms to foster markets. Thus, the Inflation Reduction Act of 2022 used changes to the tax code to create a new market for green tax credits in the US. The Act did so by making tax credits transferable (i.e. tradable),<sup>51</sup> a novel development given tax credits can ordinarily only be used by the person who ‘earns’ the credit. This market could grow to process \$80 billion in transactions per year.<sup>52</sup> States, too, create legal frameworks to de-risk and therefore grow markets, such as for terrorism insurance and bank deposits.<sup>53</sup> The potential for deliberate market building to generate significant legal complexity is

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<sup>51</sup> Inflation Reduction Act of 2022, 26 USC § 6418.

<sup>52</sup> Jim Tankersley and Lauren Hirsch, ‘In Biden’s Climate Law, a Boon for Green Energy, and Wall Street’ *New York Times* (23 November 2023) <<https://www.nytimes.com/2023/11/23/business/economy/climate-law-biden-tax-credits.html>>.

<sup>53</sup> See, e.g., Terrorism and Cyclone Insurance Act 2003 (Cth), Reinsurance (Acts of Terrorism) Act 1993 (UK), Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008 (Cth) sch 1,

especially visible in one of the most impressive examples of market building over the past 100 years: the European single market. Vast amounts of case law and legislation were developed to harmonise rules, break down tariff and non-tariff barriers, and address market deficiencies.<sup>54</sup> According to Walker, the ‘production of primary legislation peaked in the early 1990s with the completion of the Single Market Programme’, although delegated law-making continued to increase.<sup>55</sup> For policy entrepreneurs such as the European Commission, the creation of the single market was an ongoing construction project,<sup>56</sup> and complaints about the resulting complexity have been similarly enduring.<sup>57</sup>

### **1.3.3 The increasing role of law in addressing market deficiencies**

States can undertake market building through a range of methods beyond law.<sup>58</sup> They can act as ‘economic players’ by using non-legal incentives such as public investment, tariffs, or public ownership ‘to persuade or coerce’ market

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<sup>54</sup> Paul Craig and Gráinne De Búrca, *EU Law: Text, Cases, and Materials* (7th edn, Oxford University Press 2020) 664–84; Damian Chalmers, Anthony Arnall and Loïc Azoulay, ‘The Complex Weave of Harmonization’ in Damian Chalmers and Anthony Arnall (eds), *The Oxford Handbook of European Union Law* (Oxford University Press 2015).

<sup>55</sup> Neil Walker, ‘Legal and Constitutional Theory of the European Union’ in Paul Craig and Gráinne De Búrca (eds), *The Evolution of EU Law* (3rd edn, Oxford University Press 2021) 91 fn 6.

<sup>56</sup> See, e.g., European Commission, ‘Completing the Internal Market: White Paper from the Commission to the European Council’ COM 85 310 final.

<sup>57</sup> Diana Welch, ‘From “Euro Beer” to “Newcastle Brown”, A Review of European Community Action to Dismantle Divergent “Food” Laws’ (1983) 22 *Journal of Common Market Studies* 47, 55.

<sup>58</sup> See, also, the list in William J Novak, *New Democracy: The Creation of the Modern American State* (Harvard University Press 2022) 213.

participants to achieve public policy goals.<sup>59</sup> Governments may provide subsidies to help grow and maintain markets, impose tariff restrictions to encourage domestic consumption and manufacturing, and otherwise take steps to promote privately- or publicly-owned firms as ‘national champions’.<sup>60</sup> Australia provides subsidies through programs such as the ‘Automotive New Markets Initiative’ and the ‘Automotive Industry Structural Adjustment Program’ with the express objectives of growing and maintaining markets.<sup>61</sup> Many of these interventions require some degree of law, and legislation is often required to authorise expenditures for financial subsidies or to impose tariffs and duties. In Australia, all expenditure by the central government requires legislative authority,<sup>62</sup> though this is effectively pro forma. However, law, particularly in the form of regulatory law, can be the principal instrument through which governments pursue market-related goals.

Privatisation and the declining role of publicly owned corporations have limited the tools available to states to pursue market-related public policy objectives and increased the use of regulatory law to do so. As the OECD observed in 1999, declines in other forms of state involvement meant that ‘regulation is

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<sup>59</sup> John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Cornell University Press 1983) 75.

<sup>60</sup> Tanzi (n 18) 245.

<sup>61</sup> Financial Framework (Supplementary Powers) Regulations 1997 (Cth) pt 4 items 418.019, 418.022.

<sup>62</sup> *Williams v Commonwealth* (2012) 248 CLR 156.

perhaps the most pervasive form of state intervention in economic activity'.<sup>63</sup> Market deficiencies that previously might have been addressed through public investment requiring relatively little legislation frequently have become the focus of legislative action. For example, rent controls can substitute for public investment in housing as a short-term solution to high housing costs, with regulations substituting for 'taxing and spending policies'.<sup>64</sup> Such reluctance by governments to act more forcefully means that pressures for market maintenance result in legal rather than non-legal solutions. The UK private pensions case study will highlight how the decline of the state as a provider of pensions necessitated a resort to regulation, as the state lost its ability to drive higher private pension standards as a competitor.

#### **1.3.4 State provision and legal complexity**

Insofar as market relations have supplanted state provision of goods and services, they have replaced a legally simpler model of provision. Managing issues associated with state provision of goods and services does not necessarily require legislation. The state can use other methods for guiding actors providing goods and services to citizens on its behalf, such as contracts with private suppliers, guidelines for civil servants, hiring and employee management practices, and more informal means of influence. Through the direct control it exercises over its employees and contractors, the state can also assume a greater degree of good

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<sup>63</sup> OECD, 'Economic Policy Reforms 2005: Going for Growth' (2005) 124.

<sup>64</sup> Tanzi (n 18) 151.

faith and alignment of interests with its own interests. A system of state provision lacks the same degree of heterogeneity found in a market and, except where service provision is contracted-out, the presence of profit motives. Along with its other instruments of control, the alignment of interests means that even where legislation is used, often it can rely more on principles rather than prescriptive or technical rules. In contrast to market actors, government agents have fewer incentives to misconstrue legislative principles, and various non-legislative incentives to interpret them as government intended (as described above). The legislation establishing and regulating the Canada Pension Plan Investment Board (CPPIB), the government agency that invests Canadian citizens's private pensions, illustrates these dynamics. The entire body of legislation for the CPPIB comprises just over 11,000 words of primary legislation,<sup>65</sup> and just under 3,000 words of regulations.<sup>66</sup> In contrast, in the UK and Australia legislation regulating the governance, investment practices, and costs of private pension schemes spans hundreds of thousands of words. Moreover, Canada's government has many ways to influence the CPPIB, including through appointment of its directors, and it can also assume that its directors and staff will seek to carry out the legislated objectives of the CPPIB without prescriptive legislative rules. In contrast, the UK and Australia have developed extensive legislative rules relating to the liquidity, capital, and risk management of private pension schemes and extensive

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<sup>65</sup> Canada Pension Plan Investment Board Act, SC 1997, c 40.

<sup>66</sup> Canada Pension Plan Investment Board Regulations, SOR 99-190.

compliance arrangements that are not required for a state instrumentality like the CPPIB (noting that Canada also has a private pension market that is subject to substantial legislation).<sup>67</sup> The density and technicality levels these legal apparatuses have generated are remarkable in their complexity.

Electoral processes are the principal avenues through which citizens can influence legislation relating to state provision, with little or no scope for choice, competition, and profits that otherwise drives legal change. Firms play a less significant role in shaping legal arrangements with respect to state provision compared to market provision. The more limited role in shaping the law necessarily produces greater legal stability. Thus, the core provisions providing for the payment of the Age Pension in Australia — funded out of general taxation and, therefore, not requiring a specific legislative architecture for contributions — cover just 3,500 words.<sup>68</sup> In the UK private pension case study I examine, legislative arrangements for a state earnings-related pension, in effect a form of defined benefit pension, also are relatively simple. The limited scope for choice and competition, a narrower range of participants and interests, and a restricted range of issues subject to legislation mean that the state provision of goods and services generally produces less legal complexity than market provision.

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<sup>67</sup> See, eg, Pension Benefits Standards Act, RSC 1985 c 32 (2nd Supp).

<sup>68</sup> Social Security Act 1991 (Cth) pt 2.2.

## 1.4 Pensions-related concepts

A pension system helps individuals smooth consumption over a lifetime.<sup>69</sup> *Private pension schemes* are established and operated by private persons (i.e. non-state actors) with the objective of helping people save for retirement. Two types of private pension schemes will be discussed: *occupational* and *personal*. Public-sector pension schemes, restricted to civil servants, fall outside the scope of this dissertation.

*Occupational pension schemes* are established by an employer (the sponsor) and access to such schemes is restricted to employees. The sponsor may also be a group of employers or a trade union.<sup>70</sup> Occupational pension schemes may be defined benefit, defined contribution, or a combination of the two. A defined benefit pension promises a certain retirement income, whereas a defined contribution pension provides no guaranteed pension. Rather, a person's scheme income will be based on their contributions to the pension scheme and the investment performance of those contributions net of fees and taxes. Legislation or collective bargaining agreements may mandate that employers establish occupational pension schemes. Legislation or employment contracts may mandate participation by employees. Employer-specific occupational pension schemes are often referred to as 'corporate' schemes.

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<sup>69</sup> Franco Modigliano and Arun Muralidhar, *Rethinking Pension Reform* (Cambridge University Press 2004) 1.

<sup>70</sup> Juan Yermo, 'Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities' (OECD 2002) [9].

*Personal pension schemes* are open to any individual and independent of specific employers. They are generally available only on a defined contribution basis. In the UK, personal pension schemes include ‘stakeholder pension’ schemes and self-invested personal pensions (SIPPs). In Australia, personal pension schemes include industry, retail, and ‘small’ funds (including self-managed super funds).<sup>71</sup> Industry funds operate on a ‘profit-for-members’ basis, whereas retail funds are owned by financial services firms seeking to make profits.

However, the practical boundary between occupational and personal pensions is becoming increasingly blurred, often as a goal of government interventions. Some Australian corporate funds permit members to retain their membership when moving to other employees. Australian superannuation funds now operate almost entirely as personal pension schemes rather than occupational pension schemes.

## **1.5 Conclusion**

Legal complexity poses a crucial challenge to modern legal systems. The explanations for its increase over time miss important changes in political economy that have seen the growth of markets and market relations. The market building framework proposed in this chapter has sought to show how increasing market provision may produce greater legal complexity. The emergence of market deficiencies, principally created or exacerbated by market participants maximising profits, is core to this model. Such deficiencies produce pressures for law reform,

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<sup>71</sup> Australian Prudential Regulation Authority, ‘Segmentation of Superannuation Entities’ (2015) 2.

but self-interest drives market participants to avoid or dilute the effect of these reforms, leaving deficiencies unresolved and creating the need for further complex legal interventions. The market building model also proposes that other trends have contributed to market-related legal complexity: first, in the increasing use of law by states to actively construct markets and, second, in the decline of non-legal approaches to market deficiencies and shaping market outcomes. Finally, I have sought to explain not only why markets produce legal complexity, but also why their replacement of state provision removes a relatively legally simpler model for providing goods and services. In chapters 3 and 4, I will use the market building framework to enrich understandings of the complexity of UK and Australian private pensions law. The framework draws attention to the key developments that produced legal complexity and highlights how the complexity of the law far exceeds any necessary minimum to make the markets function or any demand by stakeholders for legal complexity. Market deficiencies, active market construction, the abandonment of partially non-legal approaches, and the collapse of state provision each explain elements of the complexity of private pensions law.

## 2 Methodology and case selection

Establishing causation is fiendishly difficult, yet it is the ‘main task of the social sciences’.<sup>72</sup> Theory is a key element of any project seeking to determine a causal relationship between an ‘explanandum’ (the phenomenon to be explained) and the ‘explains’ (the phenomenon that is said to cause the explanandum).<sup>73</sup> Seeking to establish a causal relationship between changes in state-market relations and legal complexity, I develop what Merton calls a ‘theory of the middle range’. Such a theory provides a specific account of how the explains causes the explanandum. It is more than a hypothesis but less than a ‘unified theory’.<sup>74</sup> Market building theory was developed both deductively and inductively,<sup>75</sup> based on synthesising existing research and evidence from the two private pension case studies. An initial framing of the theory was used to generate the research question and to select the methods for answering that question, which I now turn to.

This dissertation uses a case study methodology to provide a richer understanding of the relationship between market building and legal complexity.

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<sup>72</sup> Jon Elster, *Explaining Social Behavior: More Nuts and Bolts for the Social Sciences* (Revised edition, Cambridge University Press 2015) 15.

<sup>73</sup> *ibid* 1. See, also, Tom Clark and others, *Bryman’s Social Research Methods* (6th edn, Oxford University Press 2021) 18–19.

<sup>74</sup> Robert K Merton, *On Theoretical Sociology: Five Essays, Old and New* (The Free Press 1967) 39.

<sup>75</sup> Clark and others (n 73) 19–20.

Case studies are ‘systematic’<sup>76</sup> or ‘focused’<sup>77</sup> investigations of a single or small number of cases. A ‘case’ is a specific instance of the phenomena of interest, bounded ‘spatially and temporally’.<sup>78</sup> The phenomenon of interest is legal complexity. Two clearly bounded cases are used: Australian private pension law from 1986 to 2021 and UK private pension law from post-Second World War to 2021. These case studies are longitudinal, examining variations in legal complexity over time. They are used to generate evidence for the market building theory and the impact of changing state-market relationships on legal complexity. Specific legal developments that generated significant legal complexity are deployed as ‘units of analysis’. The remainder of this section explains why the case study method was chosen and discusses the benefits and limitations of case study research, before explaining the selection and scoping of the two cases.

### **2.1.1 Using the case study methodology**

A case study methodology is fitting because my research question requires a focus on ‘how’ changing state-market relations may have impacted legal complexity over time.<sup>79</sup> The focus on a limited set of cases permits an intensive study of the putative

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<sup>76</sup> Helen Simons, ‘Case Study Research: In-Depth Understanding in Context’ in Patricia Leavy (ed), *The Oxford Handbook of Qualitative Research* (2nd edn, Oxford University Press 2020) 678.

<sup>77</sup> John Gerring, *Case Study Research: Principles and Practice* (2nd edn, Cambridge University Press 2017) 28.

<sup>78</sup> *ibid* 38.

<sup>79</sup> Lisa L Miller, ‘The Use of Case Studies in Law and Social Science Research’ (2018) 14 *Annual Review of Law and Social Science* 381, 382; Robert K Yin, *Case Study Research and Applications: Design and Methods* (Sixth edition, SAGE 2018) 9.

causal relationship under review,<sup>80</sup> in addition to the policy, institution, or other social phenomena that is being explained. This allows for a detailed analysis of the potential causal mechanisms generating the phenomena, which goes beyond establishing a causal relationship. Therefore, case studies help identify the mechanisms by which legislative market building can generate legal complexity and can assist in ‘refining’ the conceptual and theoretical foundation of those mechanisms.<sup>81</sup> Case studies can also be attractive when researching ‘new or low information contexts’,<sup>82</sup> such as the not previously researched relationship between market building and legal complexity. Case studies are often used where there is ‘skepticism about conventional wisdom’,<sup>83</sup> because close attention to causal mechanisms allows existing theories to be interrogated. In particular, case study methodology also supports the analysis of legal complexity that cannot be explained by existing theories. For example, what factors produced the complex body of sumptuary laws that proliferated throughout Europe in the Medieval period? The emergence and complexity of such laws cannot be ascribed to the interests of a legal profession that barely existed at the time or to law merely reflecting reality. They reflected a distinct political economy that requires close analysis to be understood. Daston argues that the various motivations for

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<sup>80</sup> Gerring (n 77) 40.

<sup>81</sup> Miller (n 79) 382.

<sup>82</sup> *ibid.*

<sup>83</sup> *ibid.*

sumptuary laws, and the diversity of their scope, ‘baffles easy generalization’.<sup>84</sup> Their origin can only be understood through the type of intense analysis permitted by a case study. The origins of complex private pension law in the UK and Australia merit similar examination as they require scrutiny of the mechanisms through which market building dynamics and evolving state-market relations generated specific instances of legal complexity. Lastly, the case study method permits an iterative process that is both deductive and inductive,<sup>85</sup> allowing me to develop and explore the market building theory across multiple cases and units of analysis within each case. In addition, case study methodology is flexible in the evidence and methods that it permits.<sup>86</sup> I analyse legal texts, particularly primary and delegated legislation, and government documents such as reports, speeches, and explanatory memoranda for policy initiatives and proposed legislation. I also draw on secondary literature. The case study methodology emphasises the need for these sources of evidence to ‘converge in a triangulating fashion’.<sup>87</sup>

Research using a case study methodology must be realistic about the inferences that can be drawn from its findings and clear in how generalisations can be made. Although inferences can be drawn from case study research,<sup>88</sup> case study methodologies differ from other methodologies in how and when inferences

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<sup>84</sup> Lorraine Daston, *Rules: A Short History of What We Live By* (Princeton University Press 2022) 160.

<sup>85</sup> Yin (n 79) 181.

<sup>86</sup> Simons (n 76) 681.

<sup>87</sup> Yin (n 79) 15.

<sup>88</sup> Simons (n 76) 694.

are made. Case studies are ‘observational’ rather than ‘experimental’,<sup>89</sup> and samples are not chosen randomly so that case studies do not produce statistically generalisable results. Instead, case studies use purposive sampling methods to identify information-rich samples that offer the most potential for developing theories or knowledge.<sup>90</sup> While this dissertation articulates the market building theory, the small number of jurisdictional and subject matter cases used means that I make a partial contribution to exploring that theory’s application across other legal domains.

### **2.1.2 Case study selection**

For the purposes of this work, I have adopted a ‘critical case sampling’ strategy in which I sought case studies that ‘display features that are central to the phenomena of interest’<sup>91</sup> and are ‘prototypical or paradigmatic’ of legal complexity potentially produced by market building dynamics.<sup>92</sup> Private pension law in the UK and Australia is paradigmatic of market building. Despite their ‘private’ monikers, private pensions could not exist without the state, and governments have engaged in active construction of private pension markets. Governments provide favourable tax arrangements for private pension contributions, investment income, or benefits. In the case of personal pensions, tax legislation converts a managed fund

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<sup>89</sup> Gerring (n 77) 29.

<sup>90</sup> Yin (n 79) 38.

<sup>91</sup> Clark and others (n 73) 379.

<sup>92</sup> Gerring (n 77) 68.

or other investment vehicle into a state-endorsed fund for retirement savings. Deficiencies in the private pensions market have driven persistent attempts at law reform, particularly since the UK and Australian governments abandoned state alternatives to private pensions. The expansion of private pensions is also emblematic of the expansion of market relations since the 1980s, and the role of state lawmaking in these changes.

Selecting the temporal scope of the case studies was straightforward. For the UK, the post-war period saw the beginning of attempts to provide state earnings-related pensions as an alternative to private pensions, marking the beginning of the conflict between state and market approaches. For Australia, 1986 marked the passage of the first private pensions regulations. The year 2021 was chosen as the end date for each case study for practical reasons.

As a case study, private pension legislation has limitations. Pension policy, of which private pension policy is one part, is exceptional in the degree of public interest it attracts. It is an archetypal ‘high-profile issue’, often sitting alongside taxes in public importance.<sup>93</sup> Thus, governments have a particular interest in pension policy, creating unique policy dynamics. Yet, the very salience of pension policy makes private pensions a more useful case study. Public interest ‘supercharges’ the market building dynamics, meaning that perceived market defects quickly result in government action. Similarly, governments have focused on growing private pension markets. Efforts to grow markets and address defects

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<sup>93</sup> Pepper D Culpepper, *Quiet Politics and Business Power* (Cambridge University Press 2011) 5.

have led to numerous reforms since the 1980s, providing many units of analysis. The market building process would have been slower in a lower salience area. For example, the lower salience market for corporate control has generated relatively few legal interventions in several jurisdictions.<sup>94</sup> Furthermore, alternative and complementary case studies were considered. For example, utilities regulation demonstrates many of the market building characteristics of interest, and the related legislation has become voluminous. Similarly, legislation regulating health provision, such as through the NHS, offers a potential case study in building a state-intermediated market.

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<sup>94</sup> *ibid* chs 3–5.

