

Workshop on interoperability pricing: summary of proceedings

12 April 2023

Overview

We held a workshop on 21 March 2023 to discuss our draft recommendations for interoperability pricing for electronic lodgment network operators (ELNOs). The workshop was attended by 24 stakeholders, 3 Tribunal members and IPART Secretariat staff.

The workshop covered 4 topics:

1. Outline of IPART's review of interoperability pricing and a summary of IPART's draft recommendations
2. Responsible ELNO (RELNO) fee
3. Default RELNO surcharge
4. Issues around implementation of interoperable transaction fees.

IPART made short presentations on each topic followed by general discussion.

This paper provides a summary of the issues discussed at the workshop, including:

- Impact of interoperable transaction fees on subscribers
- Level of RELNO fee compared to IPART's 2019 estimate
- Issue resolution cost estimate for RELNO fee
- Capital cost estimate for default RELNO surcharge
- Weighted Average Cost of Capital (WACC)
- Structure of default RELNO surcharge
- Level of default RELNO surcharge
- Length of regulatory period
- Dispute resolution
- Market structure

1 Outline of IPART's review

IPART presented an outline of the review of interoperability pricing, decisions that have been made in earlier stages of the review and a summary of our draft recommendations on interoperable transaction fees.

Workshop participants introduced themselves and indicated any issues they wanted to discuss at the workshop.

IPART welcomed discussion, questions and feedback on our Draft Report at the workshop and also reminded attendees that written submissions had been sought and were due by 24 March.

2 RELNO fee

IPART presented a summary of our draft recommendations on the RELNO fee and our approach to calculating this fee.

The sections below summarise stakeholder feedback and discussion on the RELNO fee.

2.1 Impact of interoperable transaction fees on subscribers

A stakeholder asked how interoperable transaction fees would impact subscribers.

We discussed the following points:

- Interoperable transaction fees should not result in subscribers paying higher ELNO service fees for interoperable transactions than single-ELNO transactions. Interoperable transaction fees are charged between ELNOs and should be recovered from all subscribers.
- It is not certain that interoperable transaction fees will increase ELNO service fees. IPART will review ELNO service fees when 1 of 4 trigger events occurs, but it is too early to determine the outcome of the ELNO service fee review. There has been a lot of change in the eConveyancing market since the original ELNO service fees were set, in the early stages of developing eConveyancing. There may be changes in transaction volumes and costs as the market develops.

2.2 Level of RELNO fee compared to IPART's 2019 estimate

A stakeholder noted that in our 2019 review of the eConveyancing market in NSW, IPART estimated a marginal operating cost to illustrate a potential transfer price between ELNOs in an interoperable transaction. The stakeholder noted that the 2019 illustrative transfer price was considerably higher than IPART's draft recommended RELNO fee of \$0.75 per transaction.

The stakeholder queried whether these difference between \$0.75 and the 2019 transfer price of around \$13 would be recovered from ELNO service fees.

We discussed the following points:

- The 2019 estimate included the Lodgment Support Service (LSS) fee. In our Draft Report for the current review, we recommend that LSS fees should be shared between ELNOs via the ELNO interoperability agreements, and not through interoperable transaction fees. The 2019 estimate also included lodgment gap insurance, for which we estimated a cost of about \$10 per transaction. In earlier stages of the current review we explained why we do not think it is appropriate to recover lodgment gap insurance through interoperable transaction fees.
- The purpose of the RELNO fee is to recover costs incurred by the RELNO on behalf of PELNOs. These costs are likely to occur towards the end of a transaction and involve costs such as resolving errors and issues.

2.3 Issue resolution cost estimate for RELNO fee

A stakeholder inquired about IPART's issue resolution cost estimate for the RELNO fee. The stakeholder noted that IPART's estimate uses Revenue NSW's customer support costs to estimate both the probability and the cost per issue for the RELNO. The stakeholder asked why the issue resolution cost estimate for the RELNO is not higher than Revenue NSW's customer support costs, since the RELNO will deal with more complex issues and more parties than Revenue NSW.

The stakeholder said that any issue that causes a problem for Revenue NSW is going to cause a problem for the RELNO and Revenue NSW only has to deal with one party, but the RELNO in a transfer transaction is going to have to deal with 2 banks and other ELNOs to the transaction. The stakeholder asked about whether IPART has thought about adjusting the costs to reflect this.

The stakeholder noted the uncertainty around costs at the moment and that the risk of setting the price too high is that a barrier to entry is created. However, the risk of setting the price too low is that PEXA will not receive a fair price if it performs the RELNO role more frequently than other ELNOs.

A stakeholder noted that RELNOs and PELNOs will be governed by an industry payments code, that is currently in development. The code will govern the resolution process. The stakeholder agreed that transfer transactions may be complex and noted it is difficult to quantify the cost of issue resolution.

