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1 Executive Summary

1.1 Proposed interoperable transaction fees

1.1.1 Responsible ELNO Fee

PEXA agrees with IPART that a Responsible ELNO (**RELNO**) Fee should apply to all interoperable transactions. RELNO fees should compensate for the larger marginal costs (and risk) that the RELNO incurs and which the Participating ELNO(s) (**PELNO(s)**) do not incur (or incur less of). This includes costs of orchestrating the transaction, and executing and providing support for lodgement and settlement.

In determining the appropriate RELNO fee:

- The RELNO fee should be charged for each subscriber supported by an ELNO other than the RELNO, rather than being a fixed fee payable per workspace.
- It should be set for each transaction type and jurisdiction, reflecting the different risk/cost profile of each subscriber for which the ELNO assumes responsibility and the different cost bases of different transactions and jurisdictions.
- IPART should estimate financial settlement and other operating costs specific to the RELNO role using a bottom-up cost build approach. This approach should benchmark historic costs incurred by ELNOs, by transaction type and jurisdiction. These costs should then be apportioned to PELNOs based on subscriber role. PEXA agrees that estimating a Weighted Average Cost of Capital (**WACC**) for ELNOs is appropriate in order to estimate profit margin. REA Group and Domain, brokerage platforms, or software start-ups are appropriate proxies for calculating an appropriate WACC.

For reasons of practicality, the RELNO fee should be payable to the designated RELNO as at the time of settlement. This also reflects that the RELNO at the time of settlement assumes the vast majority of costs/risk.

1.1.2 Default RELNO surcharge

PEXA agrees that a default RELNO surcharge should apply when the initially designated RELNO is unable to perform the role. PEXA submits that an ELNO that has previously defaulted on RELNO responsibility should pay the default RELNO surcharge for each subsequent transaction with the feature that caused the default (whether or not the ELNO is initially designated as the RELNO) until it has demonstrated capability in practice to execute a subsequent transaction with that feature.

It is not possible at this time to identify all instances when the default RELNO surcharge should be payable (as interoperability is still being developed). However, some possible capability-based default trigger events might include: (a) lacking technical integration with a specific revenue office; (b) lacking integration to a specific financial institution; or (c) lacking the capability to process certain lodgement types (such as some registry instruments, or instruments requiring an attachment).

While the full set of circumstances when a default RELNO surcharge might be payable remains uncertain, the cost of facilitating these transactions may be a substantial portion of the ELNO Service Fee. PEXA therefore submits that an initial approach should be to set the default RELNO surcharge as 50% of the ELNO Service Fee of the Responsible ELNO for all subscriber roles in the transaction played by a defaulting RELNO. This proportion is reasonable having regard to

PEXA's actual costs for establishing relevant capabilities. It also sets an appropriate economic incentive for ELNOs to develop functionality (and avoid free-riding). In principle, PEXA agrees with IPART's proposed recommendation that the surcharge should be payable by the defaulting ELNO for the avoided cost of infrastructure or capability that it lacks at the time of the transaction. However, PEXA submits that the surcharge should be higher than this in order to create appropriate incentives for all ELNOs to implement full functionality, which is a core feature of the interoperability model and in circumstances where the new entrant is obliged under the Model Operating Requirements (**MOR**) to build full capability in all jurisdictions.

This level of cost recovery is appropriate on the basis that:

- In an interoperable transaction, the new entrant will only be able to participate in certain interoperable transactions because another ELNO has invested in the required infrastructure and capability;
- It reflects the actual costs of providing the service;
- It establishes appropriate incentives for all ELNOs to develop full capability; and
- It reflects the approach utilised by regulators in setting fees for third party access to common infrastructure (such as gas pipelines or monopoly telecommunications infrastructure).

Paying a surcharge to the party that performs the role of the RELNO does not result in 'double cost recovery'. A RELNO would only recover a default RELNO surcharge when another ELNO, which has not built the relevant infrastructure / capability is collecting some of the ELNO Service Fees for that transaction.

In determining the default RELNO surcharge, the actual capital costs incurred to establish technical integrations between an ELNO and key industry stakeholders should be assessed to determine the efficient capital costs.

1.2 Recovery of interoperability costs via ELNO Service Fees

In principle, PEXA supports IPART's draft decisions that costs associated with implementing and maintaining interoperability should be recovered via ELNO Service Fees (*Draft Decision 1*) and that subscribers that participate in an interoperable transaction should not pay more than subscribers to a non-interoperable transaction (*Draft Decision 3*).

However, PEXA submits that ELNO Service Fees are unlikely to be cost reflective (particularly following the implementation of interoperability), given: (a) the costs of establishing interoperability are considerably higher than existing regulatory estimates; (b) total costs of establishing interoperability are undeterminable at this time; and (c) ELNO Service Fees are currently subject to a CPI cap (and have been for many years). These fees were originally set in an environment where PEXA had a low share and was competing against legacy paper-based conveyancing systems.

PEXA's *actual* costs to establish interoperability will be higher than those of new entrants, as PEXA is retrofitting changes to legacy technology to ensure it remains safe and effective (as the only fully operational ELNO servicing all transaction types and jurisdictions that have e-conveyancing). Regulatory arrangements should therefore permit PEXA to recover its larger actual costs of interoperability (rather than the theoretical efficient costs of a new entrant). Given the potential for a decline in PEXA's market share following implementation of interoperability, PEXA would be able to recover its higher actual costs of interoperability if the current cap on its ELNO Service Fees were increased more than just CPI, in the short term, for a limited time period. This would provide PEXA an opportunity to earn a reasonable return on its investment in interoperability.

The costs of interoperability should only be recovered through increased ELNO Service Fees in jurisdictions in which interoperability has been introduced. Otherwise, some consumers and jurisdictions will pay for the additional costs of interoperability without the benefit (i.e. transacting with their ELN of choice in an interoperable transaction).

PEXA notes the introduction of interoperable competition inherently allows, and creates incentives for, ELNOs to charge different ELNO Service Fees in different jurisdictions. As a result, the competitive forces which motivated the introduction of interoperability are likely to change the consistent national pricing that was part of the regulatory framework when e-conveyancing was originally introduced

PEXA requests that IPART's report make findings that: (a) the costs of interoperability should be recovered through ELNO Service Fees; (b) PEXA's costs of establishing interoperability will be higher than new entrants; (c) PEXA should be afforded an opportunity to earn a reasonable return on its investments in interoperability; and (d) therefore, current ELNO Service Fees are not cost reflective and should be increased in the short term.

[redacted]

1.3 Review of market design for universal service obligations (USO) should also be referred to IPART

Issues Paper 2 raises the importance of proper market design for creating the right incentives to deliver services pursuant to universal service obligations (**USOs**).

IPART considers the recovery of costs associated with a USO are a market design issue (rather than an interoperability issue). However, failure to create appropriate economic incentives for all ELNOs to provide universal service coverage risks undermining the core objective of similar access for all consumers in all jurisdictions.

As these market design issues are outside IPART's current terms of reference, PEXA submits that the issue be formally referred to IPART for investigation and recommendation before full interoperability commences commercially.

1.4 PEXA's position on IPART's other draft decisions on interoperable transaction fees

Draft Decision 2: As noted above, PEXA supports IPART's draft decision that a RELNO should be able to charge fees to PELNO(s) in an interoperable transaction. The critical issue is what costs and risks should be reflected in the fees and how they should be structured. The fees should ensure they set the right economic incentives for industry from the outset of an interoperable market structure. In principle, PEXA agrees that fees be charged for two years from the date full interoperability commences, indexed by CPI for the second year. PEXA submits that a review of charges should begin at the end of the first full year of operation of interoperability so that findings can be implemented by the end of the second year. PEXA also considers that practical arrangements for the payment of interoperable transaction fees can be negotiated through interoperability agreements.

***Draft Decision 4*:** PEXA supports IPART's draft decision that direct price control is the appropriate method for establishing interoperable transaction fees between ELNOs. In principle, PEXA agrees that fees from a RELNO to a PELNO be prescribed for 2023-24 (both for the RELNO fee and the default RELNO surcharge). IPART should clearly outline its methodology in prescribing these fees,

including the specific costs and risks each fee reflects. PEXA submits that IPART should review efficient operating and capital costs for interoperability in two years (not four, as IPART proposes) to mitigate against risk of regulatory error in an inherently uncertain environment.

Draft Decision 5**:** PEXA agrees that the apportionment and recovery of the Lodgement Support Service (**LSS**) fee should not occur through interoperable transaction fees and can be determined via commercial negotiation of the interoperability agreement. PEXA is currently engaging in discussions with Sympli in this regard.

Draft Decision 6**:** For the reasons set out in its response to Issues Paper 1, PEXA does not agree with IPART's draft decision rejecting a common user charge for participating in an interoperable e-conveyancing market. IPART does not appear to have sufficiently taken into account the market dynamics of e-conveyancing and the public interests involved. E-conveyancing is an industry with high fixed costs and relatively low variable costs. Some new entrants are likely to vertically integrate and to self-preference. Coupled with the devaluation of customer networks as a result of interoperability, these dynamics may result in e-conveyancing market pricing above variable costs, but significantly less than the level required to recover fixed costs. This may lead to an industry in which competitors are reluctant to innovate, or to invest in new e-conveyancing functionality or the continued roll out of e-conveyancing to jurisdictions that presently do not have e-conveyancing, both on their own initiative and in response to shifting requirements and functionality of titles offices, revenue offices and other industry participants.

