



REVIEW OF THE PRICING FRAMEWORK FOR ELECTRONIC CONVEYANCING SERVICES IN NSW



Final Report
SPECIAL REVIEWS

November 2019

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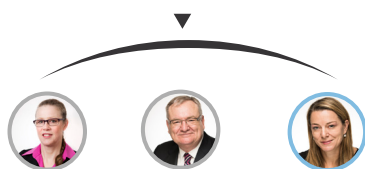
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1. Executive Summary



The development and implementation of eConveyancing has been a **success story of digitisation**. A paper-based system of real property title lodgment and financial settlement has been transformed to one that operates electronically, saving time and reducing the potential for errors and fraud, and continuing to protect the integrity of land registries and financial transactions.

New entities – electronic lodgment network operators (ELNOs) – have been created, and the roles of solicitors, conveyancers and settlement agents have changed.

The Australian eConveyancing market is well advanced



This market has evolved to the point where **three states including NSW have mandated** most property transactions to be completed electronically.

However, there are elements of the market's current structure that require further examination, particularly with respect to governance, the scope for competition, the regulation of the financial settlement component of transactions and the pricing regulatory framework. For example:

- The market is highly concentrated, with two ELNOs approved to operate in NSW
- One of the existing ELNOs, PEXA, effectively has 100% of the market as the other, Sympli, has recently completed its first transaction in NSW.
- Competition is hampered by ELNOs' current inability to interoperate with each other in transactions involving multiple parties.

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is conducting one of several independent reviews^a of these elements. The NSW Government has directed us to assess the state of the market, and then recommend an appropriate pricing regulatory framework that includes:



A maximum price or pricing methodology for the provision of services by an ELNO



Maximum prices or pricing methodologies for services provided to ELNOs by NSW Land Registry Services (NSW LRS) and by Revenue NSW.

In doing so, we must consider the need to protect customers from excessive prices while allowing ELNOs to recover their efficient costs, and the need to promote competition in the market. Effective competition can drive both lower prices and innovation in service delivery.

This report sets out our findings and recommendations, and discusses the supporting analysis, as well as any comments from stakeholders who submitted to our review.

^a An independent reviewer (Dench McClean Carlson) is reviewing the Intergovernmental Agreement for an Electronic Conveyancing National Law, focusing on governance and regulatory matters, including competition. The NSW Government also established working groups with an independent chair to develop proposals for interoperability solutions that could be applied at a national level. The ACCC is undertaking work on competition and market structure for ELNOs.

Overview of findings and recommendations for this review

Although competition is emerging, the lack of interoperability between ELNOs' systems is constraining its development.

We found that PEXA's current prices are reasonable, and so we recommend that maximum prices for any ELNO be set as PEXA's current prices with an annual CPI cap from 1 July 2020 for two years.

Interoperability between ELNOs has **significant potential to promote competition**, as it allows each party in the settlement process to use the ELNO of their choice. We consider that building direct connections between the two existing ELNOs is the preferred approach to achieve the benefits of competition in a cost-efficient way, given the current state of the market. We recommend regulators require the two existing ELNOs to build direct connections.

Regulators should allow subsequent new entrant ELNOs to choose between:

- Connecting to existing lodgment and financial settlement infrastructure
- Developing their own infrastructure and connecting to the other ELNOs in the market.

We found that NSW LRS has made savings from the increased uptake of eConveyancing so can absorb the cost of investing in a new platform to connect multiple ELNOs without introducing a new fee.

Revenue NSW's prices should be set to recover some of the costs it incurs in providing duties verification services, as these services are outside its core tax collection activities. We recommend maximum prices be set to recover the costs that ELNOs directly impact and could avoid or minimise.

Competition in the eConveyancing market has emerged

Submissions agreed that the industry is undergoing **considerable change**, in terms of competition and the regulatory environment. Uncertainty about interoperability and other aspects of the future state of the market could constrain competition.

While competition from a new entrant, Sympli, is emerging, this ELNO has recently completed its first transaction in NSW,^b and has undertaken some transactions in Victoria and Queensland. Our modelling suggests that under current cost structures, the market is likely to remain concentrated.

To develop competition in the eConveyancing market, the regulatory framework could be modelled on the principles of the competition framework for Cash Equity Settlement providers in Australia.

This would involve regulators providing guidance to new entrant ELNOs and setting approval conditions based on ELNO business plans, instead of a two-year moratorium on new entry.



^bSympli completed its first transaction in NSW in October 2019.

PEXA's current prices are reasonable as maximum prices for all ELNOs

We asked our consultant, AECOM, to **estimate the costs that a benchmark efficient ELNO would incur** in providing eConveyancing services from 2020-21 to 2023-24. We applied our standard building block method to model prices that would allow a benchmark efficient ELNO to recover those costs. We found that PEXA's existing prices were reasonable compared to all modelled scenarios.

We also investigated prices being charged by settlement agents, both for paper settlements prior to the eConveyancing mandate, and for 'e-settlement' services, where the agents take on some of the administrative tasks of running a PEXA workspace. We found that PEXA's prices are no higher than the prices paid for paper settlement.

Based on our findings on the state of the market and a benchmark efficient ELNO's costs, we consider that PEXA's current prices are reasonable, and appropriate as a maximum price for **any ELNO** in the short term.



“Based on our findings on the state of the market and a benchmark efficient ELNO's costs, we consider that PEXA's current prices are reasonable, and appropriate as a maximum price for any ELNO in the short term.”



Maximum prices indexed by CPI annually is appropriate while competition develops

We found no compelling evidence to suggest that maximum prices should be lower than PEXA's current prices, and so we recommend that maximum prices for **all ELNOs** be set at PEXA's current (real) prices from 1 July 2020, and indexed annually by CPI for two years.

This differs from the current pricing regulatory framework under the Model Operating Requirements, where CPI indexation applies to an ELNO's individual prices when it enters the market.

Interoperability between ELNOs would promote competition

Without interoperability, subscribers must use the same ELNO to complete a property transaction. We found that implementing interoperability has substantial potential to promote competition. It would allow users to **choose their preferred ELNO and open up the network effects** in the eConveyancing market, permitting ELNOs with a smaller subscriber base to compete. Effective competition would drive innovation and lower costs.

We analysed **four interoperability solutions** and compared their **potential to promote competition and their costs**. We found that **building direct connections** between ELNOs:

- has more potential to promote competition than a full central hub or access regime model, and
- is more cost-efficient than an information hub model until there are three or more ELNOs in the market.



The additional **costs of interoperability to the ELNO market as a whole are small** and are outweighed by the benefits.

We consider regulators should require that a direct connection is built between the existing ELNOs in the short term. To enable the development of efficient and effective competition, regulators should also implement a framework that **allows new entrant ELNOs to choose between: using existing infrastructure; or building their own infrastructure** and establishing direct connections with other ELNOs.

Under this model, each ELNO in an interoperable transaction would bear some of the costs of the transaction. However, the ELNO that is responsible for lodgment (or third-party fees) would bear more costs. Therefore, if this model were adopted, **a cost-reflective transfer price should be set** to ensure the costs are shared between the lodging and non-lodging ELNO. Assuming that the lodging ELNO incurred all capital costs and other fees, the non-lodging ELNO would pay a transfer price of around \$13 to the lodging ELNO (and share the costs of interoperability insurance). Note that this transfer does not represent an additional charge to subscribers.



NSW LRS has made savings from eConveyancing and so can absorb the costs of upgrading its system to accommodate multiple ELNOs

NSW LRS has invested funds in building a new platform that allows multiple ELNOs to obtain land title information and lodge changes to titles and seeks to recover those costs through an additional charge on ELNOs. NSW LRS sought to recover these costs from the ELNOs that connect to the new platform. We found that NSW LRS should be able to absorb the cost of any incremental investment in technology to permit connection by multiple ELNOs.

We consider that the **Lodgment Support Services fees being charged already cover the costs of technology required to deliver services to ELNOs**, whether that be one or several ELNOs. NSW LRS has also been able to reduce its costs significantly as a result of the transition from a wholly paper-based conveyancing process to a majority eConveyancing environment.

Revenue NSW's prices should be set to recover some of the costs of its duties verification services

In our Issues Paper we asked the threshold question whether a taxing agency should be permitted to charge for performing its core function of collecting taxes. We consider that eConveyancing has resulted in Revenue NSW undertaking additional functions (duties verification services) and incurring additional costs outside its core tax collection function.

Because ELNOs are not able to influence all of the costs associated with Revenue NSW's duties verification service, we consider that these **prices should recover only the cost items that ELNOs impact and could avoid or minimise.**

These include the variable costs related to providing ELNO subscriber support, support activities, including testing for ELNO system upgrades that exceeds base level frequency, and Revenue NSW making system changes for ELNOs.

We recommend that Revenue NSW prices to ELNOs are also CPI indexed annually.

Our recommended maximum prices



for Revenue NSW are set out below

Table 1 Revenue NSW maximum prices to ELNOs (real \$2018-19)

Revenue NSW cost relating to ELNOs	IPART maximum price to ELNOs
ELNO subscriber support to resolve duties verification errors	ELNOs to pay a share of \$608,000, proportional to the number of support inquiries generated by each ELNO).
Revenue NSW support activities (including testing for ELNO releases) that exceed base level frequency. Base level is two major and two minor releases per year, per ELNO.	\$38,000 for major release support activities \$21,000 for minor release support activities
For all Revenue NSW system changes (resulting from base-level or non-base-level ELNO activity)	Costs are likely to vary, and so Revenue NSW and ELNOs should negotiate a price for these activities through contractual arrangements (with any disputes being resolved by the eConveyancing national regulator)





We consulted with stakeholders to reach our final recommendations

For this review, we conducted public consultation as well as detailed analysis. We have:

- ▼ Released an **Issues Paper** in **March 2019** outlining our proposed approach to the review and invited comment,
- ▼ Considered all submissions to our Issues Paper and undertook analysis to develop our **Draft Report**,
- ▼ Held a **public forum** in Sydney on 3 September to provide the opportunity for interested persons to comment on our draft report,
- ▼ Considered all submissions to our Draft Report and comments at the public forum in preparing our **Final Report** and recommendations for the Premier by **November 2019**.



List of findings and recommendations



Our final findings are:

- 1 The eConveyancing market in NSW is currently highly concentrated and is likely to remain concentrated in at least the short term.
- 2 Interoperability would improve competition in the eConveyancing market and would reduce barriers to entry.
- 3 While vertical integration may lead to efficiencies in the eConveyancing process, which will ultimately benefit consumers, vertical integration also has the capacity to stifle competition and innovation in upstream and downstream markets.
- 4 The direct connection or information hub models provide the greatest prospects for competition, differentiation and innovation between ELNOs, given the current state of the market. The incremental capital cost of a direct connection between the two current ELNOs is relatively low.
- 5 An access framework could be based on the principles of the cash equities market. The framework for the cash equities market sets out that incumbent firms are compelled to facilitate access to services on a transparent and non-discriminatory basis, and the ACCC is given the power to arbitrate disputes where access negotiations between an incumbent and new entrant fail.
- 6 The Model Operating Requirements address the appropriate treatment of pass-through costs, such as ELNO insurance premiums, fees imposed by external agencies and changes in the law.
- 7 IPART's recommended pricing framework for eConveyancing will ensure consumers pay no more for eConveyancing than they did for paper conveyancing.
- 8 Other jurisdictions could adopt a similar framework for recommending ELNO prices.
- 9 NSW LRS can absorb the cost of modifying its technology platform to permit connection by multiple ELNOs.
- 10 Including Revenue NSW in the governance framework would reduce total costs to the industry, and deliver greater efficiencies.



Our final recommendations are:

- 1 The eConveyancing market be monitored at least every two years, ideally by a national regulator such as the ACCC or ARNECC (or on a state-by-state basis by regulators including IPART), to assess the effectiveness of competition and inform governance and pricing policy decisions.
- 2 NSW ORG work with ARNECC to model the competition framework for eConveyancing on the principles of the framework developed by the Council of Financial Regulators and the ACCC in their review of competition in cash equities clearing and settlement in Australia. The state-based Registrars and ARNECC can draw upon the advice and expertise in competition regulation offered by the ACCC.
- 3 Due to the continuing development of the eConveyancing market, the national eConveyancing regulator review the adequacy of the MORs to address the impacts of vertical integration.



Recommendations (continued):

- 4 A direct connection between the two current ELNOs be implemented as soon as possible to promote competition. To ensure a nationally consistent approach, it would be preferable to implement interoperability between the two current ELNOs on a national basis by ARNECC through the MORs. However, there is benefit in NSW continuing work on elements of interoperability that contribute to a national solution and, if interoperability is not pursued on a national basis, interoperability in NSW could potentially be implemented through ELNO approval conditions.
- 5 New entrant ELNOs to negotiate commercial agreements to access existing infrastructure, or build their own infrastructure and establish direct connections with other ELNOs. Any disputes over price and or non-price terms and conditions relating to access to infrastructure would be subject to arbitration provided by a party mutually agreed by the participants or by a regulator.
- 6 NSW ORG work with ARNECC to set a schedule of costs that can be used by ELNOs to calculate a cost-reflective transfer price for interoperable transactions to ensure that costs are shared fairly across ELNOs.
- 7 Maximum prices for all ELNOs be set at PEXA's current (real) prices from 1 July 2020 and CPI indexed annually (as defined by the MORs) for two years, before being reviewed again, ideally by a national regulator such as the ACCC (or on a state-by-state basis by regulators including IPART).
- 8 If an ELNO unbundles its prices for the financial settlement and lodgment components of a service, then the sum of the separate prices for financial settlement and lodgment components must not exceed the regulated maximum for the bundled price.
- 9 If an ELNO proposes to introduce new eConveyancing services, the ELNO can opt to either a) propose cost-reflective prices to the regulator based on a building block approach (or another reasonable method for estimating costs) OR b) the ELNO can demonstrate to the regulator's satisfaction that the market for a new eConveyancing service is competitive. If the ELNO can demonstrate that the market is competitive, the prices would not be regulated; otherwise, the regulator must determine them. Once approved, prices must be notified to subscribers four weeks before they are effective. Prices must also be published on the ELNO's website.
- 10 Maximum prices for each category of residual dealing made available for eConveyancing be set as shown in Table 5.3 and indexed annually by CPI, unless otherwise approved by the eConveyancing regulator on a cost-basis. ELNOs and NSW LRS work together to determine the appropriate category for each dealing.
- 11 ELNOs be able to pass through as an additional charge the efficient costs of implementing interoperability. Because these costs are not yet known, they should be reviewed at the next review of the pricing framework at the end of two year regulatory period, or sooner if an interoperability model is implemented sooner.
- 12 ELNOs not be required to offer nationally consistent pricing, but they may choose to do so on a commercial basis.
- 13 Revenue NSW charge ELNOs the following maximum prices (indexed by CPI annually):
 - \$608,000 (in real \$2018-19) proportional to each ELNOs share of inquiries generated, to recover costs relating to ELNO subscriber support
 - For any release support activities that exceed base level frequency (ie two major and two minor tests per year per ELNO to be provided at no charge), \$38,000 per major release and \$21,000 per minor release (in real \$2018-19), per ELNO
 - Prices for Revenue NSW services to ELNOs that result in a change to Revenue NSW's systems to be determined by contractual negotiations between ELNOs and Revenue NSW.



Structure of this report

The remainder of this report discusses our analysis, final findings and final recommendations in detail. It is structured as follows:

- ▼ **Chapter 2** discusses the context for our review, including the approach we used to reach our final recommendations
- ▼ **Chapter 3** discusses our final findings and recommendations on the state of the eConveyancing market
- ▼ **Chapter 4** discusses our final findings and recommendations on interoperability
- ▼ **Chapter 5** discusses our final findings and recommendations on ELNO costs and prices
- ▼ **Chapters 6 and 7** set out our final findings and recommendations on Land Registry Services and Revenue NSW's costs and prices
- ▼ **Appendices A-F set out:**
 - Our terms of reference
 - A list of submissions received on our Issues Paper and Draft Report
 - Additional information about the weighted average cost of capital (WACC) calculation used in the price modelling for ELNOs and NSW LRS
 - Steps in eConveyancing process compared to paper conveyancing process
 - Diagrams of the contestability of activities and infrastructure under different interoperability models
 - The legal framework for eConveyancing

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Abbreviations

ACCC	Australian Competition and Consumer Commission
ARNECC	Australian Registrars' National Electronic Conveyancing Council
CPI	Consumer Price Index
ECNL	Electronic Conveyancing National Law
ELN	Electronic Lodgment Network
ELNO	Electronic Lodgment Network Operator
GST	Goods and Services Tax
IGA	Intergovernmental Agreement
IPART	Independent Pricing and Regulatory Tribunal
LSS	Lodgment Support Services
MOR	Model Operating Requirements
MPR	Model Participation Rules
MRP	Market Risk Premium
NECDS	National Electronic Conveyancing Data Standard
NSW LRS	NSW Land Registry Services
ORG	Office of the Registrar General
PEXA	Property Exchange Australia Limited
RBA	Reserve Bank of Australia
RPA	Real Property Act 1900 (NSW)
Sympli	Sympli Australia Pty Ltd
WACC	Weighted Average Cost of Capital

2 Context for the review

To provide a context for this review, the sections below explain IPART's process for this review and our understanding of:

- ▼ What eConveyancing is
- ▼ The key participants in the process
- ▼ The current pricing for eConveyancing services within the scope of our review
- ▼ The legal and regulatory framework for eConveyancing nationally and in NSW
- ▼ eConveyancing practice and progress across Australian jurisdictions.

2.1 IPART's review process

IPART is an evidence-based consultative regulator. All reviews IPART undertakes, including this review of the pricing framework for eConveyancing, use a rigorous, transparent and inclusive review process. We actively engage with stakeholders and undertake research and analysis, seeking expert advice where necessary. Our approach to this and all our reviews:

- ▼ Maintains transparency
- ▼ Informs and strengthens our decisions
- ▼ Ensures genuinely impartial determinations and recommendations.

Specifically, for this review, we have undertaken detailed analysis and public consultation:

- ▼ In December 2018 we consulted on the draft Terms of Reference for the review and received eight submissions before finalising the Terms of Reference in January 2019. A copy of the full final terms of reference is at Appendix A.
- ▼ We held numerous stakeholder meetings in the first quarter of 2019 including meeting with PEXA, Sympli and other key stakeholders.
- ▼ In March 2019 we released an Issues Paper, which set out our proposed approach for the review including our approach to interoperability. We received eight submissions. A list of all submissions received is at Appendix B and submissions have been published on our website.
- ▼ We appointed AECOM to provide expert advice on the efficient costs of an ELNO, land registry and revenue office, as well as for a range of different interoperability models. Our methodology, models and consultant reports have been made publicly available, subject to any confidentiality.
- ▼ We participated in the various NSW working groups on interoperability and continued to meet with key stakeholders.

-
- ▼ In August we released our Draft Report which set our draft findings and recommendations. We received seven submissions. A list of all submissions received is at Appendix B and submissions have been published on our website.
 - ▼ In September we held a public hearing where stakeholders provided feedback on our draft findings and recommendations.

In its response to our draft report PEXA submits that “there is a real and substantial risk that IPART’s findings and recommendations could result in detriment to consumers... because they lack sound understanding of the technical, legal and financial underpinnings of eConveyancing”. PEXA also submits that our Draft Report is based on “assumptions that were not supported by consultation or appropriate prior fact finding”.¹

We consider that the eConveyancing market will remain highly concentrated in at least the short term and although competition is emerging, the lack of interoperability between ELNOs’ is constraining its development. We also found that implementing an interoperability solution has significant potential to promote the benefits of competition, including innovation and dynamic efficiency. Interoperability would allow participants to each choose their preferred ELNO and open up the network effects in the eConveyancing market, making it more viable for ELNOs with smaller subscriber bases to compete. Effective competition would drive innovation and lower costs. As a consequence, we do not agree that our findings and recommendations would cause harm to the industry. A number of submissions to our Draft Report agreed with our findings and recommendations around the need for interoperability.

2.2 What is eConveyancing?

Conveyancing is the process through which title to real property is transferred from one person to another (eg, when it is sold or inherited), and other interests in the property are dealt with (eg, a lessor’s or mortgagee’s). Typically, it includes the following phases:

- ▼ Preparation of contracts
- ▼ Exchange of contracts
- ▼ Property searches and enquiries
- ▼ Preparation and exchange of documents
- ▼ Transfer duty calculation and payment
- ▼ Financial settlement
- ▼ Document lodgment
- ▼ Document registration (when legal title is transferred).

eConveyancing is an electronic solution for some of the steps involved in this process – from preparation and exchange of documents to document lodgment. It allows solicitors, conveyancers and financial institutions to enter a secure, online workspace via an electronic lodgment network (ELN) where they can exchange data and collaborate to prepare documents, settle funds and lodge documents with land registries.

¹ PEXA Submission to the Draft Report, October 2019, pp 3 – 4.

Essentially, eConveyancing allows the parties involved to complete conveyancing transactions and disburse settlement funds electronically. It also allows other documents that are not necessarily part of a sale but relate to interests in land (eg, caveats) to be lodged electronically.

A comparison of the paper-based and eConveyancing processes is available in Appendix D.

2.3 Key participants in eConveyancing

The eConveyancing process involves the following participants:

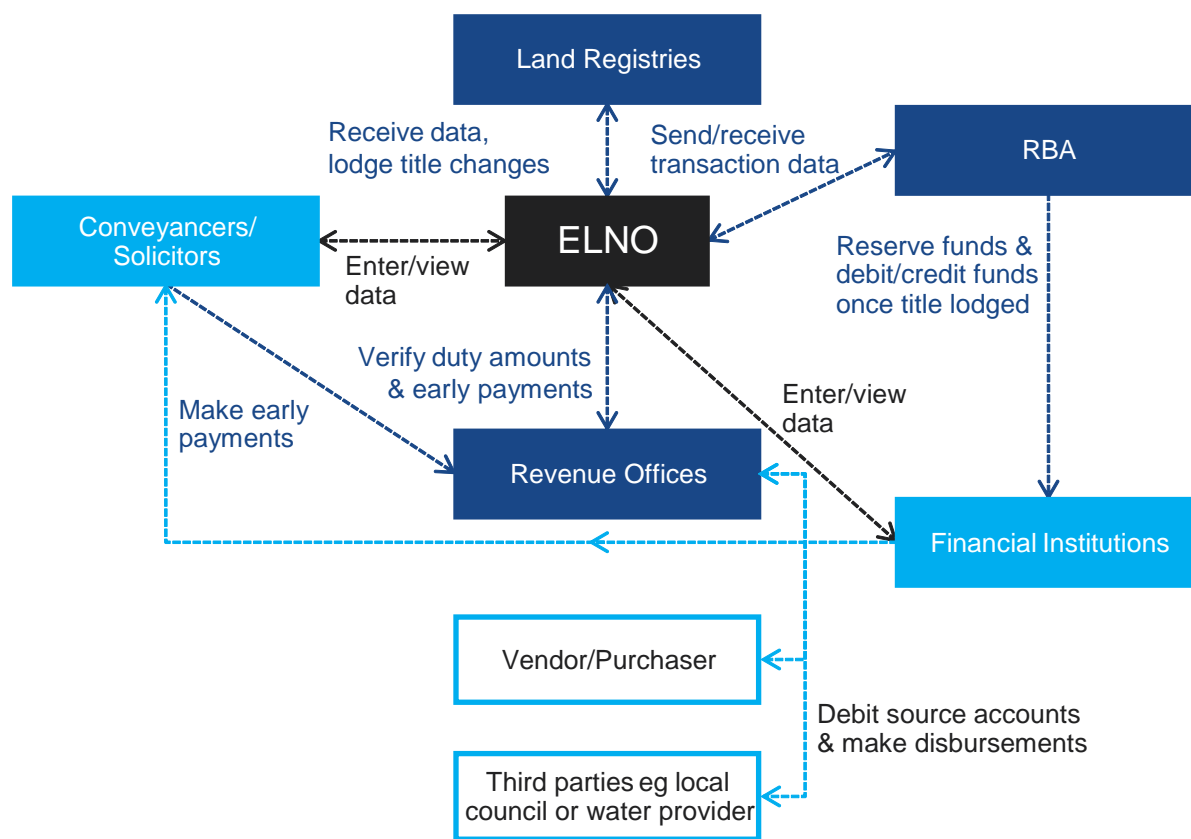
- ▼ **ELNOs.** ELNOs are businesses approved by the relevant state's Registrar General to build and operate ELNs via which documents and funds can be exchanged. There are currently two ELNOs approved in NSW – PEXA and Sympli – although only PEXA is currently operating at scale, with Sympli having conducted its first transaction in NSW on 23 October 2019.
- ▼ **Subscribers.** These are people or businesses authorised by their client to enter and exchange data to complete electronic documents and transactions via an ELN. They include:
 - **Principal subscribers**, who represent themselves – for example, financial institutions and government agencies
 - **Representative subscribers**, such as solicitors and conveyancers who represent other parties to the conveyance – typically, the vendor or purchaser.
- ▼ **The Reserve Bank of Australia (RBA).** The RBA facilitates financial settlement by reserving funds until lodgment is confirmed and transferring funds between financial institutions.
- ▼ **Each state's revenue office.** In NSW this is Revenue NSW. Revenue NSW confirms if duties have been paid and if not, the dutiable amounts are populated in the workspace and paid via the ELN at settlement.
- ▼ **Each state's registry office.** In NSW this is NSW LRS. Documents are lodged with NSW LRS, which then examines the documents and, if acceptable, registers them and updates the land titles register, which is called the Torrens Title Register. Changes to the Torrens Title Register are based on the transaction: for example, in a sale, NSW LRS replaces the vendor's name on title with the purchaser's name. NSW LRS's primary function is to maintain the Torrens Title Register. The Torrens Title Register contains all information about the ownership of land as well as interests that affect land.² The Torrens Title Register is the single source of truth for land ownership in NSW.³

Figure 2.1 outlines the participants in the eConveyancing process and how they interact with one another.

² Each parcel of land is based on plans registered by NSW LRS and has its own unique title reference.

³ Butt, P, Ticehurst, F, Rushforth, G, Hughes, L, and Stuckey-Clarke, J, *Woodman & Nettle, The Torrens System in NSW*, 2018, p 9176.

Figure 2.1 Participants in the eConveyancing process and interactions



KEY:

■ = Subscribers

■ = Send and receive data

= Not involved in the workspace

Note: Currently, eConveyancing can only occur if all parties use the same ELNO, so only one ELNO is represented in the above diagram. The issue of multiple ELNOs participating in a single transaction is discussed later in this paper.

2.4 Current prices for eConveyancing services within scope of our review

We have reviewed the fees for eConveyancing services charged by:

- ▼ ELNOs to subscribers
- ▼ NSW LRS to ELNOs
- ▼ Revenue NSW to ELNOs.

The RBA's fees to ELNOs are outside the scope of this review; however, these costs are taken into account in our analysis as part of ELNOs' operating expenditures. IPART has also not been asked to review prices that solicitors, conveyancers or financial institutions charge their customers as this is a competitive market.

2.4.1 ELNO prices for services to subscribers

ELNOs currently set their own fees, and are obliged to do so “according to a publicly available, equitable and transparent pricing policy”.⁴ From 25 February 2019, ELNOs’ pricing became subject to some pricing controls via Australian Registrars’ National Electronic Conveyancing Council’s (ARNECC’s) Model Operating Requirements Version 5, including an annual Consumer Price Index (CPI) cap on price increases.⁵ In NSW, the Conditions of Approval cap the annual price increase for ELNOs at CPI minus ‘Factor’, with the Factor set each year by the Registrar General. The Registrar General set the Factor to zero for 2018-19 and 2019-20.⁶

ELNOs currently charge a Transaction Service Fee to the participant subscribers in a transaction, who factor this cost into running their business. Solicitors, conveyancers and financial institutions operate in competitive markets so their fees to their clients for conveyancing services are not within the scope of this review. PEXA also charges subscribers a fee for providing more than one digital certificate to allow subscribers to securely sign documents, while it is not known whether Sympli will also charge its subscribers a similar fee.⁷

The results of our review of ELNOs’ pricing are detailed in Chapter 5.

2.4.2 Land registry prices for services to ELNOs

NSW LRS’s customer fees are based on the *Real Property Regulation 2014*, *Conveyancing (General) Regulation 2018*, and *Strata Schemes Development Regulation 2016*, and are updated each year based on the change in CPI.

NSW LRS currently charges **lodgment fees** of \$143.50 (GST inclusive) per lodgment for the most common documents such as transfers, mortgages and discharges of mortgage.⁸ These fees are charged by LRS to the principals in a transaction, and are collected by the ELNO from subscribers and passed through to LRS. These fees are not within the scope of our review.

The NSW LRS’s 2019-20 schedule of fees also includes fees charged to ELNOs for electronic **lodgment support services** (LSS). ELNOs take into account LSS fees as one of the input costs in setting their prices.

NSW LRS has proposed to charge ELNOs a new fee attributable to the costs of building new systems. Any new fees that NSW LRS wishes to charge ELNOs are subject to the Registrar General’s approval.