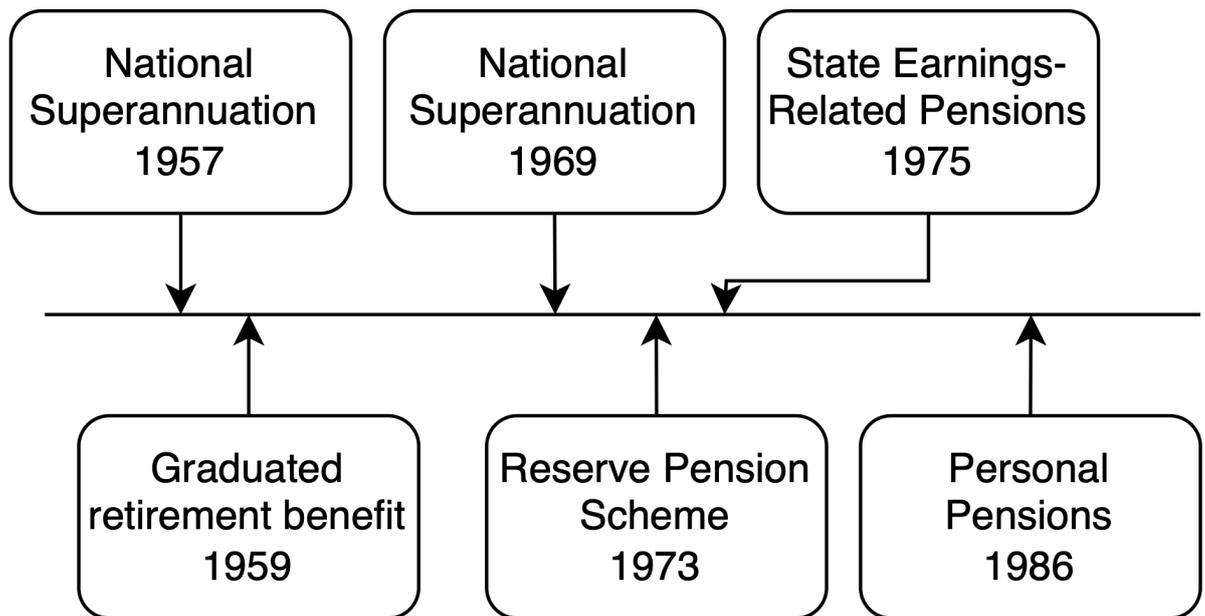
### **3 The United Kingdom**

This chapter examines the development of private pensions law in the UK. Today, such law is incredibly complex, spanning dozens of acts, regulations, and other forms of delegated legislation. Much, though not all, of this complexity has emerged since the 1980s. This chapter considers the causes of increasing legal complexity across three distinct periods: 1948 to 1980, 1981 to 1990, and 1997 to 2021. Close examination of select developments in each of these periods demonstrates how the market building framework can illuminate the causes of the legal complexity affecting private pension law today, and calls into question the application of existing explanations of legal complexity to the area of law.

#### **3.1 Markets or the state: consequences for legal complexity**

This section examines contest between different visions of earnings-related pension provision in the UK carried on between 1948 and 1986, summarised in Figure 2. These visions each had varying emphases on the role of the state and markets. As suggested by the market building theory, state alternatives to private pensions were relatively simple to establish in law and allowed the state to address deficiencies in the private pension market as a competitor. The legal complexity that emerged in this period came not principally from state provision but instead from attempts to address problems in the private pension market created by the profit motive. First, tax legislation became increasingly complex as governments sought to stamp out abuse of favourable tax arrangements. Later, governments sought to change market incentives by resorting to complex rules permitting private pensions providers to ‘contract out’ of state schemes.

**Figure 2: Key policies towards earnings-related pensions 1948-1986**



### **3.1.1 The post-war settlement and the role of earnings-related pensions**

The British state pension (BSP) was enacted following the 1942 Beveridge Report but departed substantially from the model proposed in that report.<sup>95</sup> The BSP was funded on a ‘pay-as-you-go’ basis through a new National Insurance (NI) tax in which the value of individual contributions had no relation to the pension received in retirement. Instead, the BSP provided a universal flat-rate payment to all retirees who accrued sufficient NI credits. The BSP was set at a low value intended to address pensioner poverty rather than to provide a comfortable retirement.<sup>96</sup> The ‘Beveridgean’ approach to public pension provision differed from the

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<sup>95</sup> Jose Harris, *William Beveridge: A Biography* (Oxford University Press 1997) 451–452.

<sup>96</sup> Antoine Bozio, Gemma Tetlow and Rowena Crawford, ‘The History of State Pensions in the UK: 1948 to 2010’ (Institute for Fiscal Studies 2010) 8.

‘Bismarckian’ model.<sup>97</sup> The latter aims to preserve a retiree’s pre-retirement status and therefore links the value of contributions to the value of the retirement pension. The status preservation role provided by the state in a Bismarckian system was instead fulfilled in the UK by fully or partially funded private pensions, specifically occupational pensions, that operated alongside the BSP. These occupational pensions were almost all defined benefit into the 1980s. The UK pensions model was therefore a mixed economy, in which both public and private arrangements were necessary to obtain a comfortable retirement.

Law was crucial in constituting these arrangements. Occupational pensions were encouraged by tax benefits, such as exemptions from income tax.<sup>98</sup> However, the state had historically taken a relatively hands-off approach to occupational pensions.<sup>99</sup> This began to change with s 32 of the Finance Act 1921 (UK), which made most income tax exemptions contingent on a scheme being approved by the Inland Revenue. These reforms, which substantially increased the complexity of the tax legislation and administration, sought to address market deficiencies related to perceived abuses of tax benefits, such as payment of excessive contributions and retirement benefits. The Inland Revenue imposed conditions on schemes receiving tax benefits aimed at reducing tax evasion and avoidance.<sup>100</sup> Tax

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<sup>97</sup> Karl Hinrichs and Julia F Lynch, ‘Old-Age Pensions’ in Daniel Béland and others (eds), *The Oxford Handbook of the Welfare State* (2nd edn, Oxford University Press 2021) 494–95.

<sup>98</sup> Leslie Hannah, *Inventing Retirement: The Development of Occupational Pensions in Britain* (Cambridge University Press 1986) 5.

<sup>99</sup> *ibid* 46.

<sup>100</sup> *ibid* 47.

benefits for occupational pension schemes were preserved by the post-war Labour government, though they were further subjected to dense legislative restrictions,<sup>101</sup> again to reduce excessive benefits.<sup>102</sup> Private arrangements grew rapidly in the years after 1948, as the low-level of the BSP, favourable tax arrangements, and tight labour markets encouraged adoption of occupational pensions.<sup>103</sup> Workforce membership increased from 10% in 1942 to almost 29% in 1953.<sup>104</sup>

### **3.1.2 National Superannuation 1.0**

The Beveridgean model of a low value, flat-rate state pension supplemented by occupational pensions and personal savings was quickly challenged. The Labour Party, despite having introduced the post-war reforms, regarded the private sector's central role in pension provision as problematic. Then in opposition, in 1957, Labour announced a policy for National Superannuation,<sup>105</sup> which would have provided a compulsory scheme for earnings-related pensions based on individual contributions. After a transition period, National Superannuation would have been fully funded, as Beveridge originally envisioned for the BSP, and the

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<sup>101</sup> Finance Act 1947 (UK) ss 19–23.

<sup>102</sup> *ibid* s 21(1)(d).

<sup>103</sup> Bozio, Tetlow and Crawford (n 96) 9.

<sup>104</sup> William Beveridge, 'Social Insurance and Allied Services' (1942) 92; Aled Davies, *The City of London and Social Democracy: The Political Economy of Finance in Post-War Britain* (Oxford University Press 2017) 38.

<sup>105</sup> Labour Party, *National Superannuation: Labour's Policy for Security in Old Age* (1957).

funds would have been managed by the state and invested in the stock market.<sup>106</sup> As in a Bismarckian model, National Superannuation involved a degree of redistribution between low- and high-earners and would have been transferable between jobs,<sup>107</sup> unlike most occupational pension schemes that were linked to specific employers. National Superannuation was intended to spread the benefits of earnings-related pensions to the ‘unprivileged majority’ who lacked access to occupational pensions and to therefore reunite ‘two nations in retirement’.<sup>108</sup> The model offered generous pension benefits funded through contributions made by employers, employees, and the state.<sup>109</sup> Opposition to the model was strong. White collar trade unions feared receiving lower-value pensions because of the redistributive character of National Superannuation, while insurers and employers opposed National Superannuation’s replacement of the private arrangements they provided.<sup>110</sup>

National Superannuation would have reshaped the relationship between the British State, markets, and citizens. The state would have controlled a vast pool of capital derived from the funding for National Superannuation, and occupational

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<sup>106</sup> Hugh Pemberton, “‘What Matters Is What Works’: Labour’s Journey from “National Superannuation” to “Personal Accounts”” (2010) 5 *British Politics* 41, 47.

<sup>107</sup> Hugh Pemberton, ‘The Failure of “Nationalization by Attraction”: Britain’s Cross-class Alliance against Earnings-related Pensions in the 1950s’ (2012) 65 *The Economic History Review* 1428, 1431–32.

<sup>108</sup> Labour Party (n 105) 13–16.

<sup>109</sup> Hannah (n 98) 56.

<sup>110</sup> Pemberton (n 107) 1437–39.

arrangements would have been substantially displaced. The scheme, however, would have been relatively legally simple to establish and operate, dealing with three topics: calculation and collection of contributions, the types and payments of benefits, and administration issues. Addressing these matters is quite simple, even as adjustments may be necessary to change the level of contributions or benefits. As will become clear in subsequent sections, establishing and operating a compulsory and comprehensive public social insurance scheme would prove to be less complex than the private pension market building exercise on which the UK government embarked in the 1980s and which continues into the 2020s. The future versions of UK state earnings-related pensions, which permitted opting out to encourage occupational pensions, would also prove far more legally complex than the first attempt at National Superannuation. The possibility of National Superannuation 1.0 underscores the contingency of the legal complexity produced by later attempts to expand and fix private pension markets and highlights how markets can produce greater legal complexity over the long run than state provision, as also observed with respect to relative simplicity of the Canadian pensions scheme discussed in Chapter 1.

### **3.1.3 Graduated retirement benefit**

Labour's plans marked the beginning of a cross-party program of experimentation in which social insurance models for earnings-related pensions were implemented. However, all future models would feature the ability to contract out of the state scheme. In government from 1951–64, the pressure to address the limits of occupational pensions fell on the Conservative Party. The result was a

watered-down model of an earnings-related pension in the National Insurance Act 1959 (UK), known as the graduated retirement benefit (GRB), which commenced in 1961. The GRB permitted employers to contract out of the GRB by providing an occupational pension scheme that met conditions.

Contracting-out rules were a tool for achieving two goals: first, for actively building the private pensions market (because employers were incentivised to establish a scheme and therefore avoid GRB contributions) and, second, to address deficiencies in the private pension market by establishing minimum standards for opting out. The GRB failed to achieve both objectives. Employers generally ignored it,<sup>111</sup> with most occupational pension scheme members remaining in the GRB.<sup>112</sup>

Private pensions were simply layered on top of the BSP and the GRB (rather than contracted-out of the latter). For this reason, and because the contracting-out rules were so lax,<sup>113</sup> the GRB did little to improve scheme standards, which remained a major issue into the 1970s.<sup>114</sup> The design of the GRB, particularly the lack of any annual increase in benefits, quickly made it a minor part of the pension

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<sup>111</sup> Hannah (n 98) 58.

<sup>112</sup> By 1965, 4.66 million employees were out of the GRB, with 14 million contributing to it: 'Report of the Ministry of Pensions and National Insurance for the Year 1965' (1966) Cmnd 3046 [210]. There were 11.1 million employees in occupational schemes in 1963 and 12.7 million in 1967: Francis Green, 'Occupational Pension Schemes and British Capitalism' (1982) 6 Cambridge Journal of Economics 267, 269.

<sup>113</sup> Hannah (n 98) 63.

<sup>114</sup> Secretary of State for Social Services (UK), 'Better Pensions: Fully Protected Against Inflation' (1974) Cmnd 5713 [52].

system that provided no meaningful earnings-related pension. The flat-rate BSP therefore remained the only substantial state pension.

The key point here, however, is that the ‘complicated’ contracting-out rules,<sup>115</sup> spanning dozens of pages of the Act and regulations,<sup>116</sup> were created for the purposes of encouraging private pension adoption and improving the quality of those pensions. They sought to change the incentives for employers and private pension administrators, who often established schemes merely to maximise tax benefits, so that occupational schemes would provide better benefits and improved governance. As the experience of addressing tax abuse had highlighted, dense and technical rules were a side-effect of these efforts, with government seeking to control in detail the circumstances in which contracting out of the GRB was permitted. These reforms were not responding to new technologies or economic relationships. Market deficiencies and the desire to expand market participation motivated the enactment of these complex rules.

### **3.1.4 National Superannuation 2.0**

The Labour Party remained committed to a model more akin to the 1957 proposal for National Superannuation than the GRB.<sup>117</sup> Returned to government in 1964, in 1969 it proposed a more generous and redistributive state earnings-

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<sup>115</sup> Tony Lynes, ‘The National Insurance Act, 1959’ (1960) 23 *Modern Law Review* 52, 55.

<sup>116</sup> National Insurance Act 1959 (UK) ss 7–13; The National Insurance (Graduated Contributions and Non-participating Employments – Miscellaneous Provisions) Regulations 1960 (UK); National Insurance (Nonparticipation–Assurance of Equivalent Pension Benefits) Regulations 1960 (UK).

<sup>117</sup> Department of Health and Social Security, ‘National Superannuation and Social Insurance: Proposals for Earnings-Related Social Security’ (1969) Cmnd. 3883 [7].

related pension, which would have replaced both the BSP and GRB.<sup>118</sup> Unlike 1957, the 1969 model was designed to ‘work in partnership with occupational pensions schemes’.<sup>119</sup> This would be achieved by permitting employers to partially contract out of the state earnings-related pension, resulting in lower contributions and a reduced state pension.<sup>120</sup> The government aimed to preserve private pensions, and preferably increase their use.<sup>121</sup> The Labour Party was now committed to a mixed economy for earnings-related pension provision. The National Superannuation and Social Insurance Bill 1969 (UK), which would have introduced the state earnings-related pension, was a complex piece of legislation. However, much of this complexity came from the contracting-out arrangements. The entirety of Part III of the Bill dealt with contracting out, covering 17 pages, with regulations providing further details. The core provisions for the state scheme in Parts II and III, covering contributions and benefits, were relatively simple when considering that they covered nine benefits other than the retirement pension.

The complexity of the new model of National Superannuation was again principally the result of using contracting-out rules to actively expand private pensions while addressing market deficiencies. Contracting out was strongly incentivised for white collar employees because the state scheme was designed progressively,

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<sup>118</sup> *ibid* [3]–[4].

<sup>119</sup> Department of Health and Social Security, ‘National Superannuation: Terms for Partial Contracting out of the National Superannuation Scheme’ (1969) Cmnd 4195 [1].

<sup>120</sup> *ibid* [3].

<sup>121</sup> *ibid* [25].

with higher earners paying more in contributions that they would receive in benefits.<sup>122</sup> The contracting-out rules also targeted long-standing market deficiencies like employers excessively lending scheme funds to themselves and not increasing pensionable benefits over time.<sup>123</sup> The contracting-out rules also preserved the minimal prudential standards that applied to contracting out of the GRB.<sup>124</sup> The Bill ultimately went unlegislated when Labour lost government in 1970.

### **3.1.5 The death of GRB and the brief life of reserve pensions**

The GRB was repealed in 1973 by the new Conservative government. The government committed to a ‘new relationship’ between the state and occupational pension providers.<sup>125</sup> The state would primarily provide the flat-rate BSP while occupational pension schemes delivered earnings-related pensions.<sup>126</sup> Cognisant that some people would remain uncovered by an occupational scheme, the government proposed a defined contribution state ‘reserve pension scheme’.<sup>127</sup> This scheme would provide a limited earnings-related pension based on mandatory earnings-related contributions, but it was hoped that most employees

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<sup>122</sup> This was the effect of tapering benefits once annual earnings exceeded a ‘specified sum’ and the design of contribution arrangements, which were uncapped for employers: National Superannuation and Social Insurance Bill (UK) 1969 s 1(1), (3), s 21(2)(b).

<sup>123</sup> *ibid* ss 51(2)(c)–(d).

<sup>124</sup> *ibid* s 51(2)(b).

<sup>125</sup> Secretary of State of the Department of Health and Social Security (UK), ‘Strategy for Pensions: The Future Development of State and Occupational Pensions’ (1971) Cmnd 4755 3.

<sup>126</sup> *ibid* [9].

<sup>127</sup> *ibid* [71]; Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) [11].

would contract out of the state scheme. Reserve pensions were ‘in no way intended as a rival to occupational schemes or a substitute for their expansion’.<sup>128</sup> By then, that expansion had largely stalled, with 45% of employees in an occupational scheme in 1971, the same figure as in 1963.<sup>129</sup> The reserve pension scheme was legislated but never commenced because the Labour Party won government in 1974.<sup>130</sup> The reserve pension model offered significant potential for expanding the markets in occupational pensions, which was one of the government’s ‘prime purposes’ in legislating.<sup>131</sup> Due to its high NI contribution reductions, incentives for contracting out of the state scheme and establishing an occupational scheme were substantial.<sup>132</sup> Complex contracting-out rules aimed at addressing market deficiencies were also a feature of the law, but these requirements were ‘absurdly low’ and would not have generated significant improvements.<sup>133</sup> The desire to move away from the state as a provider and competitor that could use contracting-out requirements to push better standards led to the early development of a basic regulatory system for occupational schemes, supervised by a new Occupational Pensions Board. The Board was given

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<sup>128</sup> Secretary of State of the Department of Health and Social Security (UK) (n 125) [28].

<sup>129</sup> Hannah (n 98) 63.

<sup>130</sup> Social Security Act 1973 (UK) pt III.

<sup>131</sup> Secretary of State of the Department of Health and Social Security (UK) (n 125) [25].

<sup>132</sup> Social Security Act 1973 s 77(3).

<sup>133</sup> Dryden Gilling-Smith, ‘Occupational Pensions and the Social Security Act 1973’ (1973) 2 *Industrial Law Journal* 197, 208.

powers to supervise schemes, including modifying or winding them up.<sup>134</sup> The Board survived the repeal of reserve pensions and gradually took on greater importance.

### **3.1.6 The state earnings-related pension scheme**

The new Labour government attempted for a third time to legislate a ‘National Superannuation’ model of earnings-related pensions. The state earnings-related pension scheme (SERPS) was introduced in the Social Security Pensions Act 1975 (UK) (SSP Act 1975). Unlike the 1969 National Superannuation reforms, SERPS would co-exist with the BSP. But, like in the 1969 Labour reforms and 1973 Conservative reforms, occupational pensions were regarded as ‘partners’ to the state in achieving improved retirement outcomes.<sup>135</sup> The contracting-out requirements were unprecedentedly exacting,<sup>136</sup> reflecting the government’s principal focus on addressing market deficiencies rather than expanding private pension participation.<sup>137</sup> Contracted-out schemes were obligated to offer a ‘guaranteed minimum pension’ (GMP),<sup>138</sup> which had to be

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<sup>134</sup> Social Security Act 1973 s 64.

<sup>135</sup> Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) [50].

<sup>136</sup> Social Security Pensions Act 1975 (UK) ss 33–41.

<sup>137</sup> Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) [73].

<sup>138</sup> SSP Act 1975 s 35.

defined benefit and adjusted to account for economy-wide earnings increases.<sup>139</sup> The inflation of the 1970s made this latter requirement costly to comply with, and the government promised financial support to help occupational schemes meet the contracting-out requirements.<sup>140</sup> This, in addition to the substantial reduction in contributions if an employer contracted out, dramatically increased contracting-out levels. By 1979, almost 90% of occupational pension scheme members had contracted out of SERPS,<sup>141</sup> compared to fewer than 50% opting out of the GRB in 1965. Nonetheless, workforce penetration of occupational pensions was potentially reaching its limits. Combined public and private sector membership was just two percentage points higher in 1979 (47%) compared to 1971 (45%), and membership in private sector schemes had declined significantly since 1967.<sup>142</sup> However, SERPS only commenced in 1979, the year the Thatcher government was elected.