E-conveyancing competitors will be even more reluctant to invest given the history of government intervention in e-conveyancing. Regulatory intervention has compelled an established industry participant to provide competitors with access to its technical integrations / capability and network of customers, an intervention with no obvious precedent in any other industry we are aware of. This intervention has reduced PEXA's opportunity to earn a reasonable return on its productive investments in building e-conveyancing functionality, and in creating a network of sellers, purchasers, practitioners, financial institutions, revenue offices, titles offices and other participants all using that e-conveyancing functionality for their property transactions. Unfortunately the outcome of this history, and IPART's Draft Decision 6 are unlikely to serve the purposes of e-conveyancing, to provide a more secure, reliable, and affordable method of conducting property transactions for all Australians. As such, we respectfully ask IPART to reconsider its Draft Decision 6 to ensure there is a mechanism to allow PEXA an adequate return on its investments in e-conveyancing.

2 Key issues outside of IPART's current terms of reference

IPART's second issues paper (**Issues Paper 2**) raises the importance of two issues that are outside the current terms of reference:

- A reconsideration of ELNO Service Fees; and
- The market design of universal service obligation incentives.

[redacted] Further, the market design of universal service obligation incentives should be referred to IPART for investigation and recommendation before interoperability begins.

2.1 Reconsideration of ELNO Service Fees

In Issues Paper 2, IPART made draft decisions that:

- The cost of establishing and maintaining interoperability should be funded through ELNO Service Fees; and
- Subscribers who participate in an interoperable transaction should not pay more than subscribers to a non-interoperable transaction.

These draft decisions led to IPART's preliminary finding that material costs associated with establishing and maintaining interoperability should be recovered via ELNO Service Fees. This necessarily implies that the current ELNO Service Fees are unlikely to be cost reflective (particularly following the implementation of interoperability).

PEXA requests that IPART's report make findings that: (a) the costs of interoperability should be recovered through ELNO Service Fees; (b) PEXA's costs of establishing interoperability will be higher than new entrants; (c) PEXA should be afforded an opportunity to earn a reasonable return on its investments in interoperability; and (d) therefore, current ELNO Service Fees are not cost reflective [redacted]

IPART's draft finding that there should be no common user charge also implies that ELNO Service Fees should be reconsidered. The current fees were set before the current design of interoperability was identified and while it was still possible that a common user charge would be part of the design. These regulatory decisions have substantially reduced the revenue that PEXA is likely to receive. Consequently, IPART's previous finding that existing ELNO Service Fees are sufficient to provide PEXA with a reasonable opportunity to earn a reasonable return on its investment cannot hold true.

[redacted]

[redacted]

2.2 Review of market design for universal service obligations

IPART's Issues Paper 2 acknowledges that universal service obligations for e-conveyancing (**USOs**), coupled with national pricing, create incentives for ELNOs to delay full roll-out of e-conveyancing in order to cherry-pick the most profitable jurisdictions and transactions. While IPART considers the recovery of costs associated with USOs are a market design issue (rather than an interoperability issue), failure to create appropriate economic incentives for all ELNOs to provide universal service coverage, while increasing competition through the introduction of interoperability, risks undermining the core objective of universal access for all Australians.

The issue of appropriate market design for USOs requires further consideration by a qualified economic regulator (such as IPART) before full interoperability is implemented. Failure to do so risks unintended and unforeseen economic consequences that could compromise the ongoing roll out of e-conveyancing across Australia or undermine the economic sustainability of the current e-conveyancing ecosystem.

PEXA submits that it would be in the best interests of the conveyancing industry for IPART to be issued additional terms of reference to make findings and recommendations with respect to market design for USOs as soon as possible. ARNECC has previously acknowledged that it does not have the expertise or experience to engage in issues pertaining to price regulation, and its capacity is also constrained by its work relating to the ongoing roll out of e-conveyancing and interoperability.

The introduction of interoperable competition may also require reconsideration of the universal pricing across jurisdictions that was part of the national scheme when e-conveyancing was originally introduced.

Differential pricing across jurisdictions or within subscriber sections may arise through regulatory changes to ELNO Service Fee caps or through commercial decisions, driven by competitive pressures, to charge differentially for more attractive jurisdictions or transactions. Differential pricing to cherry-pick more profitable transactions is a likely outcome of competitive markets. Jurisdictions and transactions with lower average costs (because higher transaction volumes amortise fixed costs faster) are likely to be charged lower, differential prices. This will disadvantage lower transaction volume jurisdictions.

2.3 Addressing these critical issues

Ensuring that price regulation and market design are fit for purpose from the outset of interoperability is critical to avoiding adverse economic and consumer outcomes. Examples of adverse outcomes include security breaches, purchasers' failure to secure title due to issues arising in a higher-risk multi-ENLO transaction, and collapse of ELNOs due to inability to make sustainable economic returns. Consequently, PEXA submits that the current ELNO Service Fees must be considered by relevant Registrars, upon request from PEXA under the MOR, and the market design of USOs should be referred to IPART, and resolved prior to the commencement of interoperability on a commercial basis.

3 IPART's draft decisions: PEXA's feedback

Draft decision 1: The costs of establishing and maintaining interoperability should be recovered from an ELNO's subscribers through ELNO Service Fees.

Draft decision 3: Subscribers who participate in an interoperable transaction should not pay more than subscribers in a single ELNO transaction, so an interoperable transaction fee for performing the role of RELNO should not be passed through to a PELNO's subscribers as a separate charge.

In principle, PEXA supports IPART's draft decisions that the costs of establishing and maintaining interoperability should be recovered from an ELNO's subscribers through ELNO Service Fees, and that subscribers should not pay more for an interoperable transaction than a non-interoperable transaction.

[redacted]

- The task of establishing interoperability has proven more complex and requires significantly more investment than IPART previously considered. [redacted] Instead it pointed to AECOM's estimate of around $5.5m in capex and Deloitte's estimate of between $2-13.3m depending on the extent of the ELNO's service offerings.[1]
- [redacted] although they are difficult to forecast given uncertainties in the design and phasing of interoperability.
- Interoperability is also likely to result in higher operating costs. Dealing with transactions where a subscriber has not successfully set up their side of the transaction, or where a titles office, revenue office or financial institution queries the transaction is inherently more complex when it must be routed through multiple ELNOs. This is instead of a single ELNO dealing directly with all the subscribers to the transaction. It is not possible to estimate the

[1] IPART, Final Report, Review of the Pricing Framework for Electronic Conveyancing in NSW, p.34

additional costs of this complexity until interoperability is operational and a material number of transactions involving multiple ELNOs have taken place.

- The total costs to establish interoperability remain uncertain at this time. While the remaining build costs associated with the technical components can be estimated, other costs will depend on future regulatory decisions. There will be significant additional costs to accommodate changes to the existing arrangements for governance, change and release management, renegotiation of the contractual framework with subscribers, development of a new risk and liability allocation framework, and increased insurance premiums. Many of these issues remain unresolved and will need to be added to ELNO Service Fees to allow for the recovery of costs imposed by regulatory decisions.
- Industry consultation may also lead to changes to scope, features and functionality of interoperability which may result in additional, unforeseen costs.
- Further costs may be incurred if the current scope and timing of the implementation plan for interoperability is revised. Current plans (and therefore expenditure forecasts) do not include:
  - Independent testing of end-to-end functionality and performance;
  - A full cyber-security assessment of the design and implementation;
  - Issues relating to industry readiness and potential adjustments to the timetable to accommodate findings and recommendations falling out of the ongoing interoperability readiness review.

  Such processes would normally be expected for a large multi-participant industry transformation such as the introduction of interoperability to e-conveyancing. If they are required, they will further add to the costs of introducing interoperability, and would need to be recovered via ELNO Subscriber Fees in light of IPART's Draft Decisions 1 and 3.
- If Day 2 Interoperability is deferred, this may also change the cost of interoperability. The readiness of industry is currently being considered by the readiness assessments being conducted by NSW and ARNECC. If the timeline to implement interoperability is further extended, this will add an additiona [redacted] cost per annum. This is due to the estimated additional work required as part of the implementation process.

PEXA's costs of establishing interoperability are higher than for a new entrant. In this regard, we note:

- PEXA established its system before interoperability was imposed, and consequently it is incurring higher costs to accommodate interoperability than a new entrant.
- PEXA's existing system and technology was designed and built for a non-interoperable e-conveyancing ecosystem. This now needs to be retrofitted to adopt interoperability. Retrofitting an IT system inherently incurs greater costs than a fresh build where interoperability is designed into the system from the outset (which is what the new entrant build involves).
- PEXA also incurs much greater change costs than a new entrant because it must ensure that each change to accommodate interoperability does not adversely affect the functionality of PEXA's fully operational system, which provides a critical service for the economy. Each change to implement interoperability within PEXA's systems and infrastructure must be carefully managed and tested to avoid service disruptions and ensure PEXA's service remains safe and effective. This is vital in circumstances where it is presently the only fully operational e-conveyancing service provider. By contrast, a new entrant can add changes to its system in an environment where short-term losses of functionality have much lower costs and lower public interest impacts.

In light of the above, and given that regulatory decisions have led to PEXA having higher costs to establish interoperability than a new entrant, it should be able to recover its actual costs of establishing interoperability through ELNO Service Fees rather than the theoretical efficient costs of a new entrant.