⁴ ARNECC, Model Operating Requirements (MOR) Version 5, December 2018, 5.3(e), https://www.arnecc.gov.au/__data/assets/pdf_file/0008/1435643/mor-guidance-notes-version-5-clean.pdf, accessed 7 August 2019, p 58.

⁵ Ibid, p 73.

⁶ Conditions of Approval, General Condition 3, <https://www.registrargeneral.nsw.gov.au/eConveyancing/legal-framework/approval-conditions>, accessed 12 November 2019.

⁷ Sympli’s Pricing Policy states that ‘there may be other fees payable by a Subscriber for the provision of additional products or services that are not Transaction Services. This Policy does not cover fees for these types of products and services, as these will be directly agreed between Sympli and a Subscriber’. Sympli, Pricing Policy, <https://www.sympli.com.au/wp-content/uploads/2019/07/Pricing-Policy.pdf>, accessed 7 November 2019.

⁸ See: <https://www.nswlrs.com.au/Fees> accessed 8 August 2019.

The results of our review of NSW LRS's proposed new fee are detailed in Chapter 6.

2.4.3 Revenue NSW prices to ELNOs

Revenue NSW does not currently charge ELNOs any fees, but it proposes to introduce fees for the costs of building new systems for duties verification services to ELNOs, connecting ELNOs to those systems, testing them and providing ongoing support.

The duties verification service to ELNOs checks that the details of the property dealing matches between Revenue NSW's and the ELNO's systems, allows the transfer duty amount to be displayed in the ELNO's user interface, and checks whether the duty has been paid early or whether the duty needs to be a line item in the ELNO's Financial Settlement Schedule. Under the paper conveyancing process, NSW LRS was responsible for verifying that duties were paid prior to title lodgement. Revenue NSW also provides support to ELNOs' subscribers to resolve issues that arise through this duties verification process.

The results of our review of Revenue NSW's proposed new fees are detailed in Chapter 7.

These services to ELNOs are separate to Revenue NSW's primary duty collection role. This is facilitated through the Electronic Duties Return service, which is a service that allows an approved holder (Electronic Duties Return client) to electronically assess and endorse a range of duties transactions including transfer duty, and pay duty by weekly remittance. The Electronic Duties Return service is not within the scope of our review.

2.5 The legal and regulatory framework for eConveyancing

Any pricing regulatory framework for eConveyancing we recommend must take account of the broader legal and regulatory framework. The national elements include:

- ▼ The Intergovernmental Agreement for an Electronic Conveyancing National Law (IGA) between all states and territories except the ACT. The IGA sets out the participating jurisdictions' commitment to pursue a nationally consistent approach to eConveyancing, including enacting a model law and that the model law would be led by NSW.⁹
- ▼ The Electronic Conveyancing National Law (ECNL), which is the model law that empowers the Registrar General in each jurisdiction to make the participation rules and the operating requirements for that jurisdiction.¹⁰
- ▼ ARNECC, which is the council established under the IGA and is comprised of each participating jurisdiction's Registrar General (or their nominee).

The NSW legal and regulatory framework includes:

- ▼ The ECNL, which NSW adopted by passing legislation in 2012. Among many provisions, the ECNL provides that the Registrar General's approval is required before an ELNO may operate in NSW, and that the Registrar General may impose NSW-specific conditions on an ELNO's approval.

⁹ Council of Australian Governments, *Intergovernmental Agreement for an Electronic Conveyancing National Law*, December 2011, sections 3.4, 5.1 and 8.1.2.

¹⁰ *Electronic Conveyancing (Adoption of National Law) Act 2012* (NSW) s 24(2).

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- ▼ The state's version of the Model Participation Rules (MPR) and Model Operating Requirements (MOR). The current versions commenced on 25 February 2019, and are consistent with version 5 developed by ARNECC.
 - ▼ The *Real Property Act 1900 (NSW)* (RPA), which permits the Registrar General to make Conveyancing Rules.
 - ▼ The Conveyancing Rules that the Registrar General has made, which include the legal mechanism for mandating eConveyancing in NSW.
 - ▼ The *Duties Act 1997*, which specifies that title transfer cannot occur without the payment of duties.

Further details on the legal framework can be found in Appendix F.

2.6 With mandating, ELNOs become of increased importance to the community

From 1 July 2019, the NSW Government mandated that eConveyancing must be used to lodge all mainstream documents (such as transfers, mortgages, discharges of mortgage, caveats and withdrawals of caveat). This has increased the importance of an open and competitive ELNO market to the community in NSW. Competition is emerging; there are currently two ELNOs operating in NSW, and so the market has reached a critical point.

In recognition of this, the NSW Government has committed to finding a solution whereby a subscriber on one ELN can transact with a subscriber on another ELN. This is known as interoperability between ELNOs. The NSW Government commissioned working groups to analyse the technical and governance issues for interoperability in more detail, and work towards a possible baseline model for interoperability, designed for national consistency.¹¹

Our analysis of the costs of different interoperability models, recommendations for a way forward on interoperability, and a discussion of a transfer price (to share costs fairly between ELNOs) for interoperable transactions are detailed in Chapter 4.

¹¹ NSW ORG submission to IPART Issues Paper, 8 May 2019, p 2.

3 State of the eConveyancing market

The first step in our approach to this review was to assess the state of the eConveyancing market in NSW, including the current level of competition and the possible development of competition over the next few years.

Based on our preliminary assessment of the market in our Issues Paper and submissions from industry stakeholders, we have concluded that the market is highly concentrated and is likely to remain concentrated in at least the short term. There are now two ELNOs currently operating in NSW with Sympli having conducted its first transaction in NSW on 23 October 2019, however the incumbent ELNO PEXA effectively has 100% market share. The NSW Government's mandate of the use of eConveyancing for mainstream property transactions from 1 July 2019 has meant that there is no longer competition from the use of paper conveyancing.

We have considered governance and operating arrangements, including interoperability between ELNOs, which could enhance development of competition in the market.

This chapter summarises our findings and recommendations on the eConveyancing market, and then goes on to discuss them in more detail.

3.1 Summary of findings and recommendations on the eConveyancing market

The future development of competition in the eConveyancing market depends on minimising barriers that constrain new ELNOs from entering the market or increasing their market share. We consider that maintaining the status quo will disadvantage new entrant ELNOs and will risk entrenching the current market structure – that is, a single ELNO providing services to effectively 100% of the market.

While we considered a number of different barriers to entry, the most significant barriers are:

- ▼ The network effects in the market, which mean that the market is likely to be dominated by more established ELNOs that have a larger subscriber base to complete transactions with. Introducing interoperability (discussed in detail in Chapter 4) will open up these network effects and improve competition. Most submissions to our Issues Paper supported this.

- ▼ Regulatory uncertainty resulting from measures such as a proposed two-year moratorium on new entry of ELNOs (discussed further in Section 3.5.3), would significantly delay the development of competition and could potentially reduce investment in the market. We recommend that the NSW Office of the Registrar General (ORG) work with ARNECC to model the competition framework for eConveyancing on the principles of the Council of Financial Regulators' Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia. This would involve regulators setting conditions of approval that are consistent with safe, efficient competition in the market and reflect each new entrant ELNO's business plans, instead of a two-year moratorium on new entry.

3.2 The eConveyancing market is currently highly concentrated

Only one ELNO – PEXA – is currently offering eConveyancing services at scale in NSW. PEXA has been operating in NSW since 2013, and over that time has had to compete with traditional paper conveyancing services. However, submissions to the Issues Paper indicated paper conveyancing no longer exerts much, if any, competitive pressure on the eConveyancing market in NSW.¹² The use of paper conveyancing has declined in NSW considerably, and by June 2019 eConveyancing transactions accounted for 85% of all property dealings.¹³ This is compounded by the NSW Government's mandate of the use of eConveyancing for mainstream property transactions from 1 July 2019, and the continued use of paper in other states is unlikely to have much effect on NSW prices.¹⁴

Competition from alternative ELNOs is emerging. Sympli was granted an approval to operate in NSW in July 2019 and lodged its first mortgage in NSW in October 2019;¹⁵ however, it will take time for Sympli to be fully operational and provide a comprehensive range of eConveyancing services in competition with PEXA.¹⁶ There is also the potential for other new ELNOs to enter the NSW market in future, including LEXTECH, which was granted Category One Approval to become an ELNO in May 2018. However, there is some uncertainty over the intensity of competition in the near term, as evidenced by the diversity of views from submissions to the Issues Paper. For example, NSW ORG predicts that in the near term “there will at best be a duopoly in NSW, with PEXA having the overwhelming majority of subscribers and transactions”.¹⁷ On the other hand, PEXA described the entry of “large scale new market participants” that are expected to “compete with PEXA aggressively on price”.¹⁸

Finding

- 1 The eConveyancing market in NSW is currently highly concentrated and is likely to remain concentrated in at least the short term.

¹² NSW ORG submission to the IPART Issues Paper, May 2019, p 4.

¹³ NSW ORG, eConveyancing Statistics, <https://www.registrargeneral.nsw.gov.au/eConveyancing/eConveyancing-Statistics>, accessed 9 July 2019.

¹⁴ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 2.

¹⁵ Legal Practice Intelligence, <https://www.legalpracticeintelligence.com.au/sympi-lodges-first-registry-instrument-for-new-south-wales/> accessed 1 November 2019.

¹⁶ NSW ORG, *NSW eConveyancing news*, July 2019, p3, https://www.registrargeneral.nsw.gov.au/__data/assets/pdf_file/0004/538996/NSW-eConveyancing-news-July-2019.pdf, accessed 16 August 2019.

¹⁷ NSW ORG submission to the IPART Issues Paper, May 2019, p 5.

¹⁸ PEXA submission to the IPART Issues Paper, May 2019, p 7.

3.3 The eConveyancing market is likely to continue evolving rapidly and should be monitored regularly

The eConveyancing market has developed rapidly over the past decade and is likely to continue evolving. Since ELNOs are digital platforms, a major source of change in the industry will be improvements in technology and applications over time, which allow ELNOs to increase their efficiency, improve the quality of their services and offer new products.

Competition, including the threat of competition, drives innovation and technology improvements (ie, 'dynamic efficiency'). Competition in the eConveyancing market, facilitated by interoperability, would foster entry of more efficient or innovative ELNOs and put pressure on existing ELNOs to be more efficient or innovative, ensuring the eConveyancing market delivers improvements to all participants. Dynamic efficiency in the industry may not necessarily mean there will be an ever increasing number of ELNOs over time, but could alternatively result in non-adaptive ELNOs being replaced by more efficient or innovative competitors.

Competition and innovation can occur both at the wholesale and retail service level. For example, Sympli has outsourced its financial settlement process to an ASX subsidiary, ASX Financial Settlements Pty Limited, who will act as its batch administrator in the RBA's payment system.¹⁹ This arrangement is on a non-exclusive basis, which means that future new ELNOs could also contract to use ASX's financial settlement services, including their integration with the RBA and financial institutions. This indicates that the wholesale market for infrastructure and services used by ELNOs could evolve separately from the retail market for eConveyancing services required by solicitors, conveyancers and financial institutions.

It will be important for the development of the market that new ELNOs have the option to access wholesale infrastructure services on reasonable terms. To increase the scope for innovation, and thereby maximise the dynamic efficiency of the whole eConveyancing market, competition should be allowed to develop in both the wholesale and retail segments of the market. Additionally, a market with multiple ELNOs will improve the eConveyancing market's resilience to prolonged system outages or market exit of an ELNO or infrastructure provider.

Competition and technology is rapidly evolving in the eConveyancing industry, and as suggested by the ACCC's Digital platforms inquiry "The pace of technological change needs to be matched by the pace of policy review". In line with the recommendations of the ACCC's digital platforms inquiry, the eConveyancing market should be subject to regular market monitoring, including a review of the state of competition in the market and the barriers to entry.²⁰ This monitoring would inform policy decisions around governance and pricing frameworks; for example, pricing regulation could be removed in future if competition was found to be effective. Since ELNOs are national bodies, it would be beneficial for a national regulator such as the ACCC to conduct the market monitoring; however, the task could alternatively be performed on a state-by-state basis by regulators such as IPART.

¹⁹ Sympli, *Further Response to IGA Review Issues Paper*, June 2019, p 6, <http://dmcca.com.au/wp-content/uploads/2019/07/iga-issues-submission-sympi-further-comment.pdf>, accessed 8 August 2019.

²⁰ ACCC, *Digital Platforms Inquiry Final Report*, June 2019, p 30 <https://www.accc.gov.au/system/files/Digital%20platforms%20inquiry%20-%20final%20report%20executive%20summary.pdf>, accessed 7 August 2019.

NSW Law Society in its submission to the Draft Report, agreed that the market is highly concentrated,²¹ and a number of submitters supported our recommendation that competition in the market should be monitored.²² The NSW Law Society suggested that this monitoring occur through ARNECC's existing monitoring function, while PEXA expressed the view that future assessments of the market should be conducted jointly by regulatory bodies including the ACCC, Council of Financial Regulators (CFR), ARNECC and the Registrars General of each jurisdiction.²³ While we agree that a range of regulators and other stakeholders could provide useful input to market monitoring or a competition review, we consider that one regulator should lead the market monitoring review, assisted by experts with the appropriate skills to advise on specific aspects of the review.

Recommendation

- 1 The eConveyancing market be monitored at least every two years, ideally by a national regulator such as the ACCC or ARNECC (or on a state-by-state basis by regulators including IPART), to assess the effectiveness of competition and inform governance and pricing policy decisions.

3.4 Interoperability will improve competition and reduce barriers to entry

The development of competition in the eConveyancing market in future depends on the barriers that constrain new ELNOs from entering the market, and from increasing their market share. If these barriers are low, effective competition is likely to develop over time. But if they are high, competition or the threat of competition may remain insufficient to put pressure on existing ELNOs to operate efficiently and offer innovative services. The majority of submissions to our Issues Paper agreed that there are barriers to entry (though highlighted different barriers based on their perspectives). One exception was PEXA's submission, which argued that the presence of two new entrants suggests that barriers to entry are not prohibitive and that PEXA had faced greater "difficulties" as the first firm in the market.²⁴ We recognise that the costs incurred by a first mover are likely to be higher than a subsequent market entrants (discussed further in Section 5.2.3). However, we also recognise that first movers have other advantages that new entrants do not.

Our Issues Paper identified likely barriers to entry, including the network effects in the eConveyancing market, the start-up costs for ELNOs and the regulatory environment. The remainder of this chapter will analyse each of these three barriers in detail, noting that we found that the most significant barriers to competition are the network effects in the market and regulatory uncertainty.

The eConveyancing market can be characterised as a two-sided market that exhibits network effects. This is because the value of an ELNO's services provided to any one subscriber increases as more solicitors/conveyancers and financial institutions subscribe to that ELNO's services because more transactions would be able to be completed on the ELNO's platform.

²¹ NSW Law Society submission to IPART Draft Report, September 2019, p 1.

²² ABA Submission to the Draft Report, October 2019, p 1; Sympli Submission to the Draft Report, October 2019, p 3; Law Society of NSW Submission to the Draft Report, September 2019, p 2.

²³ Law Society of NSW Submission to the Draft Report, September 2019, p 4; PEXA Submission to the Draft Report, October 2019, pp 13 – 14.

²⁴ PEXA submission to the IPART Issues Paper, May 2019, p 7.

The result is that larger and more established ELNOs have (absent interoperability arrangements) a competitive advantage over smaller new entrants.

The submissions to the Issues Paper from Sympli, the Australian Banking Association (ABA), the Law Society and NSW ORG discuss network effects in the market and highlight the impact on competition. In particular, network effects were seen to be important in the market due to the costs involved in ‘multi-homing’ or connecting to more than one ELNO. The Law Society highlighted that “practitioners will need to see tangible benefits to make the investment (including time and effort) in subscribing to new ELNOs”.²⁵ The ABA indicated that the costs of connecting to ELNOs can be considerable, for example, one major bank spent over \$10 million to build their current payment gateway to PEXA and would potentially incur similar costs to connect to each new ELNO.²⁶ The Law Society was also concerned that new ELNOs could be constrained from entering the market based on the ability or willingness of the financial institutions to build network connections with each ELN.²⁷

The submissions from a number of stakeholders, including NSW ORG, Sympli, the Law Society and ABA, support interoperability as a means of opening up network effects in the market and allowing solicitors, conveyancers and financial institutions to use their preferred ELNO(s).²⁸ The ACCC has also stated:

“In the context of electronic conveyancing, the ACCC considers interoperability to be an important pro-competitive feature. Interoperability is essential to facilitating the entrance of new ELNOs into the market and can prevent an incumbent from becoming further entrenched as the dominant service provider in the market due to network effects.”²⁹

Most submissions on the Draft Report agreed that interoperability has the potential to promote competition by allowing users to choose their preferred ELNO and open up the network effects in the market.³⁰ As noted in the NSW Law Society’s submission to the Draft Report, the extent to which interoperability will improve competition in the eConveyancing market will depend on the model chosen.³¹

Chapter 4 details the costs and competition benefits of interoperability, and concludes that the incremental cost of implementing interoperability is likely to be relatively low whereas the benefits to competition will be considerable.

Finding

- 2 Interoperability would improve competition in the eConveyancing market and would reduce barriers to entry.

²⁵ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 3.

²⁶ Australian Banking Association submission to the IPART Issues Paper, April 2019, p 7.

²⁷ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 3.

²⁸ Interoperability refers to ELNOs’ systems being able to communicate with each other, so that subscribers can use different ELNOs to complete a property transaction together.

²⁹ ACCC submission to the IGA Review Issues Paper, 26 March 2019, <http://dmcca.com.au/wp-content/uploads/2019/07/iga-issues-submission-acc.pdf>, accessed 5 August 2019, p 5.

³⁰ ABA Submission to the Draft Report, October 2019, p 2; Sympli Submission to the Draft Report, October 2019, p 3; Law Society of NSW Submission to the Draft Report, September 2019, p 2, NSW Government submission to IPART Draft Report, October 2019, p 2.

³¹ Law Society of NSW Submission to the IPART Draft Report, September 2019, p 2.

3.4.1 Start-up costs for ELNOs not likely to be a barrier to entry

There is little evidence to show whether or not the entry of new ELNOs is being hindered by the start-up costs required to establish an ELN. PEXA indicated that there were substantial difficulties and risks involved in setting up the first eConveyancing system, which have lowered barriers to entry for subsequent eConveyancing market entrants.³² The Law Society suggested that recent increases in the size of the market (due to the mandating of eConveyancing in a number of jurisdictions) would have helped new firms justify the costs required to enter the market.³³

The new entrant ELNO that made a submission to the Issues Paper, Sympli, focussed on network effects in the market and did not comment on the initial costs of entry. AECOM's analysis of an efficient new entrant ELNO suggests that, based on current costs, the market cannot sustain a large number of ELNOs; however, new ELNOs are likely to benefit from a 'second mover advantage' since they can learn from the incumbent ELNOs, base their systems on established market practices and benefit from improvements in technology.³⁴

3.5 Measures to support competition are required

The Issues Paper raised the question of whether the regulatory environment constrains new ELNOs from entering the market. Submissions to the Issues Paper focussed on the impact of pricing regulations (discussed in Chapter 5), requirements under the Model Operating Requirements (MORs) and administrative burdens. However, this question has become more imperative recently due to the release of the draft recommendations from the Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law, Draft Final Report (IGA review draft report), which could increase regulatory uncertainty in the market.³⁵ While changes to the eConveyancing regulatory framework are being debated and subsequently implemented, regulators should seek to support the nascent competition in the market.

3.5.1 Updated governance framework should support competition

A well-designed governance and regulatory framework is important to the development of safe and effective competition in the eConveyancing market. The recently released IGA review draft report includes a recommendation that the regulatory framework for competition in eConveyancing should be modelled on the 'Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia' developed by the Council of Financial Regulators and the ACCC.³⁶ At a high level, the principles of the minimum conditions for the cash equity settlement market also seem appropriate for eConveyancing, and included ensuring:

³² PEXA submission to the IPART Issues Paper, May 2019, p 7.

³³ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 3.

³⁴ AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p ii.

³⁵ See: <http://dmcca.com.au/wp-content/uploads/2019/07/IGA-Review-Draft-Final-Report-19-07-26.pdf>, accessed 5 August 2019.

³⁶ See: Council of Financial Regulators, *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia*, September 2017, <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2017/minimum-conditions-safe-effective-competition/pdf/policy-statement.pdf> accessed 8 August 2019.

- ▼ Prospective new entrants meet regulatory requirements and have adequate processes in place to ensure ongoing compliance (for example, meeting requirements under the Corporations Act and having business arrangements that ensure the certainty of securities transfer and administration)
- ▼ Incumbent firms provide access to services (including data) that are necessary to offer the competitor's service on transparent, non-discriminatory, and fair and reasonable terms
- ▼ Appropriate links between competing firms are established (which in the context of eConveyancing implies interoperability)
- ▼ There are appropriate regulatory arrangements to ensure that a firm's processes do not have unintended or detrimental impacts on other segments of the market or other participants in the market.

For further details on the regulatory framework for the cash-equities market, see Box 3.1.

A bespoke regulator could be established to oversee the market, which would ensure that governance issues (including the minimum requirements for competition) are implemented on a nationally consistent basis and that both the lodgment and financial settlement aspects of eConveyancing are regulated. This could potentially be established as part of an existing national regulator in order to save on costs and draw on existing expertise. Otherwise, as suggested by the IGA review draft report, Registrar Generals may need to make reference to requirements from other government agencies in the conditions of approval for ELNOs, to ensure that important consumer protections such as delivery vs. payment are upheld.³⁷

3.5.2 Little evidence that Model Operating Requirements are constraining new entrants

The Issues Paper asked stakeholders to consider whether there are current conditions in the MORs that may constrain new ELNOs from entering the market. Currently the MORs require ELNOs to make their services available in all jurisdictions in Australia and offer the full range of land registry documents (albeit the MORs allow ELNOs to take a staged approach). In their submission, PEXA suggests that allowing new entrants to offer services in a subset of jurisdictions would give them a competitive advantage and that new entrants should be levied to fund a universal service obligation. New entrant ELNOs have not indicated that the costs of entering smaller jurisdictions are prohibitive and some smaller jurisdictions (such as TAS, NT and ACT) have not yet introduced eConveyancing. Additionally, since ELNOs are not required by the current legal framework to offer national pricing, ELNOs may choose to set different prices based on the underlying costs of serving each jurisdiction. Future market monitoring by the regulator could consider the development of competition across jurisdictions.

³⁷ Dench McClean Carlson, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law – Draft Final Report*, July 2019 <http://dmcca.com.au/wp-content/uploads/2019/07/IGA-Review-Draft-Final-Report-19-07-26.pdf>, accessed 8 August 2019, p 10.

3.5.3 A two-year moratorium would impact ELNOs' investments and the development of a competitive market

The IGA review draft report released in July includes recommendations on the regulatory framework for the eConveyancing market. However, the IGA review draft report also recommends a two-year moratorium on further approvals of ELNOs while the framework for competition is developed.³⁸

A two-year moratorium has the potential to set back competition and investment in the industry for many years for three key reasons:

- ▼ Potential new entrant ELNOs are unlikely to begin developing their ELN platform until the moratorium is concluded and the regulatory environment is known. Due to the long lead times involved in developing an ELNO's software platform and infrastructure, this means that competition will be delayed for much longer than two years.
- ▼ Regulatory uncertainty is likely to increase the perceived risk of the eConveyancing market and impact the cost of capital for ELNOs, reducing their ability or willingness to invest in the market.³⁹
- ▼ As discussed in Section 3.4, there are considerable network effects in the industry, and a two-year moratorium on new entry would allow the existing ELNOs to cement their position in the market. This would increase the barriers to entry for new ELNOs and reduce the prospect for robust and effective competition in the market.

Since the regulatory framework for competition seeks to create minimum conditions and provide guidance to prospective ELNOs, it would seem more prudent to follow the approach taken by the Council of Financial Regulators and the ACCC. This would involve regulators providing guidance to a prospective new entrant on potential specific requirements before the submission of their application.⁴⁰ For more details, see Box 3.1.

In its most recent submission to the IGA review, the ACCC expresses similar views:

"The ACCC is particularly concerned with measures which significantly delay competition. It does not consider a two year moratorium on the entry of new ELNOs appropriate. A moratorium on new entrants was the approach taken by the Council of Financial Regulators (CFR) in relation to the cash equity clearing and settlement market, this occurred while that market was a monopoly. In contrast, new ELNOs can and have entered the e-conveyancing market. The ACCC therefore strongly cautions against such a pause on the competitive process, particularly considering the investments made by new entrants. In addition, industry as a whole will benefit from greater certainty of the market structure, and an understanding of the likely services available to their customers, in addition to the commercial opportunities for their own operation in a multi ELNO market."⁴¹

³⁸ Dench McClean Carlson, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law – Draft Final Report*, July 2019 <http://dmcca.com.au/wp-content/uploads/2019/07/IGA-Review-Draft-Final-Report-19-07-26.pdf>, accessed 8 August 2019, p 9.

³⁹ Regulatory uncertainty has been documented to increase the beta for regulated firms in the UK. For example see: Grout, P. A., Zalewska, A. (2004), 'The impact of regulation on market risk', <http://idei.fr/sites/default/files/medias/doc/conf/jjl/papers/80grout.pdf>, accessed 6 August 2019.

⁴⁰ NSW Government submitted to our Draft report that ARNECC provides some guidance as to what is required in an ELNO application in the Model Operating Requirements Guidance Notes, as well as the 'Apply to Become an Electronic Lodgment Network Operator (ELNO) Fact Sheet' (published 13 August 2019).

⁴¹ ACCC Submission to draft final report for review of InterGovernmental Agreement for an Electronic Conveyancing National Law, 20 September 2019, p 4, <https://dmcca.com.au/iga-draft-report-submission-acc/> accessed 30 October 2019.

The differences between the eConveyancing and the cash equity settlement markets should be taken into account. In the cash equity settlement market, there is a monopoly supplier of clearing and settlement services, and regulatory change was required to give the regulators the power to implement and enforce the minimum conditions. In contrast, in the eConveyancing market, there are currently two ELNOs in the market, further competition is emerging and Registrars have power to influence the market, including by imposing conditions on ELNOs in the market.

The submissions to our Draft Report from the Australian Banking Association and NSW Law Society supported the establishment of a competition framework.⁴² Though the NSW Law Society and PEXA questioned whether NSW ORG and ARNECC are the appropriate organisations to develop the framework for competition for the eConveyancing market, PEXA suggested that the CFR and ACCC should conduct this work.⁴³ However, the state-based Registrars and ARNECC are currently the primary regulators of eConveyancing and should lead the development of a competition framework, though the ACCC has noted that it can provide “input into the development of frameworks that affect the development of competition”.⁴⁴

Recommendation

- 2 NSW ORG work with ARNECC to model the competition framework for eConveyancing on the principles of the framework developed by the Council of Financial Regulators and the ACCC in their review of competition in cash equities clearing and settlement in Australia. The state-based Registrars and ARNECC can draw upon the advice and expertise in competition regulation offered by the ACCC.

⁴² Australian Banking Association Submission to the IPART Draft Report, October 2019, p 1; Law Society of NSW Submission to the IPART Draft Report, September 2019, p 5.

⁴³ Law Society of NSW Submission to the Draft Report, September 2019, p 5; PEXA Submission to the Draft Report, October 2019, p 15.

⁴⁴ ACCC Submission to draft final report for review of InterGovernmental Agreement for an Electronic Conveyancing National Law, 20 September 2019, p 7, <https://dmcca.com.au/iga-draft-report-submission-acc/> accessed 30 October 2019.

Box 3.1 The Australian cash equities market

The cash equities market in Australia comprises:

- ▼ Trading platforms, which match buyers and sellers of securities
- ▼ Clearing services, currently provided by a central counterparty that manages the pre-settlement risks between counterparties to a trade
- ▼ Securities settlement services, which involves the transfer of title to the security and transfer of cash.

In Australia, there is some competition in securities trading; however, clearing and settlement facilities are only provided by the ASX (though the *Corporations Act 2001 (Cth)* permits competition).

The cash equities market has been reviewed a number of times over the past decade. As part of most recent review, in 2017 the Council of Financial Regulators and the ACCC concluded that the prospect of competition had increased. As a consequence, the competition policy framework was updated (which included setting out 'Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia'). The minimum conditions aimed to provide guidance on measures regulators require a new entrant to consider in their business case and for cash equities settlement including:

1. Adequate regulatory arrangements:
 - a) Rigorous oversight against the Financial Stability Standards for Securities Settlement Facilities and other requirements under the Corporations Act
 - b) Application of the Council of Financial Regulator's framework for regulatory influence over cross-border clearing and settlement facilities
 - c) *Ex ante* wind-down plans and associated commitments – all competing settlement facilities (including the incumbent and any new entrants) would be required to commit *ex ante* to a notice period of at least one year prior to any planned exit from the market.
 - d) Appropriate arrangements for certainty of securities transfer and administration.
2. Access on transparent, non-discriminatory, and fair and reasonable terms, which included proposed legislative changes so that the ACCC would have the power to arbitrate disputes in relation to price and/or non-price terms and conditions of access.
3. Appropriate links between competing securities settlement facilities.
4. Appropriate regulatory arrangements for oversight of Primary and Secondary Markets.