SERPS highlights how persistent market deficiencies continued to generate pressure for law reform and resulting legal complexity. SERPS was the third major legislative reform affecting occupational pensions since 1969. Its extensive contracting-out rules, which accounted for almost half of the Act's 80 substantive

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<sup>139</sup> *ibid* ss 21, 34, 35(2), (5). Though see Pemberton's criticism of the low pension required under the GMP: Pemberton (n 106) 51.

<sup>140</sup> Bryan Ellis, *Pensions in Britain, 1955–1975: A History in Five Acts* (HMSO 1989) 53; Hannah (n 98) 62.

<sup>141</sup> Hannah (n 98) 62, fn 56, citing Government Actuary, *Occupational Pension Schemes: 1979: Sixth Survey* (1981) 5.

<sup>142</sup> *ibid* 67.

pages,<sup>143</sup> were ‘very complex’<sup>144</sup> and administratively burdensome for firms,<sup>145</sup> though the government argued the rules were as simple as possible.<sup>146</sup> This complexity came from the government’s desire to leverage the possibility of contracting out, and the resulting financial benefits of doing so, to counteract the market deficiencies produced by employers’ profit motive, which often drove poor benefits and scheme governance. Dense and technical contracting-out rules were the result.

The pressure to address market deficiencies was profound and contributed to a transformation in government’s attitude towards regulation of private pensions.<sup>147</sup> Under SERPS, the Occupational Pensions Board was given a central role in approving contracted-out schemes and supervising compliance with contracting-out requirements.<sup>148</sup> For the first time, government also regulated schemes regardless of whether they were contracted out of the state scheme, seeking to improve occupational schemes generally.<sup>149</sup> Thus, the legislation

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<sup>143</sup> SSP Act 1975 pts III, IV, sch 2.

<sup>144</sup> Department for Work and Pensions (UK), ‘The New State Pension Transition and Contracting-out: Fact Sheet’ (2021) 2 <<https://www.gov.uk/government/publications/new-state-pension-if-youve-been-contracted-out-of-additional-state-pension/the-new-state-pension-transition-and-contracting-out-fact-sheet>>.

<sup>145</sup> Hannah (n 98) 62.

<sup>146</sup> Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) iii.

<sup>147</sup> Hannah (n 98) 63.

<sup>148</sup> SSP Act 1975 ss 31, 32, 49, 50.

<sup>149</sup> Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) [74]–[81].

imposed equal access obligations and employees could complain to the Board where the access rules of a scheme discriminated between men and women.<sup>150</sup>

Market deficiencies, particularly related to the persistence of discriminatory scheme rules for men and women, had produced pressure for law reform and novel attempts to control the behaviour of all occupational pension schemes. The density and technicality of legal rules was increasing substantially, with new conduct being regulated (e.g. access requirements) and existing conduct regulated with finer degrees of control (e.g. detailed rules for the GMP).

### **3.2 The personal pensions revolution**

The Thatcher government inaugurated a period of sustained legislative activity to expand ownership of private pensions and to transform private pension provision. The market building framework helps illuminate these dynamics and how they generated significant legal complexity. In particular, the legal complexity produced in this period was principally the result of government using law to encourage or mandate participation in private pensions markets, and in specific forms of private pensions. This directly produced legal complexity, but also created market structures that were to generate problems in future, requiring further law reform. Where participation was threatened by market deficiencies, the government also proved willing to regulate private pension schemes directly, rather than through contracting-out requirements. Finally, this period contributed to legal complexity

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<sup>150</sup> SSP Act 1975 s 55.

over the longer term, as legally simpler state provision was gradually undermined in favour of private pensions.

The Thatcher government moved quickly to reduce the benefits provided by SERPS and the BSP. It did so by abolishing the link between state pension payments and earnings, providing that only prices would be considered when increasing payments.<sup>151</sup> This undermined the possibility that earnings-related pension provision would be a state responsibility.<sup>152</sup> How could SERPS promise earnings-preservation if it was not in fact linked to earnings? Policy entrepreneurs sought more expansive state action to transform the pension system, advocating the gradual abolition of occupational pensions and their replacement with defined contribution personal pensions, which would sit alongside the basic state pension.<sup>153</sup> SERPS would be abolished. This model appealed to the Thatcher government, which had grown suspicious of the collectivist model of occupational pensions and the lack of individual responsibility for contributions and investments. Advocates of personal pensions, including in the No 10 Policy Unit, were keen to embed private pensions more deeply in personal property rights rather than the employment relationship, trust law, and general legislation.<sup>154</sup>

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<sup>151</sup> Social Security Act 1980 (UK) s 1(1).

<sup>152</sup> Craig Berry, *Pensions Imperilled: The Political Economy of Private Pensions Provision in the UK* (Oxford University Press 2021) 50.

<sup>153</sup> Centre for Policy Studies, 'Personal and Portable Pensions - For All' (1983) 2.

<sup>154</sup> Hannah (n 98) 141–42.

In 1983, the government launched an Inquiry led by Norman Fowler, the Secretary of State for Social Services. Strongly encouraged by the No 10 Policy Unit,<sup>155</sup> the Fowler Inquiry's 1985 Green Paper set out 'in a radically different direction from some of the developments over the last forty years',<sup>156</sup> specifically the moves since the 1950s to introduce state provision of earnings-related pensions. The government's willingness to use its legislative powers to transform the private pensions market was clear in the Green Paper. Most radically, the Inquiry proposed that employees would be required to contribute to an occupational or personal pension,<sup>157</sup> with SERPS phased-out for most employees.<sup>158</sup> The reforms were intended to ensure that the state was no longer 'in competition' with private pensions;<sup>159</sup> individuals could only rely on the market for earnings-related pensions. The Green Paper's model, which was to be introduced in Australia in 1992, faced immediate and 'explosive' backlash in the UK.<sup>160</sup>

The criticisms made of the Green Paper's proposals provide a prescient insight into the market deficiencies that would generate ongoing pressure for law reform. Many lobby groups, including the Confederation of British Industry,

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<sup>155</sup> Aled Davies, James Freeman and Hugh Pemberton, 'Thatcher's Policy Unit and the "Neoliberal Vision"' (2023) 62 *Journal of British Studies* 77, 94.

<sup>156</sup> Secretary of State for Social Services (UK), 'Reform of Social Security' (1985) Cmnd 9517 [1.15].

<sup>157</sup> *ibid* [7.15].

<sup>158</sup> *ibid* [7.14].

<sup>159</sup> *ibid* [7.19].

<sup>160</sup> Davies, Freeman and Pemberton (n 155) 98.

recognised the risks in requiring individuals to manage their newly created investment portfolios.<sup>161</sup> The Society of Pensions Consultants noted that ‘disintermediation’ through the widespread adoption of personal pensions ‘unrealistically assumed adequate investment skills among workers’.<sup>162</sup> Personal pensions would be defined contribution and managed by an employee rather than employer. A person’s retirement income would therefore depend on them making long-term judgements about the appropriate savings rate and their investment portfolio, decisions about which many people knew or cared little. The British Insurance Brokers’ Association recognised individuals’ apathy about retirement savings, arguing that legislative ‘compulsion’ would be needed to ensure individuals saved sufficiently.<sup>163</sup> The move to personal pensions would also require individuals to effectively supervise the financial services firms investing their savings. In the context of defined benefit occupational pensions, pension scheme-related investment risks in practice fell on shareholders, because employers were liable for the solvency of their occupational pension schemes and the promises they made to employees. Employer trustees therefore had a strong incentive to ensure effective pension scheme governance. For the millions of individuals who were planning their retirement based on SERPS, they bore no investment risk and made compulsory NI contributions. A system of defined contribution personal pensions would require extensive state intervention to function in a way that

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<sup>161</sup> *ibid* 96.

<sup>162</sup> *ibid*.

<sup>163</sup> *ibid* 96–97.

encouraged individuals to save and ensured politically defensible retirement outcomes.

These criticisms bore relatively little weight with a government ideologically committed to ‘giving greater freedom and choice to individuals’.<sup>164</sup> The resistance of the financial services sector, along with employer concerns that they would be left providing pensions after the demise of SERPS, proved more decisive. Financial services firms rejected compelling ownership of personal pensions because they concluded the administration costs of managing low-paid employees’ small pots of money would make the business ‘inherently loss-making’.<sup>165</sup> The government was forced to adjust its proposals, releasing a White Paper in December 1985 with legislation enacting the Paper in 1986. While the government committed to keeping a trimmed-down SERPS,<sup>166</sup> its ‘central aim remain[ed] to see an extension of individual pension provision’.<sup>167</sup> The complex legislative programme implemented between 1986 and 1989 reflected this vision, establishing a range of new savings vehicles and encouraging their adoption.

The provisions creating personal pensions are emblematic of the legal complexity generated by the Thatcher government’s efforts at market expansion. The provisions in the Social Security Act 1986 (UK) establishing the new legal

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<sup>164</sup> Secretary of State for Social Services (UK), ‘Reform of Social Security’ (n 156) [7.22].

<sup>165</sup> Davies, Freeman and Pemberton (n 155) 98–99.

<sup>166</sup> Secretary of State for Social Services (UK), ‘Reform of Social Security: Programme for Action’ (1985) Cmnd 9691 [1.16].

<sup>167</sup> *ibid* [1.18].

concept of ‘personal pensions’ and permitting their contracting out of SERPS accounted for almost 4,000 words and conservatively contained more than 50 discretions to make delegated legislation.<sup>168</sup> The personal pension taxation provisions comprised a further 7,000 words and dozens of discretions,<sup>169</sup> growing quickly afterwards.<sup>170</sup> The government was given extensive powers to determine the terms on which personal pensions could be established and to regulate the payment of pension benefits by a personal pension scheme.<sup>171</sup> Broadly replicating its role with respect to occupational pensions, the Board of Inland Revenue was given extensive powers to determine the circumstances in which personal pensions could obtain tax concessions.<sup>172</sup> Thatcher’s introduction of personal pensions, and the legal complexity this produced, should underscore the limits of the ‘law reflects reality’ thesis, with no fundamental changes in society and the economy necessitating the legal change.

The Social Security Act 1986 (UK) introduced other changes in implementing the government vision of a transformed private pensions market. Section 15 of the Act prohibited employers from requiring membership of an occupational or personal pension scheme. This reflected the government’s interest in individualising pension provision, and contributed to the subsequent

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<sup>168</sup> Social Security Act 1986 (UK) ss 1–5, sch 1.

<sup>169</sup> Income and Corporation Taxes Act 1988 (UK) pt XIV ch IV.

<sup>170</sup> Finance Act 1989 (UK) sch 7.

<sup>171</sup> Social Security Act 1986 sch 1.

<sup>172</sup> Income and Corporation Taxes Act 1988 (UK) ss 631–638.

decline of occupational pensions, with fewer than 50% of employees joining their employers' scheme.<sup>173</sup> It also reflected the Thatcher government's willingness to use legislative power to intervene in arrangements between employers, trade unions, and employees. This was what Gamble called Thatcher's project of 'the Free Economy and the Strong State', committed to using 'the powers of the state to confront those groups that resisted' the expansion of markets and market values beyond their existing limits.<sup>174</sup> Thence, the Social Security Act 1986 (UK) required that scheme sponsors allow voluntary contributions of any amount.<sup>175</sup> The role of employers and unions in designing pension arrangements was significantly undermined by the cumulative effect of these changes.

Although it had agreed to preserve SERPS, the government nonetheless sought to undermine it, and the Social Security Act 1986 (UK) substantially reduced the pension provided by SERPS while preserving the level of NI contributions.<sup>176</sup> This had the immediate effect of potentially making it more attractive to contract out of the state scheme for younger employees, and of reducing the minimum benefits required for a private pension.<sup>177</sup> The Act also permitted employers to contract out of SERPS by establishing defined contribution occupational pension

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<sup>173</sup> David Blake, 'Two Decades of Pension Reform in the UK: What Are the Implications for Occupational Pension Schemes?' (2000) 22 *Employee Relations* 223, 227.

<sup>174</sup> Andrew Gamble, *The Free Economy and the Strong State* (Macmillan Education UK 1994) 7.

<sup>175</sup> Social Security Act 1986 s 12.

<sup>176</sup> *ibid* s 18.

<sup>177</sup> *ibid* s 9.

schemes.<sup>178</sup> Previously, employers could only contract out by establishing a defined benefit scheme. As already noted, employees could also opt-out of SERPS by acquiring a personal pension. In doing so, they obtained financial benefits in the form of reduced NI contributions. Finally, in 1989, the government established SIPPs, the first pension vehicle through which employees could directly manage their pension assets while receiving favourable tax treatment. The purpose of these various provisions was to roll-back the boundaries of state pensions and simultaneously expand the scope of market provision, both through the government's favoured vehicle of personal pensions and the less favoured option of occupational pensions.

The reforms contained in the Social Security Act 1986 (UK) represented the Thatcher government's principal instrument for expanding and transforming the private pensions market in the UK while simultaneously cutting back state provision. However, the government appeared to recognise that market expansion would have little success if the risks posed by the personal pension market were perceived as excessive for individuals. The introduction of an investor protection regime was therefore understood as core to 'encouraging' the adoption of private pensions.<sup>179</sup> This regime came with the enactment of the Financial Services Act 1986 (UK). The government stressed that, as legislated in the Social Security Act 1986 (UK), all personal pension schemes would need to be approved by the

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<sup>178</sup> *ibid* s 6, sch 2.

<sup>179</sup> Secretary of State for Social Services (UK), 'Reform of Social Security: Programme for Action' (n 166) [2.42].

Occupational Pensions Board.<sup>180</sup> The concurrent legislative attempts at market expansion and market maintenance reflect the important role of the voting public in market building dynamics. Politicians favouring market expansion generally recognise that the political defensibility of these markets, such as for personal pensions, requires that there be systems to address market deficiencies.

The Thatcher government's attempt to grow and transform the private pensions market generated, particularly in the Social Security Act 1986 (UK), a complex body of law, recognised as such at the time.<sup>181</sup> This legal complexity cannot be understood principally as a product of inexorable changes in the society and the economy or the self-interest of a bureaucracy that was generally opposed to the government's more radical inclinations.<sup>182</sup> It is inherent in the constitutive nature of the law to private pension markets and in the project of market construction undertaken by the Thatcher government. Achieving its objectives, which were motivated by a particular vision of Britain's political economy, required using complex legislative reforms. This was a political economy in which state pension provision was reduced, institutional investors were replaced by small shareholders, and individuals bore personal responsibility for their financial wellbeing. Transforming the provision of earnings-related pensions in the ways intended required substantial legal complexity.

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<sup>180</sup> *ibid* [2.44].

<sup>181</sup> John Creedy and Richard Disney, 'The New Pension Scheme in Britain' (1988) 9 *Fiscal Studies* 57, 64.

<sup>182</sup> Davies, Freeman and Pemberton (n 155) 97, 92.

Just as importantly to understanding legal complexity over the long term, the market that the Thatcher government did so much to build through its legislative action was to prove deeply flawed, producing a steady stream of scandals, scepticism of private pensions, and public demand for reform. These market flaws included extensive reliance on individual responsibility and the existence of widespread conflicts of interest, particularly on the part of for-profit personal pension schemes and their promoters. The consequences of conflicts of interest and optimistic assumptions about individual financial acumen would become quickly clear in the aggressive selling of personal pensions to people who would have been better off joining or remaining in an occupational pension. Compensation for this mis-selling ultimately cost insurers and financial advisers over £13 billion,<sup>183</sup> with many of the five million personal pensions acquired between 1988 and 1994 sold inappropriately.<sup>184</sup> The government's pension reforms left individuals to choose between a range of pension products and strategies, even as polling showed minimal understanding of the private pension system and social security more generally.<sup>185</sup>

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<sup>183</sup> Rupert Jones, 'Mis-selling bill tops £13bn' *The Guardian* (2 December 2000) <<https://www.theguardian.com/money/2000/dec/02/personalfinancenews.business>>.

<sup>184</sup> House of Commons Select Committee on Treasury, 'The Mis-Selling of Personal Pensions' (1998) Report 9 [1] <<https://publications.parliament.uk/pa/cm199798/cmselect/cmtreasy/712/71203.htm>>.

<sup>185</sup> Creedy and Disney (n 181) 63–64.

### **3.3 The market rules: New Labour and the end of SERPS (1999–2002)**

Changing relationships between the state and markets would again play a pivotal role in the project of legislative market expansion of private pensions undertaken by the New Labour government elected in 1997. The new government produced vast amounts of complex laws as it sought to increase the adoption of private pensions and address market deficiencies such as high costs and poor governance, while simultaneously dismantling SERPS. The latter move had crucial consequences for the future direction of UK pensions policy, removing the government's ability to shape market outcomes as a competitor, leaving it with only the tool of legislation to shape market outcomes.

#### **3.3.1 New savings vehicles: stakeholder pensions**

The New Labour government was committed to the expansion of private pensions, particularly to lower-income employees.<sup>186</sup> Although it talked about a 'partnership' between the public and private sectors,<sup>187</sup> the government's reforms reflected the end of the SERPS-private pensions partnership that had survived even the Thatcher government.<sup>188</sup> Having expressly rejected the possibility of moving to a

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<sup>186</sup> Secretary of State for Social Security (UK), 'A New Contract for Welfare: Partnership in Pensions' (1998) Cm 4179 23–24, 26.

<sup>187</sup> *ibid* 47.

<sup>188</sup> Deborah Cooper, 'A New Contract for Welfare: Partnership in Pensions' (1999) 19 *Economic Affairs* 3, 5.

comprehensive system of state earnings-related provision,<sup>189</sup> the Blair government legislated to convert SERPS into the state second pension (S2P) in 2002,<sup>190</sup> which in turn was converted into a flat-rate supplement to the BSP in April 2007. Employees seeking an earnings-related supplementary pension now were required to use private options. Indeed, because NI contributions to the S2P were earnings-related, and it remained possible to contract out of the S2P, the reforms strongly incentivised joining a private pension.<sup>191</sup> Policy entrepreneurs had pushed for the expansion of private provision, including the National Association of Pension Funds and the Institute for Fiscal Studies.<sup>192</sup> The World Bank had also advocated for state provision to focus on lower income pensioners, with expanded private provision covering other savers.<sup>193</sup> The government's proposals mapped closely onto the model pushed by the World Bank, with state provision aimed at those earning less than £9,000.<sup>194</sup>

The government recognised that existing private pension arrangements were failing to generate broader acceptance. Occupational pensions were in decline and not available to all employees, while the high costs of existing personal

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<sup>189</sup> Secretary of State for Social Security (UK) (n 186) 29–30.

<sup>190</sup> Child Support, Pensions and Social Security Act 2000 (UK).

<sup>191</sup> Blake (n 173) 229.

<sup>192</sup> John Macnicol, *Neoliberalising Old Age* (Cambridge University Press 2015) 57.

<sup>193</sup> *ibid*; World Bank Group, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (Oxford University Press 1994).

<sup>194</sup> Secretary of State for Social Security (UK) (n 186) 23.

pensions made them unsuitable for many people.<sup>195</sup> The government also concluded that ‘the Maxwell affair and the mis-selling of personal pensions’ required a new private pension savings vehicle to rebuild trust.<sup>196</sup> Stakeholder pension schemes were New Labour’s answer to these problems, aiming at creating a scheme that could drive wider adoption of private pensions.<sup>197</sup> Market (re)construction, with law as the vehicle, was the way forward.

Stakeholder pension schemes were created by the Welfare Reform and Pensions Act 1999 (UK) (WRP Act 1999), Part I of which created a legislative architecture for these schemes. The Act required stakeholder pensions to meet various conditions and be registered with the Occupational Pensions Regulatory Authority.<sup>198</sup> However, details were vague, with the government insisting that the schemes would need ‘adaptation’ and that this justified setting out ‘many matters of detail ... in secondary legislation’.<sup>199</sup> Conditions in the Act included requirements that stakeholder pensions be defined contribution, with members able to start and stop contributions as wished and permitted to freely transfer balances in and out of stakeholder pension schemes.<sup>200</sup> This represented a particularly market-oriented system, aimed at producing competitive dynamics in which balances

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<sup>195</sup> *ibid* 48.

<sup>196</sup> *ibid* 27.

<sup>197</sup> Cooper (n 188) 6.

<sup>198</sup> Welfare Reform and Pensions Act 1999 (UK) ss 1–2.