For the same reasons, regulatory arrangements should also allow PEXA to recover more interoperability costs through ELNO Service Fees than a new entrant. This outcome could be reached in practice by recovering these costs over a relatively short time horizon. This would mean increasing ELNO Service Fees more in the short term (while PEXA's market share is relatively high), and reducing them in the medium term (once PEXA has had a reasonable opportunity to recover its additional costs of establishing interoperability). Such regulatory pricing would be fair given that later entrants will also benefit from an interoperable system while not incurring the same costs to establish it.

Separately, the costs of establishing and maintaining interoperability should only be recovered through additional ELNO Service Fees in jurisdictions in which interoperability is implemented. Otherwise, jurisdictions that do not adopt interoperability will be paying for the cost of it, without receiving any (notional) benefit. There should be no concern that this will lead to differential fees between jurisdictions given that this is a likely outcome of interoperability, as noted above in section 2.2.

Having regard to the timetable to roll out full interoperability commercially in a phased approach (two jurisdictions at a time) from 2023 (subject to readiness) commencing with Day 2 Interoperability, PEXA submits that ELNO Service Fees should be adjusted in accordance with this timetable as jurisdictions implement interoperability.

PEXA's nationally offered ELNO Service Fees (which currently cannot be increased by more than CPI annually) are unlikely to be cost reflective, and will need to be reviewed and adjusted to reflect:

- IPART's decision that the costs of establishing and maintaining interoperability should be recovered through ELNO Service Fees;
- The additional costs of establishing and maintaining interoperability;
- PEXA's higher costs of establishing interoperability relative to a new entrant; and
- The implementation of interoperability in some jurisdictions but not others.

PEXA requests that IPART's report make findings that: (a) the costs of interoperability should be recovered through ELNO Service Fees; (b) PEXA's costs of establishing interoperability will be higher than new entrants; (c) PEXA should be afforded an opportunity to earn a reasonable return on its investments in interoperability; and (d) therefore, current ELNO Service fees are not cost reflective and should be increased in the short term.

[redacted]

Draft decision 2: A Responsible ELNO should be able to charge fees to Participating ELNOs in an interoperable transaction.

PEXA supports this decision. The critical issue for IPART's review is what costs and risks should be reflected in inter-ELNO fees and how they should be structured between the RELNO and PELNO(s).

PEXA reiterates that IPART's pricing model must ensure the right economic incentives to ELNOs are established from the outset of interoperability. The risk of 'getting it wrong' could result in

unintended economic consequences that would compromise the core objectives of e-conveyancing – to provide a more secure, reliable, efficient and affordable method of conducting property transactions for all Australians. Examples of these unintended consequences include part of the e-conveyancing system collapsing because ELNOs are not able to provide a service, a required service is turned off or integrations between systems do not work.

Draft decision 4: Direct price control is the appropriate method for establishing interoperable transaction fees between ELNOs.

PEXA supports IPART's draft decision that direct price control is the appropriate method for establishing interoperable transaction fees between ELNOs. In principle, PEXA agrees with IPART's proposal to prescribe fees from RELNO to PELNO(s) for 2023-24 (both for the RELNO Fee and the default RELNO surcharge).

PEXA maintains that irrespective of the form of regulation, the critical issue is that an economic regulator (such as IPART) should determine the method of interoperability price setting, taking into account broader questions of how its determination will affect the public interest in facilitating secure, reliable, affordable and nationally accessible e-conveyancing.

Inter-ELNO fees do not just redistribute profit between ELNOs. Rather, because of their effects on market dynamics, they can affect the public interest much more broadly, which a decision maker needs to be able to take into account. The market impacts of direct price control method are more important than the method itself. The regulator should evaluate the impact and incentives the fee creates. For example, if the fees are too low, they will not cover the fixed costs of creating back-end settlement and lodgement capability, whereas if the fees are too high they creates perverse incentives for ELNOs to target subscribers that increase their opportunity to be the RELNO.

Draft decision 5: Apportionment and recovery of the Lodgment Support Service fee should not occur through interoperable transaction fees charged by a Responsible ELNO to Participating ELNO.

PEXA agrees that the apportionment and recovery of the Lodgement Support Service (**LSS**) fee should not occur through interoperable transaction fees and can be determined pursuant to the negotiation of the interoperability agreement.

PEXA is currently engaging in discussions with Sympli to determine a suitable way of apportioning LSS fees under the interoperability agreement. See PEXA's response to IPART's Issues Paper 1, section 3.1.2, for PEXA's position on LSS fees, the solution for which is currently being devised by the Interoperability Operating Committee.

Draft decision 6: ELNOs should not be required to pay PEXA a common user charge for participating in an interoperable eConveyancing market.

PEXA acknowledges but does not agree with IPART's draft decision rejecting a common user charge for participating in an interoperable e-conveyancing market, for the reasons set out in its submission to Issues Paper 1.

[redacted] IPART's November 2019 determination regarding the adequacy of the current level of ELNO Services Fees needs to be reconsidered. IPART acknowledges that ELNO Services Fees may not be cost reflective which implies they should be reviewed and adjusted. In this regard:

- Given the absence of a common user charge (and as discussed above) it may be that higher ELNO Services Fees in the short term, and lower ELNO Service Fees in the long-term are appropriate. This will enable PEXA to earn a reasonable return on its original investment, made well before a competitive market structure was envisaged with the unusual features of interoperability, which require a player in the market to redesign its system to enable competitors access its established infrastructure and capability, and to interact with its customers.
- Without such an adjustment, the imposition of interoperability would amount to a legislative intervention that precludes PEXA from earning a reasonable return on its investment, which may deter future investment both in e-conveyancing, and in other industries highly vulnerable to government regulation.
- Providing PEXA an opportunity to earn a reasonable return on its original investment is critical for promoting further investment in e-conveyancing and ensuring the ongoing roll out of e-conveyancing nationally. IPART should have regard to examples of regulatory arrangements that promote ongoing investment in extending the reach of services. For example, owners of gas pipelines are provided regulatory holidays to provide an opportunity to earn a reasonable return, which then allows further investment in extending the network.
- Concerns about arbitrary government intervention would be heightened given that the model of interoperability imposed requires PEXA to enable other market participants to interact directly with PEXA's customers (which is beyond mere access to infrastructure and capability). Indeed, we are unaware of any previous government actions that have intervened so significantly in the business of a private sector operator.

[redacted]

- More broadly, with respect to e-conveyancing (and indeed future public-private partnerships), it demonstrates that government intervention may change the rules of the game by compelling an investor to provide third-party access to a network without appropriate compensation.

[redacted]

Failure to ensure ELNO Service Fees are cost reflective, may undermine private sector confidence in: (a) future investment in e-conveyancing (which could undermine universal service coverage, including to jurisdictions that currently do not have any e-conveyancing service); (b) future assets sold / privatised by governments; and (c) future public private partnerships in other industries.

[redacted] PEXA submits that IPART's Draft Decision 6 does not appear to have sufficiently taken into account the market dynamics of e-

conveyancing and the public interests involved, as outlined in PEXA's submission to Issues Paper 1. PEXA submits that IPART should recommend that the relevant Registrars should incorporate additional costs into ELNO Service Fees that arise from emerging market dynamics (including the impacts of vertical integration in the broader property transaction supply chain that includes e-conveyancing).

E-conveyancing is an industry with high fixed costs and relatively low variable costs. Some new entrants are likely to vertically integrate and to self-preference. Coupled with the devaluation of customer networks as a result of interoperability, these may result in e-conveyancing market pricing above variable costs, but significantly less than the level required to recover fixed costs. This may lead to an industry in which competitors are reluctant to innovate or to invest in new e-conveyancing functionality, both on their own initiative and in response to shifting requirements and functionality of titles offices, revenue offices and other industry participants.

E-conveyancing competitors will be even more reluctant to invest given the history of government intervention in e-conveyancing. Regulatory intervention has compelled an established industry participant to provide competitors with access to its infrastructure and capability and network of customers, an intervention with no precedent in any other industry that we are aware of. This intervention has reduced PEXA's opportunity to earn a reasonable return on its productive investments in building e-conveyancing functionality, and in creating a network of sellers, purchasers, practitioners, financial institutions, revenue offices, titles offices and other participants all using that e-conveyancing functionality for their property transactions.

Unfortunately, the outcome of this history, and IPART's Draft Decision 6 are unlikely to serve the purposes of e-conveyancing, to provide a more secure, reliable, and affordable method of conducting property transactions for all Australians. As such, we respectfully ask IPART to reconsider its Draft Decision 6 to ensure there is a mechanism to allow PEXA an opportunity to earn an adequate return on its investments in establishing e-conveyancing.

4 IPART's questions for stakeholders: PEXA's feedback

Question 1: Do you agree with prescribing prices rather than prescribing a pricing methodology for interoperable transaction fees? If not, what are the reasons for preferring a pricing methodology?

In principle, PEXA agrees with IPART's proposal to prescribe fees from RELNO to PELNO(s) for 2023-24 (both for the RELNO fee and the default RELNO surcharge).

PEXA submits that in prescribing interoperable transaction fees, IPART should clearly outline its methodology for doing so, including with respect to what specific costs and risks each interoperability transaction fee reflects. This will ensure transparency and assist with future reviews and adjustments to the price model where necessary.

Question 2: Do you agree that a Responsible ELNO fee should apply to all interoperable transactions?

PEXA agrees that a RELNO fee should apply to all interoperable transactions. This fee should be set on a per subscriber basis (as opposed to per workspace).