While the minimum conditions for cash equities clearing include additional requirements for the operations of a central counterparty (which is not a feature of the eConveyancing market), we consider that the fundamentals of the eConveyancing and cash equities markets are the same. This is because both facilitate changes to the ownership of assets and facilitate the associated financial settlement.

The regulators committed to "offering guidance to a prospective competitor on potential specific requirements before the submission of a licence application. However, detailed specific requirements would not be articulated or implemented until such time as a committed competitor emerged, or was likely to emerge". Some of the conditions listed above would require the incumbent sole provider in the cash equities market to make changes to systems to accommodate competition. Infrastructure work would only need to be undertaken once a competitor emerged or was likely to emerge.

Source: Council of Financial Regulators, *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia*, September 2017, <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2017/minimum-conditions-safe-effective-competition/pdf/policy-statement.pdf> accessed 8 August 2019.

3.6 We support measures that promote transparency and reduce administrative barriers

Submissions also commented on administrative or bureaucratic barriers to entry:

- ▼ The NSW ORG indicated that they have replaced bilateral agreements with ELNOs with Conditions of Approval published on their website to increase transparency⁴⁵
- ▼ Revenue NSW supports the removal of barriers for new entrants, including by streamlining its on-boarding process and by adopting a transparent position on cost recovery⁴⁶
- ▼ Sympli's submission expressed that the fees charged by Revenue NSW and NSW LRS should be clear, transparent and applied consistently to all ELNOs in the market.⁴⁷

The administrative burdens of regulation were not a focus of the analysis in the Issues Paper; however, we agree that increasing the transparency and consistency of regulation across participants in the market and streamlining processes would be beneficial to the market. The fees charged by Revenue NSW and NSW LRS are discussed in detail in Chapters 6 and 7.

3.7 National consistency provides benefits to the industry

Stakeholder comments to our Issues Paper emphasised the benefits of a nationally consistent pricing framework and the costs of jurisdictional variations.⁴⁸ ELNOs and many financial institutions are national organisations, and thus, gain efficiencies from regulations and business processes being as consistent as possible across jurisdictions. We support the conclusions reached by the IGA review draft report that national consistency of regulation is beneficial, and we considered this when we were developing our findings and regulations on a pricing framework for ELNOs.⁴⁹

3.8 The impact of vertical integration should be monitored

Vertical integration in the eConveyancing market occurs when an ELNO supplies upstream or downstream services in the conveyancing process (in addition to its core function of providing electronic lodgment and settlement services). For example, an ELNO may choose to expand its service offering to include upstream and downstream services in related markets (such as title searching and practice management software). Vertical integration may be efficient (if the provision of upstream or downstream services by an ELNO results in time or cost savings to consumers). However, a vertically integrated market structure can reduce consumer choice and be less efficient in the long term, if an ELNO engages in tactics that limit its upstream or downstream competitor's ability to compete in the market.

⁴⁵ NSW ORG submission to the IPART Draft Report, October 2019, p 6.

⁴⁶ Revenue NSW Submission to the Issues Paper, May 2019, pp 3-4.

⁴⁷ Sympli submission to the IPART Issues Paper, May 2019, pp 22-24.

⁴⁸ See: Australian Banking Association submission to the IPART Issues Paper, April 2019, p 4; PEXA submission to the IPART Issues Paper, May 2019, p 20; and The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 6.

⁴⁹ Dench McClean Carlson, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law – Draft Final Report*, July 2019 <http://dmcca.com.au/wp-content/uploads/2019/07/IGA-Review-Draft-Final-Report-19-07-26.pdf>, accessed 8 August 2019, pp 46-48.

In our Issues Paper, we asked stakeholders to comment on how vertical integration will influence competition between ELNOs and the efficiency of the conveyancing process, and how IPART's pricing framework should address vertical integration. While the Model Operating Requirements (MORs) contain some high level principles that prevent an ELNO from engaging in tactics that may reduce competition in the long term, stakeholders generally agreed that the MORs should provide clearer guidance on implementation and enforcement.⁵⁰ We understand that industry participants are currently engaging with ARNECC to enhance the MORs,⁵¹ and so our pricing regulatory framework will not directly address vertical integration. Rather, while the eConveyancing market (and the broader regulatory framework) develops, we recommend that the national eConveyancing regulator continues to monitor the impact of vertical integration on prices and competition in future reviews.

The following sections outline our findings on vertical integration in the eConveyancing market.

3.8.1 Vertical integration can lead to efficiencies

In addition to the core lodgment and financial settlement functions, both the incumbent and new entrant ELNOs are likely to offer integrated services to their subscribers. PEXA and Sympli submitted that vertical integration provides greater efficiency, because it is likely to reduce errors, save subscribers' time and allow for more transparency in comparing the prices of complementary products.⁵² For example:

- ▼ PEXA has created an online hub known as 'PEXA Plus Marketplace', which allows subscribers in NSW to purchase title searches through the PEXA platform, so that subscribers can compare and purchase their preferred service from one location.⁵³ While PEXA currently offers title searches from several providers, it intends to increase the number of suppliers available, and to add further products and services across different phases of the conveyancing process.⁵⁴ The submission to our Draft Report from the NSW Government notes that it is not always straightforward identifying vertical integration; for example, it is unclear whether PEXA Plus Marketplace is strictly an example of vertical integration since PEXA is acting as a distributor for information brokers rather than offering competing information services.⁵⁵ However, there may still be competition issues around the use of information and fairness to competing service providers. For example, the ACCC describes the need to "reduce advantages from vertical information sharing".⁵⁶

⁵⁰ NSW ORG, submission to IPART Issues paper, May 2019, p 7; NSW Law Society, submission to IPART Issues paper, April 2019, p 4.

⁵¹ PEXA, submission to IPART Issues paper, May 2019, p 16.

⁵² Sympli submission to IPART Issues paper, May 2019, p 20; PEXA submission to IPART Issues paper, May 2019, p 16.

⁵³ PEXA Plus Marketplace, <https://www.pexa.com.au/news/pexa-plus-marketplace>, accessed 20 June 2019.

⁵⁴ PEXA currently offers title searching products from Equifax and CITEC.

⁵⁵ NSW Government Submission to the Draft Report, October 2019, p 6.

⁵⁶ ACCC Submission to draft final report for review of InterGovernmental Agreement for an Electronic Conveyancing National Law, 20 September 2019, pp 4 and 8, <https://dmcca.com.au/iga-draft-report-submission-acc/> accessed 30 October 2019.

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- ▼ Sympli submitted that like PEXA, it intends to integrate its platform with those of upstream information brokers and practice management software providers, such as LEAP and Infotrack.⁵⁷ Sympli argued that such integration allows providers to offer end to end conveyancing systems, reducing the risk of error and saving subscribers' time that would otherwise be spent on re-keying data across platforms.⁵⁸ In addition, ELNO integrated service providers, such as LodgeX have emerged, who offer electronic settlement agency services for legal practices, conveyancing firms, developers, financiers and other entities who do not have the time, resources and expertise to manage the ELNO workspace.⁵⁹

We consider that vertical integration can lead to technical efficiencies in the eConveyancing process. However, if competing service providers are disadvantaged by an ELNO's vertically integrated market structure, this may lessen opportunities for new entrants to create dynamic efficiencies. As a consequence, vertical integration can create a situation where the full suite of efficiencies are not realised.

3.8.2 Vertical integration could have an impact on competition

If an ELNO chooses to supply the upstream or downstream service, it may have a distinct advantage over its upstream or downstream competitors. That is, without appropriate regulations to prevent it from doing so, the ELNO could:

- ▼ Reduce prices to gain market share in the upstream or downstream market
- ▼ Recover the costs of providing the upstream or downstream service through the prices it charges for core ELNO services (unless the regulatory framework prevents it from doing so).

Setting lower prices for upstream or downstream services may not be sustainable for a firm that is not vertically integrated (because unlike a vertically integrated ELNO, it cannot recover costs from other services). As a consequence, the firm may be constrained in its ability to enter or expand in the market, reducing competition upstream or downstream markets in the long term.

Aside from competing on pricing, there are other ways that an ELNO may disadvantage or exclude competing suppliers that wish to integrate with its platform, these include:

- ▼ Imposing higher platform access or integration fees on competing suppliers
- ▼ Explicitly excluding, or delisting certain suppliers from the ELNO platform
- ▼ Altering the presentation of the various suppliers to consumers in a way that favours the ELNO's own complementary services.

⁵⁷ Sympli is 50% owned by Australian Technology Innovators Pty Ltd, the parent company of conveyancing software providers Infotrack and LEAP.

⁵⁸ Sympli submission to IPART Issues paper, May 2019, pp 20.

⁵⁹ LodgeX, <https://lodgex.com.au/>, accessed 7 August 2019.

Stakeholders have expressed concerns that a vertically integrated market structure could result in ‘conveyancing factories’,⁶⁰ which could lead to higher prices for consumers in the long term (if smaller firms are constrained in their ability to exert competitive pressure on larger vertically integrated firms). For example, NSW Law Society submitted that “to achieve real competition, it will be important to ensure that complementary services are not cross-subsidised”.⁶¹ The appropriate regulatory framework for preventing potential negative impacts of vertical integration on competition is discussed in Section 3.8.3 (below). While this framework does not necessarily remove an ELNO’s incentive to discriminate, it may constrain the ELNO’s ability to do so.⁶²

3.8.3 The MORs have integration and separation obligations for ELNOs

In February 2019, the MORs (which are enforced by ARNECC) were updated to include ‘integration’ and ‘separation’ obligations for ELNOs that offer integrated upstream or downstream services. We consider that these obligations provide a broad framework that ensures fair and equitable treatment of upstream and downstream service providers. For example, an ELNO is required to:

- ▼ Publish a set of integration terms and conditions on its website
- ▼ Treat persons wishing to integrate on an equivalent basis, subject only to differences which are attributable to the type, level or class of integration with the ELN.

Under the MORs, there are additional requirements that apply to an ELNO (or related entity to the ELNO) that supplies or proposes to supply the upstream or downstream service. These requirements include that an ELNO must:

- ▼ Structurally or functionally separate related upstream and downstream services, and prepare, publish and implement a separation plan
- ▼ Deal with the related upstream or downstream service provider on an arm’s length basis
- ▼ Not operate in a way that gives a related upstream or downstream service provider unfair commercial advantage.⁶³

The ACCC referred to appropriate measures to address vertical integration by ELNOs in its submission to the IGA review Issues Paper. It submitted that its preferred regulatory structure is complete separation between an ELNO and downstream providers, as separation removes the incentive to discriminate on both price and non-price terms. It argued that if an ELNO is permitted to vertically integrate to offer downstream (or upstream) services, then it

⁶⁰ Dench McClean Carlson, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law – Issues Paper*, February 2019, https://www.arnecc.gov.au/__data/assets/pdf_file/0007/1433509/iga-review-issues-paper.pdf, accessed 12 August 2019, p 70.

⁶¹ The Law Society of NSW submission to IPART Issues paper, April 2019, p 4.

⁶² ACCC submission to IGA Review Issues Paper, <https://www.accc.gov.au/system/files/EO%20-%20Correspondence%20-%20Review%20of%20the%20InterGovernmental%20Agreement%20for%20an%20Electronic%20Conveyancing%20National%20Law%20-%20Signed%20by%20Cristina%20Cifuentes%2026%20March%202019.PDF>, accessed 12 August 2019, p 2.

⁶³ MORs Version 5, https://www.registrargeneral.nsw.gov.au/__data/assets/pdf_file/0009/436644/Model-Operating-Requirements-Version-5.pdf, accessed 12 August 2019, p 26.

is necessary to have robust functional separation requirements or ring-fencing in place. Such functional separation requirements may include separation of resources, employees, systems, contractor arrangements and support functions.⁶⁴

The ACCC's view is that ELNOs should be required to interact with all participants on equal terms and to provide non-discriminatory access to all participants and access seekers. Non-discriminatory access should include equal treatment for all users of the ELNO system on price, quality, reliability, timeliness of service, and equal dissemination of all information to all users.⁶⁵

3.8.4 Stakeholders prefer that vertical integration continues to be addressed through the MORs

In response to our Issues Paper, several stakeholders referred to the MORs, and generally preferred that any further regulatory measures to address vertical integration are implemented through the MORs. For example, Sympli submitted that, although it is 50% owned by Australian Technology Innovators Pty limited (the parent company of conveyancing software providers Infotrack and LEAP), Sympli will not obtain a competitive advantage from its relationships with Infotrack or LEAP. This is because (in accordance with the MORs), Sympli does not share systems or personnel with Infotrack or LEAP, and it must engage with other conveyancing software providers on an equivalent basis.⁶⁶

Stakeholders also noted that the MORs are broadly consistent with ring-fencing requirements in markets such as telecommunications and energy.⁶⁷ For example, PEXA submitted that a number of regulatory solutions have been developed to deal with "cross subsidisation" in other vertically integrated markets, such as the "recent focus on regulated electricity networks to ensure that businesses do not leverage their market power to skew competition in their favour in related and nascent complementary markets".⁶⁸

3.8.1 Review the adequacy of the MORs and industry structural developments by the national eConveyancing regulator

The MORs currently require an ELNO to structurally or functionally separate related upstream and downstream services. We note that the recent IGA review recommended "that the rules in the MOR for ELNOs operating in the wider market be reviewed by a qualified economic regulator (eg ACCC) in the near future to ensure they are clear and there is no abuse of market power"⁶⁹.

⁶⁴ ACCC submission to IGA Review Issues Paper, March 2019 <https://www.accc.gov.au/system/files/EO%20-%20Correspondence%20-%20review%20of%20the%20InterGovernmental%20Agreement%20for%20an%20Electronic%20Conveyancing%20National%20Law%20-%20Signed%20by%20Cristina%20Cifuentes%2026%20March%202019.PDF>, accessed 12 August 2019, p 2.

⁶⁵ Ibid, p 2.

⁶⁶ Sympli submission to the IPART Issues Paper, May 2019, p 21.

⁶⁷ PEXA submission to IPART Issues paper, May 2019, p 16; Sympli Submission to the Issues Paper, May 2019, p 21.

⁶⁸ PEXA submission to IPART Issues paper, May 2019, p 16.

⁶⁹ IGA Review Draft report, https://www.arnecc.gov.au/__data/assets/pdf_file/0008/1451573/iga-review-draft-final-report.pdf, accessed 15 August 2019, p 100.

While vertical integration may lead to technical efficiencies in the eConveyancing process, which will ultimately benefit consumers, it also has the capacity to stifle competition in upstream and downstream markets. Given the possible impacts on competition in both upstream and downstream markets and the continuing development of the eConveyancing market, we support a review of the adequacy of the MORs to address vertical integration.

Finding

- 3 While vertical integration may lead to efficiencies in the eConveyancing process, which will ultimately benefit consumers, vertical integration also has the capacity to stifle competition and innovation in upstream and downstream markets.

Recommendation

- 3 Due to the continuing development of the eConveyancing market, the national eConveyancing regulator review the adequacy of the MORs to address the impacts of vertical integration.

4 Interoperability would improve competition

As discussed in Chapter 3, the eConveyancing market's lack of interoperability limits competition between ELNOs in the market. There is currently no means for one ELNO's systems to exchange information with another's, all subscribers in a transaction must use the same ELNO, and only one ELNO per transaction can make the lodgment with the land registry office and complete financial settlement. This increases the network effects in the eConveyancing market, making it less viable for ELNOs with smaller subscriber bases to compete.⁷⁰

We examined the potential to improve competition by implementing a form of interoperability. We considered stakeholders' submissions on this topic. We also analysed four models for implementing interoperability to assess their implications for competition, and costs. We considered how a transfer price could be established to share costs between ELNOs in an interoperable transaction.

The sections below summarise our recommendation and findings, and then discuss these in more detail.

4.1 Summary of recommendation and findings on interoperability

Our finding is that interoperability has substantial potential to improve competition in the Australian eConveyancing market.

In our analysis of the preferred model of interoperability, we considered that it is important to assess costs and benefits based on the current structure of the market: that is, there are two ELNOs already operating, and a third has obtained the first stage of approval to commence operating.

Our finding is that establishing a direct connection between the two existing ELNOs is likely to be the most cost-efficient way to achieve interoperability in the short term, while maximising the potential for competition and innovation in the market. In the medium to long term, new entrant ELNOs may be able to enter the industry with new and more cost effective technologies or eConveyancing processes. However, if a new entrant ELNO is not providing innovative or more cost effective infrastructures for financial settlement and title lodgement, it is likely to be more cost efficient for the new entrant (and the industry) if it uses the existing infrastructure.

Therefore, our recommendation is that regulators should mandate a direct connection between the two existing ELNOs and allow new entrant ELNOs to choose between: using these incumbents' infrastructure; or building their own infrastructure and establishing direct connections with other ELNOs.

⁷⁰ The ACCC has also expressed the view that interoperability would reduce network effects and facilitate entry of new ELNOs (ACCC letter to Office of the Registrar General, 13 February 2019, p 2).

This view is based on our findings that:

- ▼ Stakeholders who made submissions generally preferred interoperability to multi-homing as a means to promote competition and choice. While there was no consensus on a preferred model, they generally agreed on some principles for interoperability.
- ▼ Of the four interoperability models we analysed,⁷¹ direct connections and an information hub are likely to be the most effective in promoting competition, service differentiation and innovation in the eConveyancing market.
- ▼ The total cost of each interoperability model is highly dependent on the number of ELNOs in the market.
- ▼ Costs are similar between direct connections and an infrastructure when there are few ELNOs in the market; however, an infrastructure ELNO or a hub option become more cost efficient compared to the other options when there are a larger number of ELNOs in the market.
- ▼ A cost-reflective transfer price should be set by NSW ORG to ensure that costs are shared fairly across ELNOs, and the lodging entity (hub or ELNO) is remunerated for the use of its lodging and settlement services.

Recommendation

- 4 A direct connection between the two current ELNOs be implemented as soon as possible to promote competition. To ensure a nationally consistent approach, it would be preferable to implement interoperability between the two current ELNOs on a national basis by ARNECC through the MORs. However, there is benefit in NSW continuing work on elements of interoperability that contribute to a national solution and, if interoperability is not pursued on a national basis, interoperability in NSW could potentially be implemented through ELNO conditions of approval.
- 5 New entrant ELNOs to negotiate commercial agreements to access existing infrastructure, or build their own infrastructure and establish direct connections with other ELNOs. Any disputes over price and or non-price terms and conditions relating to access to infrastructure would be subject to arbitration provided by a party mutually agreed by the participants or by a regulator.

4.2 Interoperability has significant potential to improve competition in the ELNO market

Competition in the ELNO market already exists, with Sympli as well as PEXA having developed eConveyancing platforms. However, given that the bulk of eConveyancing transactions involve at least two and often up to four parties, competition between ELNOs is hampered unless there is a way for multiple ELNOs to be involved in a transaction.

In our Issues Paper, we outlined five options for promoting competition between ELNOs:

- ▼ Multi-homing, where each subscriber has to subscribe to all available ELNOs and a business rule determines which subscriber in a transaction chooses which ELNO to use.

⁷¹ The four models are: full central hub, information hub, direct connections and infrastructure ELNO.

- ▼ Four models for achieving interoperability: direct connections between ELNOs, an information hub, a full central hub, and an infrastructure ELNO with an access regime. (These models are described in more detail in section 4.3.2 below).

4.2.1 Stakeholders generally preferred interoperability to multi-homing to promote competition

In submissions in response to our Issues Paper, stakeholders expressed a preference for interoperability, and considered it would be more effective in promoting competition than multi-homing. For example, the Law Society considered that multi-homing has the potential for “anti-competitive” behaviour since one subscriber in a transaction could attempt to force other subscribers to use the same ELNO. It also indicated that multi-homing would involve greater costs for practitioners.⁷² Similarly, Sympli considered multi-homing would force subscribers (solicitors, conveyancers and financial institutions) to use ELNs that are less efficient or more costly for them, and subscribers would be reluctant to incur the costs of using multiple ELNOs.⁷³

Outside our consultation process, some industry stakeholders expressed a preference for supporting competition by reducing the frictions involved in multi-homing.⁷⁴ For example, this could involve cross-recognition of one ELNO’s subscribers by others, the ability to use a single digital certificate across different ELNOs, and requiring ELNOs to provide a standardised user interface set by ARNECC potentially alongside a value-add user interface. However, we consider even with reduced frictions, multi-homing would be less effective in promoting competition because it would still require subscribers to learn different user interfaces and workflows, which would increase their costs and the likelihood of user errors. Similarly, a ‘shallow’ approach to interoperability requires all subscribers to log into one ELNO to provide final sign off on a property transaction. This form of interoperability does not allow subscribers to use only their favoured ELNO and would still increase the likelihood of user errors.

Additionally, AECOM’s modelling and sensitivity analysis showed that any interoperability model is likely to be more cost efficient than multi-homing for ELNOs. This is because the costs of each subscriber having to use each ELNO in the market are high, relative to any interoperability option modelled. AECOM estimates that the costs of multi homing (that is, the annual subscriber costs eg, on boarding, training, support and digital certificate management costs) would need to be reduced from an estimated \$1,100 per subscriber to around \$10 per subscriber for the cost of multi-homing to be similar to the cost of any interoperability option modelled.⁷⁵

4.2.2 The benefits of interoperability include dynamic and productive efficiency

As discussed in Chapter 3, competition more broadly, and interoperability specifically, can provide an incentive for ELNOs to innovate, drive costs lower and improve the quality of their services.

⁷² The Law Society of NSW submission to the IPART Issues Paper, April 2019, pp 3-4.

⁷³ Sympli submission to the IPART Issues Paper, May 2019, pp 10-11.

⁷⁴ Eg, see the suggestions of Purcell Partners in Nicholls, R, *Interoperability between ELNOs – Final Report from Working Groups*, July 2019, pp. 23-24.

⁷⁵ AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p 42.

4.3 The choice of interoperability model

The choice of interoperability model should take into account the current state of the market and the potential future development of the market in order to maximise competition and the scope for innovation as well as cost efficiency. After considering these factors, as well as stakeholder views, we consider that the best option is for the two existing ELNOs to build a direct connection between each other and allow new entrant ELNOs to choose between using existing infrastructure, or building their own infrastructure and establishing direct connections with other ELNOs.

4.3.1 Stakeholders agree on the general principles for interoperability

Although there was no consensus over a preferred model for interoperability, stakeholders who responded to our Issues Paper agreed on some basic principles. In particular, the general view was that the interoperability model must:

- ▼ Protect the integrity of the Torrens system and fulfil requirements under the *Duties Act 1997*. This means it must handle title and payments information in a transparent, reliable and secure manner and have a clear liability regime.⁷⁶
- ▼ Enable subscribers in eConveyancing transactions to use their preferred ELNO.⁷⁷
- ▼ Allow innovation in the market and not constrain ELNOs from competing on the features of their platform.⁷⁸
- ▼ Maintain the principle of ‘delivery versus payment’ (where no party can hold both the property and the funds at the same time), which would be most easily accomplished if one ELNO performs both lodgment and financial settlement for each property transaction.⁷⁹
- ▼ Be consistent across jurisdictions to minimise complexity and industry costs.⁸⁰
- ▼ Be the least complex and most cost-efficient.⁸¹

In addition, several stakeholders indicated that ELNOs should bear the costs of implementing interoperability.⁸² Further, Revenue NSW submitted that it should be able to recover any costs of supporting interoperability from the ELNOs.

⁷⁶ Australian Banking Association submission to the IPART Issues Paper, April 2019, p 4; NSW ORG submission to the IPART Issues Paper, May 2019, p 6; Sympli submission to the IPART Issues Paper, May 2019, p 11.

⁷⁷ Sympli submission to the IPART Issues Paper, May 2019, p 9; Revenue NSW Submission to the Issues Paper, May 2019, p 4; NSW ORG submission to the IPART Issues Paper, May 2019, p 5.

⁷⁸ PEXA submission to the IPART Issues Paper, May 2019, p 9; Sympli submission to the IPART Issues Paper, May 2019, p 11.

⁷⁹ Revenue NSW Submission to the Issues Paper, May 2019, p 5; Sympli submission to the IPART Issues Paper, May 2019, p 17; The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 7; NSW ORG submission to the IPART Issues Paper, May 2019, p 10; PEXA submission to the IPART Issues Paper, May 2019, p 22.

⁸⁰ Sympli submission to the IPART Issues Paper, May 2019, p 11; Australian Banking Association submission to the IPART Issues Paper, April 2019, p 1; PEXA submission to the IPART Issues Paper, May 2019, p 10.

⁸¹ NSW ORG submission to the IPART Issues Paper, May 2019, p 6; PEXA submission to the IPART Issues Paper, May 2019, p 9.

⁸² The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 7; Sympli submission to the IPART Issues Paper, May 2019, pp 17-18; Revenue NSW submission to the Issues Paper, May 2019, p 5.

The Interoperability Working Groups' Final Report found consensus on many of these principles. However, it also reached agreement on a number of important features of an interoperability solution, including business rules for identifying the lodging ELNO, potential process flows for typical property transfers and the consents or authorisations required by the lodging ELNO from subscribers of other ELNOs.⁸³ The Interoperability Working Groups also made good progress in exploring a number of key issues that require further investigation and discussion, including:

- ▼ Cyber security. The working groups drew on a review by an independent expert of the potential cyber security risks involved in implementing interoperability under a full central hub or a direct connection model, compared to the status quo. The review showed that the risks of interoperability were the same as the status quo over most risk factors, while some were incrementally worse and others incrementally better. Most participants in the working groups agreed that further analysis of the cyber security is warranted, LRS and Sympli commented that they thought the risks identified so far were manageable with existing technologies and the ABA suggested that there should be a stronger regulatory framework governing cyber security in the eConveyancing market more broadly.⁸⁴
- ▼ Requirements for authorisations for the lodging ELNO. The lodging ELNO would lodge and financially settle a property transaction on behalf of all solicitors, conveyancers and financial institutions, even though some participants use a different ELNO. To acknowledge the lodging ELNO's special role in a transaction, could necessitate changes to parts of the legal framework, including the sale contract, client authorisation forms, and around the use of trust accounts.⁸⁵
- ▼ Insurance for interoperability. icare provided advice on the impact of interoperability on risks of insurance and provided four potential frameworks for insuring in an interoperable environment which were individual commercial insurance for each ELNO, a facilitated commercial scheme (where the content of the policy is determined by consultation with government), a group policy for all ELNOs and a government insurance fund. In its submission to our Draft Report PEXA notes "there is an outstanding question as to whether such interoperability arrangements could even be insurable".⁸⁶ However, icare noted the option for a government insurance fund to be established similar to the Torrens Assurance Fund, which could be self-insured by the government.⁸⁷

4.3.2 Direct connections or information hub likely to be most effective models for promoting competition

Interoperability could be achieved in a large number of ways. For this review, we analysed four potential models:

⁸³ Nicholls, R, *Interoperability between ELNOs – Final Report from Working Groups*, July 2019, pp 7-8.

⁸⁴ Nicholls, R, *Interoperability between ELNOs – Final Report from Working Groups*, July 2019, pp 101-106.

⁸⁵ Nicholls, R, *Interoperability between ELNOs – Final Report from Working Groups*, July 2019, pp 46-51.

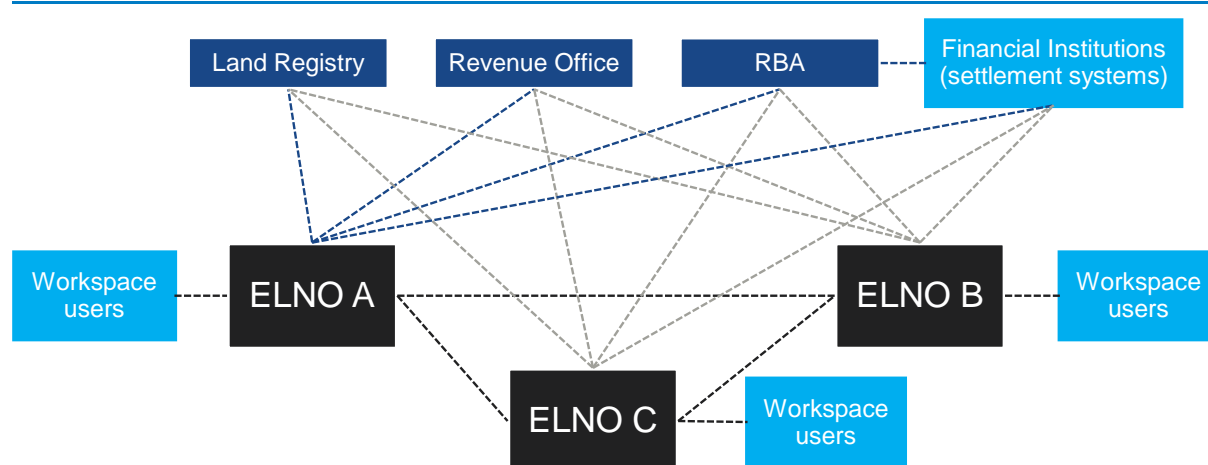
⁸⁶ PEXA submission to IPART Draft Report, October 2019, p7.