<sup>199</sup> Explanatory Notes, Welfare Reform and Pensions Act 1999 (UK) 3.

<sup>200</sup> WRP Act 1999 ss 4, 7–8.

could be moved between funds, at the cost of greater operating expenses for funds.<sup>201</sup> The move to defined contribution increased the likelihood of greater legal complexity in future, as individuals facing investment risk would demand greater state intervention. The Act enrolled employers by imposing a duty that they facilitate access to stakeholder pension schemes,<sup>202</sup> including by offering at least one stakeholder scheme to employees. Overall, stakeholder schemes were a new savings vehicle that overlapped with but did not replace occupational pension schemes and pre-existing personal pension schemes.

Substantial legal complexity was a side effect of the effort to create a new, higher standard private pension scheme. The Stakeholder Pension Schemes Regulations 2000 imposed dozens of conditions on stakeholder pensions, spread across over 13,400 words. The Regulations cross-referenced ten other Acts and regulations to apply dozens of other rules to stakeholder pensions,<sup>203</sup> to be treated as occupational pensions for this purpose. This complexity was compounded by the government's decision to allow stakeholder pension schemes established either under a trust or some other contractual arrangement, resulting in varying rules for each structure.<sup>204</sup> The regulations created prescriptive and technical obligations with respect to investment arrangements, fees and costs, member

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<sup>201</sup> Cooper (n 188) 6.

<sup>202</sup> WRP Act 1999 s 3.

<sup>203</sup> Stakeholder Pension Schemes Regulations 2000 (UK) reg 19, sch 2.

<sup>204</sup> *ibid* regs 4–5, 9–11.

disclosure, and the requirement for employers to facilitate access to stakeholder pensions. Prescription as to employer obligations spanned over 2,000 words. The legislative requirements for stakeholder pension schemes, and the arrangements for employers to offer them, were intended to produce a new private pension scheme that would reduce the costs and barriers to membership inherent in existing arrangements.<sup>205</sup> Dense and technical rules sought to improve scheme governance and reduce scheme costs. The continued presence of for-profit and non-trust schemes made changing incentives particularly challenging and pushed the government towards more detailed controls. For example, the charging restrictions were highly prescriptive, capping charges at 1% and prescribing in detail the circumstances in which members could be charged,<sup>206</sup> reflecting concerns that firms would circumvent the obligations. Numerous pension firms were highly critical of these provisions, and of the stakeholder pension scheme legislation more generally,<sup>207</sup> but the reforms appeared to reduce charges.<sup>208</sup> Amid industry lobbying (the Association of British Insurers called for a 2% cap)<sup>209</sup> and

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<sup>205</sup> Secretary of State for Social Security (UK) (n 186) 51–52; Cooper (n 188) 8.

<sup>206</sup> Stakeholder Pension Schemes Regulations 2000 reg 14.

<sup>207</sup> James F Devlin, ‘A Report for HM Treasury: Literature Review on Lessons Learned from Previous “Simple Products” Initiatives’ 20–21.

<sup>208</sup> Department for Work and Pensions (UK), ‘Personal Accounts: A New Way to Save’ (2006) Cm 6975 15.

<sup>209</sup> David White, ‘Sandler Review: Market Not Working’ *IPE Magazine* (November 2002) <<https://www.ipe.com/sandler-review-market-not-working/15530.article>>.

concerns about low adoption of stakeholder pensions in the early 2000s,<sup>210</sup> the cap was increased and further tailored. These reforms, in 2005, resulted in further complexity, with the rules limiting charges almost doubling in length.<sup>211</sup> As will also be clear in the Australian case study, managing high fees and charges was a challenge generating ever increasing legislative entanglement, with the profit motive acting as a powerful countervailing force in favour of higher costs.

Overall, the stakeholder pension interventions illustrate the dynamic of perceived market deficiencies driving legal complexity. It is emblematic of the dynamic that Lord Turner observed in 2005, that repeated failed attempts to make often costly and inappropriate private pensions work for all employees had ‘drawn the government into a series of attempts to influence the cost and integrity of selling via increased regulation, but at the cost of further complexity.’<sup>212</sup>

### **3.3.2 Automatic enrolment in occupational pensions in the UK**

Despite the effort to expand private pensions through stakeholder pension schemes and the dismantling of the state option, membership continued to decline. The number of active members in occupational schemes fell from 10.1 million in 2000 to 8.8 million in 2007, with membership in defined contribution occupational schemes (many of which were stakeholder schemes) hovering around 1 million between 2004 (when data was first collected) and 2012. Personal

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<sup>210</sup> Explanatory Memorandum, Stakeholder Pension Schemes (Amendment) Regulations 2005 (Cth) [28].

<sup>211</sup> Stakeholder Pension Schemes (Amendment) Regulations 2005 (UK) reg 7.

<sup>212</sup> Pensions Commission (UK), ‘A New Pension Settlement for the Twenty-First Century’ (2005) 28.

pensions remained uneconomic for millions of people, with costs of 1.3% or more for many employees.<sup>213</sup> These trends underscored the failure of stakeholder pension schemes and the employer notification requirements in the WRP Act 1999 to drive further market expansion. The Blair government therefore established the Pensions Commission, headed by Lord Turner, to consider the functioning of the existing pension system and the possibility of compulsory private pensions.<sup>214</sup> The Pensions Commission recommended the establishment of a National Pensions Saving Scheme (NPSS), a state-run, fully funded defined contribution scheme in which individuals would have personal accounts. This marked a dramatic change in the potential political economy of earnings-related pensions provision in the UK.

The NPSS recommendation also helps enrich our understanding of legal complexity and market building. First, the NPSS offered the potential to end the repeated attempts at market expansion. Under the new proposals, the NPSS would be the default pensions savings vehicle for most employees, with a default contribution rate of 8%.<sup>215</sup> Evidence from behavioural science indicated that most people would not default out, thereby ensuring for the first time the widespread adoption of defined contribution personal pensions. Crucially, contributions would be collected through existing tax arrangements for payroll deductions, obviating the kind of complex provisions seen in previous market expansions

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<sup>213</sup> *ibid* 110–111.

<sup>214</sup> *ibid* ix.

<sup>215</sup> *ibid* 36.

where regulations established private collection arrangements (such as in the WRP Act 1999) and sought to regulate to minimise collection costs. The benefits of the NPSS would be limited by a proposed cap on contributions of £3,000 and limits on transferring private pensions into the NPSS,<sup>216</sup> leading people to save more into private arrangements. Although not a compulsory system like that found in Australia, the NPSS default arrangements may have ended the cycle of market expansion producing ever greater volumes of legal complexity.

More importantly for understanding the dynamics of legal complexity, the creation of the NPSS offered an opportunity to break the cycle, observed by Turner,<sup>217</sup> of the state repeatedly seeking to reduce the costs and risks of private pensions through ever growing regulation and consequential legal complexity. The NPSS would act as a low-cost competitor into which pensions savings would be defaulted and into which additional voluntary savings could be deposited. The Pensions Commission estimated the NPSS could run with member costs of about 0.3%, compared with far higher costs for occupational and personal pensions. The competitive potential of the NPSS offered an alternative to ‘more regulation of selling processes and prices’,<sup>218</sup> and also to the growing regulation of investment choices. The NPSS would largely handle investment arrangements for its members, even where those investment arrangements were outsourced to the

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<sup>216</sup> *ibid* 36, 360.

<sup>217</sup> *ibid* 28.

<sup>218</sup> *ibid*.

private sector.<sup>219</sup> Private schemes would be left with more sophisticated members willing and able to more directly supervise investment of their private pensions. The possibility of the NPSS therefore highlights how non-market and particularly state provision can generate substantially less legal complexity than market provision, as examined in Chapter 1.

Ultimately, the NPSS was not implemented as recommended. For some commentators, it was the abandonment of the innovative private sector and ‘nationalisation’.<sup>220</sup> As the Director of the Association of British Insurers argued after publication of the Pensions Commission’s report, the ‘private sector can do it’.<sup>221</sup> A combination of industry lobbying and New Labour scepticism, dating from before the publication of the Pension Commission’s final report, killed the NPSS.<sup>222</sup> Instead, the government embarked again on a complex legal exercise of market expansion through the introduction of automatic enrolment into private pensions. This was shaped by policy entrepreneurs in the pension industry, whom the government had tasked with ‘coming up with a workable alternative’ to the NPSS.<sup>223</sup> These alternatives repeatedly failed to convince the Department for Work and

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<sup>219</sup> Department for Work and Pensions (UK), ‘Security in Retirement: Towards a New Pensions System’ (2006) Cm 6841 [1.51].

<sup>220</sup> Gordon L Clark, ‘The UK Occupational Pension System in Crisis’ in Hugh Pemberton, Pat Thane and Noel Whiteside (eds), *Britain’s Pensions Crisis* (British Academy 2006) 146; Martin Wolf, ‘A Challenge for the Savings Industry’ *Financial Times* (2 December 2005) 19.

<sup>221</sup> Stephen Haddrill, ‘The Private Sector Can Do It’ *Financial Times* (1 December 2005) 21.

<sup>222</sup> Pemberton (n 106) 54.

<sup>223</sup> Department for Work and Pensions (UK), ‘Personal Accounts: A New Way to Save’ (n 208) [2.5].

Pensions, which committed to the NPSS in December 2006, apparently with Blair's support.<sup>224</sup> Ultimately, however, the Pensions Act 2008 did not implement the Pensions Commission system. Instead, the Act introduced complex arrangements for employers to automatically enrol most employees who were not already members of a 'qualifying scheme' into an 'automatic enrolment scheme'. These schemes included various private schemes and, ultimately, a state scheme established under Part 1 Chapter 5 and Schedule 1 of the Act, which became the National Employment Savings Trust (NEST).<sup>225</sup> The involvement of private schemes once more necessitated substantial legal complexity.<sup>226</sup> The core provisions establishing automatic enrolment, excluding arrangements for the state scheme, spanned 66 sections and over 14,000 words.<sup>227</sup> Related delegated legislation spanned a further 50 regulations and 12,000 words<sup>228</sup>. As observed by a government report in 2010, the introduction of automatic enrolment had produced many 'detailed regulations', creating 'a potentially high regulatory burden on the smallest employers'.<sup>229</sup> Again, the creation of a complex legal architecture for automatic enrolment into private pensions cannot be explained through a 'law reflects reality' account: it reflected a particular political economy, in which the

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<sup>224</sup> *ibid* 5, [2.12], [2.25].

<sup>225</sup> Paul Johnson, Abrian Boulding and David Yeandle, 'Making Automatic Enrolment Work: A Review for the Department of Work and Pensions' (2010) Cm 7954 18–19.

<sup>226</sup> Pensions Act 2008 (UK) ss 16–28.

<sup>227</sup> *ibid* pt 1 chs 1–4.

<sup>228</sup> Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 (UK).

<sup>229</sup> Johnson, Boulding and Yeandle (n 225).

government used law to expand market relations, using employers to enrol employees into the private pensions market.

### **3.3.3 Looking forward: persistent market deficiencies**

Automatic enrolment was launched in 2012. Since then, legal complexity has continued to accrue as governments have sought to address problems related to pension scheme governance and charges, and limited consumer understanding and engagement with the private pension market. For example, between 2013 and 2015, the Conservative and Liberal Democrat coalition government launched multiple consultations and reports on addressing high charges and poor standards among schemes involved in automatic enrolment,<sup>230</sup> responding to evidence from regulators and reviews.<sup>231</sup> This resulted in the Pensions Act 2014, which provided for extensive amendments in relation to private pensions,<sup>232</sup> including a new legislative framework for the government to make delegated legislation restricting fees and charges and regulating scheme administration and governance.<sup>233</sup> The regulations spanned over 11,000 words and detailed the permitted charging structures for automatic enrolment schemes, including by capping them at

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<sup>230</sup> Department for Work and Pensions (UK), 'Better Working Pensions: A Consultation on Charging' (2013) Cm 8737; Department for Work and Pensions (UK), 'Quality Standards in Workplace Defined Contribution Pension Schemes' (2013); Department for Work and Pensions (UK), 'Better Workplace Pensions: Further Measures for Savers' (2014) Cm 8840; Department for Work and Pensions (UK), 'Better Workplace Pensions: Putting Savers' Interests First' (2014) Cm 8929.

<sup>231</sup> Office of Fair Trading, 'Defined Contribution Workplace Pension Market Study' (2013) OFT1505; Department for Work and Pensions (UK), 'Pension Charges Survey 2015: Charges in Defined Contribution Pension Schemes' (2015).

<sup>232</sup> Pensions Act 2014 (UK) pt 6, schs 17, 18, 19.

<sup>233</sup> *ibid* sch 18.

0.75%.<sup>234</sup> The later Conservative government introduced the Pension Schemes Act 2017, which established a specific legislative framework for master trusts, producing further complexity as the government tailored regulation to increasingly specific market deficiencies relating to these larger, multi-employer schemes. The core provisions of the Act spanned 50 sections and over 13,000 words,<sup>235</sup> while the related delated legislation spanned 92 regulations and 16,000 words.<sup>236</sup> The new legislation specifically sought to address the risks associated with ‘the profit motive’,<sup>237</sup> underscoring the challenges thrown up by market provision. The delegated legislation was deeply complex, providing master trust-specific amendments of various other pieces of legislation, such as the Companies Act 2006.<sup>238</sup> It also required compliance with the master trust code of practice issued by the regulator, which exceeds 100 pages.<sup>239</sup>

More recently, the government has again sought to address deficiencies in the defined contribution products now offered by most schemes, in which individuals bear all investment risk and have no clarity on their possible retirement income, and to expand market participation. The government created a legislative

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<sup>234</sup> Occupational Pension Schemes (Charges and Governance) Regulations 2015 (UK) reg 6.

<sup>235</sup> Pension Schemes Act 2017 (UK) pts 1–3, sch 1.

<sup>236</sup> Occupational Pension Schemes (Master Trusts) Regulations 2018 (UK).

<sup>237</sup> Explanatory Notes, Pension Schemes Act 2017 (UK) [11].

<sup>238</sup> Pension Schemes Act 2017 ss 30–32.

<sup>239</sup> The Pensions Regulator, ‘Authorisation and Supervision of Master Trusts’ (2018) Code of Practice 15.

framework for collective defined contribution (CDC) schemes. These schemes aim to provide an ‘aspirational’ benefit level (as opposed to a guaranteed benefit level in a defined benefit scheme) while pooling and investing member contributions, thereby distinguishing them from defined contribution schemes in which members have individual accounts.<sup>240</sup> Legislation was regarded as necessary for the creation and expansion of CDC schemes.<sup>241</sup> A range of policy entrepreneurs had advocated for CDC schemes, including firms and trade unions.<sup>242</sup> Again, the resulting legislation added substantially to the complexity of the legislative framework for private pensions, with the relevant core provisions of the Pension Schemes Act 2021 (excluding consequential and Northern Ireland amendments) spanning 51 sections and 15,000 words.<sup>243</sup> The delegated legislation totalled 27,700 words across 64 pages,<sup>244</sup> with the Code of Practice for CDC schemes coming in at 99 pages.<sup>245</sup> Consistent with the regulation of other pensions savings vehicles, the legislation included dense and technical rules for the eligibility of scheme administrators, authorisation, governance (including extensive arrangements to

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<sup>240</sup> Department for Work and Pensions (UK), ‘Delivering Collective Defined Contribution Pension Schemes: Government Response to the Consultation’ (2019) 16–18.

<sup>241</sup> Department for Work and Pensions (UK), ‘Introduction of Legislative Framework for Collective Defined Contribution (CDC) Occupational Pension Schemes’ Impact Assessment 1–2.

<sup>242</sup> Department for Work and Pensions (UK), ‘Delivering Collective Defined Contribution Pension Schemes: Government Response to the Consultation’ (n 240) 3, 7.

<sup>243</sup> Pension Schemes Act 2021 (UK) pt 1.

<sup>244</sup> Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2022 (UK).

<sup>245</sup> The Pensions Regulator, ‘Code of Practice: Authorisation and Supervision of Collective Defined Contribution Schemes’ (2022).

manage certain ‘triggering events’ that might lead to scheme termination or modification), and supervision. The complexity of CDC schemes is only likely to increase, with policy entrepreneurs lobbying the government for approval of additional business models.<sup>246</sup> Many other reforms have occurred to private pensions legislation to address perceived deficiencies,<sup>247</sup> and the recently elected Labour government has committed to further reform.<sup>248</sup> Many of these reforms target the high costs and varying performance of pension schemes, and mirror complex legislative interventions implemented in Australia (discussed in Chapter 4), including automatic consolidation of low-value accounts and introduction of a ‘value-for-money’ framework.

### **3.4 Implications for theories of legal complexity**

The development of UK private pensions law highlights the central role of market deficiencies in the increasing density and technicality of legal rules, and their rapid evolution over time. Private pension-related tax legislation quickly became increasingly dense as it sought to address abuse of scheme tax benefits, while contracting-out rules from state schemes were a means for incentivising improved standards of pension provision. The complexity of contracting-out rules increased

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<sup>246</sup> Department for Work and Pensions (UK), ‘Delivering Collective Defined Contribution Pension Schemes: Government Response to the Consultation’ (n 240) [9].

<sup>247</sup> The Pensions Schemes Act 2021 also provided extensive new powers for the Pensions Regulator and the establishment of public ‘pensions dashboard’, the legislative provisions for which spanned almost 20,000 words in the Act and regulations: Pension Schemes Act 2021 pt 4; Pensions Dashboards Regulations 2022 (UK).

<sup>248</sup> Prime Minister’s Office (UK), ‘The King’s Speech 2024: Background Briefing Notes’ (2024) 14–15.

substantially over time — peaking with SERPS — as governments sought to drive better benefits standards, such as through the ‘guaranteed minimum pension’, and scheme governance. With the decline of SERPS and the rise of defined contribution schemes, particularly after the Thatcher government allowed them to contract out of SERPS, regulatory legislation proliferated, first with the Financial Services Act 1986 and then with rapidly growing interventions under Blair and various governments since 2010, targeting issues such as the costs, performance, and governance of private pensions. Dense and technical legal frameworks, frequently amended, now exist to regulate the governance of Master Trusts and the fees and charges of schemes involved in automatic enrolment. These interventions are each trying to counteract the powerful incentives produced by the profit motive. Moves towards further regulation of these issues, such as in the new value for money framework, underscore how challenging addressing market deficiencies is, and how iterative and evolutionary the law then becomes, contributing to its complexity.

Governments have also increasingly used law to drive adoption of private pensions, both by employees and employers, and to reshape the types of pensions offered. Contracting-out arrangements were often used for this purpose under the GRB, reserve pension, and SERPS, but these efforts were supercharged with the use of complex legislative rules to establish personal pensions in 1986 and allow them to satisfy contracting-out rules, before reaching their peak in the introduction of automatic private pension enrolment for employees in the late 2000s. All these attempts at market construction used law as their principal instrument, and in doing so produced vast and complex legal edifices. Other attempts at market

construction fused with attempts to address to market deficiencies such as high costs and poor governance, including in the creation of stakeholder pensions in the late 1990s and the CDC schemes in 2021, each of which had to meet various legislative standards to be authorised.

The role of state provision in minimising legal complexity is also apparent in the UK experience. State provision was relatively legally simpler, as the various Acts establishing the GMP, reserve pensions, and SERPS demonstrated. But state provision also offered the ability to address market deficiencies outside ‘command and control’ regulatory approaches, which can require more dense and technical forms of legal control. The Labour government, when introducing SERPS, had acknowledged that its role as a competitor would allow it to ‘set standards’ by taking ‘the lead through its own pension scheme’.<sup>249</sup> The Thatcher and Blair governments’ abandonment of a mixed economy for earnings-related provision eroded and ultimately removed the alternative of state provision, leaving law as the only significant mechanism for the state to shape the private pensions market in the UK. The abandonment of SERPS also left the market as the only institution for achieving the public policy objective of improved retirement outcomes and national saving. Solely working through markets, while simultaneously trying to address their deficiencies, would generate unprecedented volumes of legal complexity between 1986 and 2020, dwarfing that generated between 1959 and the early 1980s. This was the point Lord Turner repeatedly made: trying to make a

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<sup>249</sup> Secretary of State for Social Services (UK), ‘Better Pensions: Fully Protected Against Inflation’ (n 114) [5].

deficiency-riven private pension market work for all employees had trapped the government in a cycle of every growing legal complexity, one that could only be broken by a state scheme to provide for at least some pension savers.