The RELNO fee should accurately reflect the costs and risks that the RELNO incurs in an interoperable transaction, but which are largely not incurred by PELNO(s). The RELNO responsible for the orchestration of the transaction and execution of lodgement and settlement, assumes more risk and cost. Where a transaction is queried or not processed by a subscriber, land titles office, revenue office, or financial institution, the issue will usually be raised first with the RELNO. The RELNO will have primary responsibility for determining the cause of the issue, and working with the relevant PELNO to resolve it, even if the RELNO's subscriber is not the cause of the issue. The costs associated with these RELNO responsibilities are discussed in further detail in response to Questions 4 and 5 below.

Rather than a fixed fee payable per workspace, the RELNO fee should be charged for each subscriber supported by an ELNO other than the RELNO. This is appropriate as the costs incurred by the RELNO increases as more subscribers are added to a workspace. Each subscriber creates independent and additional potential for errors, risk and exceptions that the RELNO must process. For example, independent subscribers are just as likely to call for support even if another in the workspace has already received support. Additionally, the RELNO accepts a greater risk as they are answerable to more subscribers should anything go wrong and each may make its own claim.

The RELNO fee should be specific to each jurisdiction as requirements specific to a jurisdiction can lead to higher support costs. For example, the introduction of new functionality for land registry instruments in a particular jurisdiction may result in jurisdictional-specific based cost implications for a RELNO. The RELNO fee for a jurisdiction should reflect the expected volume of issues that will be raised with the RELNO. These specific fees should be developed over time, ahead of the phased implementation of interoperability in each jurisdiction.

The RELNO fee should also be specific to the subscriber role because purchasers and vendors (and their representative practitioners) tend to generate more queries and issues than financial institutions. Individual financial institutions typically process far more property transactions than other subscriber roles, and consequently tend to have more specialised and expert operators which means fewer queries and issues. [redacted]

[redacted] This differential is reflected in ELNO Service Fees: the published fee, and the actual fees charged by PEXA and Sympli, are materially lower for financial institutions than for other subscriber roles. Although queries and issues will in part be dealt with by the subscriber's ELNO, inevitably some of these issues will generate additional tasks for the RELNO orchestrating the transaction and executing lodgement and settlement.

The RELNO fee should also be specific to the transaction type. In this regard:

- Transfers tend to generate more queries and issues than refinances because:
  - Transactions requiring settlement are multi-party transactions (involving financial institutions and practitioners), which introduces complexity and timing issues that require the ELNO to provide support to subscribers.
  - Transfer transactions require the payment of stamp duty, which the ELNO must settle as part of the transaction, and this activity generates more support queries than transactions that do not require the payment of stamp duty (such as refinances).
  - Practitioners using the PEXA Source Account, which is PEXA's trust account utilised by eligible practitioners who do not operate a statutory trust account, are also more likely to require support from PEXA.

[redacted]

- Consequently, different RELNO fees should be set for transfers and refinances.
- A higher RELNO fee would also be appropriate for multi-title transactions, which are inherently more complex. This is reflected in PEXA's pricing schedule, whereby multi-title service fees can be up to 70% higher than single-title service fees (for example, PEXA's FY23 single title caveat service fee is $17.49, but $30.36 for multi-title caveats). PEXA's FY 23 service fees for multiple title transfers are 14% higher than single title transfer service fees.

Whether the RELNO fee is set on a per workspace basis, or per subscriber basis, the total fee should add to the total additional costs incurred as a result of performing the RELNO role.

Question 4: How should we estimate the costs a Responsible ELNO incurs from completing financial settlement on behalf of Participating ELNOs?

Question 5: Which other operating costs are associated with the Responsible ELNO role? How could we estimate these costs and accurately attribute them to the Responsible ELNO role?

IPART submits that the RELNO fees should reflect the marginal costs an ELNO incurs from fulfilling its role as the RELNO, which PELNO(s) do not incur, or incur less.

The marginal operating costs of performing the RELNO role include costs associated with:

- Financial settlement; and

- Other operating costs, including, but not limited to, responding to queries, managing errors and post settlement issues, providing hosting, and increased insurance premiums. The RELNO typically incurs greater costs in managing errors, and takes on greater risks than PELNO(s).

Some costs (particularly insurance) are difficult to place entirely within either of these categories. However, there is no reason in principle for RELNO fees to be differentiated between financial settlement and other operating costs if they are incurred when fulfilling its role as the RELNO, and if the PELNO(s) would not incur these costs, or would incur them less.

A. Financial settlement costs

The additional costs the RELNO incurs as a result of completing financial settlement on behalf of all participating ELNOs include:

- Financial settlement costs charged to the RELNO by financial institutions for completing each settlement. [redacted] The RELNO bears this cost on behalf of all ELNOs to the transaction.
- Insurance costs (premiums) to cover the risk and liability the RELNO assumes by completing financial settlement on behalf of other ELNOs and its subscribers to the transaction. [redacted]

B. Other operating costs

IPART's suggestion that many 'operating costs' should either be discounted or recovered through ELNO Service Fees appears to be made on the basis that all ELNOs will need to contribute to resolving issues such as support queries, document errors, and mistaken payments. However, in practice, an ELNO will typically incur higher costs while it is the Responsible ELNO for part of a transaction. Consequently, these higher marginal costs should be recoverable, particularly as IPART acknowledges that the interoperable transaction market is likely to remain asymmetrical after the implementation of interoperability (with PEXA being the RELNO for the vast majority of transactions when settlement and lodgement are executed).

For instance:

- As the RELNO will be responsible for orchestrating the transaction and executing lodgement and settlement (noting these are the key elements of a transaction), many issues that a subscriber may encounter during a transaction are likely to be notified to the RELNO for support and resolution, whether or not it is the subscriber's ELNO.
- Following notification of an issue, the RELNO will typically need to identify the PELNO whose subscriber is the root cause of the issue. The RELNO will therefore often need to be the conduit between the PELNO and third parties (such as Titles Offices, State Revenue Offices, and financial institutions). By contrast a PELNO will typically only be involved in such issue resolution if its subscriber is the root cause of the issue.

IPART also seems to suggest that many 'operating costs' should either be discounted or recovered through ELNO Service Fees on the basis that the designated RELNO may change multiple times in a transaction. However, this approach is inappropriate for a number of reasons:

- It would not be cost reflective if a particular ELNO is the RELNO for a greater share of transactions than it is a PELNO. This is a plausible outcome if the particular ELNO has a greater share of financial institution subscribers than practitioners. The rules for assigning the RELNO role will result in the ELNO that has a higher share of financial institution subscribers also having a higher share of transactions where it plays the RELNO role. The ELNO market is likely to evolve in this asymmetric way because financial institution subscribers are likely to have different key buying factors to purchaser/vendor practitioner subscribers (noting that practitioners choice of ELNO will be materially influenced by their choice of practice management software, as explained in PEXA's submission to Issues Paper 1, section 1.2.3).

- The RELNO at the time of lodgement and settlement (or attempted lodgement and settlement) is likely to bear most of the costs (and risks) specific to the RELNO role, including:

    - For failed settlements, resupplying the service, funding additional lodgement fees, covering any land tax (as applicable), covering costs of new adjustments and any professional fees a subscriber may incur as a result of the failure.

    - For support queries, incident management, management of lodgement case errors and document errors, the RELNO will be primarily responsible for troubleshooting and resolving the subscriber's issue (regardless of whether it is being hosted by a PELNO or the RELNO). Lodgement and document errors are only identifiable by the RELNO or land registry. The RELNO is also primarily responsible for identifying what needs to occur to resolve such an error, and communicating that solution to the PELNO (which in turn passes those instructions onto its subscriber).

    - Costs associated with post-settlement issues (such as mistaken payments) are also disproportionately incurred by the RELNO responsible for settlement. While all ELNOs will contribute to solving post-settlement issues, the RELNO is primarily responsible for resolving the error or issue, and then communicating that solution to the PELNO for that PELNO to communicate to their subscriber.

    - Such queries and incidents are most likely to arise as a result of attempted settlement, increasing the costs of the RELNO at the time of lodgement and settlement.

- The cost of insurance premiums is likely to take into account the number of transactions in which an ELNO plays the RELNO role. It is unclear whether a separate and specific form of insurance will be required for interoperability. However, premiums for general insurance cover for ELNOs are likely to increase due to the increased risks and liability associated with interoperability. This was noted by The Centre for International Economics in its cost benefit analysis of interoperability.[2] A part of this premium increase will reflect the additional risk taken by the RELNO rather than PELNOs.

- It is appropriate for this additional risk to be incorporated in the RELNO fee rather than ELNO Service Fees. While all ELNOs are likely to incur a cost for insurance for interoperability, an ELNO is likely to pay a higher premium per transaction if the proportion of transactions in which it acts as the RELNO is higher than the proportion for which it acts as the PELNO role (because the activities it will undertake will be higher risk). [redacted]

[2] The Centre for International Economics, 'Final Report – Cost benefit Analysis: Addressing market power in electronic lodgement services', September 2020, Cost benefit analysis commissioned on instruction of the NSW Office of the Registrar General, pp 46, 110.

[redacted] (Also see PEXA's response to IPART's Question 7 below).

Consequently, PEXA submits that the additional insurance cost per transaction attributable to playing the RELNO role should be recovered through the RELNO fee and not through ELNO Service Fees.