⁸⁷ Nicholls, R, *Interoperability between ELNOs – Final Report from Working Groups*, July 2019, pp 107-111.

1. **Direct connections** between ELNOs (Figure 4.1). For simplicity, we assumed that under this model each ELNO builds its own software platform and connections to other participants in the market (including connections to each other ELNO). However, this model does not prohibit a new entrant ELNO from entering into a commercial arrangement to use an existing ELNO's financial settlement and lodgment infrastructure.
2. **An information hub** that enables ELNOs to exchange information with each other. (Figure 4.2). This reduces the number of connections between ELNOs, however, each ELNO would still typically have their own connections to land registries, revenue offices and financial settlement infrastructures. The information hub could potentially be owned by the government or mutually owned by ELNOs and other participants in the market.
3. **A full central hub** that enables ELNOs to communicate with other ELNOs **and** provides the infrastructure and connections required to complete financial settlement, lodgment and payment of transfer duties (Figure 4.3). Existing ELNOs' financial settlement and lodgment infrastructure would be redundant, and instead, all ELNOs would access the central infrastructure provided by a vertically separated monopolist. The central hub could potentially be owned by the government or mutually owned by ELNOs and other participants in the market.
4. **An infrastructure ELNO with an access regime** where a vertically integrated 'infrastructure ELNO' provides monopoly services, including the infrastructure for title lodgment and financial settlement, to 'retail ELNOs'. Both the infrastructure ELNO and retail ELNOs provide front-end services to conveyancers, solicitors and financial institutions (eg, the user interface). As discussed in Section 4.3.4, there is the possibility of having more than one infrastructure ELNO (Figure 4.4).

Note that the two hub models we analysed are at the two extremes in terms of the number of services they provide. A hub could offer any subset of the full central hub's services.

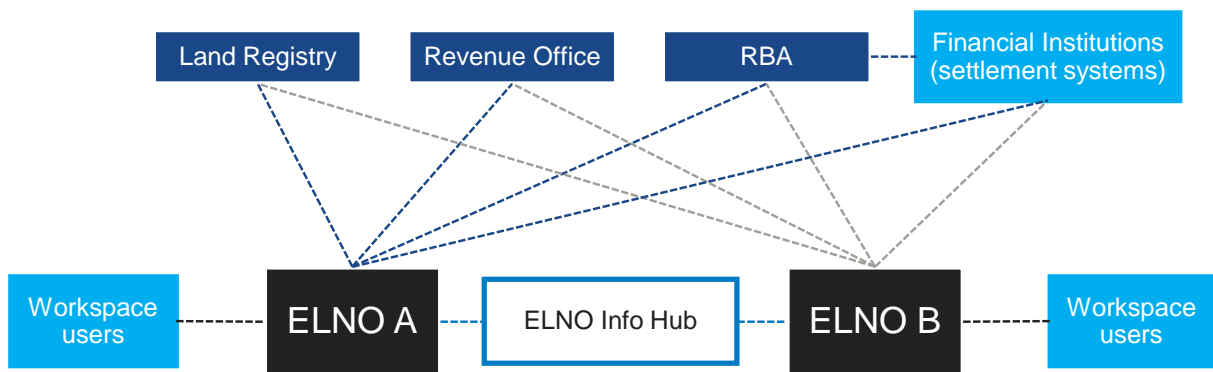
Figure 4.1 Direct connections between ELNOs



Note: Workspace users include the staff of solicitor/conveyancing firms and financial institutions.

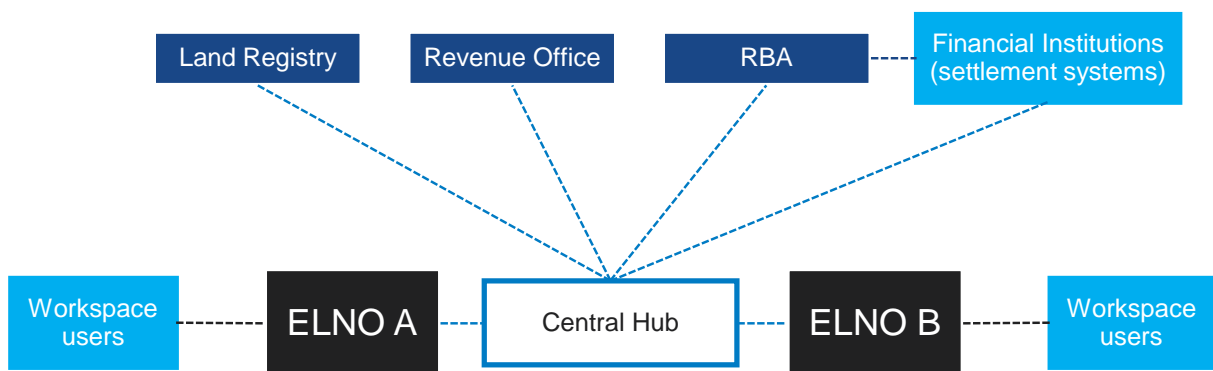
Data source: IPART.

Figure 4.2 Central infrastructure between ELNOs – information hub



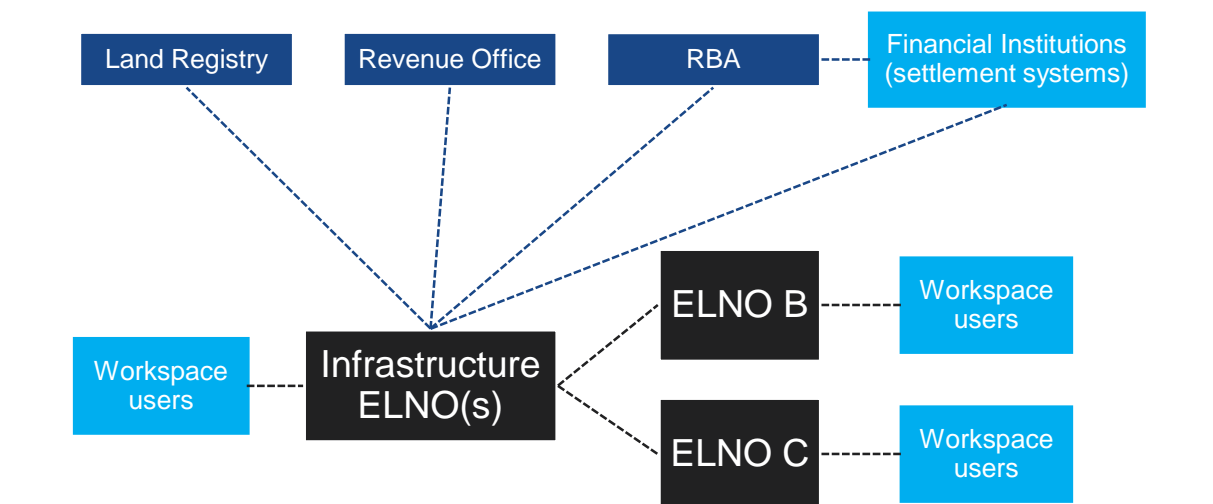
Data source: IPART.

Figure 4.3 Central infrastructure between ELNOs – full central hub



Data source: IPART.

Figure 4.4 Infrastructure ELNO with an access regime



Data source: IPART.

All these models would allow solicitors, conveyancers and the staff of financial institutions to use their preferred ELNO. However, our analysis found that the greatest number of eConveyancing activities and infrastructure components were contestable under the direct

connection and information hub models. Therefore, these models have the greatest potential to promote competition, product differentiation and innovation.

The infrastructure ELNO or full central hub models would result in a single infrastructure provider. This means that:

- ▼ Competition between ELNOs would be focused on the user interface (which could include specialised tools or processes to assist subsets of clients such as property developers or financial institutions) and potentially client facing elements of cyber security (such as endpoint security)
- ▼ The infrastructure provider would have little incentive to develop innovative infrastructure services (eg, for lodgment and financial settlement) and would likely focus its efforts on the competitive retail elements of the eConveyancing process.

Diagrams showing the contestable and non-contestable elements under each interoperability model are available in Appendix E.

PEXA cautioned that even under a direct connection model of interoperability, innovation in settlement and lodgment infrastructure would be “stymied” due to the need for ELNOs to mirror each other’s capabilities.⁸⁸ We agree that there will always need to be a level of standardisation because ELNOs connect to the same systems (including at land registries and revenue offices) and will need to agree on data standards for communication among themselves. However, there is no compelling evidence that each ELNO would be constrained from using that data in different ways, or that there would be barriers to the lodging ELNO translating the basic financial information required for a transaction into the format required by its payment system.

Finding

- 4 The direct connection or information hub models provide the greatest prospects for competition, differentiation and innovation between ELNOs, given the current state of the market. The incremental capital cost of a direct connection between the two current ELNOs is relatively low.

4.3.3 Direct connections between the two existing ELNOs is cost-efficient but other models may be more cost-efficient if there are many ELNOs

Achieving interoperability would improve competition and should be cost effective. We asked AECOM to model the additional expenditure that would be required to implement interoperability under each of the four models for different numbers of ELNOs – taking into account capital expenditures (CAPEX) and operating expenditures (OPEX). In line with the current state of the market, this modelling reflects that two independent ELNOs already exist and have already invested in their retail software platform and infrastructure for lodgment and settlement.

⁸⁸ PEXA Submission to the Draft Report, October 2019, p 39.

This analysis indicates that:

- ▼ The total incremental cost of each interoperability model is highly dependent on the number of ELNOs in the market.
- ▼ The costs of any interoperability model is predominantly due to additional capital expenditure. However, these additional capital costs are outweighed by savings on operating expenditures that would be incurred if multi-homing was required.
- ▼ The incremental cost of establishing interoperability between the two current ELNOs is relatively low regardless of whether direct connections or an infrastructure ELNO model is chosen.
- ▼ An infrastructure ELNO model becomes more cost efficient compared to the other options when there are a larger number of ELNOs in the market.

Capital expenditure

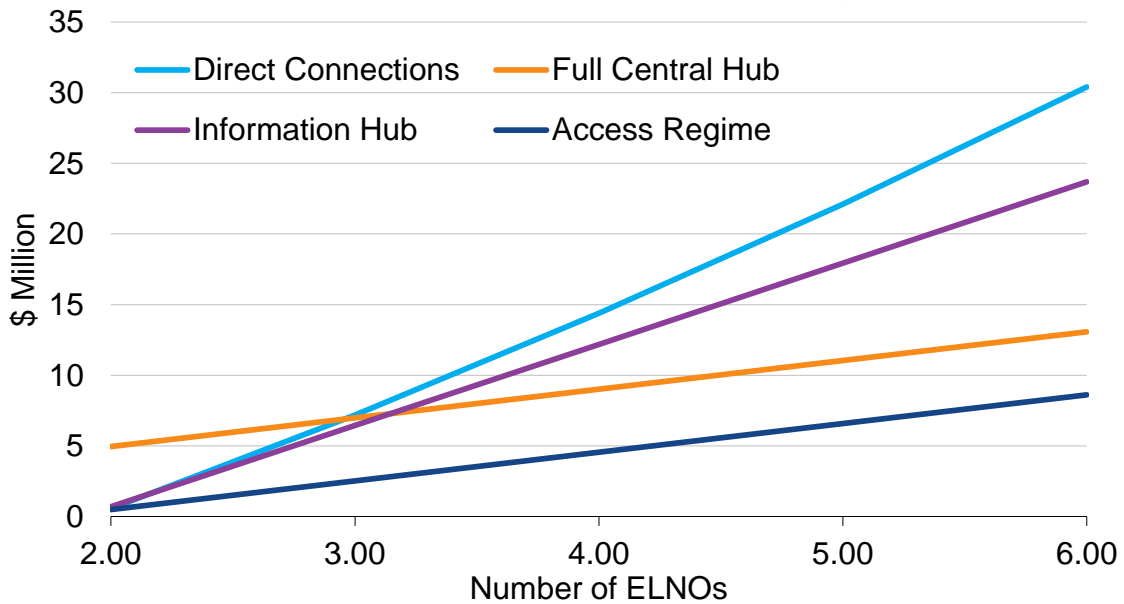
The additional capital expenditure required to achieve interoperability depends on:

- ▼ Whether a hub is built, and if so, the range of services it provides
- ▼ The number of ELNOs in the market, and hence the number of connections that need to be established to pass information between ELNOs or between ELNOs and a hub
- ▼ Whether new entrant ELNOs establish their own infrastructure to lodge and settle property transactions (including software and connections to revenue offices, land title registries, financial institutions and the RBA).

Figure 4.5 and Figure 4.6 summarise the results of AECOM's modelling of additional capital expenditure for the four models of interoperability. It shows that:

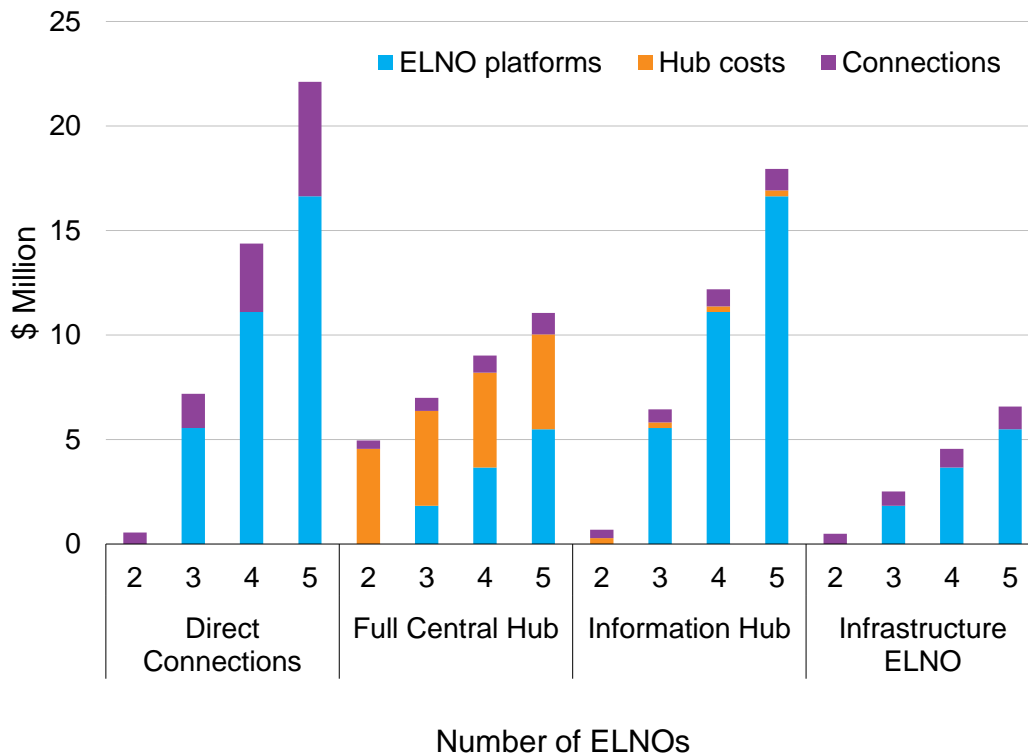
- ▼ For two ELNOs, the additional capital expenditure is similar for the direct connections, information hub and infrastructure ELNO models. It is considerably higher for the full central hub model due to the infrastructure required for it to provide lodgment and settlement services for all ELNOs in the market.
- ▼ For three ELNOs, the additional capital expenditure is similar under the direct connections, information hub and full central hub models. It is lower under the access regime because no hub is built and the new entrant utilises the lodgment and settlement infrastructure of one of the two existing ELNOs.
- ▼ As further ELNOs enter the market, the direct connections and information hub models become more costly if all new entrants build infrastructure for lodgment and settlement, rather than only establish a retail platform. However, as noted above, they could instead enter into an access arrangement with one of the existing ELNOs, reducing these costs.

Figure 4.5 Additional cumulative capital expenditure with interoperability



Data source: AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p 36 and IPART calculation.

Figure 4.6 Additional cumulative capital expenditure with interoperability by type



Data source: AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p 36 and IPART calculation.

Under a direct connection model and an infrastructure ELNO, each ELNO could bear their own costs required to enable communication between ELNOs because the costs are symmetric. However, if a new central hub were built, ELNOs would need to contribute to the

costs of establishing the hub. AECOM's modelling suggests that while an information hub would require around \$274,000 of infrastructure, the full central hub would require \$4.54 million due to the greater extent of its services.⁸⁹ These costs would need to be recovered from ELNOs through up-front fees and/or per-transaction fees.

AECOM's modelling also suggests that each benchmark efficient ELNO's lodgment and financial infrastructure represents capital expenditure of around \$3.7 million, with an expected asset life of five years. This expenditure would be utilised to support both an ELNO's own transactions, as well as the interoperable transactions where it plays the role of 'lodging ELNO'. The cost that would need to be recovered from other ELNOs in an interoperable transaction for the use of this infrastructure would be minimal. As a simple illustration, if there are two ELNOs in the market that have built lodgment and settlement infrastructure and around 1.3 million transactions per year in Australia, over five years the total cost of this infrastructure would be around \$1.12 per transaction.⁹⁰ This cost could form part of a transfer fee, as discussed in Section 4.4 below.

In its submission to our Draft Report, PEXA notes "that there will be significant costs, estimated at between \$25-\$30 million (not including costs of renegotiating the legal and contractual framework) to redesign its entire system to accommodate any form of direct connection interoperability, if this is even feasible".⁹¹ However, this figure is well in excess of AECOM's estimates of around \$5.55 million in capital expenditure required to build a new ELNO system that could accommodate interoperability and Deloitte's estimates of between \$2 million to \$13.3 million depending on the extent of the ELNO's service offerings (including 'Robotic Process Automation').⁹² Expenditure of \$25 to 35 million to upgrade an existing ELNO platform would be unlikely to represent an efficient investment in the market.

Operating expenditure

Every ELNO in the market would incur operating expenses to support their eConveyancing services and activities in the market. AECOM's cost modelling suggests that, for an efficient ELNO, under all four interoperability models:

- ▼ ELNO's operating expenses are lower if there is interoperability in the market because, when there is no interoperability, subscriber costs (which include subscriber on boarding, training and digital certificates) are higher due to multi-homing.
- ▼ Most operating expenses do not vary based on whether the firm is a 'retail ELNO' or 'infrastructure ELNO'.
- ▼ Many operating expenses do not vary with the number of transactions. As an ELNO's market share increases, its expenditure on marketing and customer support increases, and it incurs greater pass-through costs (such as LSS fees). However, the costs and number of staff required to maintain IT assets used for lodgment and settlement do not change.

⁸⁹ AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p 36 and IPART calculation.

⁹⁰ Ibid.

⁹¹ PEXA Submission to the IPART Draft Report, October 2019, p 5.

⁹² AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, pp ii, 36; Deloitte, *The future of the Australian conveyancing industry 2025 and 2030*, June 2018, pp 62 – 63.

This suggests it would not be necessary for the lodging ELNO to recover operating expenditures from other ELNOs in an interoperable transaction as part of a transfer price.

Under the full central hub, information hub and infrastructure ELNO models, there would be some additional operating expenditure to support interoperable transactions and maintain the infrastructure, which would need to be recovered from other ELNOs. AECOM's modelling shows that the efficient operating costs would be \$600,000 per year for a full central hub, \$200,000 per year for an information hub and \$100,000 per year for an infrastructure ELNO.⁹³

Sunk costs

There are already two ELNOs in Australia that have made investments to build the infrastructure required for financial settlement and title lodgment. Under the full central hub model, these assets would be redundant as the hub would perform these services for all ELNOs. Similarly, if a single infrastructure ELNO were to be appointed to settle and lodge all transactions under an access regime, the other ELNO's infrastructure would no longer be used. We consider that direct connections minimises sunk costs.

Costs to other participants in the market

The ABA indicated in its submission to our Draft Report that our analysis of the interoperability models did not take into account the costs of the various models of interoperability to financial institutions.⁹⁴ Similarly, PEXA indicated that we hadn't considered the infrastructure costs imposed on others including financial institutions, land registries and revenue offices.⁹⁵

In the absence of interoperability, participants in the market (including financial institutions, land registries and revenue offices) would incur costs to connect to new ELNOs in the market. For revenue offices, this represents a cost of supporting the government's decision to allow competition in the market and for land registries, making these connections is part of their role as a monopoly provider of a necessary input in the eConveyancing process. For financial institutions, the decision to invest in connecting to any new ELNOs is a commercial decision of each financial institution if interoperability is established via direct connections or more than one infrastructure ELNO. That is, a financial institution would only incur additional costs from connecting to more than one ELNO if it considered that the benefits outweighed the costs. If a full central hub became the preferred interoperability model, all participants in the market would be compelled to connect to that hub.

Incremental costs per interoperable property transfer transaction

We considered the potential incremental costs of implementing interoperability under each of the four models, compared to having no interoperability. It does not include estimates of the costs of any additional insurance required for interoperable transactions.

⁹³ AECOM efficient cost modelling.

⁹⁴ ABA Submission to the IPART Draft Report, October 2019, p 2.

⁹⁵ PEXA Submission to the IPART Draft Report, October 2019, p 5, 9, 12.

Table 4.1 provides an illustrative example of these costs using AECOM’s CAPEX and OPEX estimates under the assumptions that there are:

- ▼ Two ELNOs in the market
- ▼ A total of around 1.3 million transactions per year in Australia
- ▼ CAPEX costs are recovered over five years.

Table 4.1 Incremental costs of interoperability compared to no interoperability

	Direct Connections	Information Hub	Full Central Hub	Infrastructure ELNO
Total CAPEX for ELNOs and hub if applicable (\$ millions)	0.55	4.95	0.68	0.48
Total OPEX for ELNOs and hub if applicable (\$ millions)	-18.91	-18.67	-17.06	-18.83
CAPEX per transaction (\$)ª	0.41	3.74	0.52	0.36
OPEX per transaction (\$)	-14.28	-14.10	-12.88	-14.22

ª Assuming 20% of transactions require interoperability.

Source: AECOM, NSW LRS, IPART analysis.

4.3.4 Combining direct connections now with potential for an access regime in future maximises cost efficiency and the scope for innovation

The choice of interoperability model should take into account that the market already has two ELNOs and make full use of the established financial settlement and lodgment infrastructure. Interoperability should also be designed to allow future new entrant ELNOs to access the existing infrastructure, but allow scope for infrastructure innovation in future.

Current state of the market

Taking into account that there are two ELNOs already in the market, it would not be cost efficient for the industry to ignore the sunk costs of the existing infrastructure to construct a full central hub. It would be similarly inefficient to have a single infrastructure ELNO, when two ELNOs currently have invested in the capability to lodge and settle transactions. While having two ELNOs means that duplication of lodgment and settlement infrastructure has occurred, this duplication improves the market’s resiliency against market exits or the prolonged unavailability of an ELNO or their infrastructure provider. A direct connection could be built between the two existing ELNOs in order to maximise the use of existing investments, maximise competition between infrastructure providers and incentivise innovation around that infrastructure.

Future development of the market

There would be benefits to allowing competition and interoperability in the eConveyancing market to develop flexibly. New entrant ELNOs should be able to choose to use the infrastructure of one of the two existing ELNOs or the ASX’s financial settlement infrastructure on a fair and reasonable basis. This would provide new entrants a choice of infrastructure provider, less replication of infrastructure in the market overall and would address financial institutions’ concerns around having to connect to a large number of

ELNOs.⁹⁶ A new entrant ELNO would be unlikely to make the commercial decision to build a replica of the existing infrastructure unless there are clear cost savings or other benefits over accessing the existing infrastructure. However, the entry of further ELNOs with their own financial settlement and lodgment infrastructure should not be ruled out by regulation. For example new ELNOs may be able to enter the market with innovative infrastructure, including by using faster and more cost efficient technologies over time or by using different financial settlement methods. If an ELNO can convince financial institutions of the benefits or cost savings of building new infrastructure and meet the standards set by regulators, they should be allowed to build it and form direct connections with other ELNOs in the market.

Though PEXA notes in its submission that there are no examples of this type of ‘hybrid’ model interoperability in the world⁹⁷, there are examples of similar market structures in the banking, payments and telecommunications industries in Australia (see Box 4.1). While each market has its own unique characteristics, there are some commonalities with the eConveyancing market. As described in the NSW Government’s submission to the Draft Report “As this is a technology based industry, it is to be expected that new business models not currently thought of will emerge, and the regulatory and market structure settings should encourage that continuing market evolution”.⁹⁸

Regulatory landscape and national consistency

A nationally consistent approach to interoperability would be beneficial to the market since ELNOs and financial institutions operate across multiple jurisdictions in Australia. Otherwise, these national institutions would face additional costs if interoperability is implemented differently in each jurisdiction. Submissions to our Draft Report also expressed a strong preference for a nationally consistent approach to interoperability:

- ▼ The Law Society of NSW indicated that a national approach to interoperability is vital and should be implemented through the MORs. They have “concerns about NSW departing from a national approach, for the long term integrity, efficiency and stability of the national system”. However, they also conceded that “given the imminent commencement of a second ELNO in NSW, this work needs to progress as a matter of urgency”.⁹⁹
- ▼ The ABA indicated that while a direct connection between the two current ELNOs may be found to be the appropriate outcome, they would prefer to continue the work of the NSW Interoperability Working Groups on a national level to determine the industry agreed approach to interoperability.¹⁰⁰
- ▼ Sympli agreed that a national approach would be preferable, and was not aware of any reason why a direct connection could not be implemented nationally or why regulations would need to be varied between states or territories.¹⁰¹
- ▼ PEXA indicated interoperability “must be subject to appropriate industry consultation at the national level to enable fact-based decision making. Accordingly, PEXA strongly believes that a rigorous cost-benefit analysis of interoperability is required”.¹⁰²

⁹⁶ Australian Banking Association submission to the IPART Issues Paper, April 2019, p 5.

⁹⁷ PEXA Submission to the IPART Draft Report, October 2019, p 4.


⁹⁸ NSW Government’s Submission to the IPART Draft Report, October 2019, p 2.

⁹⁹ Law Society of NSW Submission to the Draft Report, September 2019, p 5.

¹⁰⁰ ABA Submission to the Draft Report, October 2019, p 2.

¹⁰¹ Sympli Submission to the Draft Report, October 2019, p 5.

¹⁰² PEXA Submission to the Draft Report, October 2019, pp 9-10.



While ARNECC continues to investigate a national model for interoperability, NSW or a subset of jurisdictions could continue to pursue interoperability at a faster pace. This could include working on elements that are required for any potential model of interoperability and contribute towards a national solution such as:

- ▼ Establishing protocols or business rules including for designating the lodging ELNO
- ▼ Investigating legislative changes or other legal arrangements required to enable use of trust accounts in interoperable transactions, and
- ▼ Exploring requirements including the minimum data standards required to complete a transactions and minimum cyber security requirements.

Interoperability will influence the future competitiveness of the eConveyancing market. Implementing interoperability ahead of a national model should avoid creating unnecessary sunk costs. For example, pursuing a direct connection would require developing APIs which may still be useful if another interoperability method is chosen. However, pursuing a central infrastructure would require greater capital investment that would be redundant if another model, or a different form of central infrastructure was later implemented nationally.

Box 4.1 Similar market structures and interoperability models in other industries

Firms often face a 'build or buy' decision over their infrastructure, including the choice to host their software platforms on their own servers built and maintained in-house or to buy this capacity eg, buy using externally hosted cloud servers. In addition, a number of industries have a flexible market structure where firms are interconnected or interoperable and can choose to build their own infrastructure or buy access to existing infrastructure in the market.

Telecommunications

In the telecommunications industry, interoperability exists in both the fixed-line and mobile phone markets where there are a mixture of operators that provide both retail services and wholesale infrastructure, and other firms that provide retail services only. In these markets, regulation seeks to promote competition, encourage economically efficient use of and investment in infrastructure and to achieve 'any-to-any connectivity' regardless of the network the end-user is on.

There are some differences in the customer expectations and risks faced by telecommunications firms and ELNOs. For example, ELNOs are expected to authenticate their users and ensure the integrity of the messages being sent for financial settlement and lodgment. Nevertheless, in both markets, service reliability is important – for example, in making determinations in the telecommunications industry, the ACCC has regard to ensuring the safe and reliable operation of a telecommunications network, or facilities used to supply carriage services.

Banking and payments

There are a number of examples in the banking and payments industry of interoperability and interconnectivity that involve institutions with full infrastructure or connectivity and smaller institutions that enter into commercial arrangements to access that infrastructure.

For example, larger financial institutions (including the big four banks) are required to have their own Exchange Settlement Account with the RBA and process their own wholesale transactions (including transactions arising from the ASX's Austraclear securities settlement system and SWIFT). Similarly, for retail payments, some (generally larger) financial institutions have built their own infrastructure to integrate with the New Payments Platform (NPP) to deliver faster payments and have connected to the Community of Interest Network (COIN) to enable settlement of PEXA, cheque and direct entry transactions. Smaller financial institutions and other businesses generally settle their wholesale and retail payments through commercial agency arrangements with one of the larger banks or specialised service providers. This market structure allows smaller banks and financial institutions to transact in the wholesale market and offer a full range of services to their customers without needing to have a full operational capacity and capital expenditure, while also mitigating the risks that would arise in the payments system if transactions were settled by a very small number of institutions.