Finally, the above analysis should call into question the applicability the ‘law reflects reality’ thesis of legal complexity. Private pensions are creatures of law, that have been sustained and encouraged by governments committed to their position in a mixed economy or as the only model for earnings-related pension provision. Little about them, and the legal interventions targeting them, can be characterised as products of changes in a naturally occurring reality: they are creatures of politics. While new technologies emerged that affected the delivery and administration of private pensions, none of the legal interventions discussed in this chapter came about because of those changes. Similarly, the changes in economic relationships that shaped private pensions were more often creatures of law than naturally occurring developments, with the introduction of new corporate and legal forms and legal arrangements for acquiring private pensions. The legal developments, and the complexity they manifested, came about because of market deficiencies produced by the profit motive, commitments to using law to expand market participation, and the collapse of the state as a provider of earnings-related pensions. The self-interest explanation also appears to carry relatively little weight for explaining the complexity of private pension law, with no clear evidence for any stakeholders demanding greater legal complexity. Often, some mix of firms, politicians, and bureaucrats opposed reform, which often came in a compromised form as a result. Complexity may have been a side effect of such

watering down, such as by creating exemptions, but it was not the principal goal of lawmakers or firms.

## **4 Australia**

Private pension or superannuation legislation in Australia is complex, spanning hundreds of acts and pieces of delegated legislation. As in the UK, most of it has emerged since the mid-1980s. This chapter examines the causes of the complexity of superannuation legislation in Australia and considers how the market building framework helps enrich our understanding of its causes. The Australian government's involvement in the formation and expansion of a market in superannuation, now one of the largest in the world, provides a rich case study of how market building dynamics generate legal complexity. It also highlights the limits of the 'law reflects reality' thesis and underscores how the increasing importance of markets has generated pressures for law reform and resulting legal complexity.

### **4.1 The context to compulsory private pensions**

As in the UK, Australian governments grappled with the idea of enhanced state pension provision for several decades before committing to private pensions. Such models held out the possibility of being substantially legally simpler than regulation of private arrangements, as the development of the law post-1986 would demonstrate. Their abandonment left private pensions as the only mechanism for achieving improved retirement outcomes, and the government committed to using law to drive participation in superannuation.

Federally, the state provision of pensions started in 1908, when Australia replaced various subnational schemes with a means-tested age pension funded

out of general revenue, rather than specific pension contributions.<sup>250</sup> Beginning in the 1920s, proposals were made by various parties to introduce additional state pension provision, on contributory and non-contributory bases.<sup>251</sup> The last major effort came in the 1970s when the Labor government launched an inquiry into a system of national superannuation. The Hancock Inquiry's final report, published in 1976 after Labour lost office to a conservative Liberal government, recommended the introduction of a national superannuation pension, comprising both a flat non-contributory pension and an earnings-related component.<sup>252</sup> The model was intended to 'leave scope for non-governmental forms of retirement income provision (especially occupational superannuation)'.<sup>253</sup> However, it did not permit opting out of the state system, unlike the UK's GRB, reserve pension, and SERPS. Private pensions would have built on, rather than replaced, the state system. The Liberal government rejected the Hancock Inquiry's model. Trade unions offered lukewarm support, with an apparent preference for a universal basic state pension supplemented by worker-owned superannuation,<sup>254</sup>

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<sup>250</sup> Invalid and Old-age Pensions Act 1908 (Cth) ss 15, 24.

<sup>251</sup> Terry Carney and Peter Hanks, *Social Security in Australia* (Oxford University Press 1994) 33–35.

<sup>252</sup> National Superannuation Committee of Inquiry (Cth), 'Final Report: Part One' (1976) Parliamentary Paper 155/1976 xi.

<sup>253</sup> *ibid* 3.

<sup>254</sup> Emily Millane, 'The Ghost of National Superannuation' (PhD Thesis, Australian National University 2019) 131.

potentially in the new union-controlled superannuation funds established in the mid- to late-1970s.<sup>255</sup>

These union-controlled funds already represented a significant change in Australia's system of occupational pension schemes. Employer-provided superannuation had a long history in Australia, where it was first provided to white-collar and government employees.<sup>256</sup> Payments to and from superannuation schemes received favourable tax treatment. Contributions made by employers were tax-exempt until 1983, while lump-sum payments from a superannuation fund were taxed at a maximum rate of 3%.<sup>257</sup> Nonetheless, membership remained limited, at 34% in 1974.<sup>258</sup> Trade unions were instrumental in pushing for greater provision of occupational superannuation in the late-1970s and the 1980s.<sup>259</sup> New or more generous superannuation arrangements offered a way around wage controls that were widespread in the 1970s and the Australian Council of Trade Unions (ACTU) committed to campaigning on expanded superannuation in 1979.<sup>260</sup> The Australian Labor Party (ALP) proposed a model of national superannuation in

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<sup>255</sup> Bernard Mees and Cathy Brigden, *Workers' Capital: Industry Funds and the Fight for Universal Superannuation in Australia* (Allen & Unwin 2017) 32.

<sup>256</sup> *ibid* 14, 16.

<sup>257</sup> Department of Treasury (Cth), 'Towards Higher Retirement Incomes for Australians: A History of the Australian Retirement Income System since Federation' [2001] Economic Roundup Centenary Edition 74–75.

<sup>258</sup> *ibid* 74.

<sup>259</sup> Mees and Brigden (n 255) 32–35.

<sup>260</sup> David Plowman and Garry Weavan, 'Unions and Superannuation' in Bill Ford and David Plowman (eds), *Australian Unions. An Industrial Relations Perspective* (Macmillan 1989) 251.

its 1982 election manifesto,<sup>261</sup> but key ALP figures admitted that they had little interest in a state scheme.<sup>262</sup> Instead, the ALP government elected in 1982 would look to private pensions, undertaking a legislative programme of market expansion between 1983 and 1993.

## **4.2 Mandating private pensions in Australia (1992)**

The shift to compulsory superannuation in Australia in 1992 highlights how state-led market expansion can generate significant legal complexity. By the mid-1980s, the government regarded occupational superannuation rather than a state scheme as the means through which to deliver improved retirement outcomes.<sup>263</sup> Policy entrepreneurs had won the argument against any state provision of earnings-related pensions, partly by seizing on increasing concerns about the size of the state, particularly in its welfarist form. Prime Minister Paul Keating, for example, emphasised the need to ensure the sustainability of the social security system,<sup>264</sup> in addition to the economic benefits of increased national savings and the resulting domestic investment.<sup>265</sup>

Legislative reform was central to the expansion of superannuation, initially by putting it on a more sustainable tax footing, and later by making it compulsory. The

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<sup>261</sup> Millane (n 254) 187.

<sup>262</sup> *ibid* 165–166.

<sup>263</sup> Rhonda Sharp, 'The Rise and Rise of Occupational Superannuation Under Labor' [1992] *Journal of Australian Political Economy* 24, 35.

<sup>264</sup> Paul Keating, 'A Retirement Incomes Policy' (1991).

<sup>265</sup> Paul John Keating, 'Speech to Australian Institute of Management' (1995).

reduced tax concessions ensured that the expansion of private pensions would be fiscally sustainable by reducing the scope for tax avoidance and minimisation. However, the changes ‘enormously increased the complexity’ of private pension legislation,<sup>266</sup> contributing to it being ‘extremely complex’.<sup>267</sup> Yet, the changes laid the ‘groundwork for the extension of the superannuation provisions to the whole workforce’.<sup>268</sup> Moreover, between 1988 and 1991, the government and trade unions worked through the industrial relations system to introduce superannuation into employment awards, which governed the terms and conditions on which many workers were employed. This was market expansion through law and the legal system, using decisions by the Australian Industrial Relations Commission (AIRC), but not legislative action. The exercise was highly successful, although, again, legally and administratively complex and difficult to enforce,<sup>269</sup> with dozens of industrial awards requiring amendments. Membership of a superannuation fund rose from 42.4% in 1988 to 72.2% in 1991.<sup>270</sup> Superannuation assets increased from just over 20% of GDP in 1982 to over 50% by 1990.<sup>271</sup> However, some employees were not covered by the award system. The government also wanted a

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<sup>266</sup> Malcolm Edey and Brian Gray, ‘The Evolving Structure of the Australian Financial System’ in Malcolm Edey (ed), *The Future of the Financial System* (Reserve Bank of Australia 1996) 35.

<sup>267</sup> Malcolm Edey and John Simon, ‘Australia’s Retirement Income System: Implications for Saving and Capital Markets’ (National Bureau of Economic Research 1996) Working Paper 25.

<sup>268</sup> Paul J Keating, ‘The Story of Modern Superannuation’ (2007) 1.

<sup>269</sup> Edey and Simon (n 267) 6.

<sup>270</sup> Parliamentary Research Service, ‘Superannuation Guarantee (Administration) Bill 1992’ (Department of the Parliamentary Library 1992) 1.

<sup>271</sup> Edey and Simon (n 267) 12.

mechanism through which it could control the level of compulsory superannuation contributions rather than leaving it up to employers or the AIRC,<sup>272</sup> which rejected increased contributions in April 1991.<sup>273</sup> Key ALP and trade union figures committed to legislating the compulsory expansion of private pensions to almost all employees.<sup>274</sup> The dual objectives of market expansion and addressing market deficiencies such as insufficient savings rates drove legislative intervention, necessitated in part by the abandonment of any state scheme.

The result was the Superannuation Guarantee (Administration) Act 1992 (Cth) (SGA Act 1992).<sup>275</sup> The Act is dense and highly technical, particularly with respect to its definitions, which account for thousands of words. It created the Superannuation guarantee charge (SGC), which is a tax payable when an employer fails to contribute the legislated superannuation to an eligible fund (which must be operated as a trust). Constitutional restrictions meant that the government could not oblige employers to pay superannuation. Instead, the structure of the legislation effectively coerces employers into paying superannuation, rather than paying the SGC. These arrangements are frequently described as complicated. In keeping with a ‘law reflects reality’ explanation of legal complexity, it is common to blame the complexity of Australia’s superannuation legislation in part on

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<sup>272</sup> Parliamentary Research Service (n 270) 1.

<sup>273</sup> Paul Kelly, *The March of the Patriots: The Struggle for Modern Australia* (Melbourne University Press 2011) 145.

<sup>274</sup> *ibid.*

<sup>275</sup> The Superannuation Guarantee Charge Act 1992 (Cth) is also a core part of the framework, but it is incorporated into the SGA Act 1992

federalism. However, its origins are partly elsewhere. Mandating the provision of private pensions by almost all Australian employers to their employees was an inherently complex exercise, reflecting the legal complexity produced as a side effect of the constitutive role of law in markets. Moreover, the resort to law to drive market expansion reflected changing understandings of state-market relations in Australia,<sup>276</sup> which also underlay the abandonment of a state scheme. In sum, the political choice to expand private pensions using law was not an inevitable result of changes in technology, society, or the economy.

#### **4.2.1 Market deficiencies for all Australians**

The decision to legislate compulsory private pensions for almost all Australian workers now exposed almost all Australian households, regardless of their financial literacy and wealth, to the private pension market and its deficiencies. As the Financial System Inquiry (1997) observed, compulsory superannuation represented a form of government endorsement, ‘imply[ing] that government should provide greater regulatory assurance in relation to superannuation than would normally apply for market linked investments’.<sup>277</sup> This had been lacking in the SGA Act 1992. The Occupational Superannuation Standards Act 1987 (Cth) (OSS Act 1987), enacted as the government was trying to encourage voluntary or award-based adoption of occupational superannuation, was the first purely regulatory legislation for superannuation. It represented a limited attempt to

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<sup>276</sup> Nicholas Morris, *Management and Regulation of Pension Scheme: Australia - A Cautionary Tale* (Routledge 2018) 16.

<sup>277</sup> Stan Wallis and others, ‘Financial System Inquiry’ (1997) Final Report 193.

address market deficiencies. The Act provided for the creation of operating standards through delegated legislation, which were an early instance of the type of technical and dense rules that would come to characterise Australian private pensions law. It also created the Insurance and Superannuation Commissioner to supervise superannuation schemes. The Occupational Superannuation Standards Regulations 1987 (Cth) (OSS Regulations 1987) provided for dozens of standards. However, they related principally to the functioning of private pensions, such as their vesting, portability, and preservation until age 55. Such rules again highlight the constitutive role of law in markets, and the legal complexity that this produces. Addressing market deficiencies was nonetheless also an objective of the OSS Act 1987 framework, with the regulations creating limited governance, investment, financial reporting, and disclosure obligations.

It quickly became clear that the deficiencies in the private pension market would demand further action. The structure of the market contributed to the need for law reform over the long term, with different types of schemes having varying incentives. The market included non-profit industry funds run by unions, low-cost corporate funds administered and generally subsidised by employers, and retail funds established by financial services firms such as banks and insurers. Most schemes outsourced various functions, such as investment management, to for-profit firms, a relationship that would be an important locus for future regulation.

With the move to compulsory private pensions in 1991–92, the government recognised that there was a need ‘to build confidence in the ... system’.<sup>278</sup> Potential market deficiencies were clear. For example, the push to expand superannuation schemes beyond the large, union-dominated workplaces to which they had been confined raised important issues of governance, supervision, and member protection. No longer could it be assumed that trade unions would exercise some degree of supervision over the superannuation schemes in which their members held interests. Smaller employers would have fewer resources than their larger peers to establish and supervise superannuation schemes. Perhaps most crucially, it was clear that defined contribution schemes would become a significant part of the private pension market. The SGA Act 1992 required employers who were unwilling or unable to set up their own corporate schemes to make contributions to a personal pension, generally either an industry or retail scheme. Practically all such schemes were defined contribution.<sup>279</sup> These schemes raised various new issues because members would directly bear investment risk and would be charged fees, which were generally subsidised or waived in corporate funds. Improved governance and prudential regulation would be important for all funds.

Following the announcement of compulsory superannuation in 1991, reports from parliamentary committees and the Law Reform Commission all

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<sup>278</sup> Department of Treasury (Cth) (n 257).

<sup>279</sup> Law Reform Commission, ‘Collective Investments: Superannuation’ (1992) [2.8]–[2.9].

recommended enhanced regulation,<sup>280</sup> and the Prime Minister committed to a strengthened legislative framework.<sup>281</sup> The original 20-section, 6,000-word OSS Act 1987 was replaced by the 385-section, 66,800-word Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act 1993), with the 25-regulation, 9,400-word OSS Regulations 1987 replaced by the 230-regulation, 42,000-word Superannuation Industry (Supervision) Regulations 1994 (Cth) (SIS Regulations 1994).<sup>282</sup> The new SIS Act 1993 framework built on the density and technicality of its predecessor. It reduced the scope of trusts law by prescribing in detail requirements for governing rules of superannuation entities,<sup>283</sup> while creating many more obligations with respect to the regulator and the use of auditors and actuaries.<sup>284</sup> Significantly, the complexity of the SIS Act 1993 came despite observations that the OSS Act 1987 regime had already represented a legislative system ‘greatly in need of simplification’.<sup>285</sup>

The project of market expansion undertaken during the 1980s and early-1990s thus produced vast, complex legislative edifices relating to tax and regulation. The OSS Act 1987, SGA Act 1992, and SIS Act 1993 were all part of the

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<sup>280</sup> Senate Select Committee on Superannuation, Parliament of Australia, ‘Safeguarding Super: The Regulation of Superannuation’ (1992); Law Reform Commission (n 279).

<sup>281</sup> Department of Treasury (Cth) (n 257) 85–86.

<sup>282</sup> Both the original OSS Act 1987 and OSS Regulations 1987 had grown substantially since their original enactment.

<sup>283</sup> Superannuation Industry (Supervision) Act 1993 (Cth) pt 6.

<sup>284</sup> Department of Treasury (Cth) (n 257) 86.

<sup>285</sup> Senate Select Committee on Superannuation, Parliament of Australia (n 280) [10.14].

government's effort to expand private pensions across the Australian workforce, including to address the market deficiencies that undermined that goal. Predictably, the OSS Act 1987 and then the SIS Act 1993 failed to address all these deficiencies. The private pension market remained subject to 'endemic principal-agent and conflict of interest problems',<sup>286</sup> with varying standards of scheme governance, competition, and high fees and costs. These factors would now affect the retirement prospects of millions of Australians, creating ongoing pressure for law reform, and, seemingly inevitably, more legal complexity.

### **4.3 Expanding competition in the superannuation system**

Significant legal complexity has been generated in seeking to increase competition in the superannuation system. This section examines two instances in which law was used ostensibly to expand market competition: first, through the creation of a new savings vehicle in 1997 and, second, through obligations developed between 1997 and 2021 that increased the role of portability and choice in the superannuation system.

#### **4.3.1 Retirement Savings Accounts**

The superannuation system established in 1992 required that all superannuation funds be administered as trusts. In 1997, the recently elected conservative Liberal-National government legislated for the creation of retirement savings accounts (RSAs) as an alternative to products offered by superannuation funds. RSAs could

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<sup>286</sup> Morris (n 276) 5.

be offered by financial institutions such as banks and life insurance companies without a trust structure, and they attracted the same tax benefits as contributions to superannuation funds. RSAs were intended to drive ‘competition and choice in the superannuation industry’, thereby producing better consumer outcomes, such as lower fees.<sup>287</sup> The Retirement Savings Account Act 1997 (Cth) was 200 sections long, spread across 140 pages and over 34,000 words. Regulations made under the Act ran to 88 pages and 20,600 words.<sup>288</sup> Consequential amendments to superannuation legislation spanned over 100 pages.<sup>289</sup> RSA legislation was, and remains, highly dense and technical. It contains detailed rules for the approval of RSA institutions and for their operating standards, in addition to extensive regulatory supervision arrangements, offences, and powers for courts. For example, the Act created over 26 new offences and dozens of obligations. It has been amended 47 times since 1997, while remaining a similar length. In contrast, the regulations have almost doubled in size to 43,000 words, or 8,000 more words than the Act. The introduction of RSA legislation therefore significantly increased the complex web around private pensions law.

RSA legislation was not responding to any developments in the ‘real’ world. Rather, the government was using legislation to transform that world by permitting a new set of financial services entities and products into the retirement savings

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<sup>287</sup> Explanatory Memorandum, Retirement Savings Accounts Bill 1996 (Cth) 1.

<sup>288</sup> Retirement Savings Accounts Regulations 1997 (Cth).

<sup>289</sup> Retirement Savings Accounts (Consequential Amendments) Act 1997 (Cth).

system, a system that was the product of previous legal arrangements . These products would be unconnected to employers, making them a form of personal pension, and entirely portable and transferable, unlike interests in many superannuation funds. One cannot discount private interest explanations of these changes — RSAs potentially offered a windfall to the financial services firms permitted to offer them — but such private interests were not directly seeking legal complexity. Such complexity was the by-product of the immediate purpose of expanding the range of persons permitted to offer more retirement savings products.

The LNP government’s efforts at lifting competition and reducing private pension costs through law ultimately proved futile. Evidence from 2001 indicated that RSAs were the most expensive means of retirement saving, with expense ratios of 2.5%, compared to 1.15% for large industry funds.<sup>290</sup> The vast legislative apparatus failed to address RSA providers’ profit incentives. Predicted to account for around 10% of all superannuation assets in 1998,<sup>291</sup> today RSA products are almost non-existent. Only four financial institutions offer RSAs to new members,<sup>292</sup> and RSAs hold just AUD\$1.3 billion.<sup>293</sup> That is a rounding error in a superannuation

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<sup>290</sup> Reserve Bank of Australia, ‘Australian Funds Management: Market Structure and Fees’ [2003] Reserve Bank of Australia Bulletin 55, 60.

<sup>291</sup> Wallis and others (n 277) 131.

<sup>292</sup> Australian Prudential Regulation Authority, ‘List of Institutions Offering Retirement Savings Accounts’ (14 March 2023) <<https://www.apra.gov.au/list-of-institutions-offering-retirement-savings-accounts>> accessed 4 June 2024.

<sup>293</sup> Australian Prudential Regulation Authority, ‘Quarterly Superannuation Performance Statistics - September 2004 to December 2023’ KeyStats <<https://www.apra.gov.au/sites/default/files/2024->

system managing over AUD\$3.6 trillion. The complex body of RSA legislation stands as a testament to the iterative and accretive character of attempts to address market deficiencies, with mixed success.