Separately, for reasons of practicality, and on the basis that the RELNO that executes lodgement and/or settlement will incur the vast majority of costs (and risks) that are specific to the RELNO role, the RELNO fee should be payable to the ELNO that is the designated RELNO as at the time of lodgement / settlement. In this regard:

- Under PEXA's current system, the majority of support queries received relate to the management of documents and errors relating to verification. A smaller proportion of support queries relate to settlement and post settlement issues.
- [redacted] emi-fixed nature of costs, with a highly variable transaction volume, suggests a medium-term average should be taken to estimating these per transaction costs. [redacted]

C. How IPART should estimate costs associated with the RELNO role

PEXA submits that an appropriate approach for IPART to estimate financial settlement costs and other operating costs specific to the RELNO role would be to:

- Benchmark financial settlement costs based on:
  - Historic costs per transaction charged by financial institutions to PEXA for performing financial settlement; plus
  - Historic insurance premiums PEXA incurred for bearing responsibilities that will in future be carried out by the RELNO, converted to a per transaction premium cost.
- Benchmark other operating costs based on the historic costs PEXA incurred per transaction for performing RELNO activities.

These costs should be apportioned to PELNOs based on the role of each of their subscribers' role (as stated in PEXA's response to Question 2) as the RELNO fee.

- Financial settlement costs should be split equally amongst all subscribers.
- Other operating costs specific to the RELNO role should be apportioned to subscriber roles based on the level of activity that generally corresponds to the role. As the major incumbent, PEXA has the most representative and useful data to suggest the level of exception processing activity. [redacted]

For the reasons described above (as part of PEXA's response to Questions 4 and 5), the RELNO fee should be payable to the ELNO which is the designated RELNO as at the time of settlement.

Question 3: Do you agree that a default Responsible ELNO surcharge should apply when an ELNO cannot fulfil its role as the designated Responsible ELNO?

PEXA agrees that a default RELNO surcharge should apply when the ELNO initially designated is unable to perform the role, for the following reasons:

- In an interoperable market, the new entrant ELNO(s) are only able to participate in interoperable transactions because one ELNO has invested in the required infrastructure / capability to process a particular transaction. Notwithstanding, all new entrant ELNO(s) will benefit from access to that infrastructure and capability in an interoperable transaction when they collect ELNO Service Fees from their subscribers. In effect, the new entrant is relying on, and benefiting from, access to the proven infrastructure and capabilities of another ELNO. Therefore principles in access regulated industries are relevant and should apply. Namely that an access service provider's legitimate business interests should be accounted for in IPART's pricing model to ensure there is a mechanism for allowing an ELNO with proven capability / infrastructure to perform the RELNO role, a reasonable opportunity to earn an appropriate return on investments and the creation of existence value).

- To ensure that revenue reflects costs, the ELNO with capability lacked by other ELNOs should be able to recover the fixed costs of building that capability. The cost to extend an ELNO's infrastructure and capability to cover all transaction permutations requires significant and sustained capital investments. Accordingly, the fixed costs an ELNO has incurred to develop that infrastructure and capability (which are avoided by other ELNOs) are therefore relevant and should be accounted for by IPART in calculating the default RELNO surcharge.

- In an interoperable market, the default RELNO surcharge will also incentivise all ELNOs to develop and maintain their own infrastructure to perform the RELNO role in all circumstances (noting full capability for all ELNOs in all jurisdictions is contemplated by the regulatory framework and model of interoperability). It would also support the objectives of delivering universal service coverage across all jurisdictions. Without an appropriate financial charge between the defaulting RELNO and the ELNO that performs the RELNO role, there would be only weak incentives for the defaulting RELNO to invest in building out its infrastructure and capability. This would not be in consumers' interests and will result in the cherry picking of jurisdictions with high transaction volumes by new entrants. As discussed in PEXA's submission to Issue Paper 1, the requirements in the MOR that an ELNO must provide universal coverage appears to be unenforceable in practice.[3]

The default RELNO surcharge is akin to an access fee applied in other access regulated industries, which is payable for providing access to infrastructure and facilities that a new entrant has not yet developed. For as long as new entrants rely on accessing and using a previously operating ELNO's existing infrastructure and capabilities to transact, they will be benefiting from that access in two ways: (a) because they are able to transact in circumstances where they do not own the capability or infrastructure to do so; and (b) because they will have avoided the costs of establishing and maintaining that infrastructure and capability. For these reasons, PEXA submits that cost recovery principles applied to compensate an access provider in access regulated regimes should be adopted to determine the types of capital costs that should be recovered through this surcharge. There are a number of examples of regulators recognising and paying for access to infrastructure and existence value in regulated markets, including:

[3] See: PEXA's response to Issues Paper 1, Section 2.2, p.16

- Prospective greenfield gas pipelines whereby regulatory holidays are available to speculative investors to encourage investment in building out necessary network coverage. The gas access regime allows for pipelines to apply for a 15 year no coverage decision, which provides a commitment that no regulation will apply for that time. The objective of this approach is to address concerns relating to asymmetric truncation of returns and promote investment for infrastructure that serves a public benefit.

- ASX and Chi-X, where the ASX provides clearing and settlement services (analogous to the role of RELNO) to competitor Chi-X. ASX charges a fee to Chi-X for this service, which is required to be on materially the same terms as the fee charged to ASX affiliated entities (i.e. the ASX listing market). This fee takes into account the legitimate business interests of ASX and any parties seeking access to its services.

Paying a surcharge to the party that performs the role of the RELNO does not result in 'double cost recovery' to that RELNO. If a default RELNO surcharge is payable, then by definition the RELNO has paid for all of the required infrastructure and the other defaulting ELNO has not. But the RELNO would not be collecting the subscriber ELNO Service Fees for the transaction that are paid to the defaulting ELNO.

As the capability of new ELNOs will not be known until interoperability commences, it is not possible to identify at this point all the circumstances that could result in an ELNO defaulting on its designated role as the RELNO. However, some possible capability based default trigger events that would result in a default RELNO surcharge include:

- Lacking technical integration with a specific revenue office;

- Lacking integration to a specific financial institution; or

- Lacking the capability to process certain lodgement types (such as some registry instruments, or instruments requiring an attachment).

To ensure the default RELNO surcharge is applied in an expedient and consistent manner, PEXA submits that it should also apply to all transactions where:

- An ELNO has defaulted in a previous transaction due to an identified "trigger event";

- That ELNO has not subsequently successfully performed the RELNO role in a transaction with that trigger event; and

- That ELNO is a party to a transaction in which the trigger event is present (whether or not the ELNO is initially designated as the RELNO).

There are strong grounds for setting liability for the surcharge whenever a known trigger event is present, even if there is no re-designation of the ELNO role in a particular transaction:

- *Establishes sound economic incentives for new entrant ELNO(s) to invest in establishing their own infrastructure and building their own network.* This in turn has public interest and consumer benefits as each ELNO will be incentivised to build out its respective network in order to avoid the surcharge. This in turn supports the objectives of continuing the national roll out of universal e-conveyancing coverage.

- *Provides the RELNO with capability opportunity to recover its fixed cost* for: (a) relatively uncommon transactions, that may not be fully recoverable if other ELNOs are collecting subscriber fees for those transactions; and (b) low volume jurisdictions (such as the ACT, TAS and SA).

- *Is more resistant to gaming*. An ELNO (e.g. Sympli) could potentially avoid incurring the surcharge while also avoiding the need to invest in infrastructure by tactically avoiding the surcharge trigger events. For example, the ELNO could seek to actively avoid the role of

RELNO from the outset of a transaction meaning there would not be a change in the ELNO. By requiring an ELNO to establish that it has the capability to be the RELNO, it will not be able to engage in a strategy of actively avoiding certain trigger events relating to the designation of the RELNO.

PEXA notes that, under the MOR, there would need to be a process for the proper independent verification of assertions and an enforcement regime for inaccurate claims of RELNO capability. From a consumer welfare perspective, failure to disclose a lack of capability to perform a particular transaction may also put the end user at risk. This is also appropriate in circumstances where the new entrant has maintained that it is building toward being a fully functional ELNO.

As the regulatory regime under the MOR is not currently tailored to address these concerns, PEXA submits that IPART should recommend that the MOR is updated to ensure there is an avenue for ARNECC to receive complaints about, and appropriate powers to investigate and apply appropriate regulatory penalties for, inaccurate claims of RELNO capability. In terms of enforcement, compensation should also be payable to the aggrieved RELNO that would receive lower ELNO Service Fees as a result of the inaccurate claim of capability by the ELNO.

Once an ELNO has demonstrated it has the capability and infrastructure to execute a specific transaction, it would not be obliged to pay the default RELNO surcharge.

Question 6: What are your views on recovering a share of the capital costs of developing financial settlement and lodgment infrastructure via a default Responsible ELNO charge?