The eConveyancing industry and the broader payments industry all serve a range of clients from the general public to large businesses. As in the eConveyancing market, the banking and payments industry has a strong need to authenticate users in systems, correctly identify end-clients, maintain high levels of security and protect the integrity of transaction and asset ownership records.

Sources:

<https://www.accc.gov.au/system/files/Fixed%20line%20telecommunications%20services%20declaration%20inquiry%20-%20Final%20decision.pdf>, <https://www.accc.gov.au/system/files/MTAS%20FAD%20Discussion%20Paper%20-%20August%202019%20-%20PUBLIC.pdf>, <https://rba.gov.au/payments-and-infrastructure/riits/user-doc/pdf/oper-legal-arrangements.pdf>, <https://rba.gov.au/payments-and-infrastructure/riits/about.html> accessed 29 October 2019.

4.4 A cost-reflective transfer price should be used to share costs between ELNOs in an interoperable transaction

The appropriate regulatory approach to transfer pricing between ELNOs – both in terms of the governance arrangements and the pricing framework – depends on the choice of interoperability model. The regulatory pricing framework also needs to take into account whether the market is symmetric and any pass-through fees that need to be shared. These factors determine whether it is important to have a cost-reflective transfer price for interoperable transactions.

4.4.1 Interoperability model

The appropriate tools to regulate transfer pricing depend on the interoperability model implemented:

- ▼ An infrastructure ELNO model involves a vertically integrated monopolist that provides the infrastructure for title lodgment and financial settlement to other ELNOs. In this case, regulation is required to ensure fair access to services at reasonable prices.
- ▼ Direct connections involve competing ELNOs who require reciprocal access between their networks in order to complete a property transaction. In this case, regulation has an important role to play in ensuring competing ELNOs coordinate efficiently and that new entrant ELNOs can connect to incumbent ELNOs in reasonable timeframes. Under a direct connection model, the importance of the regulatory pricing framework depends on the symmetry of transactions, which is discussed below.
- ▼ Various other forms of central hub could also be chosen, ranging from a minimal messaging service to a hub that performs the same roles as an infrastructure ELNO but does not offer retail services (ie, is vertically separated). The appropriate governance arrangements for a hub depends on its ownership structure, but it would be important that ELNOs contribute to its capital and operational expenditures through upfront fees and/or per-transaction fees.

4.4.2 Symmetry of the market

Another key factor that will influence the need for regulation of transfer prices, and the form of regulation that is appropriate the extent to which each ELNO in an interoperable transaction is as likely to be the lodging ELNO.

If the market is symmetric, each ELNO in the market would be equally likely to play this role. Therefore, the transfer price for an interoperable transaction is not as important, as over time the payments would net to zero across ELNOs. For example, regulators in the US telecommunications industry have implemented a ‘bill and keep’ policy where the interconnection price between telecommunications networks is set to zero. If the market is not symmetric, at least one ELNO is more likely to be the lodging ELNO. If an access regime or full central hub model of interoperability is implemented, some ELNOs will never be the lodging ELNO.

Even under direct connections, the Australian eConveyancing market is unlikely to be completely symmetric (particularly in the short term), since the initial ELNO PEXA will be integrated with a larger number of financial institutions than the recent entrant ELNO Sympli or future new entrants. Indeed, discussions in the Interoperability Working Groups suggested that regardless of the decision mechanism chosen to determine the lodging ELNO, PEXA may need to perform the role of ‘lodging ELNO of last resort’ in cases where a financial institution involved in a transaction is not connected to the ELNO that should be performing lodgment and financial settlement. For these reasons, PEXA is likely to perform the role of lodging ELNO more often than its competitors. For example, if a new entrant ELNO initially connected to the four major banks (including integration for funds transfers from trust accounts), it would potentially be able to process only around 72% of financial settlements using a reservation batch at the RBA.¹⁰³ Since the market is unlikely to be symmetric, it is important that the transfer price is cost reflective, since the payments will not net to zero across ELNOs over time.

4.4.3 Third party transaction fees

ELNOs currently pay fees to two third parties as part of a property transaction, and another is likely to be required in an interoperable transaction:

- ▼ **Interoperability insurance** may in future be required to cover risks that are unique to interoperable transactions. The form of insurance is being discussed by the industry and the costs are currently unknown.¹⁰⁴
- ▼ **Lodgment gap insurance** covers the risk that the registration of a title is prevented by a dealing on the title between the final title activity check prior to settlement and lodgment. Based on AECOM’s estimates the cost per transaction is around \$10 per transaction.¹⁰⁵ There should be no additional lodgment gap insurance payments with any model of interoperability.
- ▼ The **LSS fee** is currently charged by NSW LRS to an ELNO when a workspace is created. It is assumed that the LSS fee will only be charged once per title in an interoperable transaction and that ELNOs can share title and activity information. The lodging ELNO is likely to be the representative of the incoming mortgagee but the workspace is typically initiated by the vendor’s solicitor/conveyancer, as such, the ELNO charged the LSS may not be the lodging ELNO. For a property transfer, NSW LRS charges an LSS fee of \$14.79 (GST inclusive) per title in the transaction.¹⁰⁶ There should be no additional LSS fees with any model of interoperability.

Since the services that these fees pay for benefit all parties to a transaction, the fees should be shared across ELNOs in an interoperable transaction.

¹⁰³ RBA correspondence indicated that in the four months from March to June 2019, 72% of current property reservation batches involved one or more of the four major banks, while the remaining 28% of batches involved at least one other financial institution.

¹⁰⁴ NSW ORG, Directions paper on proposed eConveyancing interoperability regime, 6 February 2019, pp 23-24

¹⁰⁵ AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p 13.

¹⁰⁶ NSW LRS, *2019/2020 Fees for NSW LRS*, <https://www.nswlrs.com.au/Fees> accessed 16 August 2019.

4.4.4 The access framework could be modelled on the cash equities settlement market

As discussed in Chapter 3, the regulatory framework for competition in the eConveyancing market could be modelled on the 'Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia'¹⁰⁷ developed by the Council of Financial Regulators and the ACCC. An access framework for the eConveyancing market could also be modelled on the cash equities market, where:

- ▼ Incumbent service providers are required to facilitate access to services “on a transparent and non-discriminatory basis with terms and conditions, including price, that are fair and reasonable”; and
- ▼ It was proposed that ACCC be given legislative powers to arbitrate disputes on price or non-price conditions of access to services where negotiations between an incumbent and new entrant fail.

Recommendation

- 6 NSW ORG work with ARNECC to set a schedule of costs that can be used by ELNOs to calculate a cost-reflective transfer price for interoperable transactions to ensure that costs are shared fairly across ELNOs.

Finding

- 5 An access framework could be based on the principles of the cash equities market. The framework for the cash equities market sets out that incumbent firms are compelled to facilitate access to services on a transparent and non-discriminatory basis, and the ACCC is given the power to arbitrate disputes where access negotiations between an incumbent and new entrant fail.

4.4.5 Illustrative transfer price schedule and calculations

Using the CAPEX costs from Section 4.3.3 and the three pass-through fees discussed above, Table 4.2 shows how these could be set out in a schedule that enables ELNOs to determine a transfer price for an interoperable transaction. A transfer price is a cost-sharing arrangement between ELNOs for interoperable transactions, and is not an additional charge to subscribers in a transaction and nor does it represent the price a retail ELNO would pay to access financial settlement and title lodgment infrastructure. PEXA noted in its submission to our Draft Report that the transfer price will need to reflect PEXA's actual costs of lodgment and financial settlement.¹⁰⁸ We do not agree: the transfer price should reflect the efficient cost of lodgment and financial settlement rather than the actual costs of any individual ELNO, as it would not be fair for other ELNOs to have to pay prices above efficient costs. The net transfer price will need to take into account that the party which pays for each of the pass-through fees may vary by transaction. For example, LSS fees are likely to be incurred based on which party opens a workspace rather than which party is the lodging ELNO.

¹⁰⁷ See: Council of Financial Regulators, *Minimum Conditions for Safe and Effective Competition in Cash Equity Settlement in Australia*, September 2017, <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2017/minimum-conditions-safe-effective-competition/pdf/policy-statement.pdf> accessed 8 August 2019.

¹⁰⁸ PEXA Submission to the Draft Report, October 2019, p 5, 9, 12.

The cost schedule in Table 4.2 assumes there are:

- ▼ Two ELNOs in the market with a bilateral connection
- ▼ Four participants in the property transaction
- ▼ A total of around 1.3 million transactions per year in Australia
- ▼ CAPEX costs are recovered over five years.

Table 4.2 Illustrative cost schedule for interoperable transactions (\$)

	Cost per transaction	Without sharing, who incurs the cost?
CAPEX for title lodgment and financial settlement	1.12	Lodging ELNO
LSS fee	14.79	The ELNO whose client first opened the workspace
Lodgment gap insurance	10.00	Rule not known
Interoperability Insurance	Costs are unknown	Rule not known
CAPEX for interoperability between ELNOs and OPEX	Assumed that each ELNO bears their own costs	Not applicable

Source: AECOM, NSW LRS, IPART analysis.

Using the illustrative cost schedule, a net transfer price for a transaction can be calculated under various scenarios (Table 4.3). For example, under Scenario 1 each ELNO represents two participants in the transaction and, assuming the lodging ELNO incurred the capital costs and paid all pass-through fees, the non-lodging ELNO would need to pay a transfer price of \$12.96 to the lodging ELNO (and share the costs of interoperability insurance). However, if the lodging ELNO incurred the capital costs, while the non-lodging ELNO paid all pass-through fees, the lodging ELNO would need to pay the non-lodging ELNO \$11.83 (and share the costs of interoperability insurance).

Under Scenario 2, the lodging ELNO represents one participant in the transaction, while the non-lodging ELNO represents three participants. Assuming the lodging ELNO incurred all costs, the non-lodging ELNO would need to pay a transfer price of \$19.44 to the lodging ELNO (and share the costs of interoperability insurance). However, if the lodging ELNO incurred the capital costs only, the lodging ELNO would need to pay the non-lodging ELNO \$5.35 (and share the costs of interoperability insurance).

Table 4.3 Illustrative transfer price calculations (\$)

Cost for:	Scenario 1	Scenario 2	
	Each ELNO serves 2 participants	Lodging ELNO	Non-lodging ELNO
CAPEX for title lodgment and financial settlement	0.56	0.28	0.84
LSS fee	7.40	3.70	11.09
Lodgment gap insurance	5.00	2.50	7.50
Interoperability Insurance	Costs are unknown	Costs are unknown	Costs are unknown
Net transfer price:			
Assuming the lodging ELNO paid all costs	12.96		19.44
	paid to lodging ELNO		paid to lodging ELNO
Assuming the lodging ELNO paid only the capital costs	11.83		5.92
	paid to non-lodging ELNO		paid to non-lodging ELNO

Source: AECOM, NSW LRS, IPART analysis.

5 ELNO costs and prices

In the second step of our approach to this review, we have considered the findings from our analysis of the state of the market, as well as ELNO cost information, to decide on an appropriate ‘form of regulation’ for ELNOs (ie, the set of methods used to regulate prices).

The form of regulation for ELNOs governs how initial prices are set, and how prices are adjusted from year to year, and will differ depending on:

- ▼ The assessment of efficient costs
- ▼ How prices are controlled
- ▼ Incentives for efficiency and innovation
- ▼ The state of competition.

The following sections outline our findings on the appropriate methodology for estimating the cost of providing ELNO services. This methodology has been used for our approach to setting maximum prices ELNOs can charge their subscribers (solicitors, conveyancers and financial institutions).

As required by our terms of reference, we have also considered whether our recommended approach to any element of the NSW pricing regulatory framework could be an appropriate model for other jurisdictions. Each of these matters is discussed below along with our responses to stakeholder submissions to our Issues Paper and Draft Report.

5.1 Summary of findings and recommendations

The appropriate form of price regulation is maximum prices for all ELNOs, set at PEXA’s current prices and indexed by CPI, for a two year regulatory period starting from 1 July 2020. PEXA’s current prices are shown in Table 5.1 below. These prices would be indexed on 1 July 2020 by CPI as defined in the MORs and those prices would be the maximum prices that apply for any ELNO from 1 July 2020. Further CPI indexation would then apply from 1 July 2021. This will ensure that while competition develops in the eConveyancing market, consumers pay a price that reflects efficient costs.

Both NSW Government and Sympli submitted that the existing CPI price increase cap regulation under the MORs applies to the prices that each individual ELNO sets when it enters the market.¹⁰⁹ Our recommended maximum price cap regulation differs from this approach, and would require both the MORs and Conditions of Approval to be amended.¹¹⁰

Using a building block model and AECOM’s efficient cost information, we tested the efficiency of PEXA’s current prices and found that for almost every market share scenario, PEXA’s current prices are reasonable compared to modelled prices for a benchmark efficient

¹⁰⁹ NSW Government submission to IPART Draft Report, October 2019, p 6; Sympli submission to IPART Draft Report, September 2019, p 7.

¹¹⁰ Model Operating Requirements Version 5, Section 5.4.3, p 8

ELNO. We also compared paper conveyancing prices to PEXA’s current prices and found that consumers are no worse off under eConveyancing than paper conveyancing. As a consequence, we consider that PEXA’s prices are reasonable, and that setting the maximum prices for all ELNOs at PEXA’s current price and indexing prices annually by CPI, is appropriate while competition in the eConveyancing market develops.

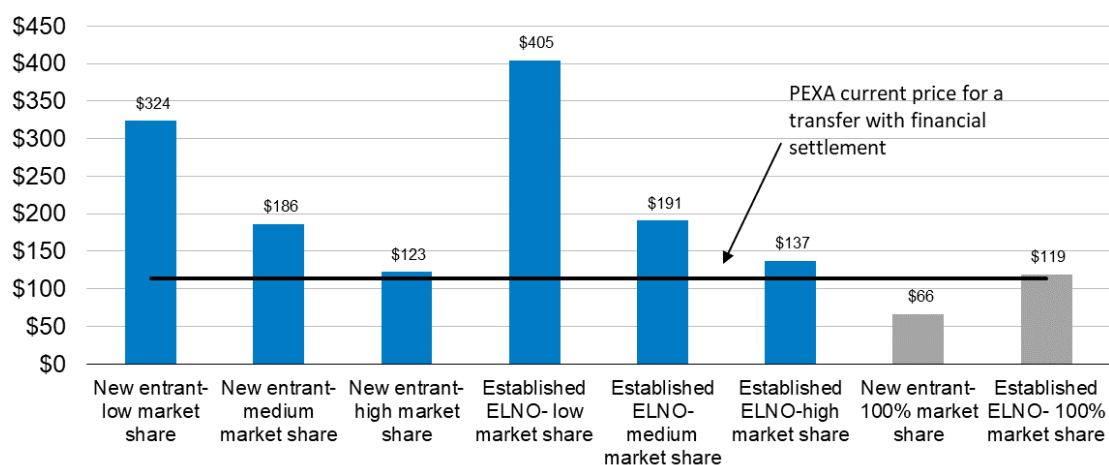
We consider the maximum prices that we have recommended should allow pricing innovation, as this is a characteristic of a competitive market. As a consequence, we have recommended how our pricing framework should allow for ELNOs to offer different pricing models, while ensuring that their prices do not exceed efficient costs.

Other jurisdictions could adopt a similar approach to this review for assessing efficient costs and recommending prices. We consider that our framework is transferable to other jurisdictions and that it does not create any barriers to national consistency.

5.2 Cost modelling indicates that PEXA’s current prices are reasonable

Using a building block model (see Box 5.1) and AECOM’s efficient cost information, we tested the efficiency of PEXA’s current prices and found that, for a range of market share scenarios, PEXA’s current prices are reasonable compared to modelled prices for a benchmark efficient ELNO (see Figure 5.1). Where the modelled prices are substantially higher than PEXA’s current prices, this is due to market share assumptions that are much lower than PEXA’s actual market share. As a consequence, we consider that PEXA’s prices are reasonable, and that setting the maximum prices for all ELNOs at PEXA’s current real prices (see Table 5.1) and indexing prices annually by CPI, is appropriate while competition in the eConveyancing market develops.¹¹¹

Figure 5.1 Prices for a benchmark efficient ELNO (transfer with financial settlement)



Note: These building block modelled prices assume that all recommended price increases occur in the first year of the regulatory period, and that all costs are recovered in two years.

Data source: IPART, AECOM modelled efficient costs.

¹¹¹ Our pricing recommendations are in real terms, CPI will need to be applied to PEXA’s current prices for the first year of the regulatory period (1 July 2020).


Table 5.1 PEXA's current fee schedule as at 1 July 2019 (\$) inc GST

Conveyancing Transaction	Single Title	Multiple Titles ^a
Transfer Title or Transfer by Third Party	114.07	130.68
Caveat or Withdrawal of Caveat	16.06	27.94
Caveat or withdrawal of caveat with Financial Settlement	30.91	47.52
Mortgage	42.79	59.29
Discharge Mortgage	20.68	32.67
Discharge Mortgage with Financial Settlement	42.24	54.01
Mortgage with Caveat Withdrawal	42.79	59.29
Mortgage (with Financial Settlement or Express Refinance)	57.20	73.59
Discharge Mortgage (Express Refinance)	42.24	54.01
Priority Notice or Priority Notice Withdrawal	9.13	9.13
Priority Notice Extension	4.62	4.62
Transfer of Interest	76.01	92.29
Transfer of Interest with Settlement	114.07	130.68
Encumbrance or Withdrawal of Encumbrance	36.19	48.07 introductory offer ^b
Survivorship or Transmission	36.19	52.80 introductory offer ^b
Survivorship or Transmission with financial settlement	36.19	52.80
Lease	42.79	59.29
Lease with Settlement	57.20	73.59
Title Information Re-Supply	5.61	N/A
Nomination to paper dealing	19.58	31.35
Nomination to electronic dealing, Consent, Form 24, Form 25, Notice of Sale, Notice of Acquisition	0.00	0.00

^a Related to multiple titles on the same registry instrument.

^b Introductory pricing available until 31 December 2019 unless extended by PEXA. Regular price for multi-title Survivorship and Transmission is \$36.19 plus \$16.61 per title, while multi-title Encumbrance and Withdrawal of Encumbrance are \$36.19 plus \$11.88 per title.

Source: <https://www.pexa.com.au/pricing>



Our cost consultant, AECOM, estimated the capital and operating costs that a benchmark efficient new entrant ELNO would incur in NSW from 2018-19 to 2022-23. This involved estimating the following costs:

- ▼ Development of an eConveyancing platform that performs the core ELNO service of financial settlement and lodgment. That is, the software development effort required (including activities such as project management, quality assurance and process design).¹¹²
- ▼ IT hardware (eg PCs and local network equipment).
- ▼ Building connections to around 10 financial institutions.
- ▼ General staff costs, such as executive staff costs, human resources staff etc.
- ▼ General operating expenditure, for example, the cost of renting office space.
- ▼ Marketing and customer acquisition/retention costs.
- ▼ Any pass through costs, for example land registry fees and lodgment gap insurance.

¹¹² AECOM estimates that it would take a benchmark efficient ELNO around two years to develop an eConveyancing platform.

Box 5.1 Building block model for ELNOs

The building block approach is commonly used by IPART and other regulators to estimate the total revenue a business needs to generate to recover the efficient costs of providing services to the required standard over the price determination period. The building block approach typically includes the following components:

- ▼ An efficient level of operating expenditure (operating, maintenance and administration expenses)
- ▼ An allowance for a return on assets, which represents the cost of capital invested in a benchmark efficient business through equity and debt markets, and requires us to:
 - Determine the value of the initial asset base
 - Decide on an appropriate rate of return (the WACC)^a
 - Multiply the value of the asset base by the rate of return
- ▼ An allowance for a return of those assets (depreciation)
- ▼ An allowance for tax and working capital.

After estimating efficient costs for a benchmark ELNO, we then:

- ▼ Forecasted the total number of eConveyancing transactions in NSW over the regulatory period using NSW ORG statistics^b
- ▼ Estimated the proportion of total eConveyancing transactions for a benchmark efficient ELNO under a range of market share assumptions, as shown in Table 5.2.

These steps allow us to estimate an efficient price per transaction, that enables a benchmark efficient ELNO to recover its costs over the regulatory period.

^a For more information on the WACC that we have estimated for ELNOs, see Appendix C.

^b We assumed that the number of eConveyancing transactions in NSW will be fixed at 736,000 per year until 2022, based on IPART calculations and forecasted national conveyancing transactions in Deloitte Economics, *The future of the Australian conveyancing industry 2025 and 2030*. This is an upwards revision from 700,000 which we assumed in our Draft Report.

Source: IPART, Deloitte Economics, *The future of the Australian conveyancing industry 2025 and 2030*, June 2018, p 57.

We considered the time period over which firms in other markets with technology platforms recover all their efficient costs (with high fixed costs) and note that the evidence available suggests these types of firms are unlikely to recover costs in the first few years of operations.¹¹³ As shown in Figure 5.1 (above) prices for a benchmark efficient new entrant ELNO with a low market share would need to be around three times higher than the incumbent ELNO to recover its costs in its first two years of operations. This is because AECOM estimates that it would cost a new entrant benchmark efficient ELNO around \$5.5 million to develop the software for an eConveyancing platform, and that ELNOs have relatively high fixed costs (such as salary costs) and so prices that reflect efficient costs vary depending on the number of transactions that an ELNO can recover its costs from.

¹¹³ We looked at various technology firms such as Spotify, Uber, Tesla, Transferwise, Amazon Web Services, and Afterpay and found that they took several years to make a profit, or are yet to make a profit.

Recommendation:

- 7 Maximum prices for all ELNOs be set at PEXA's current (real) prices from 1 July 2020 and CPI indexed annually (as defined by the MORs) for two years, before being reviewed again, ideally by a national regulator such as the ACCC (or on a state-by-state basis by regulators including IPART).

5.2.1 Our cost estimates were based on a benchmark efficient ELNO

In our Issues Paper, we proposed to recommend prices based on the costs of a benchmark efficient ELNO, in order to ensure that our pricing framework accounts for new entrant ELNOs that may have different cost structures from the incumbent ELNO.

Stakeholders generally did not favour the concept of modelling costs for a notional benchmark efficient ELNO on the basis that PEXA is currently the only ELNO operating in NSW with observable costs. For example:

- ▼ The Law Society submitted that developing a benchmark efficient ELNO would be difficult given the difference in business models between the incumbent and (potential) new entrants.¹¹⁴
- ▼ PEXA opposed the benchmark efficient ELNO, on the basis that it would look very like PEXA anyway.¹¹⁵
- ▼ Sympli supported development of a benchmark efficient ELNO model, but also cautioned that developing a view on a benchmark efficient ELNO's costs would be difficult, because PEXA's actual costs constitute the only cost information available, as Sympli (at the time of submitting to our Issues Paper) and other potential new entrants had not yet commenced operations in NSW.¹¹⁶

However, we consider that modelling costs for a benchmark efficient ELNO allows us to understand the costs that an efficient new entrant would incur entering the current ELNO market, rather than using actual costs (based on the incumbent ELNO's cost structure) to recommend prices.

Our cost estimates for the benchmark efficient ELNO assume that the ELNO:

- ▼ Commenced development of its bespoke eConveyancing platform in 2018-19, in a market where protocols for industry communication and processes had already been developed by established ELNOs¹¹⁷
- ▼ Operates in NSW, and expands into one additional jurisdiction in every year after launch
- ▼ Software and IT hardware assets depreciate over a period of five years.

We provided AECOM with a number of market share assumptions, shown in Table 5.2, to model costs for the benchmark efficient ELNO under a range of transaction volume scenarios,

¹¹⁴ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 5.

¹¹⁵ PEXA submission to the IPART Issues Paper, May 2019, p 18.

¹¹⁶ Sympli, submission to IPART Issues paper, May 2019, p15.

¹¹⁷ AECOM, *Estimating costs of electronic conveyancing services in NSW - Public Report*, August 2019, p ii

from which the ELNO can recover costs. These varying market share assumptions also informed the different scenarios for the maturity of the benchmark efficient ELNO's customer base – for example, whether it has an existing customer base to defend and (or) seeks to acquire new customers.

Table 5.2 ELNO market share scenarios - IPART assumptions (%)

Market share scenario	2020	2021	2022	2023
New entrant ELNO – Low customer base	2	5	10	15
New entrant ELNO – Medium customer base	5	10	20	30
New entrant ELNO – High customer base	10	20	35	50
Established ELNO – Low customer base	20	20	20	20
Established ELNO – Medium customer base	50	50	50	50
Established ELNO – High customer base	80	80	80	80

Source: IPART.

To demonstrate the effect that market structure has on costs and prices, we modelled two additional scenarios for our Final Report (shown in Figure 5.1 above) including:

- ▼ A benchmark efficient new entrant ELNO with 100% market share, where the modelled price for transfer with financial settlement is around \$66
- ▼ A benchmark efficient established ELNO with 100% market share where the modelled price for a transfer with financial settlement is around \$119.

These scenarios show that efficient costs and prices depend on not only the number of ELNOs in the market, but also whether the market consists of new entrant(s) and/or established ELNO(s). Our considerations for market structure and recommending prices are discussed below.

5.2.2 ELNO cost recovery is sensitive to market share assumptions

AECOM's finding is that ELNOs have relatively high fixed costs (the largest being salary and software development costs) and so they require a high volume of transactions to achieve cost recovery. Demand for eConveyancing is also relatively fixed though it fluctuates with changes in the property market. As a consequence, ELNOs are constrained in their ability to create additional demand for eConveyancing transactions, and so as new ELNOs enter the market, the number of transactions that an existing ELNO can recover costs from will decrease.

Given the current nature of costs and demand for ELNO services, AECOM estimates that a mature eConveyancing market will remain concentrated for full service ELNOs (ie ELNOs with lodgment and financial settlement infrastructure). However, we note that ELNO cost structures may change substantially if technology developments result in efficiencies, and if the nature of services that ELNOs offer changes as the market evolves (See Box 5.2). It is also important to note that competition in the eConveyancing market may take various forms; ranging from a market where several ELNOs operate at a point in time, to a market with fewer ELNOs that compete by displacing competing ELNOs (usually through innovation).

Box 5.2 Costs may change as the eConveyancing market evolves

As discussed above, we appointed AECOM to model costs for a benchmark efficient ELNO, based on current eConveyancing practices and processes. However, ELNO cost structures may change substantially as the market evolves and ELNOs vary:

- ▼ The types of products and services that they offer
- ▼ The way that these services are offered to consumers.

Deloitte, in its report on 'the future of the Australian conveyancing industry 2025 and 2030', estimated that capital expenditure required to develop an eConveyancing platform could vary from \$2 million to \$13 million, depending on how the market evolves.

Deloitte described possible scenarios for the future of the eConveyancing market from 2022 to 2030, which vary based on the following characteristics:

- ▼ Uptake of eConveyancing among practitioners
- ▼ The distinctiveness of conveyancing as a standalone service
- ▼ Degree to which the industry becomes digitally led
- ▼ Number of players in the market (scenarios vary from two to six eConveyancing platform players)
- ▼ Level of integration with other parts of the conveyancing process
- ▼ Degree of automation.^a

Deloitte notes that currently only the preparation, settlement and lodgment of property exchange has been digitally enabled by ELNOs, and that there may further opportunities to digitise other stages of the conveyancing process.

^a ChatBots are an example of Robotic Process Automation (commonly used in industries such as Airlines) which can respond to certain customer queries, but filter complex queries to human operators.

Source: Deloitte, The future of the Australian eConveyancing industry 2025 and 2030, <https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-economics-future-australian-conveyancing-industry-2025-2030-111018.pdf>, accessed 31 October 2019.

5.2.3 ELNOs have substantial intangible assets

Given the nature of software and IT services, when using the building block model to estimate efficient prices for a benchmark ELNO, we considered the initial asset base (as discussed in Box 5.1) and the appropriate method for valuing an ELNO's intangible assets.¹¹⁸ This allows us to determine an allowance for a return on assets to ensure that investment continues into the future to meet growth in demand and to maintain the business's long term viability.

PEXA submitted that determining an initial asset base for a benchmark efficient ELNO (or any ELNO) would be challenging, as a high proportion of ELNO assets are intangible.¹¹⁹ We agree

¹¹⁸ Once the value of the initial asset base is established, this value is 'rolled forward' at the end of each year in a price setting period. That is, it is adjusted to reflect capital expenditure, asset disposals, depreciation and CPI over the year.

¹¹⁹ PEXA submission to the IPART Issues Paper, May 2019, pp 18-19

that one of the key issues in establishing the initial asset base is the approach used to value intangible assets, and whether and how research and development costs should be capitalised for ELNOs. To estimate the efficient valuation of intangible assets, we asked AECOM to model two scenarios:

- ▼ Intangible assets for a benchmark efficient **new entrant** ELNO
- ▼ Intangible assets for a benchmark efficient **established** ELNO.