#### **4.3.2 Encouraging fund choice and switching**

The Liberal-National government also sought to increase the pace of people switching between private pension providers and the ability to choose between providers. Improved switching and fund choice would create the ‘greater competition’ that would reduce fees and improve member outcomes.<sup>294</sup> Yet the government’s push for market expansion came against the backdrop of existing arrangements. Trustees were not obliged to permit members to transfer their superannuation balances into other funds and trustee transfer rules varied. Similarly, employees were not entitled to select their own superannuation fund, and these generally were selected through an industrial award, an employer-union agreement, or by an employer, though some employers offered a range of funds to their employees. These arrangements reflected the corporatist origins of superannuation as employer- or union-provided and defined benefit, which was impractical to transfer between different superannuation funds. The Liberal-National Party (LNP) went to the 1996 election promising to transform superannuation into a competitive market, particularly one where for-profit retail superannuation funds would challenge corporate and industry funds. These efforts

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02/Quarterly%20superannuation%20performance%20statistics%20-%20September%202004%20to%20December%202023\_0.xlsx> accessed 3 July 2024.

<sup>294</sup> Prime Minister of Australia, ‘A Better Superannuation System’ (2001) 7.

were supported by other policy entrepreneurs, most importantly the committee behind the 1997 Financial System Inquiry, which endorsed greater choice of fund.<sup>295</sup> Reflecting the dynamic and iterative nature of attempts to address perceived market deficiencies, the Inquiry noted that law reform to expand choice would also require further regulation to protect consumers.<sup>296</sup> Superannuation was to be transformed into a market where products would become like other financial products, bought and sold rather than provided as an employment benefit. A system of occupational pensions was to be transformed into one of personal pensions.

Reflecting its constitutive character, law was the central instrument in efforts to increase competition. Attempts at law reform initially stalled between 1997–2001.<sup>297</sup> However, the LNP introduced a compromised version of choice of fund legislation in 2003, which was substantially different to earlier versions. Now, employees could no longer opt out of the fund chosen through an industrial award and employers would not be obliged to offer a list of superannuation funds and RSAs. Instead, employers would give employees a ‘standard choice form’ through which the employee could select a superannuation fund. The form would also identify a default fund, chosen by the employer, applicable if employees did not

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<sup>295</sup> Wallis and others (n 277) 488.

<sup>296</sup> *ibid* 487.

<sup>297</sup> For discussion of the earlier Bills, see Information and Research Services, ‘Taxation Laws Amendment Bill (No. 7) 1997’ (Department of the Parliamentary Library 1998) Bills Digest 129 1997–98; Explanatory Memorandum, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998 (Cth).

make a choice. This framework required substantial legal complexity. A new Part 3A establishing choice of fund requirements was inserted into the SGA Act 1992,<sup>298</sup> and multiple other amendments to superannuation legislation were made. The choice of fund provisions covered technical matters such as the various funds deemed to satisfy the choice requirements (e.g. funds chosen under an industrial award) and the definition of ‘eligible choice funds’, to which employers were restricted when selecting a default fund. The legislation also stipulated how employees selected funds and when employees were required to give standard choice forms. Concerns about the possibility of personal pension mis-selling like that experienced in the UK also led to the introduction of a new prohibition on fund trustees seeking financially to induce consumers to select their funds.<sup>299</sup> Additional rules, such as of the form and content of the choice forms, appeared in delegated legislation.<sup>300</sup>

Similarly, facilitating the transferal of superannuation balances between funds added to legal complexity. The government’s initial attempt at permitting transferability through delegated legislation was voted down in September 2003.<sup>301</sup> The revised regulations introduced after this failure were amended to prevent members from transferring superannuation balances out of funds that had

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<sup>298</sup> Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 (Cth) sch 1 item 22.

<sup>299</sup> *ibid* sch 1 item 23.

<sup>300</sup> Superannuation Guarantee (Administration) Amendment Regulations 2005 (No. 1) (Cth).

<sup>301</sup> Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) (Cth); Explanatory Statement, Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 5) (Cth) 1.

received an employer contribution in the previous six months. Allowing employees to transfer active superannuation balances would have effectively provided unlimited choice of fund (e.g. an employee could be placed in a fund chosen through an industrial award but then immediately transfer out).<sup>302</sup> The new regulations introduced in October 2003 set up a regime for the compulsory transfer of superannuation balances on receipt of a request from a member, contained in the SIS Regulations 1994.<sup>303</sup> The regulations provided extensive technical rules for when and how transfers needed to be made, and carved-out various funds and interests from the new arrangements. For example, transferability did not apply to the defined benefit component of superannuation funds, and a long definition of this concept was provided.<sup>304</sup> The Australian Prudential Regulation Authority (APRA) was also given discretion to administer the regime, such as by suspending a trustee's obligation to transfer superannuation balances in certain circumstances.<sup>305</sup> As with choice of fund, transferability increased legal complexity as a side-effect of efforts to expand competition.

Choice of fund and transferability legislation has only grown more complex since their enactment, underlining the ways in which market expansion is a highly iterative process that produces gradually ratcheting levels of legal complexity. For

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<sup>302</sup> Senate Select Committee on Superannuation, Parliament of Australia, 'Draft Superannuation Industry (Supervision) Amendment Regulations 2003 and Draft Retirement Savings Accounts Amendment Regulations 2003' (2003) [12.5].

<sup>303</sup> Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 5) (Cth) sch 1 item 10.

<sup>304</sup> *ibid* sch 1 item 10 regs 6.30, 6.31.

<sup>305</sup> *ibid* sch 1 item 10 regs 6.36, 6.37.

example, choice of fund provisions were amended shortly after their enactment to ameliorate various implementation issues and to prevent employer's clawing-back the costs of providing choice arrangements.<sup>306</sup> Choice of fund provisions in the SGA Act 1992 have since risen from 2,700 words, as originally enacted, to 5,400 in June 2024, while transferability rules in the SIS Regulations 1994 have increased from 1,400 words to over 5,100. An important driver of this growing complexity continues to be the push for competition. Multiple Liberal-National governments sought to expand choice of fund provisions so that they would override union-employer agreements, pushing Bills in 2016 and 2019,<sup>307</sup> the latter ultimately passing in 2020.<sup>308</sup> Efforts to drive fund switching and choice have been iterative in part because they have struggled to drive market change in the face of apathetic employees and fund members. Thus, efforts to improve inter-fund switching rates have failed repeatedly, and rates of switching more than halved between 2005 and 2009.<sup>309</sup> The Super System Review concluded in 2009 that 'that the model of member-driven competition through "choice of fund" ... has struggled to deliver a competitive market'.<sup>310</sup> Moreover, converting occupational pensions into personal pensions, which could be easily switched between, markedly increased costs for

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<sup>306</sup> Explanatory Memorandum, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2005 (Cth) 5.

<sup>307</sup> Superannuation Legislation Amendment (Choice of Fund) Bill 2016 (Cth); Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019 (Cth).

<sup>308</sup> Treasury Laws Amendment (Your Superannuation, Your Choice) Act 2020 (Cth).

<sup>309</sup> Super System Review, 'Part One: Overview and Recommendations' (2010) Final Report 9.

<sup>310</sup> *ibid* 6.

fund trustees. Allowing fund choice creates incentives for greater investment in marketing to attract members.<sup>311</sup> Research in 2014 found that marketing costs as a percentage of operating expenses had increased from a ‘negligible percentage of assets’ to 16% of all expenses.<sup>312</sup> Overall, attempts to increase competition generated significant legal complexity, and in some ways compounded the problems produced by the profit motive, driving superannuation funds to increase costs to attract members. The persistence of high costs, as explained later, would also lead to more complex legal interventions.

#### **4.4 Prudential legislation**

The development of prudential legislation for private pension providers in Australia illustrates the relationship between persistent market deficiencies and legal complexity. Prudential regulation aims to address agency problems and reduce ‘the risks associated with the business model’ of a private pension provider,<sup>313</sup> which should be managed through good governance arrangements. Agency problems are persistent in the private pension system, with a highly heterogeneous range of largely self-interested actors involved in the administration of private pension assets and little involvement from fund members (the principal in the principal-agent relationship). Private pension providers face governance risks with respect to the management of fund assets and outsourcing of investment choices

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<sup>311</sup> Productivity Commission, ‘Superannuation: Assessing Efficiency and Competitiveness’ (2018) Inquiry Report 91 562–563.

<sup>312</sup> RiceWarner, ‘Superannuation Fees: Financial System Inquiry’ (2014) 24.

<sup>313</sup> Armour and others (n 49) 63.

to fund managers or advisers. Yet, as enacted, the SIS Act 1992 contained relatively few prudential provisions.<sup>314</sup> This eventually proved unsustainable, reflecting the disconnect between governments and regulators that regarded superannuation as akin to any other market-linked investment product<sup>315</sup> and consumers who regarded superannuation as the promise of a comfortable retirement. The government's decision to make superannuation compulsory contained an implicit promise about the integrity of superannuation assets. Consequently, members of collapsed superannuation funds or members who experienced significant reductions in pension balances never accepted the notion that the government bore no responsibility for their plight. In response to several crises, between 2000 and 2012 the Australian government was led to establish a vast and complex legislative apparatus for prudential regulation. By 2023, this framework spanned over 16 legislative prudential standards, 28 APRA prudential guides, and scores of provisions of the SIS Act 1993.<sup>316</sup> The strength of the profit motive, compounding agency problems and business and investment risks, means that prudential regulation will always be inadequate, generating persistent pressures for law reform, with legal complexity a side effect as governments regulate governance in ever more granular detail.

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<sup>314</sup> Senate Select Committee on Superannuation, Parliament of Australia (n 280) 32.

<sup>315</sup> Council of Financial Regulators, 'Annual Report' (1999) 9.

<sup>316</sup> Australian Law Reform Commission, 'Superannuation and the Legislative Framework for Financial Services' (2023) Background Paper FSL11 11–8 fig 2.

#### 4.4.1 Enhancing the ‘safety’ of superannuation in Australia (2000–04)

By 2000, superannuation was a core pillar of Australia’s retirement income system, with the value of assets more than doubling between September 1995 and December 2002.<sup>317</sup> The retirement prospects of over 88% of workers’ now were inextricably linked to the performance of their superannuation.<sup>318</sup> Beginning in the late 1990s, a series of Australian financial services firms collapsed due to fraud and mismanagement, culminating in the collapse of HIH Insurance, Australia’s second largest insurer, in 2001. Although the firm did not offer any retirement products, HIH Insurance’s problems cast a shadow over the superannuation industry.<sup>319</sup> Four superannuation fund trustees also collapsed during this period,<sup>320</sup> generating significant media coverage and public debate about the safety of superannuation savings.<sup>321</sup> However, it was the demise of Commercial Nominees of Australia Pty Ltd (‘Commercial Nominees’) that most clearly exposed the risks facing investors in the age of compulsory superannuation. Commercial Nominees was a trustee of several hundred superannuation funds and managed assets of over \$300 million.<sup>322</sup> Its mismanagement of one of these funds produced losses of

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<sup>317</sup> Explanatory Memorandum, Superannuation Safety Amendment Bill 2003 (Cth) [3.1].

<sup>318</sup> *ibid.*

<sup>319</sup> Barry Dunstan, ‘Trustees under Threat’ *Australian Financial Review* (21 May 2001) 43.

<sup>320</sup> Senate Select Committee on Superannuation and Financial Services, Parliament of Australia, ‘Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services: Second Report - Some Case Studies’ (2001) 1, 9, 15, 25.

<sup>321</sup> Anne Lampe, ‘Who’s Looking After Your Super?’ *Sydney Morning Herald* (21 November 2001) 5.

<sup>322</sup> Senate Select Committee on Superannuation and Financial Services, Parliament of Australia (n 320) [4.1].

around \$25 million for almost 25,000 investors.<sup>323</sup> APRA received extensive criticism for failing to prevent Commercial Nominees's misconduct,<sup>324</sup> which was described by one industry body as already in breach of superannuation legislation.<sup>325</sup> By August 2001, following extensive media coverage and a Parliamentary report, the Minister for Financial Services committed to improved prudential regulation of superannuation firms.<sup>326</sup> He particularly noted the challenges facing small funds in ensuring appropriate resources for risk management and prudential controls.<sup>327</sup> The Governor of the Reserve Bank of Australia and APRA's CEO separately already had suggested that 'licensing standards [and] some capital requirements', both of which were enacted, offered the best way to force fund consolidation.<sup>328</sup>

The government's legislative interventions were significant. Implementing several recommendations from the Superannuation Working Group,<sup>329</sup> the Australian Parliament passed the 121-page Superannuation Safety Amendment

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<sup>323</sup> *ibid* [4.3].

<sup>324</sup> Ben Seeder, 'APRA under Fire for Super Failures' *Australian Financial Review* (29 March 2001) 5.

<sup>325</sup> Senate Select Committee on Superannuation and Financial Services, Parliament of Australia (n 320) [3.45].

<sup>326</sup> Cynthia Banham, 'Hockey Flags Move To Tighten Super Regulation' *Sydney Morning Herald* (27 August 2001) 31.

<sup>327</sup> *ibid*.

<sup>328</sup> Dunstan (n 319); Senate Select Committee on Superannuation and Financial Services, Parliament of Australia, 'Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services: First Report' (2001) [3.38].

<sup>329</sup> Superannuation Working Group, 'Options for Improving the Safety of Superannuation' (2002).

Act 2004 (Cth) (SSA Act 2004) with the purpose of ‘modernis[ing] and strengthen[ing] the prudential regulation of superannuation’.<sup>330</sup> At the heart of the SSA Act 2004 was a new scheme requiring most superannuation trustees, as newly designated registrable superannuation entities (RSEs), to hold an RSE licence. These licenses were obtained from APRA, which was granted powers to screen and reject applicants. Applicants needed to meet set requirements, including with respect to capital, the fitness and propriety of trustees of funds and RSE licensees, and the ability to meet the obligations imposed on RSE licensees under the SSA Act 2004.<sup>331</sup> RSE licensees were subject to extensive conditions, such as to prepare and comply with a risk management strategy and a risk management plan,<sup>332</sup> the latter to be prepared for each superannuation entity a trustee managed. Application requirements and licence conditions were highly technical and dense. For example, risk management strategies and plans were subject to detailed requirements as to their content, maintenance, and modification, spanning over 3,100 words in primary legislation,<sup>333</sup> with a further 850 words on these matters and capital requirements in delegated legislation.<sup>334</sup> The SSA Act 2004 also expanded the range of matters about which operating standards could be made in delegated legislation. The Act provided that standards could be made with respect to the

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<sup>330</sup> Explanatory Memorandum, Superannuation Safety Amendment Bill 2003 (Cth) (n 317) [2.1].

<sup>331</sup> Superannuation Safety Amendment Act 2004 (Cth) sch 1 item 29 ss 29DA, 29D(1)(a)–(b), (d).

<sup>332</sup> *ibid* item 29 ss 29E(1)(c), (e).

<sup>333</sup> *ibid* item 29 pt 2A div 8, item 29 pt 2B divs 5–6.

<sup>334</sup> Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 3) (Cth) regs 3A.04, 4.07A, 4.07B.

adequacy of trustee resources, outsourcing, and the fitness and propriety of RSE licensees.<sup>335</sup> Technical operating standards spanning just under 1,800 words were quickly made under these powers.<sup>336</sup> Finally, reflecting the government's objective of driving out smaller, poorly resourced funds, the Act strengthened arrangements for the amalgamation of superannuation funds.<sup>337</sup> Overall, the complexity of the legislative framework for superannuation increased substantially as a result of the amendments made by the SSA Act 2004 and the delegated legislation that it authorised.

This was a direct result of its attempt to address the private pension market deficiencies produced by the profit motive. Smaller, less efficient funds faced pressure to minimise administration costs and maximise member returns to attract new members. These pressures contributed to mismanagement of superannuation assets through excessive risk-taking and insufficient resources for risk management. The profit motive also resulted in many funds, represented by groups such as the Corporate Super Association, opposing robust prudential reforms. This led to the government's rejection of the Superannuation Working Group's proposal for a full superannuation prudential framework,<sup>338</sup> as already existed for insurers and banks. There was nothing natural about these choices,

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<sup>335</sup> SSA Act 2004 sch 1 items 40–41, amending s 32(2) of the SIS Act 1993.

<sup>336</sup> Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 3) regs 4.14–4.17.

<sup>337</sup> SSA Act 2004 sch 1 item 58, inserting Part 18.

<sup>338</sup> Superannuation Working Group (n 329) 37–38.

which reflected the political economy of private pensions and regulation. Moreover, the structure of the market in which the government was intervening through the SSA Act 2004 did not reflect some inevitable reality. It had been the product of the political economy of the late 1980s and early 1990s, and the policy and legislative choices this produced. Smaller, poorly resourced and run superannuation funds reflected an unwillingness to confront the structure of the superannuation market. The SSA Act 2004 was not responding to new technologies or social and economic relationships.

A further potential but flawed explanation of the complex legislation introduced by the SSA Act 2004 focuses on the self-interest of lawyers and bureaucracy, and of superannuation firms. There is substantial evidence against this interpretation. Government and regulators had long resisted enhanced prudential regulation of superannuation. Even when advocating for new powers to address perceived issues among smaller superannuation entities, APRA continued to resist the imposition of various obligations on super trustees. This included rejecting obligations to diversify investment portfolios and education requirements for trustees.<sup>339</sup> More generally, government resisted imposing more burdensome legislative arrangements on trustees, as observed above. Various representatives of the superannuation industry, such as the Association of Superannuation Funds of Australia and the Australian Institute of Superannuation Trustees, opposed the imposition of significant prudential obligations and raised concerns about the

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<sup>339</sup> Senate Select Committee on Superannuation and Financial Services, Parliament of Australia (n 328) [4.13].

complexity of existing superannuation legislation.<sup>340</sup> This evidence challenges a private interest explanation of the complexity of the SSA Act 2004. Lawyers, too, opposed moves towards a more fulsome prudential framework, with the legal profession's peak body, the Law Council of Australia, arguing instead for 'updat[ing] and simplify[ing] existing regulations'.<sup>341</sup>

#### **4.4.2 The move to a full prudential framework (2007–12)**

The 2008 Global Financial Crisis finally provided a catalyst for the imposition of a complete prudential framework on the superannuation industry, which had previously been rejected. But the legislation introduced in this period once more substantially increased the complexity of the legislative framework for superannuation. The reforms reflected the steady ratcheting up of legal complexity predicted in market-building dynamics. Politicians and regulators tend to seek greater control over market actors as they are forced to address persistent market flaws and failures. In the superannuation system, problems endured in relation to divergent risk management practices with respect to investment,<sup>342</sup> operational,<sup>343</sup> and liquidity risks.<sup>344</sup>

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<sup>340</sup> Productivity Commission (n 1) xix.

<sup>341</sup> Superannuation Working Group (n 329) 33.

<sup>342</sup> These relate to choices about asset allocation, such as the types of assets in which to invest and the degree of risk to take on in allocating investments.

<sup>343</sup> These relate to the daily operation of a fund, such as key person risks, fraud management, and supervision of compliance with internal processes and policies.

<sup>344</sup> These relate to the ability of the fund to meet withdrawals without having to incur excessive losses in the sale of illiquid assets.

The market volatility during the GFC also led to a massive decline in superannuation asset values, and the retirement savings of many Australians. Between December 2007 and March 2009, Australian superannuation funds lost over AUD\$247 billion (AUD\$355 billion in 2023 dollars), equivalent to more than 30% of the assets they held at the beginning of December 2007.<sup>345</sup> These losses ranked as the second worst in an OECD analysis of private pension investment performance across 30 countries.<sup>346</sup> Collapsing superannuation balances undermined the public confidence in the regulation of superannuation. As the Australian Securities and Investments Commission observed in late 2009, compulsory superannuation had transformed expectations of financial regulation and, by proxy, the relationship between the state and markets. As the consumer protection regulator noted,

You have groups of people who lose money at the wrong time in their life and it is no answer to them to say: 'Well, it was a risk, you know. There was disclosure. You should have read the disclosure statement.' The fact is that they cannot easily come back into the workforce.<sup>347</sup>

Media coverage stressed the threat to the legitimacy of the superannuation system.<sup>348</sup> Superannuation became 'a topic spoken about at backyard barbecues'

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<sup>345</sup> Analysis of Australian Prudential Regulation Authority, 'Quarterly Superannuation Performance Statistics - September 2004 to December 2023' (n 293) Table 1a.