The default RELNO surcharge should reflect the capital and operating costs the party acting as the RELNO incurs, and continues to incur, to develop and maintain the infrastructure and capabilities which the other ELNO must access in order to participate in interoperable transactions. This level of cost recovery is appropriate on the basis it:

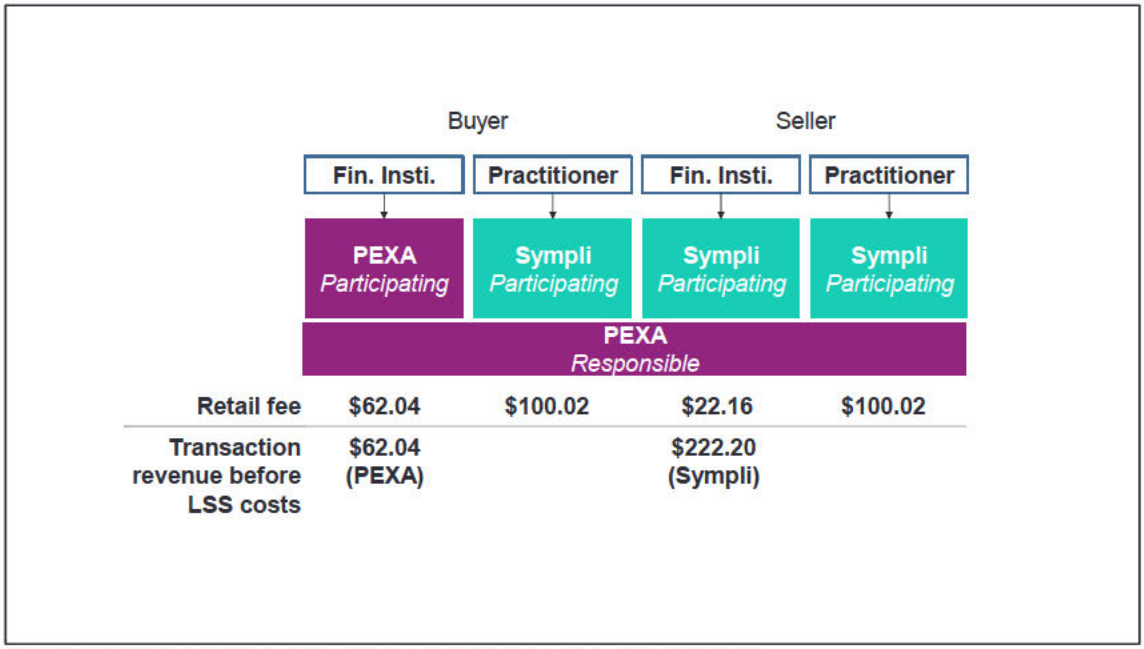
- Reflects the actual costs of providing the service;
- Establishes strong incentives for all ELNOs to develop full capability; and
- Is analogous to the approach utilised by regulators in setting fees for third party access to common infrastructure, such as gas pipelines or monopoly telecommunications infrastructure.

Although IPART has not specifically recognised the costs of establishing connections to, and building integrated functionality with, land titles offices, revenue offices, and financial institutions (see Issues Paper 2, section 3.3.3), PEXA submits these costs are relevant to setting the default RELNO surcharge because:

- In the absence of a surcharge that accounts for these fixed costs, interoperability will result in PEXA, acting as the RELNO for an asymmetrical quantity of transactions for the foreseeable future [redacted]
- Conversely, the new entrant will benefit from interoperability by being able to participate in interoperable transactions (and collect ELNO Service Fees) while it develops its capability. This is in circumstances where it is avoiding the capital and operating costs of establishing and maintaining its own infrastructure and capability, and is instead accessing and utilising the technical integrations and capability of another ELNO.

- For example, in a four-party transaction with financial institutions and practitioners, without a default RELNO surcharge, could result in the following scenario:

Exhibit 1



Source: PEXA and Sympli published pricing as at 4 August 2022

In this example, which is a scenario that would be relatively common, the subscriber revenues of the RELNO would have been less than 28% of those of the PELNO, even though the RELNO would bear the fixed costs of building and maintaining the financial settlement and lodgement infrastructure to enable the transaction to proceed.

PEXA agrees with IPART's preliminary finding that capital costs of establishing integrations and developing capability should be recoverable through the default RELNO surcharge, for a number of reasons:

- *It would be reasonable for an additional fee to be payable to the RELNO which reflects a capital cost component.* Where the RELNO completes financial settlement on behalf of a PELNO, it is providing that PELNO access to the connections and integrated capabilities that it has established and maintained on an ongoing basis with industry stakeholders (such as titles offices, SROs and financial institutions).

- *The capital cost component would represent the avoided cost of the infrastructure or facility that the initially designated RELNO does not have at the time of the transaction.* A PELNO that does not have the integration with a specific stakeholder (such as a financial institution) has avoided the capital cost of establishing this integration, but with interoperability, benefits from the RELNO's investment to establish and maintain that integration. Establishing these integrations involve significant ingenuity and capital investment to design, develop and ultimately implement in the e-conveyancing ecosystem, which includes connections and integrated functionality with eight financial institutions and five state revenue offices.

- *A material default RELNO surcharge creates the right incentives for ELNOs to invest in their own infrastructure and develop the necessary capability to perform the RELNO role.* A default RELNO surcharge can create a strong economic incentive to other ELNOs to invest in establishing their own financial settlement integrations and infrastructure. This in turn promotes universal service coverage by multiple ELNOs. In this respect, there may be benefit in setting the surcharge above a capital recovery level to incentivise all ELNOs to

build and maintain their own comprehensive systems capable of handling all transaction permutations.

PEXA also understands and agrees that the default RELNO surcharge would apply on a per transaction basis. However, as stated in PEXA's response to Question 3, this surcharge should apply to all transactions where a 'trigger event' arises, as opposed to only transactions where the initially designated RELNO defaults.

The efficacy of the default RELNO surcharge to deliver on its objectives will depend on its applicability being sufficient to: (a) create an incentive for the PELNO to develop its own infrastructure; and (b) allow the RELNO a fair means of recovering its capital costs for establishing the infrastructure (given the mismatch between ELNO Service Fees and capital cost recovery, as described in PEXA's response to Questions 1 and 3 above).

The capital cost of infrastructure required to provide services when another ELNO defaults cannot be identified at this time. The capability of new ELNOs is presently unknown and unsubstantiated, and will only become apparent once interoperability commences. It is manifestly difficult to set a cost-reflective default RELNO surcharge in advance when the nature of the trigger, the frequency of each trigger's occurrence, and therefore the nature and cost of the infrastructure required to facilitate each trigger are unknown / unidentifiable.

Precisely because the triggers for default events are likely to be associated with less frequent transactions and situations, the cost of facilitating them may be more than the ELNO Service Fees collected for these transactions. ELNO Service Fees are generally similar across a wide variety of transactions. As a first approximation it is therefore appropriate to set a default RELNO surcharge equivalent to 50% of the relevant ELNO Service Fee of the Responsible ELNO for all of the roles in the transaction played by the defaulting RELNO. It is appropriate for the defaulting ELNO to pay the default RELNO surcharge with reference to the ELNO Service Fees of the Responsible ELNO, as opposed to its own ELNO Service Fees, as by definition the defaulting ELNO does not have the capability to be a party to the transaction without the RELNO's investment in infrastructure. Pricing should be set by an ELNO with the capability to perform a transaction. These default RELNO surcharges could then be subject to subsequent regulatory pricing review once knowledge of the typical trigger events for a defaulting RELNO is developed.

If IPART does not accept this approach to setting the default RELNO surcharge, PEXA submits that IPART should calculate the cost of the surcharge to reflect:

- Where the trigger for change of default RELNO is lack of connection to or integrated functionality with a financial institution, the capital and operating costs of establishing and maintaining integration with the relevant financial institution; and
- Where the trigger for change of default RELNO is inability to transact with a titles office, state revenue office, RBA, or other institution, the capital and operating costs of establishing and maintaining that integrated functionality with the relevant institution.

A large number of connections are required to build full functionality. The costs incurred by PEXA to build this infrastructure and integrated capability in circumstances where a new ELNO may default from RELNO responsibilities is potentially significant. Below are examples of the types of connections required, and costs incurred, to build particular specialised functionality:

These examples highlight the high cost incurred by PEXA in facilitating transactions that would otherwise be unable to occur, and support setting the RELNO default surcharge at 50% of ELNO Service Fees (should IPART agree that this is the appropriate mechanism for setting the surcharge). As stated above, unless this surcharge is materially higher than the capital costs, ELNOs will not have sufficient commercial incentive to build and maintain comprehensive RELNO capabilities, a core feature of the interoperability model. Such a scenario would be problematic given it would lead to new entrant ELNO(s) cherry picking profitable transactions and jurisdictions (notwithstanding the MOR provisions that in practice are unlikely to be enforced). This would be a poor consumer outcome, and would undermine universal service objectives.

Establishing and maintaining technical integrations with Land Titles Offices are another likely situation where RELNO default events may arise. PEXA has not been able to provide cost data for building and maintaining this functionality as past technical releases typically bundled a number of functionality upgrades. This difficulty attributing costs to the infrastructure required to provide functionality for specific trigger events further supports initially setting the default RELNO surcharge as a proportion of ELNO Service Fees.

Question 7: Do you agree with our approach to categorising the costs of interoperability that should be recovered through other charges and not through interoperable transaction fees?

A. Costs of establishing and maintaining interoperability

In principle, PEXA agrees that the costs of establishing and maintaining interoperability should be recoverable from an ELNO's subscribers through ELNO Service Fees. As previously submitted to IPART in 2019, PEXA considers that there will be significant additional costs associated with establishing and maintaining interoperability, which would ultimately need to be recoverable through ELNO Service Fees. The costs of establishing and maintaining interoperability are significant but the total costs cannot be established until a significant number of issues are resolved and their cost implications determined.

The costs of establishing and maintaining interoperability should only apply to ELNO Service Fees in jurisdictions where interoperability is introduced (e.g. NSW and QLD). Otherwise, subscribers in other jurisdictions would be forced to pay for the costs of interoperability even though it is not available in their jurisdiction.