For a benchmark efficient new entrant ELNO, AECOM estimates that the value of intangible assets would be around \$5.55 million (reflecting the ELNO's capital investment in software development). However, because we are required by the terms of reference to have regard to the extent to which PEXA has invested capital and developed intellectual property (in its capacity as the initial ELNO), AECOM took a different approach to modelling intangible assets for an established ELNO. This is because, PEXA as the first mover, incurred costs from the following activities:

- ▼ Developing the first eConveyancing platform in Australia (and the first of its kind across international jurisdictions). The first mover is likely to incur substantial costs for research and development.
- ▼ Establishing processes and standards that subsequent entrants can then follow, for example, establishing data standards.
- ▼ Building relationships with stakeholders to encourage the uptake of eConveyancing, both from financial institutions and solicitors/conveyancers.
- ▼ Educating subscribers to use an ELNO platform.

5.2.4 Method for valuing PEXA's intangible assets as the initial ELNO

We asked AECOM to estimate the value of intangible assets for a benchmark efficient **established** ELNO, reflecting activities that are unique to the first mover, such as research and development.

In our Issues Paper, we proposed three methods for valuing the first mover's intangible assets, including:

1. **Capital invested approach** - based on research and development costs (and the cost of developing industry acceptance of eConveyancing), capitalising these expenses and look at the balance of these expenses today that remains unamortised.
2. **Discounted cash flow valuation** - estimate expected incremental cash flows generated to the firm by intellectual property. This will require separating out the portion of the aggregated cash flows of a firm that can be attributed to intellectual property and discounting back these cash flows at an appropriate discount rate.
3. **Relative valuation** - estimating the value of intellectual property by looking at how the market values the firm with intellectual property and comparing it with how the market values otherwise similar companies without intellectual property.

Because we do not have information on expected returns for an ELNO, and there is no ELNO operating in Australia without intellectual property, the second and third methods were not

feasible. As a consequence, we used the first method (capital invested approach, ie the efficient cost of the effort undertaken) to estimate the value of intangible assets for a benchmark established ELNO. We applied this to the initial asset base for an established ELNO in the building block model, and found that PEXA's current prices were reasonable compared to all modelled scenarios. This is consistent with our recommendation that ELNO maximum prices should be set at PEXA's current prices and indexed by CPI.

5.3 Maximum prices indexed by CPI will allow competition to develop

Our recommendation is that maximum prices, indexed by CPI, is an appropriate form of regulation while competition in the eConveyancing market develops. This is a less prescriptive form of regulation which will allow new entrant ELNOs to enter the market with prices at or below PEXA's prices. As in other competitive markets, new entrant ELNOs would likely need to offer lower prices or better quality service to gain market share, and so the pricing framework that we have recommended allows new entrant ELNOs to compete with the incumbent ELNO.

Most stakeholders such as ABA, NSW Government, NSW Law Society and Sympli agreed with our recommended form of regulation for ELNOs,¹²⁰ except PEXA, who preferred price monitoring rather than price regulation.¹²¹ We do not agree that price monitoring is appropriate while there is one ELNO in the market with effectively 100% market share,¹²² and consider that price regulation is necessary to protect consumers while competition develops. Consistent with our Draft Report, we recommend that the market should be reviewed again in two years to assess the state of competition in the market, and whether price regulation continues to be appropriate. We consider that price monitoring may be suitable as the market becomes workably competitive, but not while the market remains highly concentrated.

PEXA argued that if price regulation is recommended then prices should be set based on modelled cost scenarios for a benchmark efficient ELNO (rather setting maximum prices at PEXA's current prices). PEXA contended that our recommended approach will stifle innovation and create barriers to entry for new ELNOs.¹²³ We do not agree that recommending prices based on modelled costs for a benchmark efficient ELNO is appropriate in this instance because:

- ▼ Cost modelling is very sensitive to market share and market structure assumptions. Figure 5.1 shows that recommended prices would require us to decide on an appropriate ELNO market share assumption, which assumes a particular market structure.

¹²⁰ ABA submission to IPART Draft Report, September 2019, pp 1-2; NSW Government submission to IPART Draft Report, September 2019, p 3; NSW Law Society submission to IPART Draft Report p, September 2019, p 5; Sympli submission to IPART Draft Report, September 2019, p 6;

¹²¹ PEXA submission to IPART Draft Report, October 2019, p 46.

¹²² While Sympli completed its first transaction in NSW in October 2019, it may take some time for a new entrant to build market share.

¹²³ PEXA, submission to IPART Draft Report, September 2019, pp 45-46.

- ▼ In recommending maximum prices, we considered submissions to our Draft Report and real- world evidence from new entrant ELNOs. New entrants did not raise any concerns that our pricing framework would create additional barriers to entry or innovation.¹²⁴ For example, Sympli announced its entry to the market in 2018 and promised prices that are 15% to 50% lower than PEXA’s (without regulatory intervention). Sympli has published prices on its website in 2019 that are consistent with this announcement.¹²⁵
- ▼ Our pricing framework should ensure that consumers do not pay more for eConveyancing than they did for paper conveyancing (discussed further in Section 5.6). If we were to recommend prices based on modelled cost scenarios for a benchmark efficient ELNO, a number of these scenarios would not meet this objective.

5.3.1 Allowing for pricing innovation and pricing for new services

Competition creates incentives for product and service innovation, which is likely to result in ELNOs varying their service offering and pricing models. To attract and retain customers ELNOs may choose to differentiate their pricing policies from their competitors, for example through offering subscription or membership fees, or other innovative pricing models. While our recommendation is implementing maximum prices (shown in Table 5.1, above) we consider that our pricing framework should be flexible, so that it does not stifle pricing innovation.

Both PEXA and Sympli have published prices based on ‘Transaction Service Fees’ and a fee for the provision of digital certificates (see Box 5.3). However, our pricing framework has considered how ELNOs can vary their prices, while ensuring that prices do not exceed efficient costs (given the current concentrated nature of the eConveyancing market).

Box 5.3 PEXA and Sympli’s current pricing policies (as at July 2019)

- ▼ PEXA currently sets its prices as ‘Transaction Service Fees’ (ie determined by the type of transaction, and whether it includes both lodgment and financial settlement) and a fee for the provision of digital certificates.
- ▼ Sympli has also recently published a pricing policy, which notes that its policy covers Transaction Service Fees (similar to PEXA), but there may be other fees payable by a Subscriber for the provision of additional products or services that are not Transaction Services - these types of products and services will be agreed directly between Sympli and a subscriber.

Source: PEXA Pricing Schedule, <https://www.pexa.com.au/pricing>, accessed 14 August 2019; Sympli Pricing Policy, <https://www.sympli.com.au/wp-content/uploads/2019/07/Pricing-Policy.pdf>, accessed 8 August 2019, p 5.

PEXA does not support our draft recommendation that the sum of the unbundled prices for financial settlement and lodgment components of a service must not exceed the regulated maximum price and that financial settlement is not regulated by the MORs.

¹²⁴ Sympli agreed with our recommended pricing framework and we did not receive any submissions to our Draft Report from Lextech.

¹²⁵ Sympli’s Pricing, <https://www.sympli.com.au/pricing/>, accessed 1 November 2019.

PEXA also submitted that IPART has not demonstrated that regulating new eConveyancing services is necessary nor would a building block approach be the best method to determine regulated prices as PEXA is concerned about the 'significant practical difficulties in applying a building block model to new services where costs are shared across services'¹²⁶. However, we maintain that our pricing framework is appropriate while competition develops in the eConveyancing market, and will ensure that consumers pay no more for eConveyancing than they did for paper conveyancing. In response to submissions, we have made minor changes to our recommendations to provide additional clarity and more flexibility for ELNO implementation. The sections below describe how we recommend that an ELNO should be permitted to vary its prices, while ensuring the prices do not exceed efficient costs. This includes the following scenarios:

- ▼ **Unbundling prices for lodgment and financial settlement:** While PEXA and Sympli's current maximum prices cover both lodgment and financial settlement services, ELNOs may choose to vary their pricing model by charging separate prices for the lodgment and financial settlement components of a service. If an ELNO unbundles its prices, the combination of maximum fees for lodgment and settlement that a subscriber pays should not exceed the regulated maximum price for the bundled service, on a per transaction basis. PEXA disagreed with this recommendation, submitting that cost synergies are not realised when these services are unbundled.¹²⁷ However, we maintain our recommendation because:
 - In most cases, subscribers will require both financial settlement and lodgment to be undertaken together
 - PEXA's price schedule already lists the price for a lodgment-only service, which IPART has recommended is appropriate as a maximum price for all ELNOs.
- ▼ **Maximum prices for ELNO service fees¹²⁸ (excluding transaction service fees)** - we consider that the maximum prices charged for any ELNO service fees (such as for digital certificates) that are not transaction service fees, should be set at direct cost unless an ELNO is approved to charge a higher price by the eConveyancing regulator.
- ▼ **Maximum prices for transactions with multiple titles** - maximum prices for multiple title transactions should be based on:
 - PEXA's current price for a single title, plus
 - Any direct pass through costs (for example, additional LSS fees).¹²⁹

¹²⁶ PEXA submission to IPART draft report, pp 47-48

¹²⁷ PEXA submission to IPART draft report, pp 47-48

¹²⁸ Under the MORs, ELNO service fees means fees charged by the ELNO to a subscriber for access to and use of the ELN. https://www.registrargeneral.nsw.gov.au/__data/assets/pdf_file/0009/436644/Model-Operating-Requirements-Version-5.pdf, accessed 9 August 2019, p 10.

¹²⁹ Currently PEXA charges a separate price for transactions that involve multiple titles. For example, the price for single title transfer with financial settlement is \$114.07, while the price for a multiple title transfer with financial settlement is \$130.68.

- ▼ **Maximum prices for new eConveyancing services provided by, or as part of the ELN-** should not exceed the efficient costs of providing the service (based on the building block methodology or another reasonable method for demonstrating efficient costs) and the ELNO should notify the eConveyancing regulator of the prices four weeks before they are effective.¹³⁰ The notification should be accompanied by a brief notice that explains how the ELNO has estimated efficient costs. If the ELNO considers that the new service is offered in competition with providers (and therefore does not require regulation), the ELNO should demonstrate to the eConveyancing regulator that there is competition for that service and therefore its price would not require regulating.
- ▼ **Subscription or membership fees -** We consider that subscription and membership fees and prices should be unregulated, provided that ELNOs offer subscribers a choice between paying transaction service fees (on a per transaction basis) and a subscription or membership fee. To assist subscribers in making informed decisions about prices, we recommend that ELNOs publish all prices on their website, including any subscription fees.

Recommendations

- 8 If an ELNO unbundles its prices for the financial settlement and lodgment components of a service, then the sum of the separate prices for financial settlement and lodgment components must not exceed the regulated maximum for the bundled price.
- 9 If an ELNO proposes to introduce new eConveyancing services, the ELNO can opt to either a) propose cost-reflective prices to the regulator based on a building block approach (or another reasonable method for estimating costs) OR b) the ELNO can demonstrate to the regulator's satisfaction that the market for a new eConveyancing service is competitive. If the ELNO can demonstrate that the market is competitive, the prices would not be regulated; otherwise, the regulator must determine them. Once approved, prices must be notified to subscribers four weeks before they are effective. Prices must also be published on the ELNO's website.

5.4 Prices for residual dealings that are not yet available for eConveyancing

While most common dealings in NSW are now mandated to be completed electronically, there are some residual dealings that can currently only be completed on paper.¹³¹ Our pricing framework has addressed how those residual documents should be priced if they are made available for eConveyancing before the next pricing review, based on PEXA's approach to pricing "other land registry documents" and indexed by CPI annually (see Table 5.3).¹³²

For example, PEXA and NSW LRS are yet to offer services for a number of small volume transactions, such as change of name, transfer of lease and postponement of mortgage.

¹³⁰ NSW Law Society submitted to our Draft Report that the concept of a "new eConveyancing service" requires further clarification. Two weeks' notice is insufficient having regard to the cost disclosure obligations, and suggested that four weeks is more appropriate. NSW Law Society submission to IPART Draft Report, September 2019, p 5.

¹³¹ NSW ORG, Schedule of eDealings, <https://www.registrargeneral.nsw.gov.au/eConveyancing/schedule-of-e DEALINGS>, accessed 16 August 2019.

¹³² PEXA, Other Land Registry Documents, <https://www.pexa.com.au/other-land-registry-documents-pricing>, accessed 16 August 2019.

As a consequence, we consider that as residual dealings become available for eConveyancing, ELNOs and NSW LRS should work together to determine the appropriate category for each dealing, based on the following categories:

- ▼ Record an interest (with and without financial settlement)
- ▼ Vary an interest (with and without financial settlement)
- ▼ Discharge an interest (with and without financial settlement)
- ▼ Change ownership (with and without financial settlement)
- ▼ Act on a land title (with and without financial settlement)

We have recommended a maximum price for each category, based on PEXA's current pricing schedule, as shown in Table 5.3. PEXA submitted that it would not be appropriate to extend this assessment to prices for dealings that are not currently offered, because PEXA will not know the actual costs of providing these dealings until they are in fact offered.¹³³ In response to PEXA's submission we recommend that if an ELNO considers that the cost of offering these dealings is substantially different from the recommended prices shown in Table 5.3, then the ELNO should seek approval from the eConveyancing regulator to set prices for residual dealings on a cost- basis.

Table 5.3 Residual dealing maximum prices (\$) inc GST as at 1 July 2019

Classification	IPART recommended maximum real price (single title)
Record an interest	42.79
Vary an interest	42.79
Discharge an interest	20.68
Change ownership	114.07
Act on a land title	16.06
Record an interest with financial settlement	57.20
Vary an interest with financial settlement	57.20
Discharge an interest with financial settlement	42.24
Change ownership with financial settlement	114.07
Act on a land title with financial settlement	30.91

Source: PEXA approach to pricing "other documents", <https://www.pexa.com.au/other-land-registry-documents-pricing>.

Recommendation

- 10 Maximum prices for each category of residual dealing made available for eConveyancing be set as shown in Table 5.3 and indexed annually by CPI, unless otherwise approved by the eConveyancing regulator on a cost-basis. ELNOs and NSW LRS work together to determine the appropriate category for each dealing.

¹³³ PEXA Submission to IPART Draft Report, October 2019, p 48.

5.5 Incorporating additional costs into ELNO prices

Our terms of reference requires us to recommend a maximum price or pricing methodology for ELNO services, which may include any pass through mechanisms. Because we are making recommendations that will impact ELNO costs, our pricing framework needs to address how these additional costs will be reflected in ELNO prices, as well as a mechanism for any other relevant pass through costs that are imposed on ELNOs.

5.5.1 Interoperability costs

As discussed in Chapter 4 we are recommending interoperability be implemented in the eConveyancing market. Each ELNO would incur some costs to implement interoperability, however, the incremental cost of establishing interoperability between the two current ELNOs is relatively low (regardless of whether direct connections or an infrastructure ELNO is chosen).

Ultimately the interoperability and timing for implementation is a decision of the eConveyancing regulator. However, we consider that it is reasonable for the efficient costs incurred by ELNOs to be reflected in maximum prices. We recommend that the eConveyancing regulator reviews the implementation costs associated with interoperability to be reflected in maximum prices as part of its decision. This could be guided by IPART's review and our cost consultant's work.

5.5.2 Revenue NSW costs to ELNOs

We have also recommended prices that Revenue NSW can charge ELNOs to recover some of their additional costs associated with eConveyancing (see Chapter 7). While we consider it is appropriate that Revenue NSW recovers its costs from ELNOs for the provision of duties verification services, we consider that ELNOs should not be able to increase their prices. It is possible for ELNOs to avoid these charges, and so permitting ELNOs to pass through these costs would remove the incentive for ELNOs to reduce support inquiries and testing activities with Revenue NSW. We note that both PEXA and Sympli submitted that if Revenue NSW is permitted to charge additional fees to ELNOs, ELNOs should be able to pass through these costs in a transparent manner or include these fees as part of an ELNO's efficient costs.¹³⁴ While PEXA argued that ELNOs have no direct control over the costs that Revenue NSW incurs, Chapter 7 explains that we have recommended Revenue NSW prices to ELNOs which recover only the costs that ELNOs can avoid.

5.5.3 The MORs address appropriate treatment of other pass through costs

We are satisfied that the MORs address the appropriate treatment of any other pass through costs that may be imposed on ELNOs. Currently the MORs permit an ELNO to request the Registrar General's approval for proposed changes to its pricing schedule, in the event:

¹³⁴ PEXA submission to IPART Issues Paper, May 2019, p 25; Sympli submission to IPART Issues Paper, May 2019, p 4.

- ▼ Of any changes to insurance premiums payable by the ELNO (for insurance policies that it is required to hold under the MORs)
- ▼ That a change in law gives rise to any changes in operating costs for the ELNO
- ▼ That additional fees or costs are imposed on the ELNO by the Registrar, Land Registry or other government agency.¹³⁵

As a consequence, we do not recommend any additional measures for pass through mechanisms, but consider that this should continue to be monitored in future reviews by the eConveyancing regulator.

Recommendation

- 11 ELNOs be able to pass through as an additional charge the efficient costs of implementing interoperability. Because these costs are not yet known, they should be reviewed at the next review of the pricing framework at the end of two year regulatory period, or sooner if an interoperability model is implemented sooner.

Finding

- 6 The MORs address the appropriate treatment of pass through costs, such as ELNO insurance premiums, fees imposed by external agencies and changes in the law.

5.6 PEXA's prices are no higher than paper conveyancing prices

In our Issues Paper, we proposed to consider benchmarking eConveyancing prices to paper conveyancing prices as a cross check for the building block model, and to ensure that consumers are no worse off under eConveyancing than paper conveyancing. Stakeholders such as the NSW Law Society supported this approach to recommending prices.¹³⁶

To do this, we collected information on prices for paper conveyancing and found that solicitors and conveyancers are no worse off under PEXA's current eConveyancing prices, and that, if cost savings from no longer requiring settlement cheques are included, they in fact may save up to \$66 per transaction.

To compare paper and electronic conveyancing prices, we collected pricing information from paper settlement agents, who were commonly used by solicitors and conveyancers, and typically performed the same functions that ELNOs now complete electronically (see Table 5.4).

¹³⁵ Model Operating Requirements Version 5, https://www.arnecc.gov.au/__data/assets/pdf_file/0007/1426156/model-operating-requirements-5-clean.pdf, accessed 19 August 2019.

¹³⁶ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 5.

Table 5.4 Paper settlement agent services and equivalent ELNO services

Paper settlement agent service	ELNO service
Meet with other participants (or their representatives) at an agreed settlement venue to exchange the certificate of title, cheques, sign documents and pay duties (if required).	Facilitate the exchange of electronic documents in a virtual workspace.
Bank cheques following settlement (to pay the outgoing mortgagee, the vendor's proceeds of the sale, council rates, real estate agent commission and any other relevant disbursements).	Disburse settlement funds electronically.
Lodge documents in person at the NSW LRS counter, to register changes to land title records.	Lodge documents electronically with NSW LRS.
Receive new title from NSW LRS and notify solicitor/conveyancer/financial institution that registration is successful.	ELNO receives confirmation from NSW LRS that registration is successful and notifies subscriber.

Note: After the exchange of contracts, paper settlement agents were given instructions from solicitors/conveyancers to complete some or all of the above activities.

Source: IPART.

Table 5.5 shows average prices as at June 2019 for paper settlement agent services (\$304), and compares them to eConveyancing prices (\$238). It also shows that a solicitor/conveyancer would pay around \$66 less for eConveyancing, than for a paper settlement.¹³⁷ This assumes, however, that the average cost of cheques for a paper settlement is around \$70, and so the savings vary depending on the type of transaction (which would affect the number of cheques required).

Table 5.5 also shows that some paper settlement agent firms are offering electronic settlement (e-settlement) services for solicitors/conveyancers, who prefer to outsource the activities that they undertake in the ELNO workspace.¹³⁸ The average price for e-settlement agent services has been included in our estimate for total average costs per eConveyancing transaction, because it captures the time (and costs) that a solicitor/conveyancer would incur in the ELNO workspace.

¹³⁷ This assumes that for eConveyancing, the solicitor/conveyancer pays the PEXA transfer fee of \$112 and the e-settlement agent fee.

¹³⁸ We found that there is substantial variation in the activities that electronic settlement agents offer to solicitors and conveyancers.

Table 5.5 Average paper conveyancing and eConveyancing prices- June 2019 (\$) inc GST

Services provided to solicitors/conveyancers	Average price per transaction
Paper conveyancing - agent fee	101
Paper conveyancing - duties payment fee	43
Paper conveyancing - banking fee	27
Paper conveyancing- final search fee	30
Paper conveyancing - NSW LRS lodgment fee	42
Paper conveyancing - Average cost of cheques ^a	70
Paper conveyancing- total average cost (sum of all services above)	304
eConveyancing - e-settlement agent service	125
eConveyancing - PEXA fee for transfer document with financial settlement	112
eConveyancing - total average cost (e-settlement agent fee + PEXA fee for a transfer)	238

^c Based on KPMG estimate for average cost of cheques, assuming that each settlement requires seven cheques, https://www.registrargeneral.nsw.gov.au/__data/assets/pdf_file/0003/331095/eConveyancing-Final-Report.pdf, p 12.

Source: IPART, information collected from settlement agents, PEXA website.

Finding

- 7 IPART’s recommended pricing framework for eConveyancing will ensure consumers pay no more for eConveyancing than they did for paper conveyancing.

5.7 Our recommended pricing framework could be adopted nationally

While stakeholders expressed a strong preference for nationally consistent prices (see Box 5.4), there may be differences in costs across jurisdictions, and so ELNOs should be free to vary prices by jurisdiction. While we have assessed efficient costs for ELNOs operating in NSW only, and concluded that PEXA’s current national prices are reasonable, we consider that other jurisdictions could adopt a similar framework for recommending ELNO prices.

In our Issues Paper we noted that ELNOs are required by the MORs to offer services in all jurisdictions, but may do so in accordance with the ELNO’s business plan.¹³⁹ Currently both PEXA and Sympli offer nationally consistent prices, on the basis that they have national infrastructure and relationships with financial institutions (which also operate nationally).

Our terms of reference requires us to have regard to differences in costs of providing services between jurisdictions for nationally consistent pricing. We consider that nationally consistent pricing is a commercial decision, and that ELNOs should not be required to do so.¹⁴⁰ This is because our analysis showed that cost reflective prices in each jurisdiction may differ substantially, because:

- ▼ Each jurisdiction has its own land registry and revenue office, and so the costs of an ELNO connecting to these agencies may vary.

¹³⁹ MORs version 5, Section 5.2.

¹⁴⁰ NSW Government submitted to our Draft Report that ELNOs are not currently required to offer national prices, however we consider that it is within the scope of IPART’s terms of reference to consider whether ELNOs should be required to do so. NSW Government submission to IPART Draft Report, October 2019, p 7.

- ▼ The number of transactions ELNOs can recover costs from will also vary by jurisdiction (based on different property market conditions in each state). As discussed above, our assessment of prices that reflect efficient costs was highly sensitive to transaction volume assumptions.

While ELNOs currently publish national prices, they should be able to vary prices in each jurisdiction. We consider that the framework that we have applied to modelling efficient costs and prices could be adopted by the national eConveyancing regulator.

Recommendation:

- 12 ELNOs not be required to offer nationally consistent pricing, but they may choose to do so on a commercial basis.

Finding:

- 8 Other jurisdictions could adopt a similar framework for recommending ELNO prices.

Box 5.4 Stakeholder views on national prices

- ▼ The Australian Banking Association (ABA) emphasises that IPART’s review should be conducted with reference to the importance of a nationally consistent approach to eConveyancing. The ABA notes that state-based variations within the national framework are likely to add to the costs and risks of eConveyancing participants. The ABA estimates that the current level of variation between states with regard to eConveyancing adds around 10 to 15% to member banks’ costs.¹⁴¹
- ▼ PEXA considers that economies of scale, national regulatory arrangements and national level infrastructure led it to set national prices and would drive any other efficient new entrant ELNO to do likewise (noting that financial institutions also have national pricing regimes); however, PEXA also cautions against a pricing regime that permits new entrant ELNOs to cherry-pick profitable jurisdictions. PEXA also notes that as a result of its national pricing regime, it does not allocate costs by jurisdiction.¹⁴²
- ▼ The Law Society supports nationally consistent pricing for administrative simplicity and the resulting lower administrative costs.¹⁴³

Source: Stakeholder Submissions to IPART Issues Paper

¹⁴¹ Australian Banking Association submission to the IPART Issues Paper, April 2019, p 4.

¹⁴² PEXA submission to the IPART Issues Paper, May 2019, p 20.

¹⁴³ The Law Society of NSW submission to the IPART Issues Paper, April 2019, p 6.

6 Pricing for NSW Land Registry Services

Our terms of reference for this review ask us to recommend a price or pricing methodology for services NSW LRS provides to ELNOs. When finalising the terms of reference, NSW ORG advised of NSW LRS's intention to introduce fees for ELNOs attributable to costs of building new systems, testing and ongoing maintenance.¹⁴⁴

The proposed new fee is in addition to the existing **lodgment support service** (LSS) fees that NSW LRS already charges ELNOs. LRS also charges **registration fees** to parties to a property transaction which ELNOs collect on LRS's behalf. These fees are outside the scope of this review.

Rather, the price we have been asked to advise on relates to additional investment in the technology platform to enable NSW LRS to connect to multiple ELNOs. NSW LRS seeks to recover the costs of the new system from the ELNOs that connect to it via the new platform.

The sections below set out our finding that NSW LRS should be able to absorb the cost of expenditure on technology upgrades and discuss the analysis that led to it in more detail. This is the same as our draft finding.

6.1 Our finding on NSW LRS pricing

We found that NSW LRS should be able to absorb the cost of any incremental investment in technology to permit connection by multiple ELNOs.

We consider that providing appropriate technology to connect to ELNOs, whether one or multiple, is a core business requirement for NSW LRS. NSW LRS charges LSS fees to ELNOs which should cover the costs of connections to ELNOs, and these fees would be expected to cover the costs of the technology as it is maintained and upgraded over the period of the concession.

NSW LRS has also been able to reduce its costs significantly as a result of the transition from a wholly paper-based conveyancing process to a majority eConveyancing environment, and has not been required to reflect those lower costs in lower prices. If they are able to realise the gains of cost savings, they should symmetrically be expected to absorb cost increases.

Finding

- 9 NSW LRS can absorb the cost of modifying its technology platform to permit connection by multiple ELNOs.

¹⁴⁴ Office of the Registrar General submission to Draft Terms of Reference, 4 December 2018, p 1.

6.2 NSW LRS currently charges fees to PEXA

NSW LRS currently operates a technology platform that only connects PEXA.¹⁴⁵ NSW LRS charges LSS fees (per transaction) to PEXA. The LSS fees were established prior to LRS obtaining the concession for the land registry, and are regulated in the same way as LRS's registration fees: set initially in the *Real Property Regulation 2014* and indexed by CPI annually for the 35-year term of the concession. The schedule of LSS fees for 2019/20 is set out in Table 6.1.

Table 6.1 LSS fees to ELNOs (2019-20)

Category	Electronic services	Fees (including GST) (\$)
LSS 1	Initial supply of title data, verifications that documents are in an appropriate form for electronic lodgment and automated checks for changes in title data initially supplied	14.79
LSS 2	Initial supply of title data, verifications that documents are in an appropriate form for electronic lodgment	9.86
LSS 3	Supply of updated title data following changes in title data initially supplied	4.94

Source: Land Registry Services, *2019/20 Fees*, June 2019; *Real Property Regulation 2014*, Schedule 1 Fees, http://www.nswlrs.com.au/land_titles/current_nsw_land_registry_fees accessed 2 August 2019.

In our Draft Report, we stated that “NSW LRS charges LSS fees to PEXA to recover the capital and operating cost of the technology platform as well as other operating costs associated with electronic conveyancing”.

NSW LRS submitted that we had mischaracterised the LSS fees, because the LSS fees were introduced (by the Government, prior to the concession sale) to offset the decline in use of final title searches as eConveyancing increased and paper settlements decreased.¹⁴⁶ We consider that, whatever the context for the initial establishment of LSS fees, costs associated with connections to ELNOs are appropriately allocated to per-transaction fees (ie, the LSS fees) charged to ELNOs.

PEXA's submission to our Draft Report agreed that NSW LRS should be able to absorb the cost expenditure on technology upgrades, but argued that the cost of the investment should be recovered from second and future ELNOs. However, we note that if LRS were allowed to introduce a new price to recoup its investment in a multi-ELNO platform, the price should be charged to all ELNOs, including PEXA, just as the LSS fees are charged to all ELNOs, not just PEXA.

6.3 NSW LRS has developed a new multi-ELNO technology platform

NSW LRS has incurred costs to develop a multi-ELNO platform.¹⁴⁷ It will also incur costs to maintain and operate the platform, but in response to a request for information, NSW LRS

¹⁴⁵ NSW LRS submission to IPART Issues Paper, 30 April 2019, p 2.

¹⁴⁶ NSW LRS submission to IPART Draft Report, 1 October 2019, p 1.

¹⁴⁷ NSW LRS submission to IPART Issues Paper, 30 April 2019, p 2.

submitted that it sought to recover only the capital costs of its investment in a new system for connecting with ELNOs.¹⁴⁸

We considered whether NSW LRS should be permitted to recover this incremental cost via an additional fee, and in our Draft Report we concluded that the expenditure was best categorised as expenditure on technology to provide an existing service, rather than a new service for which the expenditure could be separately recovered. The regulatory framework for eConveyancing has always allowed for the entry of new ELNOs, so the requirement for LRS to have a platform to which multiple ELNOs could connect is integral to delivering LSS. LRS could therefore be expected to be able to recover these costs through the existing LSS fees.