We discussed the following points:

- Revenue NSW is a proxy for the issue resolution cost estimate. We currently have limited access to reliable data that can be made publicly available. We encourage stakeholders to send us better cost information if available, ideally through the written submission process so additional information can be taken into account while finalising our recommendations.
- We agree that RELNOs may deal with more parties and more complex issues for transfer transactions. We note that the RELNO fee would also apply to refinance transactions, which can be much simpler and involve fewer parties. Different transaction types will impact the cost of issue resolution, which we will take into consideration.
- The RELNO fee is intended to capture the issues typically occurring at the later stages of a transaction during lodgment and settlement. There will be other issues that happen earlier in the transaction where both RELNOs and PELNOs are involved and will deal with those issues on behalf of their own subscribers.

- We have set a relatively short regulatory period of 2 years to manage the uncertainty and address risks that fees are set too high or too low.

3 Default RELNO surcharge

IPART presented a summary of our draft recommendations on the default RELNO surcharge and our approach to estimating this fee.

AECOM presented a short summary of its approach to estimating software development costs.

The sections below summarise stakeholder feedback and questions on the default RELNO surcharge.

3.1 Capital cost estimate for default RELNO surcharge

A stakeholder suggested that IPART has underestimated capital costs for the default RELNO surcharge. They noted that it has taken PEXA and Sympli several years to develop their systems and queried AECOM's estimates for the length of time it would take an ELNO to develop its system. The stakeholder suggested that the assumptions for number of days to develop lodgment and financial settlement infrastructure are not a reasonable estimate.

A stakeholder suggested using cost information on actual software development from ELNOs.

IPART discussed the following points:

- We estimated the cost for an efficient new entrant, not the cost for a first mover. First mover costs would be substantially higher than our estimate.
- We are open to feedback on our approach to estimating capital costs for the default RELNO surcharge e.g. size of the project team, number of developer days, hourly rates and other costs such as the cost of an ELNO negotiating connections to third parties.

3.2 WACC

A stakeholder queried the assumptions in IPART's WACC calculation for the default RELNO surcharge. This included the proxy firms used to calculate the equity beta, and the gearing ratio. IPART advised that we are open to feedback on inputs to the WACC calculation for the Final Report and invited further feedback in written submissions.

3.3 Structure of default RELNO surcharge

A stakeholder noted that it costs a lot of money and takes a long time for ELNOs to establish and maintain connections with all the parties necessary to provide universal coverage and that interoperable transaction fees need to create an incentive for ELNOs to build their own capability and not free-ride. The stakeholder noted the costs of establishing and maintaining connections to revenue offices, the tax office and practitioner trust funds.

The stakeholder said that ELNOs are only required to connect to land registries and the regulations do not require financial settlement, so setting the default RELNO surcharge too low risks creating an incentive for new entrant ELNOs never to develop financial settlement infrastructure.

Another stakeholder clarified that there will be adjustments to the payments code to require ELNOs to have financial settlement and revenue office connections, that do not exist in current regulations (such as the MORs).

3.4 Level of default RELNO surcharge

A stakeholder noted that our recommended default RELNO surcharge is about 1% of a typical ELNO service fee.

IPART noted that the default RELNO surcharge represents capital costs of developing lodgment and settlement infrastructure and webhosting costs. We have not set the surcharge in reference to the ELNO service fees because ELNO service fees are due to be reviewed again to ensure they are cost-reflective.

4 Implementation

IPART presented a summary of our draft recommendations on implementation issues such as the length of the regulatory period, proposed amendments to the Model Operating Requirements (MORs) and future reviews of interoperable transaction fees.

The sections below summarise stakeholder feedback and questions on implementation issues.

4.1 Length of regulatory period

IPART's draft recommendation is that interoperable transaction fees should apply for a 2-year regulatory period and be reviewed again. IPART also proposed that ELNOs report data on interoperable transactions to support future reviews of interoperable transaction fees.

A stakeholder asked whether the delay to the Day 1 interoperable transaction, which has been postponed from March to September 2023, would impact IPART's proposed regulatory period. Considering this change, IPART invited workshop participants to provide feedback on what would be an appropriate regulatory period and when the best time would be to review interoperability fees.

A stakeholder suggested it would be preferable to wait until interoperability is implemented to collect data from ELNOs on interoperable transactions. The stakeholder also suggested implementing the fee in one state initially.

Another stakeholder expressed support for a 2-year regulatory period and the proposal to collect data from ELNOs to inform future reviews.

4.2 Dispute resolution

A stakeholder was concerned there may be delays to ELNOs reaching agreement on matters such as the practical arrangements for payment of interoperable transaction fees. IPART asked whether there should be a timeframe for agreement, how long, and what should be the consequences for not reaching agreement.

The stakeholder also noted that the MORs will include a dispute resolution mechanism for Interoperability Agreements.

4.3 Market structure

A stakeholder noted that while IPART has not been asked to look at market structure, they consider there needs to be more analysis of the eConveyancing market structure because building 2 sets of infrastructure can be expensive. The stakeholder noted that because ELNOs have high fixed costs, market share has a large impact on sustainability, creating a risk for continuity of service and coverage.