Consequently, IPART's draft decision to recover the cost of establishing and maintaining interoperability through ELNO Service Fees (as well as certain operating costs the RELNO will assume), means that PEXA's ELNO Service Fees in jurisdictions that have implemented interoperability should be increased above the current regulatory cap, at least for a period of time.

PEXA understands that IPART's current terms of reference are too narrow to allow it to investigate and make recommendations with respect to ELNO Service Fees. [redacted]

[redacted]

B. Costs relating to increased insurance premiums

PEXA queries IPART's finding that interoperability insurance can be recovered from ELNO Service Fees.

As outlined above, because the RELNO assumes a higher level of risk and potential liability in an interoperable transaction, the RELNO will likely be required to pay a higher insurance premium in respect of providing interoperable functionality (relative to the PELNO) per transaction.

It follows that increased insurance premiums the RELNO incurs as a result of the activities and risk profile it assumes should be recoverable via the RELNO fee, rather than ELNO Service Fees.

However, if IPART ultimately decides that insurance costs should be recovered via ELNO Service Fees, this reinforces PEXA's submission that current ELNO Service Fees are unlikely to be cost reflective of the considerable additional risk created by the introduction of an interoperable system [redacted]

C. Lodgement gap insurance

PEXA agrees with IPART's draft recommendation that Lodgement Gap Insurance should be recoverable through ELNO Service Fees.

However, PEXA notes that its current 'Lodgement Gap Insurance' is a limited contractual coverage provided to PEXA's own subscribers when PEXA is lodging the dealing. It has not been designed for interoperability and consequently, will not necessarily be extended to non-PEXA subscribers (when PEXA is acting as the RELNO) or to PEXA's subscribers when PEXA is not lodging the dealing.

Whether other ELNOs provide insurance with similar features will be their own business decision, and so should be recovered through ELNO Service Fees.

D. LSS Fees

PEXA agrees that LSS Fees should be apportioned between ELNOs pursuant to interoperability agreement negotiations, which are currently underway.

E. Cost of providing a Universal Service

PEXA welcomes the further exploration of options for cost recovery for providing a Universal Service.

To ensure that the objective of universal service coverage for e-conveyancing in Australia is not undermined by the introduction of interoperability, PEXA submits that options for cost recovery of universal service coverage should be considered by IPART.

Cost recovery for providing a Universal Service is an established financial mechanism regulators apply to ensure infrastructure is established in higher cost, more novel areas. An example is network coverage in the mobile telephone industry. Regulators were concerned that there would be no financial incentive among mobile network operators to build coverage in low-traffic, regional areas. As a result, a USO was introduced under which:

- Telstra delivers the universal service to ensure that all Australians have access to payphones and standard telephone services;
- In order to fund this obligation, a telecommunications industry levy is applied to other mobile network operators, alongside government funding.

This telecommunication USO is a long-standing and essential consumer protection that ensures everyone has access to basic telephony services regardless of where they live or work. The industry levy provided to Telstra recognised the high public value and economy-wide benefits of providing network coverage.

In a similar vein, a USO could be introduced to e-conveyancing through inter-ELNO fees that provide ELNOs with an incentive to invest the significant costs required to provide services for the high complexity, low volume transactions, and jurisdictions expected to have relatively lower volumes, such as Tasmania, the ACT, and the Northern Territory.

F. Founding ELNO fee

While PEXA acknowledges IPART's decision that a Founding ELNO fee is not recoverable, PEXA disagrees with this outcome on the basis set out in answer to IPART's Draft Decision 6. As such, we respectfully ask IPART to reconsider its Draft Decision 6 to ensure there is a mechanism to allow PEXA an opportunity to earn an adequate return on its investments in establishing e-conveyancing.

[redacted]

Question 8: Do you agree with reviewing efficient operating and capital costs associated with interoperability for 4 years from 2023-24 to 2026-27? Or do you think we should review efficient costs for a shorter or longer period than this?

PEXA disagrees that a four year is period is appropriate for reviewing efficient operating and capital costs. PEXA submits that a two year period is more appropriate.

Reviewing in four years may be appropriate for a stable system. However, for a nascent technology industry where the impact of interoperability remains uncertain (and is yet to be implemented), a

shorter review period is appropriate to mitigate against the risk of regulatory error and unforeseen economic consequences. For instance:

- Operating and capital costs associated with interoperability remain highly uncertain given the number of issues that remain unresolved to ensure interoperability can be safely and effectively implemented. As a result, initial cost estimates will possibly be wrong and need to be adjusted promptly.
- The costs of implementing interoperability and the ongoing costs associated with operating in an interoperable market structure are likely to be disproportionately incurred by PEXA.
- Fees should be reviewed promptly in the light of the potential market dynamics driven by Sympli's ability to leverage vertical integration across the property transaction supply chain (in circumstances where regulations prevent PEXA from vertical integration).

Accordingly, the operating and capital costs associated with interoperability should be reviewed again within two years from the commencement of Day 2 Interoperability.

PEXA agrees that this two-year period should commence from 2023-24 if commercial interoperability in fact commences in 2023 in NSW and Queensland under the current timetable as outlined at the June 2022 Ministerial Forum, subject to independent assessments as to readiness.

However, if this timetable slips because the timing proves to be infeasible, then the review should be undertaken within two years of commercial interoperability commencing.

Question 9: Do you agree with our proposed approach for estimating efficient financial settlement costs, other efficient marginal operating costs and efficient capital costs associated with developing financial settlement and lodgment infrastructure? Is there any other information we should consider in estimating these costs?

A. RELNO Fee: Critique of IPART's proposed cost build-up approach for estimating costs

Please refer to PEXA's response to Questions 4 and 5 for PEXA's suggested approach for estimating efficient financial settlement and other operating costs, and apportioning these costs between the RELNO and PELNOs.

PEXA's suggested approach differs to IPART's proposed approach in two main respects:

- The estimated costs will need to be based on historic financial costs associated with performing the RELNO role [redacted]
- Costs should be estimated for a two year period from 2023-24 to 2024-25 for the reasons outlined in PEXA's response to Question 8.

PEXA also submits that using Sympli's operating costs in the estimation may not provide a true reflection of the costs associated with the RELNO role given the early stages of its technical development and platform. IPART has also recognised that PEXA will be performing the RELNO role in most instances in the early stages of interoperability.

PEXA agrees that utilising an external consultant is an appropriate approach for IPART to assess the cost information provided by PEXA and Sympli.

B. Default RELNO Surcharge: Critique of IPART's proposed approach for estimating costs

In principle, PEXA agrees with IPART's proposal to recommend that a default RELNO surcharge should be payable to the RELNO for the avoided cost of the infrastructure or facility that the initially designated RELNO lacks at the time of the transaction.

[redacted]

To ensure a more accurate approach to estimating the efficient capital cost for developing financial settlement and lodgement capability, PEXA submits that actual capital costs incurred to establish technical integrations between ELNO and key industry stakeholders should not be disregarded or discounted.

To the extent an ELNO has funded the build of back-end settlement and lodgement infrastructure and integrated functionality as between itself and SROs or financial institutions (with respect to settlement) or Land Titles Offices (with respect to lodgement), IPART should ensure any costs the ELNO has incurred in establishing that capability are accounted. PEXA will not be able to provide any forecast capital costs due to its financial reporting and continuous disclosure obligations.

As discussed in PEXA's response to Question 6, given the full list of circumstances of typical trigger events for a defaulting RELNO surcharge is uncertain and the cost of facilitating these transactions may be more than the ELNO Service Fee, PEXA submits that an initial approach should be to estimate these costs as 50% of the ELNO Service Fees that the RELNO would have charged subscribers represented by the defaulting ELNO. This proportion is reasonable given PEXA's actual costs for some known potential 'trigger events' (integration with a non-major financial institution, and ability to perform complex dutiable transactions with a state revenue office). It is also appropriate to provide economic incentives for ELNOs to develop full functionality and avoid free-riding.

Question 10: Do you agree with our proposed approach for estimating a margin? Specifically, do you agree with using mortgage banks as proxy companies to estimate the equity beta and gearing ratio for ELNOs?

PEXA agrees that estimating a WACC for ELNOs is an appropriate approach for estimating the required profit margin.

However, PEXA does not consider mortgage banks are an appropriate proxy to estimate the equity beta and gearing ratio for ELNOs for three reasons:

- The variability and volatility of revenue is much greater for an ELNO relative to mortgage banks.

- The major component of revenue for mortgage banks is interest payments linked proportionally to the size of the outstanding loan book. This is a relatively stable and known revenue stream.
- Conversely, ELNO revenue is directly proportional to property transaction volumes, which are highly variable [redacted]

- ELNOs are an emerging, speculative technology platform, with an inherently different risk profile to established mortgage banks. ELNOs are exposed to the technology risk of the relatively novel e-conveyancing industry, and the additional technical risk of implementing interoperability.
- Mortgage banks have a markedly different capital structure relative to ELNOs, with a significantly greater balance sheet and ability to take on debt.

As a result, the WACC for an ELNO is significantly higher than for a mortgage bank. Therefore, the equity beta and gearing ratio of mortgage banks are not an appropriate proxy for ELNOs.