NSW LRS submitted that it “invested in the new multi-ELNO platform to the timetable and specification supported by the Registrar General on the understanding that incremental cost recovery over the remaining duration of the concession would occur at a rate determined by IPART”.¹⁴⁹

We asked our cost consultant AECOM to assess the cost of accelerating the investment, and they concluded that it was not material, because it is unlikely to have increased the costs in total.¹⁵⁰

6.4 NSW LRS has realised cost savings from the transition to eConveyancing

We noted in our Issues Paper that there may be some cost savings to NSW LRS as a result of lodgment via ELNOs, and these should be taken into consideration when setting prices for the services NSW LRS provide to ELNOs.

In response to our Issues Paper, NSW LRS submitted that “all cost savings to NSW LRS resulting from electronic settlement services were available to NSW LRS under its previous technology platform, which only connected PEXA”.¹⁵¹

We consider that the savings available to NSW LRS under its previous technology platform are relevant to our consideration of NSW LRS’s proposed additional fee. NSW LRS has experienced savings from the transition to eConveyancing, a much more automated and lower-cost process than paper conveyancing. The prices that applied for registration of documents in 2017 were recovering the costs of manual paper transactions, which at the time constituted more than 80% of transactions; as at July 2019 paper transactions constituted only 6% of transactions, and this number is projected to be 100% by 2021/22.¹⁵² However, the regulatory regime for registration prices does not require savings to be reflected in lower prices.

¹⁴⁸ NSW LRS information return, 10 May 2019.

¹⁴⁹ NSW LRS submission to IPART Draft Report, 1 October 2019, pp 1, 3.

¹⁵⁰ AECOM, *Estimating costs of electronic conveyancing services in NSW*, November 2019, p 45.

¹⁵¹ NSW LRS submission to IPART Issues Paper, 30 April 2019, p 1.

¹⁵² Deloitte Access Economics, *Impact of e-Conveyancing on the Conveyancing Industry*, May 2018, <https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-economics-impact-e-conveyance-pexa-220518.pdf>, p 2 and p 15 for 2016-17 take-up rates and 100% digital projected date; ORG website <https://www.registrargeneral.nsw.gov.au/eConveyancing/eConveyancing-Statistics>, accessed 18 August 2019 for July 2019 figures.

NSW LRS submitted on our Draft Report that new costs have arisen as a result of eConveyancing, as well as savings, and that it is inconsistent that IPART is allowing Revenue NSW the opportunity to recover costs of building and testing systems but not NSW LRS.¹⁵³ We note that:

- ▼ NSW LRS is already recovering costs via LSS fees, while Revenue NSW has no existing fees for ELNOs
- ▼ As a result of eConveyancing, Revenue NSW undertakes additional functions to provide electronic settlement services, and therefore it is appropriate for it to recover some of those costs through prices to ELNOs.

Similarly to the way that NSW LRS has been able to realise the additional savings from increased eConveyancing volumes, we consider they can absorb the cost from their additional expenditure on a multi-ELNO platform.

Box 6.1 provides some additional information on what would be the efficient incremental costs to develop a multi-ELNO technology platform.

¹⁵³ NSW LRS submission to IPART Draft Report, 1 October 2019, p

Box 6.1 Incremental efficient costs to develop a multi-ELNO platform

At the beginning of our review we asked our cost consultant, AECOM, to estimate the costs of a benchmark efficient land registry developing a multi-ELNO technology platform. AECOM estimated these costs as \$4.2 million, of which approximately 30% was attributable to a document management system, which is independent of the number of ELNOs connected. Thus their estimate of the efficient incremental cost to LRS of upgrading their technology platform was \$2.9 million.¹⁵⁴ AECOM also advised that a 5-year depreciation period would be appropriate for software investment.

AECOM's estimate of \$2.9 million is the quantum of incremental costs attributable to the replacement of a single-ELNO connection with a multi-ELNO connection. For illustration, if NSW LRS were to be allowed to introduce a new price to recover these costs (from all ELNOs connected to the new platform), we would apply a simplified (because there are no operating costs) building block model

The building block approach is commonly used by IPART and other regulators to estimate the total revenue a business needs to generate to recover the efficient costs of providing services to the required standard over the price determination period. The building block approach typically includes the following components:

- ▼ An efficient level of operating expenditure (operating, maintenance and administration expenses) – but NSW LRS did not seek to recover operating expenditure, so we did not include this component
- ▼ An allowance for a return on assets, which represents the cost of capital invested in a benchmark efficient business through equity and debt markets, and requires us to:
 - Determine the value of the initial asset base – in this case, \$2.9 million
 - Decide on an appropriate rate of return (the WACC) – in this case, 3.7% post-tax real^a
 - Multiply the value of the asset base by the rate of return
- ▼ An allowance for a return of those assets (depreciation)
- ▼ An allowance for tax and working capital.

We then forecast the total number of eConveyancing transactions in NSW over the regulatory period. Using Deloitte's forecast number of conveyancing transactions from 2020 to 2025 and calculations, and assuming that around 36% of these transactions occur in NSW.

These steps allow us to estimate an efficient real price of 82 cents per transaction that would enable NSW LRS to recover its \$2.9 million efficient costs over the regulatory period of five years.

^a For more information on the WACC that we have estimated for NSW LRS, see Appendix C.

Source: AECOM and IPART calculations, Deloitte Economics, *The future of the Australian conveyancing industry 2025 and 2030*, June 2018, p 57.

¹⁵⁴ AECOM, Estimating costs of electronic conveyancing services in NSW, August 2019, p 53.

7 Prices for Revenue NSW services to ELNOs

Revenue NSW has incurred (and is incurring) costs to facilitate electronic settlements by building and testing new systems and performing ongoing support and maintenance for ELNOs. IPART has been asked to recommend prices, or a pricing methodology, to recover these costs.

To reach our recommendations, we posed a threshold question about whether a taxing agency should charge for performing its core function (collecting taxes) before considering how those charges should be recovered. We then considered:

- ▼ Which costs should be recovered through prices to ELNOs
- ▼ What form of price regulation is appropriate
- ▼ How prices should be adjusted from year to year.

We examined information provided by Revenue NSW on its costs and cost structure for services to ELNOs and considered stakeholder comments on this issue. The sections below summarise our findings and recommendations, then discuss the evidence and analysis that underpins them.

7.1 Summary of findings and recommendations on prices for Revenue NSW services

Revenue NSW should charge ELNOs for the provision of services related to duties verification as this service is outside its core business of collecting taxes. As a result of eConveyancing, Revenue NSW undertakes additional functions to provide these services, and therefore it is appropriate for it to recover costs through prices to ELNOs.

However, because some of the costs that Revenue NSW incurs are not influenced by an ELNO's actions or decisions, we consider that the prices it charges to ELNOs should only partially recover these costs. We also consider that prices that recover Revenue NSW costs should apply to all ELNOs to ensure competitive neutrality, and that these prices should not discourage innovation for ELNOs. The costs that we consider Revenue NSW should recover through prices to ELNOs include:

- ▼ The costs related to providing ELNO subscriber support
- ▼ Support activities for ELNO product releases (that do not result in a change to Revenue NSW's systems) that exceed base level frequency
- ▼ Providing services to ELNOs which result in a change to Revenue NSW's systems.

We consider that the appropriate form of price regulation is maximum prices that are directly connected to ELNOs' actions (or their subscribers' actions), as this will encourage efficient use of Revenue NSW services. Our recommended maximum prices are shown in Table 7.1 below. These prices are based on information provided by Revenue NSW and reviewed for efficiency

by our cost consultant AECOM, on the efficient costs that Revenue NSW incurs or expects to incur in providing duties verification services. In response to our Draft Report, Revenue NSW proposed some changes to its cost information and price proposal and also clarified some of the terminology that it uses to describe services to ELNOs.¹⁵⁵ We agree with most of Revenue NSW's revised proposal and have altered our final recommendations accordingly. The prices that we recommend and the changes between Draft and Final Report are shown in Table 7.1.

In addition, including Revenue NSW in the governance and change framework for eConveyancing would reduce the total costs of its duties verification services to the industry.

Table 7.1 Revenue NSW maximum prices to ELNOs (real \$2018-19)

Revenue NSW costs imposed by ELNOs	IPART Draft maximum price to ELNOs	IPART Final maximum price to ELNOs
Costs relating to ELNO subscriber support	\$15.20 per support inquiry to Revenue NSW (based on reported Revenue NSW costs)	\$608,000 per annum with ELNOs to pay a share of these costs, proportional to each ELNO's share of inquiries generated ^c
Support activities for ELNO product releases that exceed base level frequency. (Base level is two major and two minor releases per year, per ELNO) ^a	\$125,000 per ELNO for each product release that exceeds base level frequency	\$38,000 for each major release \$21,000 for each minor release that exceeds base level frequency
Services provided to ELNOs (that result in a change to Revenue NSW's systems) ^b	Costs are likely to vary, and so Revenue NSW and ELNOs should negotiate a price for these activities through contractual arrangements (with any disputes being resolved by the national regulator)	No change

a Referred to as 'testing activities' in our Draft Report

b: Referred to as 'bespoke' services in our Draft Report

c: This price is based on the same quantum of costs outlined in our Draft Report. The difference in price is largely driven by the method of recovery.

Source: NSW Government submission to IPART Draft Report, October 2019, pp 8-11.

7.2 Revenue NSW should charge for duties verification services

In our Issues Paper, we noted that because Revenue NSW's role is to collect transfer duties it may not be appropriate to charge ELNOs fees for a system that assists Revenue NSW to perform its primary function of collecting a range of taxes, duties and levies.

To examine this issue, we held discussions with Revenue NSW and considered information it provided on its role in the eConveyancing process, and the costs that it incurs in performing this role. We found that as a result of eConveyancing, it:

- ▼ Undertakes additional functions to enable ELNOs to verify that duties have been paid, or whether duties need to be paid at financial settlement. We consider that this duties verification service is outside its core business of collecting taxes.

¹⁵⁵ NSW Government submission to IPART Draft Report, October 2019, p 3.

- ▼ Has incurred costs and is likely to continue to incur costs to undertake these additional functions.

For these reasons, we are satisfied that Revenue NSW should charge ELNOs for some of the costs that it incurs as a result of providing a duties verification service. Our reasoning for recovering each type of cost is explained below.

7.2.1 Revenue NSW undertakes additional functions to provide duties verification services

Revenue NSW administers State taxation and revenue, including transfer duties which amounted to around \$7.6 billion in NSW in 2018-19.¹⁵⁶ Because section 301 of the Duties Act 1997 requires that a transfer of ownership cannot be registered without first confirming that duties have been paid, duties **verification** plays an essential role in the conveyancing process in NSW.¹⁵⁷ Revenue NSW has an electronic duties return (EDR) system for invoicing and collecting transfer duties, and also maintains other manual payment channels.¹⁵⁸ In an eConveyancing transaction, a practitioner can use EDR or manual payment channels for paying duty in advance and then the ELNO connection to Revenue NSW confirms that the duty has been paid; **or** the transfer duty can be a disbursement at the time of settlement, in which case the ELNO connection to Revenue NSW is used for payment as well (see Box 7.1 for more information on the steps in the duties verification process).

Under the paper conveyancing system, duties were typically paid with a cheque at settlement, and then details of the property transaction were verified by NSW LRS counter staff (by manually accessing Revenue NSW's database via an electronic portal) when documents were lodged for registration (which may have been several days after settlement).¹⁵⁹ If the duties details did not match the property transaction details (eg, name, land details, dutiable amount), the documents were requisitioned back to the lodging party to correct. Only if there was a tax issue (eg, dutiable amount discrepancies due to particular circumstances of the transaction) did Revenue NSW become involved.

However, with the introduction of eConveyancing, the ELNO service replaces the NSW LRS verification service (because the ELNO has connections to Revenue NSW's system to verify that duties have been paid), as shown in Figure 7.1.

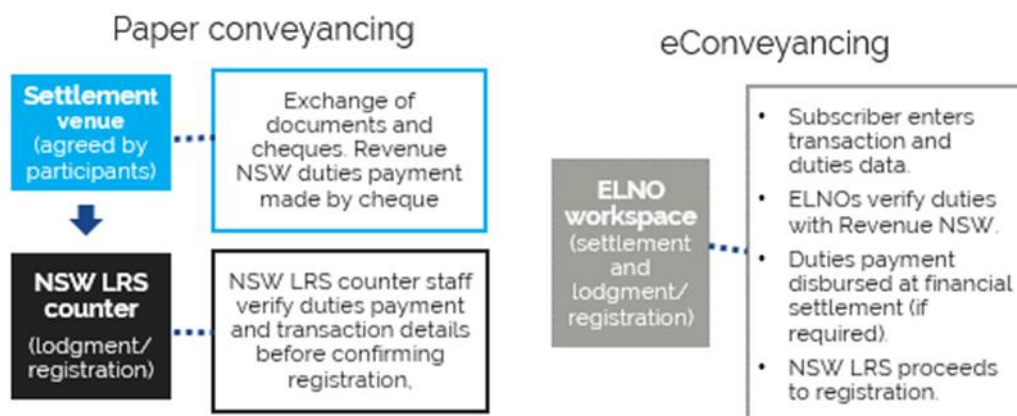
¹⁵⁶ Revenue NSW Data and Statistics, <https://www.revenue.nsw.gov.au/help-centre/resources-library/statistics>, accessed 16 August 2019.

¹⁵⁷ Revenue NSW Submission to the Issues Paper, May 2019, p 4.

¹⁵⁸ For example, Revenue NSW still performs commissioner assessments on paper.

¹⁵⁹ The duties verification service consisted of a web service which NSW LRS counter staff used to validate party, property and price information.

Figure 7.1 Duties payment verification under paper conveyancing and eConveyancing



Note: Under both paper and eConveyancing, duties can be paid in advance of settlement.

Source: IPART, information provided by Revenue NSW.

Box 7.1 Steps in eConveyancing duties verification process

To complete the duties verification process in an eConveyancing transaction, the following steps typically occur:

- ▼ Subscriber obtains duties assessment via EDR service (a service that allows an approved holder (Electronic Duties Return client) to electronically assess and endorse a range of duties transactions, including transfer duty).^a A duties assessment number (DAN) is issued to identify the transaction. The subscriber should manually check that data entered via EDR matches data entered in ELNO workspace, including:
 - Land details (title reference or property description)
 - Transferee details
 - The consideration (dutable amount)
- ▼ Subscriber enters DAN into ELNO workspace
- ▼ Revenue NSW's system then verifies that duties assessment details match property data entered in ELNO workspace
- ▼ If verification is successful, Revenue NSW's system will return the duties payable (if any) and the required payment information to the ELNO
- ▼ If the verification is unsuccessful, subscriber will see an error message. The transaction cannot progress until the error is resolved and a successful verification is received. Where the error relates to the data entered in the ELNO workspace, the subscriber can correct the data and resubmit the information in the ELNO workspace for a further verification. However, where the error relates to the data entered when creating the duties assessment, the error must be corrected by Revenue NSW, and so the subscriber must contact Revenue NSW (by phone or email) to resolve it.

^a Clients must register for Electronic Duties Return by engaging an approved Client Service Provider who completes all Revenue NSW transactions on their behalf. Clients then send information to Revenue NSW through their Client Service Provider.

Source: <https://www.revenue.nsw.gov.au/help-centre/resources-library/gd002.pdf>, accessed 9 July 2019.

7.2.2 Revenue NSW has incurred and will continue to incur costs to undertake the duties verification function

Revenue NSW incurs a range of costs as a consequence of performing its additional duties verification function:¹⁶⁰

- ▼ The current Revenue NSW system was set up for a single ELNO, PEXA. As new ELNOs enter the market, Revenue NSW incurs costs from ELNOs building gateway systems to interrogate Revenue NSW systems.
- ▼ Revenue NSW manages data standards and compliance with the Revenue Office Messaging Standards.¹⁶¹
- ▼ Once new ELNOs are on-boarded, Revenue NSW continues to incur costs from maintaining connections between the ELNO and Revenue NSW systems (eg testing, patching and ELNOs releasing new products and document types).
- ▼ Subscribers frequently require support from Revenue NSW to resolve data matching errors. This typically occurs when the duties assessment data in the EDR system does not match the data in the ELNO workspace, and subscribers contact Revenue NSW to resolve the error. In this situation, Revenue NSW bears some of the cost of providing support to the ELNO's subscribers.¹⁶²

7.3 Revenue NSW should only partially recover the costs of verification services from ELNOs

The costs Revenue NSW incurs in providing duties verification services to ELNOs (discussed above) do not result in additional benefits to Revenue NSW, and are not necessarily connected to its actions or decisions.¹⁶³ Therefore, to decide how Revenue NSW should recover these costs, we considered whose actions or decisions drive costs for Revenue NSW.

We found that multiple parties benefit from Revenue NSW's duties verification services, including:

- ▼ **ELNOs** (who benefit from offering a broader and more efficient service to subscribers, therefore enhancing their business model)
- ▼ **NSW LRS** (whose counter staff no longer have to confirm duties payment before proceeding to registration of the transfer of ownership, resulting in substantial cost savings to NSW LRS)
- ▼ **Subscribers and property buyers** (who no longer have to pay duties with a cheque at settlement).

¹⁶⁰ For example, the IGA review notes that the cost to titles and revenue offices to connect to a new ELN are estimated to be from a few hundred thousand dollars to five million dollars.

¹⁶¹ NSW Government submission to IPART Draft Report, October 2019, p 7.

¹⁶² These costs are imposed by external parties and cannot be avoided by Revenue NSW (because data mismatching is often due to incorrect subscriber data entry, or an error in the ELNO interface).

¹⁶³ Prior to the inclusion of duties verification in eConveyancing, Revenue NSW received duties payment, and did not have to undertake an additional compliance function.

We also found that multiple parties impact on the costs Revenue NSW incurs to provide duties verification services, including:

- ▼ **ELNOs** (whose interfaces may be the source of errors but are not incentivised to fix them because Revenue NSW bears the cost of the problem, and whose routine product upgrades and changes create costs for Revenue NSW, who must assist with testing)
- ▼ **Subscribers** (who may be the source of mis-keying errors due to poor data entry, and other administrative errors)
- ▼ **ARNECC and NSW ORG** (who determine the schedule for making dealings available electronically and for new ELNOs to enter the market).

In addition, the NSW Government contributed to the decision to include duties verification in the eConveyancing process (and has now mandated its use). We understand that this decision was intended to safeguard property settlements from failing, which was the Government's primary goal for eConveyancing. As a consequence, we consider that prices to ELNOs should only recover the costs that ELNOs can influence. We note Revenue NSW's view that partial cost recovery for government services is generally inappropriate.¹⁶⁴ However, in this instance, we consider that prices that Revenue NSW charges to ELNOs should only partially recover the costs it incurs to provide duties verification services, because:

- ▼ Charging ELNOs for all activities (including those that are unavoidable) could be a barrier to entry and innovation. We consider that the parties who can influence the costs are in the best position to bear them.
- ▼ PEXA has already been on-boarded, and so charging only new entrants would provide it with an unfair advantage over its competitors. As a consequence, any new fees should apply consistently to all ELNOs.

7.4 Prices to ELNOs should recover only the costs that ELNOs can avoid

Revenue NSW provided information on the range of cost items it incurs in providing duties verification services. For each cost item reported by Revenue NSW, we considered:

- ▼ Can the ELNO avoid imposing this cost? If not, then the parties who can influence the cost should bear it.
- ▼ Would the activity (and associated costs) be unnecessary if the ELNO ceased its activities? If not, then the cost might be the result of a government policy, in which case, it may be appropriate to assign the cost to the NSW Government.
- ▼ Would the cost be recovered from all ELNOs and not just new entrants? We consider that any fees that we recommend should apply to all ELNOs to ensure a level playing field.

Table 7.2 shows the costs that we found should be recovered through ELNO prices are shaded in grey. We consider that the remaining costs (unshaded) should be borne by the NSW Government, as they have resulted from the decision to include duties verification in the eConveyancing process.

¹⁶⁴ Revenue NSW submission to IPART Issues Paper, May 2019, p6.

We also considered stakeholder comments on Revenue NSW prices to ELNOs (see Box 7.2).

Box 7.2 Stakeholder submissions on Revenue NSW prices to ELNOs

In response to our Issues Paper, stakeholders expressed varying views on whether Revenue NSW costs should be recovered from ELNOs, and if so, on what basis. For example:

- ▼ NSW ORG preferred that Revenue NSW costs are recovered for technical set up, on-boarding and ongoing maintenance.
- ▼ NSW Law Society submitted that Revenue NSW benefits from having duty paid up front and better payment reconciliation and compliance management, and so its costs should not be recovered from ELNOs.
- ▼ PEXA submitted that Revenue NSW's efficient costs should be recovered on a per transaction basis (to ensure that costs recovered in proportion to the ELNO's use of Revenue NSW system)
- ▼ Sympli submitted that it is inappropriate for Revenue NSW to charge a fee to assist it in its primary function of collecting taxes, but that if it does recover costs, prices should apply to all ELNOs.

Source: Stakeholder submissions to IPART Issues Paper

Table 7.2 Final findings on Revenue NSW cost items that should be recovered through prices to ELNOs

Cost type	Can the ELNO avoid imposing the cost?	Would activity be unnecessary if the ELNO ceased operations?	Would the fee be applied equally to all ELNOs to ensure competitive neutrality	Should cost be recovered from Revenue NSW prices to ELNOs?
ELNO verification system capital costs, including: <ul style="list-style-type: none"> ▼ Systems development ▼ Hardware: licences, servers ▼ Automated testing 	No, capital costs are incurred regardless of the number of ELNOs in the market	No	Yes, but for new capital costs only	No
ELNO on-boarding cost (one-off cost relating to joint integration testing)	Yes	Yes	No (because PEXA has already been on-boarded and so it would not be appropriate to charge new entrants)	No
Variable costs relating to ELNO subscriber support	Yes	Yes	Yes	Yes
Cost of governance and change management of ELNO services	No (decisions about governance and change timetable are determined by ARNECC)	No	Yes	No, but Revenue NSW should be officially included in the governance framework, see section 7.6.
ELNO system maintenance (testing for ELNO product releases)	Base level product releases are unavoidable. Additional releases are avoidable.	Yes	Yes	Yes for additional releases only, to avoid stifling innovation for ELNOs
Situation-specific ELNO costs (bespoke service changes)	Yes	Yes	Yes	Yes
General ELNO-related operating expenditure, including: <ul style="list-style-type: none"> ▼ Revenue NSW management ▼ Tax technical costs^a ▼ Contingency amount (10% of total costs)^b 	No	No	Yes	No

a Costs of Revenue NSW engaging with the industry to educate about Revenue NSW processes under eConveyancing

b We do not consider this to be an efficient cost.

Source: IPART, information provided by Revenue NSW.

7.5 Appropriate form of regulation is maximum prices

We consider that the appropriate form of regulation is to set the maximum prices that are directly connected to an ELNO's actions (or its subscribers' actions), indexed by CPI annually (as defined by the MORs). We prefer this form of regulation to setting up-front fixed fees or prices that are spread across all ELNO transactions, because it will encourage efficient use of Revenue NSW services.

Accordingly, we are recommending maximum prices to recover Revenue NSW's costs in providing ELNO subscriber support, support activities for ELNO product releases, and providing services to ELNOs that result in a change to Revenue NSW's systems (see Table 7.1 above). We are also recommending that the prices take effect when ELNOs enter into operating agreements with Revenue NSW, and be indexed by CPI for the next 2 years, then be reassessed.¹⁶⁵

We set our recommended maximum prices based on information provided by Revenue NSW on costs that it incurs (or expects to incur) from providing these duties verification services to ELNOs. Our cost consultant, AECOM also assessed the efficiency of these costs and found them to be efficient. These prices and the approach we used to calculate them are discussed in more detail below.

Recommendation

- 13 Revenue NSW charge ELNOs the following maximum prices (indexed by CPI annually):
- \$608,000 (in real \$2018-19) proportional to each ELNO's share of inquiries generated, to recover costs relating to ELNO subscriber support
 - For any release support activities that exceed base level frequency (ie two major and two minor tests per year per ELNO to be provided at no charge), \$38,000 per major release and \$21,000 per minor release (in real \$2018-19), per ELNO
 - Prices for Revenue NSW services to ELNOs that result in a change to Revenue NSW systems to be determined by contractual negotiations between ELNOs and Revenue NSW.

7.5.1 Price for providing ELNO subscriber support should reflect Revenue NSW's efficient staffing costs

We are recommending that Revenue NSW charges each ELNO a share of \$608,000 in staffing costs, proportional to the ELNO's share of subscriber duties verification inquiries to Revenue NSW. For example, if ELNO A generated 60% of subscriber support inquiries to Revenue NSW it would pay \$364,800, and ELNO B would pay \$243,200 (the remaining 40% of inquiries generated).

This price reflects Revenue NSW's efficient staffing costs to respond to inquiries, and should provide an incentive for ELNOs to reduce the number of inquiries Revenue NSW receives

¹⁶⁵ In our Draft Report, we recommended that prices take effect from 1 July 2020, however Revenue NSW submitted that implementing prices when ELNOs enter into an operating agreement with Revenue NSW is a more practical approach. We consider that this is reasonable. NSW Government submission to IPART Draft Report, October 2019, p 11.

(either through subscriber education or improving the ELNO platform interface). Our cost consultants, AECOM, reviewed the efficiency of Revenue NSW support costs and found that they were efficient, with AECOM's independent estimates of support costs coming out at similar levels to Revenue NSW's reported costs.¹⁶⁶

Our final recommendation for recovering Revenue NSW's subscriber support costs differs from our draft recommendation (that Revenue NSW charges ELNOs a maximum price of \$15.20 per inquiry it receives from an ELNO's subscribers). In response to our Draft Report, Revenue NSW submitted that:

- ▼ A fixed fee arrangement would make cost recovery arrangements simpler for both ELNOs and Revenue NSW, and while still incentivising ELNOs to reduce the number of inquiries made to Revenue NSW over time.
- ▼ The fixed cost model would be more appropriate while participants are still in a learning, transitional phase.¹⁶⁷
- ▼ 100% of staffing costs (ie, \$608,000) should be recovered from ELNOs. This varies from 75%, which we used in our Draft Report to calculate a per inquiry price (see Box 7.3).¹⁶⁸

After considering the arguments put forward by Revenue NSW and the State Revenue Commissioners eConveyancing Committee, who submitted that they prefer a pricing model that is easy to administer,¹⁶⁹ we agree that the fixed cost approach is reasonable. We also consider that Revenue NSW recovering 100% of its subscriber support staffing costs meets AECOM's assessment of efficient costs.¹⁷⁰ These costs and maximum prices should be reviewed in two years, so that any actions taken by ELNOs to reduce costs imposed on Revenue NSW, or other cost reductions as subscribers become more familiar with eConveyancing and make fewer errors, can be reflected in lower prices. In the meantime, there is still an incentive for an ELNO to improve its performance relative to its peers, as it will pay a lower share of the annual cost.

¹⁶⁶ AECOM, Estimating costs of electronic conveyancing services in NSW – Draft report, August 2019, pp 51-52

¹⁶⁷ Revenue NSW expressed some concerns that subscribers who are new to eConveyancing may be penalised by ELNOs contacting Revenue NSW under the per inquiry pricing model.

¹⁶⁸ NSW Government Submission to IPART Draft Report, September 2019, p 3.

¹⁶⁹ State Revenue Commissioner's eConveyancing committee submission to IPART Draft Report, p 2.

¹⁷⁰ AECOM Estimating costs of electronic conveyancing services in NSW - Final Report, November 2019, p 54.

Box 7.3 Our draft approach to recommending Revenue NSW subscriber support inquiry prices

For our Draft Report, Revenue NSW provided us with the following information on the costs it incurs from providing ELNO subscriber support:

- ▼ Revenue NSW incurs around \$608,000 in annual staffing costs from providing support to ELNO subscribers when they encounter errors in the duties verification process. (The ELNO subscriber support team consists of five full time employees, of various clerk grades, and one technical expert).
- ▼ Staff in this team spend around 75% of their time addressing ELNO subscriber enquiries, reducing the staffing costs allocated to ELNO subscriber support activities to \$456,000.
- ▼ From July 2019, around 250,000 transactions per year in NSW are estimated to be dutiable
- ▼ Of the dutiable transactions in NSW, around 12% encounter a duties verification error, which will result in approximately 30,000 support inquiries to Revenue NSW per year.

Source: Information provided by Revenue NSW.