<sup>346</sup> OECD, 'Pensions at a Glance 2009: Retirement-Income Systems in OECD Countries' (2009) 32.

<sup>347</sup> Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, 'Inquiry into Financial Products and Services in Australia' (2009) Report [5.25].

<sup>348</sup> Sally Patten, 'Retirement Funds to Take Big Hit' *Australian Financial Review* (16 October 2008) 29.

and the government was flooded with letters from angry fund members.<sup>349</sup> Debates highlighted both prudential concerns and investment returns. In May 2009, the Australian government established the Super System Review to examine all elements of Australia's superannuation system, including its governance, efficiency, structure, and operation. The Review's final report reflected on the implications of a fully privatised model of compulsory private pensions. It noted that '[s]ystem design and regulatory settings' may not have 'sufficiently' accounted for the model of private pension provision.<sup>350</sup> The extensive interventions it recommended offered a partial corrective to this, seeking to address many acute market deficiencies and to more directly engage with questions of market structure and product design. The Super System Review recommended the implementation of a full prudential framework even more robust than that rejected in 2002–03. It recommended that APRA be given vast new powers to regulate prudential matters. This reflected the ongoing need for more robust risk management and governance improvements to ensure the stability and security of retirement savings for Australians. The inadequacies of the SSA Act 2004 had been highlighted by the GFC, and prudential standards offered one way to improve investment practices and liquidity and capital adequacy. The Review emphasised the market building purposes of these recommendations, linking capital and liquidity requirements to the need to maintain confidence in private pension.<sup>351</sup> ASIC had made similar

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<sup>349</sup> Mees and Brigden (n 255) 170.

<sup>350</sup> Super System Review (n 309) 6.

<sup>351</sup> Super System Review, 'Part Two: Recommendation Packages' (2010) Final Report 163.

points in the wake of the GFC.<sup>352</sup> Market deficiencies, catalysed by public pressure and a need to preserve public confidence, drove legislative reform.

The Super System Review's governance recommendations were implemented by the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012 (Cth) (TOPS Act 2012). In introducing the legislation, the government emphasised Australians' entitlement 'to be confident' in superannuation fund governance and 'that their superannuation is being managed ... prudently'.<sup>353</sup> Schedule 1 of the Act imposed dozens of dense new trustee obligations, including through new covenants that would be statutorily included in a trust's governing rules.<sup>354</sup> The Super System Review had suggested these should 'enhance, expand and clarify' existing obligations.<sup>355</sup> New obligations sought to better manage conflicts of interest and improve investment practices.<sup>356</sup> The amendments also empowered the government to establish new trustee covenants through regulations,<sup>357</sup> reflecting a propensity to establish more powers to make delegated legislation so as to manage future market crises. The prudential provisions of the TOPS Act 2012 reflected a similar trend towards delegating

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<sup>352</sup> Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia (n 347) [5.26].

<sup>353</sup> Commonwealth, *Parliamentary Debates*, House, 16 February 2012 1574 (Bill Shorten, Minister for Financial Services and Superannuation and Minister for Employment and Workplace Relations).

<sup>354</sup> Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012 (Cth) sch 1 item 12 ss 52–52A.

<sup>355</sup> Super System Review (n 309) 12.

<sup>356</sup> TOPS Act 2012 sch 1 item 12 s 52(2)(d), (6).

<sup>357</sup> *ibid* sch 1 item 12 s 54A.

lawmaking powers to regulators and ministers, in addition to a high degree of detail and technicality. APRA was granted a power to make prudential standards in relation to 'prudential matters', a term broadly defined in the Act across dozens of subsections and paragraphs, and to apply them generally or to specific RSEs.<sup>358</sup> The TOPS Act 2012 largely left in place the reforms introduced by the SSA Act 2004, though it repealed the limited capital requirements. The increasing density and technicality of the reforms in the TOPS Act 2012 underscores the ways in which legal complexity results from continuing attempts to change market incentives, such as through new trustee covenants and detailed prudential rules, to address market deficiencies produced by heterogeneous market actors generally pursuing their own self-interest.

Notably, the delegated legislation made by APRA under its new prudential powers exceeded the complexity of the TOPS Act 2012. The nine prudential standards, each of which was a legislative instrument, made in 2012 came in at over 25,000 words, substantially longer than the entirety of the 1987 superannuation regulatory regime. APRA argued that many of the prudential obligations it was implementing reflected the existing practices of many superannuation trustees. This should help again highlight how attempts to shape incentives on market actors drives legal complexity. Imposing what APRA called

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<sup>358</sup> *ibid* sch 2 item 1 s 34C(1), (4), (5).

‘minimum standards’<sup>359</sup> across a heterogeneous set of market actors resulted in significant legal complexity because it required dense, highly technical drafting, differentiation with respect to diverse types of superannuation entities, and regular amendment to maintain the obligations over time. Yet these forms of complexity are to be expected given the wide range of superannuation trustees in the market and the differing extents to which their interests aligned with members.

#### **4.5 High fees and persistent underperformance**

Concerns about the performance of superannuation entities — the financial returns they generate for their members net of fees and taxes — have been a key driver of legal complexity since the origins of modern superannuation. Insofar as performance affects the financial safety of a firm, it is related to prudent superannuation fund management. However, I will consider here how government has been forced to grapple with the *efficiency* of superannuation fund management, a key determinant of fees and therefore of performance. Efficiency is defined with reference to the costs of superannuation fund management. I focus specifically on how government has, in response to acute market weaknesses, assembled ever-more complex legislative arrangements to regulate fees and to drive less efficient superannuation funds out of the market. Fees and efficiency are both crucial for members because it is difficult to ‘beat the market’ through

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<sup>359</sup> Australian Prudential Regulation Authority, ‘Regulation Impact Statement: Superannuation Prudential Standards’ OBPR ID: 14155 4 <<https://www.apra.gov.au/sites/default/files/Prudential-Standards-RIS.pdf>>.

exceptional investment performance, and fees therefore determine much of the variation in financial performance between funds.

#### **4.5.1 Early regulation (1987–94)**

While the OSS Act 1987 permitted the setting of standards with respect to investment,<sup>360</sup> the resulting standards principally restricted certain forms of investment, such as loans to members, and required investments be made on ‘an arms length basis’.<sup>361</sup> Prescriptive disclosure standards made under the Act also required that members be given information that would allow them to assess the performance of the fund,<sup>362</sup> though no fee disclosure was required. The SIS Act 1993 marked the first attempt to grapple with how to improve superannuation fund performance and efficiency. However, it did so principally through enhanced member disclosure. This included requirements to help members understand the ‘management’ and ‘investment performance’ of the fund.<sup>363</sup> Specific obligations to disclose of ‘fees, charges, expenses and administrative or other operational costs’ were also introduced.<sup>364</sup> The SIS Act 1993 was generally light-touch and process-oriented. It preserved and expanded the earlier investment restrictions,<sup>365</sup> while also requiring the development of an ‘investment strategy’ that took account of

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<sup>360</sup> Occupational Superannuation Standards Act 1987 (Cth) s 7(2)(h).

<sup>361</sup> Occupational Superannuation Standards Regulations 1987 (Cth) reg 16.

<sup>362</sup> *ibid* reg 17.

<sup>363</sup> Superannuation Industry (Supervision) Regulations 1994 (Cth) reg 2.27.

<sup>364</sup> *ibid* regs 2.10(3)(k), 2.16(1)(i), 2.24(1)(d), 2.29(1)(l).

<sup>365</sup> SIS Act 1993 ss 109.

various matters prescribed in the Act.<sup>366</sup> It also prescribed trustee supervision of investment managers.<sup>367</sup>

The increased intensity of investment and fees-related regulation visible in the shift from the OSS Act 1987 to the SIS Act 1993 reflected the government's understanding that the performance and efficiency of superannuation would be central to a privatised system of compulsory retirement savings. However, obligations remained limited. This was partly the legacy of a system dominated by defined benefit corporate funds. In these funds, the employer shares the risks of a fund underperforming, and may be liable to make additional contributions to a scheme to fund the promised employee retirement benefits.<sup>368</sup> The corporate fund also bore the cost of fees incurred in operating the fund. In defined contribution funds, which predominated following compulsory superannuation, members bear greater risks with respect to investment performance and fees.<sup>369</sup> The lack of regulation of performance and fees also reflected assumptions about how markets functioned and how individuals behaved. For example, in 1983, the Commonwealth Task Force on Occupational Superannuation argued that 'disclosure arrangements would be preferable to ... more stringent forms of

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<sup>366</sup> *ibid* s 52(2)(f).

<sup>367</sup> *ibid* s 102.

<sup>368</sup> Rosemary Kelly, 'Superannuation and the Marketisation of Retirement Incomes' (1997) 8 *Labour & Industry* 57, 60.

<sup>369</sup> Productivity Commission (n 311) 85.

regulation'.<sup>370</sup> These views echoed those of the 1981 Australian Financial System Inquiry, which observed that 'disclosure by superannuation funds can serve as a substitute for regulation'.<sup>371</sup> These statements reflected the deregulatory political economy of the 1980s and 1990s. Interest groups such as the Association of Superannuation Funds of Australia also contributed to the recommendations of both the Task Force on Occupational Superannuation and the Australian Financial System Inquiry.<sup>372</sup> It would take persistent market deficiencies, and a financial crisis, to overcome the resistance of government and industry to stronger, non-disclosure regulation.

#### **4.5.2 The Global Financial Crisis and tackling fees (2008–12)**

The GFC provided an impetus for reforms to tackle superannuation fees and administration costs. These reforms for the first time directly targeted the types and levels of fees that superannuation trustees could charge,<sup>373</sup> producing highly technical and dense legislative arrangements, with the scope and detail of regulation expanding dramatically. The results were mixed, with the laws struggling to counteract the powerful incentives for higher fees and costs produced by the

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<sup>370</sup> Commonwealth Task Force on Occupational Superannuation, 'Final Report' (1983) Parliamentary Paper 27/1983 [4.40].

<sup>371</sup> JK Campbell and others, 'Australian Financial System' (1981) Final Report [45.153].

<sup>372</sup> Commonwealth Task Force on Occupational Superannuation (n 370) [1.15]; Campbell and others (n 371) [45.153].

<sup>373</sup> There had been limited reforms in 1995 to limit fees on accounts with less than \$1,000: Department of Treasury (Cth) (n 257) 86.

profit motive, notably among costly retail funds, and the lobbying of superannuation funds who wanted to limit stronger regulation.

As discussed earlier, the GFC saw massive reductions in the value of Australian superannuation assets. However, even before this there was increasing evidence that many superannuation funds were underperforming, or at least perceived as such, in ways that were harming members. By 2002, there was strong evidence that non-profit industry funds generated higher investment returns than for-profit retail funds, even when ‘controlling for fund size, membership, benefit structure, and expenses’.<sup>374</sup> The media provided substantial coverage of fees and performance in 2008 and 2009. For example, in October 2008, Ferguson noted the ‘acute problems that have emerged in recent months, including ... [the] worst performance in 20 years, high fees and a lack of transparency’.<sup>375</sup> The Super System Review, launched in May 2009, confirmed the need for more efficient superannuation products for employees who remained with the default superannuation fund selected by their employer, many of which funds had persistently high fees. Table 1 illustrates the high fees faced by most consumers between 2004 and 2009.<sup>376</sup> Most superannuation accounts were held by industry

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<sup>374</sup> Rice, Michael and Ian McEwin (2002) ‘Superannuation Fees and Competition’ (Report, Phillips Fox Actuaries and Consultants, 9 April 2002), cited in Morris (n 276) 123.

<sup>375</sup> Adele Ferguson, ‘Super Reform to Result in Lower Fees, Industry Consolidation’ *The Australian* (30 October 2008) 26.

<sup>376</sup> The table is taken from RiceWarner, *Superannuation Fees Financial System Inquiry* (July 2014), 9.

or retail funds in these years,<sup>377</sup> with retail (referred to as ‘commercial’ in Table 1) fund members facing the highest average fees. Fees consistently above 1.8% on retail accounts between 2004–09 represented a serious market deficiency.

**Table 1: Fees on superannuation accounts by fund type**

Segment	Fee rate (bps)									
	2004	2005*	2006	2007*	2008	2009*	2010	2011	2012*	2013
Corporate	75	77	78	76	73	77	80	79	79	78
Commercial	206	198	189	185	181	183	185	170	164	157
Industry	118	116	113	110	107	117	126	113	110	107
Public Sector	66	68	70	70	69	75	81	82	79	76
<b>Total excluding small funds</b>	<b>140</b>	<b>142</b>	<b>139</b>	<b>127</b>	<b>132</b>	<b>136</b>	<b>140</b>	<b>129</b>	<b>124</b>	<b>120</b>
Self-managed Super Funds	101	94	87	93	98	100	101	100	98	95
<b>Total</b>	<b>130</b>	<b>128</b>	<b>126</b>	<b>124</b>	<b>121</b>	<b>124</b>	<b>127</b>	<b>120</b>	<b>116</b>	<b>112</b>

\* These figures have been estimated by interpolating between years for which data is available.

The Super System Review made a range of recommendations to reduce fees, which the government largely implemented between 2012–13. Most significantly, the government legislated for a new low-cost ‘MySuper’ product. MySuper products would be the default option for employees.<sup>378</sup> Obtaining authorisation to provide a MySuper product was crucial for superannuation trustees because more than 80% of employees remained with the employer’s default fund and product.<sup>379</sup> Given the aim of implementing a ‘simple and cost-effective’<sup>380</sup> product across a heterogenous industry that had demonstrated a

<sup>377</sup> *ibid* 14.

<sup>378</sup> Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012 (Cth) sch 1 item 1.

<sup>379</sup> Super System Review (n 309) 11.

<sup>380</sup> Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 (Cth) 3.

tendency towards excessive fees and charges, the legislative arrangements for MySuper were predictably highly complex.<sup>381</sup> The provisions regulated in detail the obligation to obtain authorisation to offer a MySuper product, their required characteristics, and the fees they could charge. Only six types of fees could be levied, each one defined in the Act, and the legislation prescribed the circumstances in which each fee was permitted to be charged.<sup>382</sup> APRA was given extensive powers to approve and cancel authorities to offer a MySuper product. Additional amendments restricted fees and costs for all superannuation products,<sup>383</sup> including through the introduction of a new Part 11A of the SIS Act 1993 on 'general fees rules'.<sup>384</sup> The government also specifically targeted activity- and performance-based fees.<sup>385</sup> Performance-based fees were perceived as harmful because of their potential to increase risk-seeking, and because they eroded member returns despite there being little evidence they improved performance.<sup>386</sup> The restrictions on performance-based fees highlight the reactive nature of the amendments, targeting the specific symptoms generated by profit-related incentives. The persistence of excessive fees, and particularly harmful performance fees, underscored the failure of general trusts law and the SIS Act

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<sup>381</sup> Core MySuper Act 2012 sch 1 item 9.

<sup>382</sup> *ibid* ss 29V, 29VA.

<sup>383</sup> Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012 (Cth) sch 1.

<sup>384</sup> *ibid* sch 1 item 40.

<sup>385</sup> *ibid* sch 1 item 36 ss 29VC, 29VD.

<sup>386</sup> Super System Review (n 351) 81–82.

1993 to ensure superannuation trustees acted in the best interests of their members. As always, the response to persistent market deficiencies, as predicted in the market building theory, was greater resort to denser and more technical legal interventions as government sought to regulate in detail the superannuation industry's heterogeneous fee and charging arrangements.

Reforms related to the MySuper package further highlight these dynamics, with the government adding to the intensity of performance- and fee-related disclosure obligations. New obligations now spanning over 5,000-words required trustees to create superannuation product dashboards for MySuper and choice products, and to undertake various other public disclosures of investment choice and performance.<sup>387</sup> Regulations also provided further detail on compliance with MySuper, with 89 pages of amendments providing for matters such as prescriptive fee disclosure templates and non-textual modifications of the Corporations Act.<sup>388</sup> The new legislation imposed obligations to provide data to APRA, too, which would then 'publish information on the operation and efficiency of superannuation funds' and 'fees, costs and returns' of MySuper products.<sup>389</sup> The MySuper disclosure requirements built on 2010 reforms which imposed highly detailed form and content requirements for superannuation product disclosure documents, with

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<sup>387</sup> Further MySuper Act 2012 sch 3 pt 1 items 5–15.

<sup>388</sup> Superannuation Legislation (MySuper Measures) Amendment Regulation 2013 (Cth).

<sup>389</sup> Explanatory Memorandum, Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (Cth) [3.3]–[3.4].

rules spanning over 4,500 words in regulations.<sup>390</sup> These regulations aimed to ameliorate the widely varying standards and approaches to consumer disclosure under the basic financial product disclosure regime, with superannuation disclosure documents varying between 46 and 154 pages.<sup>391</sup> The regulations covered matters such as the length, font size, and structure of superannuation disclosure documents, as well as specific disclosures for things such as superannuation risks and fees and costs. Exhaustive and intricate disclosure obligations were becoming a core feature of the regulatory regime as governments worked to drive down fees and costs, particularly through greater comparability of standardised superannuation products and disclosure documents. It was hoped this would increase product switching, thereby enhancing competition and forcing down product costs.

In total, then, the government's post-GFC attempts to reduce superannuation fees in the face of public pressure for improved fund performance resulted in an intricate legislative architecture spanning dozens of obligations in multiple acts and regulations, with significant new discretions granted to APRA and the government. MySuper did appear to bring down fees for many members. However, as Figure 3 illustrates based on data from 2013,<sup>392</sup> the benefits were

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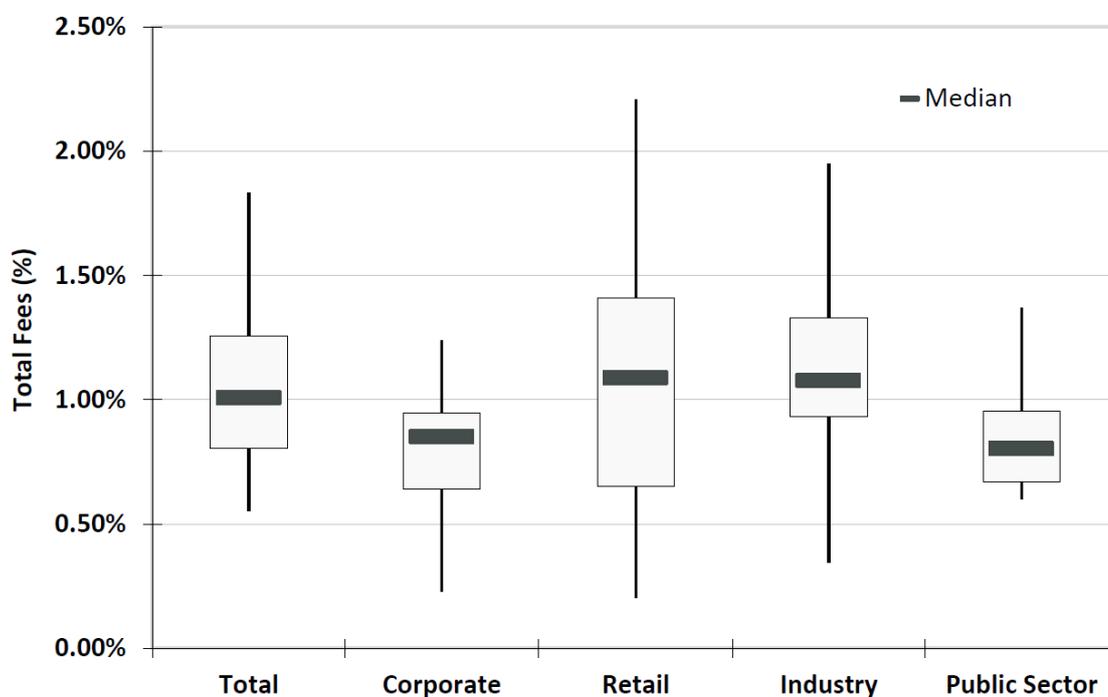
<sup>390</sup> Corporations Amendment Regulations 2010 (No 5) (Cth) sch 1 item 6 (inserting a new subdiv 4.2B), item 17 (inserting a new sch 10D).

<sup>391</sup> Regulation Impact Statement, 'Corporations Amendment Regulations 2010 (No 5) (Cth)' [8].