PEXA submits that digital property advertising platforms such as Domain Holdings Australia Ltd and REA Group Ltd should be used as proxy companies to estimate the equity beta and gearing ratio for ELNOs. These companies are more comparable to ELNOs as:

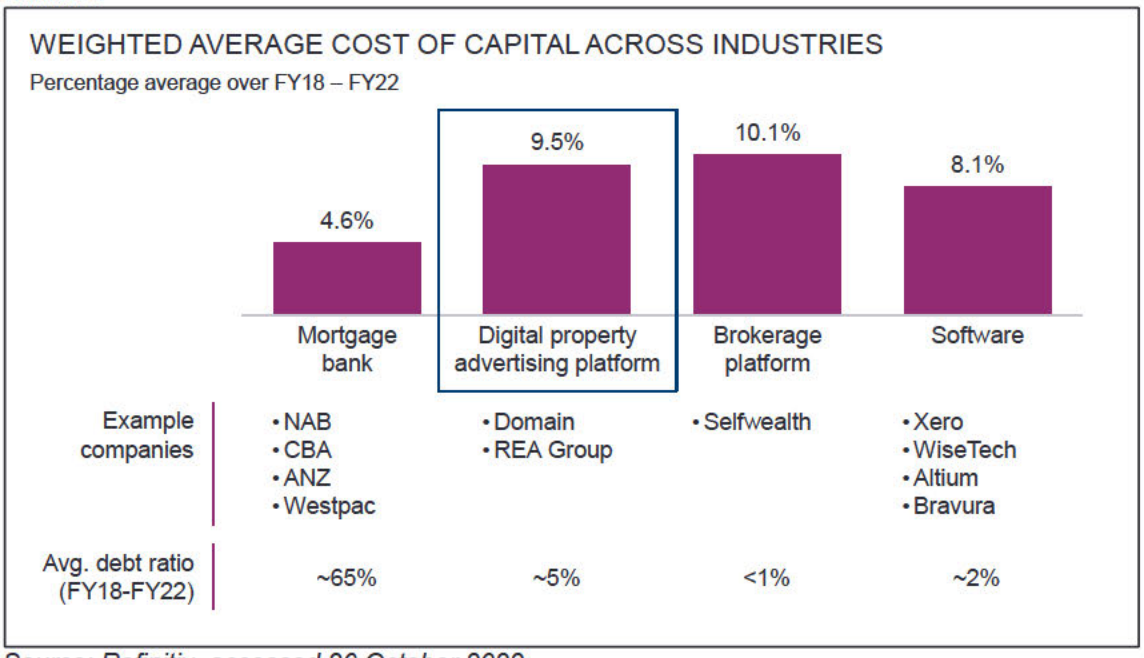
- Revenue is inherently linked to the number of properties advertised for sale, and therefore similarly exposed to volatility in property market transaction volumes.
- Gearing ratios are more similar (possibly because their revenue profiles are volatile and so both companies and financiers are less willing to tolerate the higher gearing ratios typical for mortgage banks).
- Technology risk as a digital platform is more similar to ELNO technology risk (although ELNOs tend to have even more complex technology platforms).

Beyond digital property advertising platforms, online brokerage companies and software start-up companies would also be more comparable proxy companies over mortgage banks to ELNOs.

- The volatility and variability of revenue for online brokerage companies is similar to ELNOs, with revenue linked to the number and value of stock transfers undertaken on the platform.
- Software start-up companies share the business risks inherently associated with emerging technologies faced by ELNOs but not mortgage banks.

Average WACCs and debt ratios for mortgage banks, ELNOs and these other industries are shown in Exhibit 2. PEXA notes that its last reported debt ratio was 11%.

Exhibit 2



Source: Refinitiv, accessed 26 October 2022

The appropriateness of comparable WACCs is dependent on the time at which the investment is made. The WACCs for digital advertising platforms, brokerage platforms and software companies show in Exhibit 2 are only appropriate for capital investments made in a company that is no longer in 'experimental' stage. These WACCs should only apply once a business is operating, with established revenue and cashflows, and in relation to capital investments made to expand existing functionality as opposed to the establishment of significantly new business lines. As PEXA is an established business, with core functionality built, these WACCs are appropriate comparators to estimate the required margins and capital returns under the RELNO fee and default RELNO surcharge. For investments made during PEXA's early stages and initial establishment, a more comparable WACC would be that of companies that are pre-IPO and in early start-up phase. A much higher WACC would be appropriate for estimating margins and capital returns on the much higher risk investments made to bring an e-conveyancing market into existence.

Question 11: What are your views on our proposed approach to forecasting transaction volumes?

PEXA understands that IPART's proposed approach to forecasting transaction volumes is to obtain data from land registry offices and seek information from ELNOs.

[redacted]

The specifics of how IPART will calculate the forecast based on data from land registry offices and ELNOs is unspecified in Issue Paper 2.

IPART's approach to forecast transaction volumes needs to be sophisticated and take into account the mid-to-long term property cycle.

[redacted]

[redacted]

Consequently, IPART should not assume that average volumes over the past five years [redacted] is representative of likely volumes for the next few years.

[redacted]

Question 12: When setting the default Responsible ELNO surcharge, how should the capital costs of developing financial settlement and lodgment infrastructure be shared across ELNOs in a transaction?

As stated above in PEXA's response to Question 3, the default RELNO surcharge should be paid to the ultimate RELNO in all transactions where a 'trigger event' occurs.

Broadly, PEXA agrees with IPART's proposed approach that the default RELNO surcharge per transaction should be based on a calculation of the efficient capital cost associated with developing the relevant financial settlement and lodgement infrastructure and integrated capability and adding an efficient profit margin.

- The efficient capital costs should be based on benchmarking the actual and forecast capital costs incurred by RELNOs for establishing and ongoing maintenance of the infrastructure for 'trigger event' transactions.
- The efficient profit margin is based on an appropriate rate of return based on comparable industry WACCs. (See response to Question 10 for PEXA's position on appropriate comparable industries).

As stated in PEXA's response to Question 3, these capital costs should be allocated differently across ELNOs in a transaction, proportionate to the subscriber role. This is consistent with the

approach taken to the RELNO fee and ELNO Service Fees. This outcome is achieved in setting the default RELNO surcharge as a proportion of ELNO Service Fees.

Question 13: Do you agree with recommending charges for 2 years? If not, what time period do you prefer and why?

In principle, PEXA agrees with IPART recommending charges for two years from the date Day 2 Interoperability commences on the basis that:

- Costs associated with interoperability are inherently uncertain meaning a longer period increases the risk that IPART's recommendations will not be fit for purpose; and
- The date that Day 2 Interoperability commences should be the trigger for IPART's recommended charges commencing, given this is the official date that interoperable transactions will commence commercially in NSW and QLD.

To ensure the charges only apply for two years, PEXA submits that the review of charges should commence one year from the date that Day 2 Interoperability commences commercially. This will ensure sufficient time for industry engagement and review, and implement any necessary changes at the start of year 2.

Question 14: Do you agree with indexing by CPI for the second year of the regulatory period? If not, what approach do you prefer and why?

PEXA supports IPART's proposed approach of indexing the second year of the regulatory period by CPI.

Question 15: Have we identified the relevant matters that should be implemented through amendments to the Model Operating Requirements?

PEXA agrees that the following draft decisions would need to be reflected in amendments to the MOR:

- The costs of establishing and maintaining interoperability should be recovered from an ELNO's subscribers through ELNO Service Fees (see Draft Decision 1).
    - References to 'costs of establishing and maintaining interoperability' in the MOR may be needed (including to the definition of Interoperability Service Fees).
- Subscribers who participate in an interoperable transaction should not pay more than subscribers in a single ELNO transaction (see Draft Decision 3).
    - The MOR should not allow for any pass through to subscribers of the fees that a RELNO will be able to charge PELNOs for participation in an interoperable transaction.

In addition to these matters, PEXA submits that:

- New definitions will be required to facilitate IPART's recommendations. For example, new definitions will be required regarding the triggers for when the default RELNO surcharge applies.

PEXA also agrees with IPART's proposal to make further recommendations about the following matters that would be implemented through the MOR:

- When interoperable transaction fees should be charged;
- The methodology for determining interoperable transaction fees or the level of prices;
- Arrangements for adjusting or reviewing interoperable transaction fees.

In addition to amendments to the MOR, PEXA submits that IPART should provide recommended guidance to be incorporated in associated MOR Guidance notes. For example, this guidance should outline what costs can be recovered via ELNO Service Fees and in which specific jurisdictions. This is necessary given the MOR is a model regulatory instrument, which is incorporated in each jurisdiction that has e-conveyancing.

PEXA also refers to its response at Question 3 above, that, under the MOR, there would need to be a process for the proper independent verification of assertions and an enforcement regime for inaccurate claims of RELNO capability. As the regulatory regime under the MOR is not currently tailored to address these concerns, IPART should recommend that the MOR is updated to ensure there is an avenue for ARNECC to receive complaints about, and appropriate powers to investigate and apply appropriate regulatory penalties for, inaccurate claims of RELNO capability. In terms of enforcement, compensation should be payable to the aggrieved RELNO that would receive lower ELNO Service Fees as a result of the inaccurate claim of capability by the ELNO.

Question 16: Do you think it is appropriate for the practical arrangements between ELNOs for payment of interoperable transaction fees to be negotiated through Interoperability Agreements?

PEXA agrees that the practical arrangements relating to the payment of interoperable transaction fees can be included in the interoperability agreement.

PEXA considers that these are practical and mechanical matters that PEXA and Sympli as sophisticated commercial parties can determine as between themselves.