<sup>392</sup> The figure is taken from RiceWarner (n 312) 24.

mixed, with fees remaining high for many products, particularly those offered by for-profit retail funds.

**Figure 3: MySuper fees in 2013**



Later data confirms this picture, with the Australian Treasury finding that fees on MySuper accounts with a balance of AUD\$50,000 rose from 0.89% in 2014 to 1.01% in 2020. Changing incentives to address high fees and costs proved exceptionally difficult, and industry lobbying and regulatory philosophies appeared to prevent resort to fee bans and caps like those found in the UK.<sup>393</sup> The limits of the MySuper reforms, particularly for the millions of people left in underperforming choice and MySuper products, would produce further pressure for reform in the coming years, again resulting in further complex legislative reforms.

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<sup>393</sup> Where stakeholders schemes and auto-enrolment schemes faced fee caps.

### **4.5.3 The struggle continues (2019–21)**

Reflecting ongoing public pressure to address high fees and underperformance, complex legal interventions later were introduced by a conservative Liberal-National government, building on the MySuper reforms undertaken by the earlier Labor government. Crucially, this period saw simpler legal interventions, such as fee caps, as governments were forced to grapple with the apparent failure of disclosure, product standardisation, and market competition to drive down fees and costs.

#### **4.5.3.1 *The Protecting Your Superannuation Package***

As discussed, it had long been recognised that fees could have a disproportionate impact on low-value superannuation accounts. This justified the 1995 restrictions on the fees chargeable on accounts with less than \$1,000, though these rules still permitted fees up to the entire investment return (if any).<sup>394</sup> The problem of fees on low value accounts became acute in the late-2010s. This was because employees frequently accrued multiple private pensions as they changed jobs,<sup>395</sup> and many of pensions accumulated relatively little savings. By June 2016, 40% of all superannuation accounts held less than \$6,000, representing 9.5 million accounts.<sup>396</sup> Of these, 60% were inactive, having received no contributions in the

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<sup>394</sup> Superannuation Industry (Supervision) Regulations (Amendment) 1995 (SR 1995 No. 64) (Cth) item 17, inserting reg 5.17 into the SIS Regulations 1994.

<sup>395</sup> David Murray and others, 'Financial System Inquiry' (2014) Final Report 90.

<sup>396</sup> Regulation Impact Statement, 'Protecting Your Super Package' 8 <<https://treasury.gov.au/sites/default/files/2019-03/t332527-Explanatory-material.docx>> accessed 28 June 2024.

previous 13 months.<sup>397</sup> The average fees on low-value accounts could be as high as 9%.<sup>398</sup> The government now undertook two significant legislative interventions. They attracted widespread support from civil society, including consumer groups and think tanks,<sup>399</sup> and opposition from large financial advice firms and superannuation schemes.<sup>400</sup> First, amendments to the SIS Act 1993 introduced a cap on fees for accounts with a balance of less than \$6,000 and prohibited the charging of exit fees on all superannuation accounts.<sup>401</sup> The new s 99G of the SIS Act 1993, in conjunction with regulations made under it,<sup>402</sup> imposed a relatively simple legislative prohibition on fees greater than 3%. However, the new prohibitions reflected the increasing technical control exercised through law. This sought to respond to specific market deficiencies, such as exit fees and high fees on low-value accounts, symptoms of deeper problems underlying the move to a system of market provision. Self-interest provides a strong force for higher fees in a market, with longstanding evidence that profit-oriented parts of the market (retail funds) charged markedly higher entry and exit fees than other types of

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<sup>397</sup> *ibid.*

<sup>398</sup> Explanatory Memorandum, Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2018 (Cth) [5.30].

<sup>399</sup> Senate Economics Legislation Committee, Parliament of Australia, 'Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 [Provisions]' (2018) [2.3]–[2.10].

<sup>400</sup> *ibid* [2.11]–[2.13], [2.61]–[2.67], [2.137].

<sup>401</sup> Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019 (Cth) sch 1.

<sup>402</sup> Treasury Laws Amendment (Protecting Your Superannuation Package) Regulations 2019 (Cth) item 31.

superannuation entities.<sup>403</sup> In response to the proposed legislation, various stakeholders, including the Law Council of Australia, reflected on the challenge and complexity of confronting profit-related incentives for higher fees and warned about possible avoidance of fee restrictions.<sup>404</sup> Addressing market incentives and the deficiencies they produce is an inherently difficult activity, particularly in the face of industry lobbying and potential regulatory arbitrage.

In addition to fee restrictions on low-value accounts, the government established far more legally complex arrangements for superannuation entities to transfer inactive low-value accounts to the Australian Tax Office (ATO), which would then be empowered to consolidate these funds in a person's active account. The core provisions spanned over 4,900 words in the new Parts 3B and 4B of the Superannuation (Unclaimed Money and Lost Members) Act 1999 (Cth) (SUMLM Act 1999).<sup>405</sup> That Act already provided for a range of circumstances in which accounts were required to be transferred to the ATO,<sup>406</sup> and by September 2022 the Act was 165 pages long. Consolidation of the accounts covered by the SUMLM Act 1999 was sensible given that many fees are fixed value, rather than percentage-based, so that having multiple accounts will generally be undesirable. Again, however, legal complexity was a necessary product of newly imposed transfer obligations on

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<sup>403</sup> Sue Taylor, 'Captured Legislators and Their Twenty Billion Dollar Annual Superannuation Cost Legacy' (2011) 21 *Australian Accounting Review* 266, 275.

<sup>404</sup> Senate Economics Legislation Committee, Parliament of Australia (n 399) [2.71], [2.68]–[2.82].

<sup>405</sup> PYS Act 2019 sch 3 item 30.

<sup>406</sup> Explanatory Memorandum, Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2018 (Cth) (n 398) [4.5]–[4.6].

privately-operated superannuation firms, in response to the growing number of specific circumstances in which it was apparent that consolidation would be desirable. Moreover, the very problem of duplicative superannuation accounts was the product of a privatised model of superannuation. A model of state provision would bypass such problems, as superannuation payments would be held by the state regardless of the job in which they were obtained in. The UK model of SERPS avoided this problem, and the Canadian model discussed in Chapter 1 also underscores one way in which the entire system of fees and performance regulation can largely be avoided in a state model.

#### **4.5.3.2 *The Your Future, Your Super Package***

Across several decades, then, various Australian governments had collectively built a vast legislative architecture, containing dozens of conduct and disclosure obligations, aimed at reducing fees and improving superannuation performance. Yet, writing in December 2018, the Productivity Commission observed that '[c]onduct regulation appears to be missing in action',<sup>407</sup> a point underscored by a Royal Commission's findings of serious misconduct among (particularly retail) superannuation entities.<sup>408</sup> This was despite 'a cornucopia of regulation aimed at trying to ensure members' best interests are met'.<sup>409</sup> In response to the enduring concerns about funds' failing to act in members' best interests, the government

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<sup>407</sup> Productivity Commission (n 311) 26.

<sup>408</sup> Commonwealth of Australia, 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' (2019) Final Report Volume 1 136–137.

<sup>409</sup> Productivity Commission (n 311) 27.

had in 2017 introduced legislation to impose new obligations on RSEs to conduct annual outcomes assessments of each superannuation product they offered, though the legislation was passed only in April 2019.<sup>410</sup> These were procedural obligations requiring trustees to determine whether they were promoting the ‘financial interests of the beneficiaries’,<sup>411</sup> having regard to various matters prescribed in the legislation. The Law Council of Australia argued that these amendments were largely of ‘symbolic value’, requiring only that a trustee assert compliance with existing legislative obligations.<sup>412</sup>

Continued problems with respect to fund performance appeared to support such observations. Investment performance between individual superannuation funds and types of funds continued to vary substantially. For example, retail funds underperformed not for profit funds by almost two percentage points,<sup>413</sup> while 5.2 million accounts holding AUD\$269 billion were in underperforming superannuation funds.<sup>414</sup> Underperformance potentially had enormous impacts on individuals, such that some employees in an underperforming fund could be 54% worse-off than someone in a top performing fund (losing out on as much as

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<sup>410</sup> Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019 (Cth) sch 1.

<sup>411</sup> *ibid* sch 1 item 6, inserting s 50(9)(a).

<sup>412</sup> Law Council of Australia, ‘Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017’ (2017) 5.

<sup>413</sup> Productivity Commission (n 311) 7.

<sup>414</sup> *ibid* 10.

AUD\$660,000).<sup>415</sup> Despite their decline, fees continued to significantly erode superannuation balances and remained high relative to other OECD countries.<sup>416</sup> Approximately four million accounts holding AUD\$275 billion were paying fees above 1.5%<sup>417</sup> High fees could reduce member balances by about 12% in retirement.<sup>418</sup> To deal with these problems, the Productivity Commission recommended that funds underperforming a benchmark by more than 0.5 percentage points a year, across a rolling 8-year period, should be forced to undertake a 12-month period of remediation or even be withdrawn from the market.<sup>419</sup> Reflecting the pressure the conservative government was under to fix ongoing market deficiencies, it implemented an even more interventionist set of reforms. It required that the regulator, APRA, conduct the performance assessments (rather than the fund or an auditor) and that funds would be immediately closed to new members if they failed the performance test after just two consecutive years.

The provisions establishing the new legislative scheme for annual performance assessments were extremely complicated, prescribing in great technical detail how assessments were to be conducted and how benchmarks

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<sup>415</sup> *ibid* 10–11.

<sup>416</sup> *ibid* 14.

<sup>417</sup> *ibid* 15.

<sup>418</sup> *ibid* 30.

<sup>419</sup> *ibid* 67.

were to be calculated. The Act amendments spanned over 3,000 words,<sup>420</sup> with more than 9,500 words now appearing in regulations,<sup>421</sup> and contained the kind of definitions ('part 6A products') that reflect a legislative framework becoming unmoored from the world it regulates. Indeed, more than half of all words in the regulations relate to technical legislative definitions, and the regulations contain more than a dozen mathematical equations. Relevantly to a self-interest account of legal complexity, the Law Council of Australia criticised some of the new defined terms, observing that 'regulation of superannuation funds is already very complex' and new concepts 'add to that complexity'.<sup>422</sup> The density of regulation governing trustee performance and fee arrangements now reached its zenith, with all elements of both subject to review as part of the performance framework. The government has recently issued a 49-page consultation paper on 'improv[ing] the sophistication of the' fund assessments, which would require further legislative reform.<sup>423</sup>

#### **4.6 Implications for theories of legal complexity**

The complexity of Australia's private pensions legislation has its roots in many of the causes suggested by the market building theoretical framework. Even more so

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<sup>420</sup> Treasury Laws Amendment (Your Future, Your Super) Act 2021 (Cth) sch 1 item 9.

<sup>421</sup> SIS Regulations 1994 pt 9AB.

<sup>422</sup> Law Council of Australia, 'Exposure Draft Regulations to Support Treasury Laws Amendment (Your Future, Your Super)' (2021) 22 <<https://lawcouncil.au/publicassets/fdded65f-8f16-ec11-9440-005056be13b5/4008%20-%20Treasury%20Laws%20Amendment%20-%20Your%20Future%20Your%20Super%20Measures.pdf>>.

<sup>423</sup> Department of the Treasury (Cth), 'Annual Superannuation Performance Test - Design Options' (2024) Consultation Paper 4.

than the UK, legal complexity has been produced through efforts to expand participation in superannuation, first through tax changes that made expansion fiscally sustainable, then through tribunal decisions and employment awards, before culminating in compulsory superannuation implemented through the SGA Act 1992 and its related legislation. The Act has spawned over a dozen Australian Taxation Office determinations and hundreds of court and tribunal judgments. The creation of compulsory private pensions through law generated legal complexity, but it also marked the abandonment of a state scheme that would have been legally simpler to establish and operate. A state scheme would have allowed contributions to be collected through the tax system, rather than in payments to hundreds of superannuation funds mandated through the SGA Act 1992 model, while minimising the need for escalating legal interventions to address lack of competition, poor performance, excessive fees, and inappropriate governance. These market deficiencies were pivotal in driving growing legal complexity as governments tried, and frequently failed, to change incentives and control market actors. The crucial role of the profit motive in these dynamics is underscored in the Australian case study, with market deficiencies most acute in the for-profit retail fund segment of the market. This segment consistently had the highest fees and worst performance, the most egregious misconduct in sales and advice (as shown in the 2019 Royal Commission), and was the locus of governance and prudential failures that saw the collapse of trustees like Commercial Nominees. The final three sections of this chapter, on competition, prudential regulation, and fees and performance, have highlighted how governments have produced increasingly dense and technical laws to address deficiencies, adding to the range of trustee

and other market participant behaviour that is regulated and the degree to which they are regulated, often through highly technical and detailed rules. As in the UK, legal complexity accrued as governments intervened, iteratively, building laws upon laws to reduce fees, drive out underperforming funds, and enhance competition. Nonetheless, not all features of the market building framework are visible in Australia. Despite repeated attempts, the Australian government never acted as a competitor to private pensions in providing earnings-related pensions. Therefore, it never had access to the kind of non-regulatory tools available to the UK government through the GRB, reserve pension, and SERPS. Regulation, either through incentives in the tax system or legislative obligations, has been the only tool ever really utilised by the Australian government. The key driver of legal complexity was, even more so than in the UK, the growing reliance on such tools to address market deficiencies and in the use of law to drive market participation.

## **Conclusion**

This dissertation has examined the relationship between the expansion of markets and market relations and legal complexity. It has demonstrated how a specific drive to market expansion has mandated the increasingly intricate legal architecture around private pension provision in the UK and Australia. Chapter 1 introduced market building theory to highlight dynamics that have gone unrecognised or insufficiently explored in existing accounts of legal complexity. Core to the theory is recognition of the constitutive role of law to markets. As the two case studies of UK and Australian private pensions law have also demonstrated, law is crucial in establishing the conditions for market development. The discussion has shown the difficulty of addressing market deficiencies, as underscored by the UK and Australian governments' repeated attempts to improve market competition, fund performance, governance and prudential fund management, while also reducing private pension fees and costs. Over time, law grew increasingly dense and technical, across both governments of varying ideological commitments, as the range of regulated conduct expanded and the level of legal detail for specific conduct ballooned. Complex legal interventions accrued as previous efforts to address deficiencies failed or proved inadequate. Repeatedly, the profit motive was core to the process of growing legal complexity, driving market actors to avoid laws or to lobby to weaken them, thereby triggering further market deficiencies. In Australia, for example, private pension funds were instrumental in opposing robust prudential regulation in 2000–4. This may have contributed to the second-worst investment performance in the OECD during the

GFC, and the resulting introduction of a vast, dense, and technical prudential framework, in which most regulation occurred through detailed rules in delegated legislation made by APRA. The failure of RSAs to drive further competition rested on financial services firms seeking to maximise profits through exorbitant fees of, on average, 2.5%. The central role of the profit motive was particularly evident in the persistence of high fees among for-profit private pension funds in Australia. In the UK, market actors opposed any role for a state scheme in 2005, a scheme that would have been relatively legally simple to implement. Significantly, as predicted by market building theory and by Lord Turner, the Pensions Commission model may have helped to break the cycle of palimpsest-like volumes of regulation aimed at addressing market deficiencies associated with universal market provision.

Beyond highlighting the increased legal complexity created by the role of legal interventions in challenging profit-related incentives and reducing market deficiencies, market building theory has also drawn attention to other important factors driving dense and technical lawmaking. The theory calls for a greater focus on how states actively seek to constitute markets and expand participation. In the Australian case study, this drew attention to the legal complexity produced in the late-1980s using tribunals to insert private pension entitlements into employment awards and the complexity produced by the 1992 move to compulsory private pensions. The UK case study highlighted the role of law and resulting legal complexity in automatic enrolment of employees into private pensions. In both case studies, the active state construction of markets was reflected in the creation of new legal forms, including personal pensions (1986), RSAs (1997), stakeholder pensions (1999), and CDC schemes (2017). Complex legal frameworks resulted

from each of these projects of market construction. Market building theory has also sought to highlight the decline of non-law responses to market deficiencies, which has resulted in greater recourse to complex regulatory interventions. The potential of state schemes was most visible in the UK case study, with the government acting as a competitor to private pension providers by delivering various state earnings-related pensions. In Australia, as predicted by market building theory, the abandonment of any possibility of a relatively legally simple state scheme helped lay out the road for the more complex lawmaking project needed to constitute, expand, and sustain a sizeable private pension market.

Markets, then, have been shown to produce growing legal complexity, and necessitate more dense and technical laws than state provision. Yet, the market building theory I advocated also fails to answer several questions key to understanding growing legal complexity: thus, why are markets expanding and state provision declining? Why have states used law to encourage or mandate participation in markets? Why have states abandoned non-legal instruments and institutions when seeking to change incentives and address market deficiencies?<sup>424</sup> Answering each of these questions will help provide richer theoretical and empirical accounts of legal complexity, drawing attention to extensive changes in political economies that have contributed to growing legal

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<sup>424</sup> There is evidence that this trend may be reversing, with greater resort to subsidies and public investment as part of industrial policies. See, eg, 'Subsidies and Protection for Manufacturing Will Harm the World Economy' *The Economist* (13 July 2023) <[www.economist.com/leaders/2023/07/13/subsidies-and-protection-for-manufacturing-will-harm-the-world-economy](http://www.economist.com/leaders/2023/07/13/subsidies-and-protection-for-manufacturing-will-harm-the-world-economy)>.

complexity. Integrating the work of political economy scholars will be crucial in this. For example, Gingrich has demonstrated that both left- and right-wing political parties will use markets, though for different reasons, with varying purposes, and in distinctive ways.<sup>425</sup> More recently, Baradaran has linked growing legal complexity to neoliberalism and changes in political economy since the 1960s.<sup>426</sup>

The two case studies I examined have highlighted also the limitations of existing accounts of legal complexity. I have argued that the development of novel technologies and new economic and social relationships played a minor role in the growing complexity of UK and Australian private pensions law. Indeed, a ‘law reflects reality’ account struggles to explain the decisions to use law to expand markets and to address market deficiencies. These are shaped by political dynamics, only alluded to in this dissertation, that play a central role in the resort to markets, thereby generating market-building dynamics. Similarly, the case studies have highlighted the many attempts by regulated firms, lawyers, and government actors to stop legal interventions or to water down more dense and technical rules. This was seen in industry’s opposition to a full prudential framework in Australia, APRA’s resistance to detailed investment portfolio and education rules, and the Law Council of Australia’s criticism of annual performance assessments and legislatively defined terms in the ‘Your Future, Your

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<sup>425</sup> Jane R Gingrich, *Making Markets in the Welfare State: The Politics of Varying Market Reforms* (Cambridge University Press 2011).

<sup>426</sup> Mehrsa Baradaran, *The Quiet Coup: Neoliberalism and the Looting of America* (W W Norton & Company 2024).

Super' reforms. Self-interest may, partly, have driven actors' behaviour, but market building theory shows that legal complexity is more often the indirect result of people pursuing self-interest than the objective of their behaviour.

It is worth considering the implications of market building theory for the future, too. The theory suggests that the complexity of private pensions legislation in both the UK and Australia is likely to increase in coming years. The profit motive inevitably will continue to drive market deficiencies, which will in turn result in further complex legal interventions. Indeed, Morris, reflecting on Australian superannuation regulation in 2018, emphasised the continued persistence of market deficiencies and the need for further regulation. He called for greater resort to competition law rules, disclosure obligations, regulator powers, and regulation of product design.<sup>427</sup> In the UK, the Labour government elected in July 2024 has already announced a new Pensions Bill.<sup>428</sup> Several of the proposed reforms mirror those implemented in Australia, including automatic consolidation of low-value accounts and introduction of a 'value-for-money' framework.<sup>429</sup>

In my discussion, I have made the case that this growing complexity threatens the rule of law, including by making it harder to understand, comply with, and enforce. I will finish by emphasising that legal complexity, particularly in domains as individually economically important as private pensions law, threatens

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<sup>427</sup> Morris (n 276) 158.

<sup>428</sup> Prime Minister's Office (UK) (n 248) 14–5.

<sup>429</sup> Similar to the performance assessments introduced in the Your Future, Your Super reforms.

the democratic legitimacy and accountability of the law. The increasing complexity of our laws risks making it almost impossible to have meaningful citizen participation in debates about the development of the law, and specifically in the regulation of private pensions in the UK and Australia.

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