7.5.2 Our approach to recommending support inquiry prices was generally supported

Stakeholders who responded to this issue in their submissions broadly agreed that recommending prices that recover Revenue NSW's costs of providing subscriber support will promote efficient decisions by ELNOs.¹⁷¹ However, there were some exceptions to specific elements of our pricing recommendation for subscriber support including:

- ▼ NSW Law Society, who has some reservations about Revenue NSW recovering the costs of ELNO subscriber support. This is because NSW Law Society contends that Revenue NSW has benefited from automation occurring from eConveyancing and mandatory use of the Electronic Duties Return process.¹⁷²
- ▼ PEXA, who agreed with IPART's broad methodology for recommending Revenue NSW prices, but questioned the efficiency of Revenue NSW subscriber support costs. PEXA argued that these costs have not been subject to benchmarking or stakeholder review.¹⁷³
- ▼ The State Revenue Commissioners eConveyancing Committee, who contended that ELNOs should provide their own subscriber support, and that \$15.20 is a very low price for providing subscriber report.¹⁷⁴

¹⁷¹ NSW Government submission to IPART Draft Report, September 2019, p 8; PEXA submission to IPART Draft Report, September 2019, p 51.

¹⁷² NSW Law Society submission to IPART Draft Report, October 2019, p 6.

¹⁷³ PEXA submission to IPART Draft Report, October 2019, p 51.

¹⁷⁴ The State Revenue Commissioners eConveyancing Committee submission to IPART Draft Report, September 2019, p 2. The State Revenue Commissioners eConveyancing Committee did not acknowledge that our recommendation price for subscriber support was based on efficient costs, as assessed by AECOM, and was also consistent with Revenue NSW's actual costs.

While we agree that eConveyancing may have resulted in Revenue NSW gaining efficiencies from activities associated with its core business of collecting taxes, we maintain our conclusion that eConveyancing has resulted in Revenue NSW undertaking functions and incurring additional costs outside its core function of collecting taxes (as discussed in Section 7.2.1, above). As a consequence, it is appropriate for Revenue NSW to charge ELNOs for **duties verification** subscriber support (because these costs are associated with activities that are outside its core business, and because these costs are linked to activities which ELNOs can avoid or minimise). If ELNOs bear these costs, then they are more likely to invest in systems or improve subscriber education to reduce the number of duties verification errors.

As noted in our Draft Report, AECOM has examined the efficiency of Revenue NSW's staff costs (including number of staff, time spent resolving duties verification errors and an appropriate salary multiplier for the industry) and is satisfied that Revenue NSW costs are efficient.¹⁷⁵

7.5.3 Prices for ELNO release support activities that exceed base level frequency should reflect Revenue NSW's costs per test

We are recommending Revenue NSW charge a maximum price of \$38,000 for major release support activities and \$21,000 for minor release support activities (that do not result in a change to Revenue NSW's system) per ELNO for each product release that exceeds base level frequency. Base level frequency is two tests for major releases and two tests for minor releases per year, per ELNO, and major and minor releases should be defined by product number (see Box 7.4). We maintain our recommendation that ELNOs should not pay for base level release support activities because:

- ▼ A technology platform requires system releases and upgrades, and so a base level of release support activities is unavoidable for an efficient ELNO.
- ▼ The three parties involved (Revenue NSW, NSW LRS and the ELNO) impose costs on each other for their own system upgrades and product releases, and so the release support activities incurred by each party should offset one another.

Maximum prices that we have recommended for major and minor release support activities reflects Revenue NSW's advice that it incurs costs which include the following activities:

- ▼ Attending test forums (such as showcases and scope meetings)
- ▼ Performing impact analysis of planned releases
- ▼ Test planning activities
- ▼ Data management (ie creating test data)
- ▼ Test environment setup
- ▼ Development and testing support
- ▼ Reviewing test summary reports
- ▼ Regression testing support.

¹⁷⁵ AECOM, estimating the costs of electronic conveyancing services in NSW, November 2019, p 50.

Box 7.4 summarises the changes that Revenue NSW proposed in its submission to our Draft Report, which we have considered for our Final Report. While we have accepted some of Revenue NSW's proposed changes, we have maintained the definition of base level frequency from our Draft Report. Revenue NSW proposed to define base level frequency as one major and one minor release per ELNO per year, because this is more likely to reflect an efficient ELNO in a mature market.¹⁷⁶ However, we do not consider that one major and one minor release is a reasonable assumption for an efficient ELNO in the current eConveyancing market (which is in a developing phase, rather than a mature phase).

Box 7.4 Revenue NSW proposed changes to release support activities

Revenue NSW proposed several changes to its cost proposal for release support activities in response to our Draft Report. These include:

- ▼ Describing testing as release activities that do not result in a change to Revenue NSW systems, as this better describes the variety of tasks that Revenue NSW undertakes to support ELNO product releases (ie not just testing), and also clarifies the distinction between release activities and bespoke services.
- ▼ Revising the costs for major and minor release activities that exceed base level frequency, per year per ELNO to:
 - \$21,000 for minor release activities (defined by ELNO product release number, ie ELNO product release 1.2 from 1.1 would be considered a minor release)
 - \$38,000 for major release activities (defined by ELNO product release number, ie ELNO product release 2.0 from 1.2 would be considered a major release)
- ▼ Revising the definition of base level frequency to one major and minor release per year per ELNO (from two major and two minor releases per year per ELNO in our Draft Report). Revenue NSW submitted that two major and two minor releases per year closely reflects PEXA's activities, but new entrant ELNOs may have lower frequency testing requirements.

Source: NSW Government submission to IPART Draft Report, October 2019 pp 8 -11.

The State Revenue Commissioners eConveyancing Committee submitted that prices for release support activities should be negotiated between Revenue NSW and ELNOs (rather than IPART recommending a maximum price).¹⁷⁷ We do not agree with this approach, because negotiated prices may result in different outcomes for each ELNO which would create an uneven playing field. Because Revenue NSW submitted that 'the types of activities undertaken by Revenue NSW when releases are made are standard and the associated costs are generally stable from one release to another',¹⁷⁸ we consider that recommending regulated prices is the best way of ensuring fair and transparent outcomes for ELNOs. This is in contrast to services which result in a change to Revenue NSW's systems (where costs are difficult to identify), and so recommending a regulated price is not feasible (discussed further in Section 7.5.4, below).

¹⁷⁶ NSW Government submission to IPART Draft Report, September 2019, p 3.

¹⁷⁷ State Revenue Commissioners eConveyancing Committee submission to IPART Draft Report, September 2019, p 2.

¹⁷⁸ NSW government submission to IPAR Draft Report, October 2019, p 10.

Revenue NSW also advised that it intends to implement new technology that will enable automated testing over the next two to three years. We expect that this will reduce release support costs materially, so future charges for release support activities have the potential to be lower, and so these costs should be reviewed in two years.

7.5.4 Price for Revenue NSW system changes should be negotiated between ELNOs and Revenue NSW

We are recommending that Revenue NSW and ELNOs negotiate a price for services that result in a change to Revenue NSW's systems through contractual arrangements. Any disputes about this price should be resolved by ARNECC, or the newly appointed eConveyancing national regulator.

Revenue NSW proposed that it should charge ELNOs for costs that it incurs from making changes to its systems to accommodate the requirements (or requests) of a particular ELNO. However, because these costs are situation-specific, they could vary widely. Therefore, we consider it is appropriate for Revenue NSW to charge ELNOs for services that result in a change to Revenue NSW's systems through contractual arrangements.¹⁷⁹ This is consistent with our Draft recommendation, noting that we have refined the terminology from our Draft Report (ie, bespoke services), to clarify that these are services which result in a change to Revenue NSW's systems.

In other jurisdictions, state revenue offices have indicated that they intend to enter into an agreement with ELNOs to recover costs of setting up (or updating) their system.¹⁸⁰ For example, the IGA review report notes that the revenue office in one jurisdiction has recovered costs from PEXA through its trading agreement.¹⁸¹ Sympli also submitted that it is currently in the process of connecting its systems to Revenue NSW, and has entered into a commercial arrangement to offset Revenue NSW costs.¹⁸²

We consider that a similar contractual negotiation process should be used to determine a price for services that result in a change to Revenue NSW's systems provided by Revenue NSW, and that any disputes that may arise from pricing negotiations should be resolved by ARNECC, or other appropriate regulator.

7.6 Revenue NSW should be included in the eConveyancing change and governance framework

Revenue NSW submitted in response to our Issues Paper that it is not formally included in some areas of the change and governance framework for eConveyancing, which results in Revenue NSW incurring additional costs. These costs could be reduced or avoided through improved consultation and coordination among all key stakeholders. Although Revenue offices have contracts with ELNOs, the current governance framework does not ensure that

¹⁷⁹ The IGA review notes that revenue offices have their own contracts with ELNOs and presumably can provide directions under those contracts, IGA review draft report, p 8.

¹⁸⁰ IGA review draft report, p 69.

¹⁸¹ IGA review draft report, p 126.

¹⁸² Sympli submission to the IPART Issues Paper, May 2019, p 9.

their requirements are considered in the approval process for ELNOs, or that they have oversight over matters such as change control.¹⁸³

For example, Revenue NSW submitted that:

- ▼ Under the MORs, a new ELNO can stage its entry into the market, which may be desirable to encourage new entrants. However, this creates greater cost for Revenue NSW as the on-boarding process can take a number of years. As a consequence, efficient costs are not likely to occur until an ELNO is operating at scale, and until all registry documents are transitioned to eConveyancing.
- ▼ Revenue offices are required to use the NECDS as the basis for their messaging services, given the many common data fields and the interchange of information between services.¹⁸⁴ Nationally, the revenue offices have to maintain a separate set of revenue office standards with the ELNOs to ensure maintenance of the ELNO service. Work is currently under way to move the NECDS to a new regime so that all ELNOs have equal opportunity to influence change.¹⁸⁵ It would reduce costs if the management of the revenue office data standards were included in this regime.
- ▼ Currently, change in the eConveyancing process is prioritised through ARNECC, with the key priority being the inclusion of the full suite of documents. Revenue NSW acknowledges that this may be the correct priority, but the result may be that changes which could increase efficiencies for Revenue NSW are delayed (for example, upgrading the ELNO interface to resolve duties verification data matching errors). Revenue NSW may therefore incur higher costs as a consequence of the change timetable being agreed without its input.¹⁸⁶

Because the eConveyancing IGA Review has recommended that revenue offices should be included in the governance framework, Revenue NSW's concerns should be dealt with through the IGA review. The IGA review also notes that a 'system-wide change control process should be developed to coordinate system change and manage priorities and risks between ELNOs, registrars, revenue office, financial institutions and any other connected entities.¹⁸⁷ We agree with these recommendations, and our finding is that including Revenue NSW in the governance framework would reduce total costs to the industry, and deliver greater efficiencies.

Finding

- 10 Including Revenue NSW in the governance framework would reduce total costs to the industry, and deliver greater efficiencies.

¹⁸³ IGA review draft report, p106.

¹⁸⁴ Revenue NSW Submission to IPART Issues Paper, May 2019, pp 2,3.

¹⁸⁵ The IGA review draft report notes that ARNECC and revenue offices are taking steps to ensure the API and data standards for land registry and revenue office connections are made accessible. IGA review draft report, p99.

¹⁸⁶ Revenue NSW Submission to IPART Issues Paper, May 2019, p7.

¹⁸⁷ IGA review draft report, p10.



Appendices

A Terms of reference

Review of Electronic Conveyancing Services in NSW - Final Terms of Reference

I, Gladys Berejiklian, Premier of New South Wales, under section 12A of the Independent Pricing and Regulatory Tribunal Act 1992 (the Act), request the Independent Pricing and Regulatory Tribunal (Tribunal) to investigate and report on an appropriate pricing regulation framework for the provision of electronic conveyancing services in New South Wales in accordance with this Terms of Reference.

Context

Electronic conveyancing is a system of settlement of real property transactions via an Electronic Lodgement Network (ELN). An entity that operates and administers an ELN is known as an Electronic Lodgement Network Operator (ELNO).

Currently the national regulations require the sole ELNO, Property Exchange Australia (PEXA), to determine its fees according to a publicly available, equitable and transparent pricing policy. However, the extent to which this policy properly reflects market conditions has never been tested. State and national regulators have not assessed PEXA's approach to introducing its original fees.

Additionally, the current fee regime may be reasonable while paper conveyancing as an alternative to electronic conveyancing provides competitive pressure on PEXA's prices, but such competitive pressure disappears when paper conveyancing is no longer an alternative. In NSW, paper conveyancing for some property and finance dealings has already been removed, and by 1 July 2019, all mainstream property dealings are mandated to be electronic. The NSW government intends to review and identify appropriate regulatory settings for the fees charged for the provision of eConveyancing services to ensure they are fair and transparent for all parties.

The NSW government recognises that electronic conveyancing is a national reform and strongly supports a nationally consistent regulatory regime. Although the IPART review and report will only consider pricing in NSW, the NSW government intends to share IPART's findings with other jurisdictions to support its overall aim of a nationally consistent pricing framework.

The task

IPART is requested to:

- a) Undertake a review and consultation process on the state of the electronic conveyancing market;
- b) Recommend an appropriate pricing regulatory framework, which includes:
 - A maximum price or pricing methodology for the provision of services by an ELNO, which may include any pass-through mechanisms, and a methodology for making annual adjustments to price;
 - A maximum price or pricing methodology for services provided to ELNOs by NSW Land Registry Services; and

- A maximum price or pricing methodology for services provided to ELNOs by Revenue NSW.

c) Consider the appropriate timeframe in which any pricing framework should be adopted and any transition measures; and

d) Consider the appropriate scope and frequency for future reviews of the pricing framework.

In determining an appropriate pricing framework, the Tribunal should have regard to the following matters:

i) Protection of consumers from potential pricing abuses due to the current status of electronic conveyancing as a highly concentrated market;

ii) The potential for additional ELNOs to enter the market over the next 1-5 years, the costs and effectiveness of interoperability, and how this should be reflected in the pricing framework;

iii) The cost of providing the services concerned, including the implication of differences in costs between jurisdictions for nationally consistent pricing;

iv) The extent to which PEXA invested capital and developed intellectual property to support its ELN in its capacity as the initial ELNO;

v) The possibility of applying the NSW approach to any of the elements of the pricing regulatory framework as a model for other jurisdictions.

vi) Any other matter the Tribunal considers relevant.

Process and timeframe

The Tribunal consulted with the public on these terms of reference.

The Tribunal is to undertake the review in an open, fair and robust manner to ensure public confidence in the process, including releasing a draft report for public consultation and conducting at least one public hearing during the course of the review.

The Tribunal is required to provide a final report to the Premier within ten months of receiving the terms of reference. The final report will be made publicly available.

The Finance, Services and Innovation cluster will meet the agreed costs of the review.

B List of submissions

Table B.1 Submissions to our Issues Paper

Date	Submitter
31 May	PEXA
23 May	Revenue NSW
13 May	Sympli
8 May	Office of the Registrar General (NSW ORG)
7 May	Australian Banking Association
30 Apr	NSW Land Registry Services
26 Apr	The Law Society of NSW
24 Apr	Individual - Anonymous

Table B.2 Submissions to our Draft Report

Date	Submitter
20 Sept	Law Society of NSW
26 Sept	State Revenue Commissioners eConveyancing Committee
1 Oct	Sympli
1 Oct	Australian Banking Association
1 Oct	NSW Land Registry Services
3 Oct	Property Exchange Australia Ltd
9 Oct	NSW Government

C WACC

Our WACC estimate

We estimated separate WACCs for ELNOs and for NSW Land Registry Services (NSW LRS) because we consider that these types of businesses face different levels of systematic risk. Our WACC estimate for ELNOs is set out in Table C.1 and for NSW LRS in Table C.2 below.

We adopted IPART's standard WACC methodology to calculate market-based parameters, and our recommended industry parameters as set out below:

- ▼ equity beta of one and gearing ratio of 60% for a benchmark ELNO, and
- ▼ equity beta of 0.6 and gearing ratio of 50% for a benchmark land registry.

IPART's measure of uncertainty (discussed below) is currently within one standard deviation of the long term average of zero. As per IPART's decision rule, we recommend adopting the midpoint, post-tax real WACC of:

- ▼ 4.6% for a benchmark ELNO, and
- ▼ 3.7% for a benchmark land registry.

Table C.1 Final decision WACC calculation for a benchmark ELNO

	Step 1		Step 2 - Final WACC range		
	Current market data	Long term averages	Lower	Midpoint	Upper
Nominal risk free rate	1.80%	3.10%			
Inflation	2.10%	2.10%			
Implied Debt Margin	2.00%	2.60%			
Market Risk premium	8.8%	6.0%			
Debt funding	60%	60%			
Equity funding	40%	40%			
Total funding (debt + equity)	100%	100%			
Gamma	0.25	0.25			
Corporate tax rate	30%	30%			
Effective tax rate for equity	30%	30%			
Effective tax rate for debt	30%	30%			
Equity beta	1.00	1.00			
Cost of equity (nominal post-tax)	10.6%	9.1%			
Cost of equity (real-post tax)	8.3%	6.9%			
Cost of debt (nominal pre-tax)	3.8%	5.7%			
Cost of debt (real pre-tax)	1.7%	3.5%			
Nominal Vanilla (post-tax nominal) WACC	6.5%	7.1%	6.5%	6.8%	7.1%
Post-tax real WACC	4.3%	4.9%	4.3%	4.6%	4.9%
Pre-tax nominal WACC	7.8%	8.1%	7.8%	7.9%	8.1%
pre-tax real WACC point estimate	5.5%	5.9%	5.5%	5.7%	5.9%

Table C.2 Final decision WACC calculation for a benchmark land registry

	Step 1		Step 2 - Final WACC range		
	Current market data	Long term averages	Lower	Midpoint	Upper
Nominal risk free rate	2.20%	3.10%			
Inflation	2.30%	2.30%			
Implied Debt Margin	2.20%	2.60%			
Market Risk premium	8.8%	6.0%			
Debt funding	50%	50%			
Equity funding	50%	50%			
Total funding (debt + equity)	100%	100%			
Gamma	0.25	0.25			
Corporate tax rate	30%	30%			
Effective tax rate for equity	30%	30%			
Effective tax rate for debt	30%	30%			
Equity beta	0.60	0.60			
Cost of equity (nominal post-tax)	7.5%	6.7%			
Cost of equity (real-post tax)	5.1%	4.3%			
Cost of debt (nominal pre-tax)	4.4%	5.7%			
Cost of debt (real pre-tax)	2.1%	3.3%			
Nominal Vanilla (post-tax nominal) WACC	5.9%	6.2%	5.9%	6.1%	6.2%
Post-tax real WACC	3.6%	3.8%	3.6%	3.7%	3.8%
Pre-tax nominal WACC	7.0%	7.2%	7.0%	7.1%	7.2%
pre-tax real WACC point estimate	4.6%	4.8%	4.6%	4.7%	4.8%

Sampling dates for market observations

We sampled market observations for the current year to the end of September 2019. For earlier years in the trailing average calculation of the cost of debt we sampled to the end of September in each year.

Tax rate

We assume that the benchmark efficient ELNO is a pure-play ELNO, of which PEXA is the first to operate in Australia. While PEXA reported total revenue for the financial year 2017-18 of about \$38 million, we estimate that its total revenue for the financial year 2018-19 is likely to significantly exceed \$50 million as the percentage of electronic lodgment dealings to total dealings has almost doubled since May 2018. We do not know how many electronic conveyancing firms will eventually operate in Australia. Based on press reports of the expected eventual size of the Australia-wide eConveyancing market (\$240 million per year according to Financial Review¹⁸⁸), even if there were three equally sized players, each one would be above the turnover threshold. Therefore, we use a tax rate of 30%.

NSW LRS's annual turnover is substantially higher than the \$50m threshold.¹⁸⁹ Therefore, we use a tax rate of 30%.

¹⁸⁸ See <https://www.afr.com/street-talk/pexa-and-the-2b-path-to-profitability-20180926-h15w4m> which quotes the \$240m revenue figure.

¹⁸⁹ NSW LRS's revenue from titling service only is around \$193 million as of FY 2016. NSW Government Finance Services & Innovation, *Annual Report 2015-16*, p 182.

Regulatory period

We are proposing that the maximum price for ELNOs be reviewed in two years. The appropriate regulatory period for calculating the trailing average for current debt and the geometric average inflation forecast is therefore two years.

If NSW LRS were to be allowed to charge a new price for its incremental investment in a multi-ELNO platform, the price would be set for five years. The appropriate regulatory period for calculating the trailing average for current debt and the geometric average inflation forecast is therefore five years.

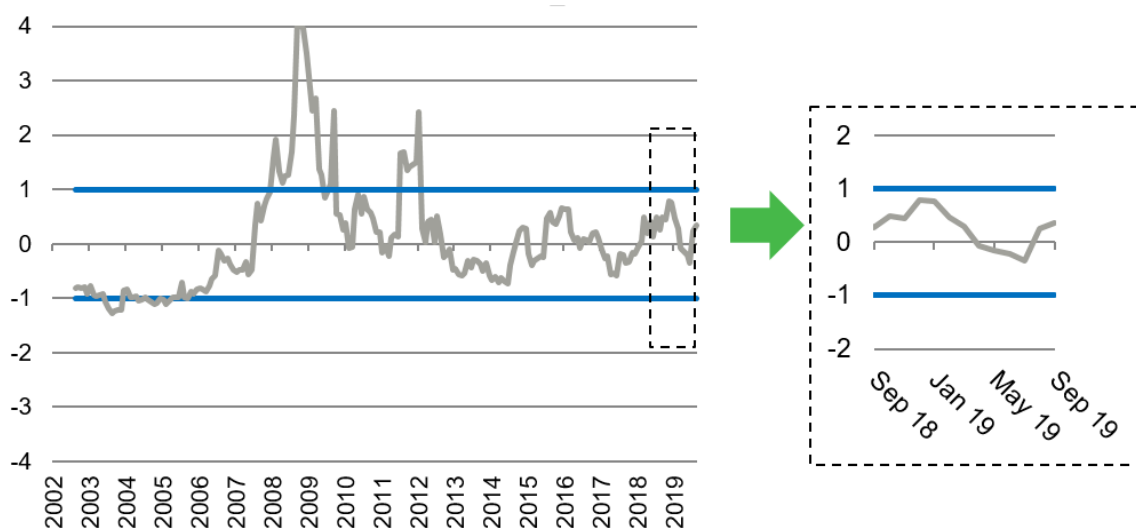
Application of trailing average method

For firms that were never subject to IPART's pre-2018 WACC method, there should be no need to restructure their debt portfolio to match the 2018 WACC method assumptions. Instead, our WACC calculation assumes that the transition to trailing average is complete.

Uncertainty index

We tested the uncertainty index for market observations to the end of September 2019. It was within the bounds of plus and minus one standard deviation of the long-term mean value of zero. Therefore, we recommend maintaining the default 50% - 50% weighting between current and historic market estimates of the cost of debt and the cost of equity.

Figure D.1 IPART's uncertainty index



Data source: Thompson Reuters, Bloomberg and IPART calculations.

Proxy company analysis to determine beta and gearing

We undertook proxy company analysis to determine the level of systematic risk faced by a benchmark ELNO and a benchmark land registry and their appropriate gearing ratios.

There are no listed pure-play ELNOs or land registries. Therefore, to estimate an appropriate equity beta and gearing ratio, we considered listed firms whose returns are likely to be correlated with those of ELNOs and LRS.

Revenues of a benchmark ELNO are likely to be impacted by real estate market activity

We consider the returns of firms in the real estate industry are likely to be positively correlated with those of ELNOs and land registry services as the revenues of ELNOs and LRS's eConveyancing related business will be driven largely by the volume of transactions in the real estate market.

Nevertheless, as discussed below, we consider the extent of exposure to the activity in the real estate market is likely to be different between a benchmark ELNO and a benchmark LRS, and this is reflected in our choice of proxy firms used to estimate equity beta and gearing ratios.

Real Estate Investment Trusts (REITs) best match the systematic risk profile of the eConveyancing related part of the LRS business

For a benchmark land registry, eConveyancing related activities are a small part of its business. NSW LRS earns revenues from a variety of activities such as document registration services (including those provided to ELNOs), titling and plan services, information products and services, and Water Access Licence registration and search. Therefore, the volume of transactions in the real estate market would have some impact on a benchmark land registry revenue, but not to the same degree as on a benchmark ELNO.

Given the degree of LRS's exposure to the real estate market, we consider that Real Estate Investment Trusts (REITs) best match the systematic risk profile of the ELNO-related part of the LRS business. REITs returns are influenced by the ups and downs of the real estate market, but tend to be more stable than a typical real estate stock. REITs offer stable recurring rental income from office, retail and industrial property tenants and provide diversification benefits as they invest in properties across numerous sectors and locations. In addition, REITs are required to distribute at least 90% of their income to investors in the form of dividends, providing higher yields than those typically found in the traditional fixed-income markets.

Mortgage Banks best match the systematic risk profile of a benchmark ELNO

Contrary to a benchmark land registry, eConveyancing activity is the core business of an ELNO, and the number of transactions in the real estate market has a direct impact on the revenues of an ELNO. Based on ORG's statistics regarding conveyancing transactions, transfer, mortgage and discharge of mortgage involving financial settlement will account for around 70% to 80% of an ELNO's total transactions. Since ELNOs' revenues would likely be driven by the number of property transactions, we consider Mortgage Banks, whose returns would be highly correlated with the number of property transactions, would best match the systematic risk profile of a benchmark ELNO.

ELNOs' businesses involve development and maintenance of a platform used to facilitate electronic settlement of property transactions, and hence it could be argued that IT & Software businesses, securities depositories, derivative exchanges or clearing houses which operate similar IT infrastructure to clear and settle investment transactions are comparable to ELNOs. We agree that there may be similarities in that ELNOs would invest capital in developing and operating technology-based platforms, and as a result, intangible assets may represent a substantial proportion of their total assets. However, we consider ELNOs and these business do not bear similar systematic risks as the demand for ELNOs' services is directly linked to property transactions, which, in turn, are influenced by sentiments in real estate markets.

We recommend an equity beta of 0.6 for a benchmark land registry based on asset beta of 0.37 and gearing of 50%

Table C.3 presents estimated asset betas and gearing ratios for REITs for different sample periods. We estimated asset betas and gearing ratios over two sample periods:

- ▼ From December 2002 to April 2019 to estimate beta and gearing ratio using all available data
- ▼ From April 2016 to April 2019 to estimate beta and gearing ratio for the most recent 3 year period.

Median unlevered beta (ie, asset beta) is around 0.37 and median gearing ratio is around 50% across the two sample periods. Based on the sample using all available data, we recommend adopting an asset beta of 0.37 and gearing ratio of 50%, which translates into **an equity beta of 0.6**.

Table C.3 Estimated asset beta and gearing ratios for REITs for different sample periods

Sample	Sample size	Median unlevered beta (asset beta)	Median gearing
All available data since December 2002	162	0.37	48%
Last 3 years of data since April 2016	112	0.37	47%

Source: Datastream and Secretariat's analysis.

We recommend an equity beta of one for a benchmark ELNO based on asset beta of 0.48 and gearing of 60%

Table C.4 shows estimated asset betas and gearing ratios for Mortgage Banks for the two sample periods. Using all available data, the median asset beta is 0.36 and the median gearing ratio is 57%. The asset beta estimated using the last 3 years of data is 0.48, which is substantially higher than that estimated using all available data, and the median gearing ratio is 65%.

Table C.4 Estimated asset beta and gearing ratios for Mortgage Banks for different sample periods

Sample	Sample size	Median unlevered beta (asset beta)	Median gearing
All available data since December 2002	13	0.36	57%
Last 3 years of data since April 2016	7	0.48	65%

Source: Datastream and Secretariat's analysis.

To understand whether there has been change in the systematic risks of firms classified as Mortgage Banks, we estimated asset betas for two additional samples using:

- ▼ 10 years of data from April 2009
- ▼ 5 years of data from April 2014.

The median asset betas estimated using these two samples are similar to that estimated using all available data, at around 0.31 to 0.36, indicating the betas of Mortgage Bank firms are likely to have increased substantially in the last three years.

We recommend adopting the median asset beta of 0.48 estimated using the last three years of data and gearing ratio of 60% for a benchmark ELNO.¹⁹⁰ This translates into **an equity beta of one**.

Professor Damodaran notes that risk and return models are silent on how long a time period one needs to use to estimate betas, but it is worth noting the trade-off involved in choosing a time period for beta estimation. By going back further in time, we get the advantage of having more observations in the regression, but this could be offset by the fact that the firm itself might have changed its characteristics, in terms of business mix and leverage, over that period. The objective is not to estimate the best beta we can over the last period but to obtain the best beta we can for the future.¹⁹¹

Although the sample size is small, we consider betas estimated using most recent data better reflect changes in the risk characteristics of Mortgage Banks over time, and is more

¹⁹⁰ We found that the median gearing ratios of firms in Financial Technology & Infrastructure, Securities & Commodity Exchanges, and Financial & Commodity Market Operators & Service Providers ranged from 10% to 25%. The average gearing ratio of PEXA over FY 2017 and 2018 is 20%. Based on this evidence, a lower gearing ratio of around 20% to 25% may be more appropriate for a benchmark ELNO, because firms with large intangible assets relative to total assets would have difficulty accessing debt market due to high valuation risk and poor collateralizability. While Lim et al. (2017) confirmed that firms with large tangible assets, on average, have higher financial leverage (holding other things equal), they also provided new evidence that intangible assets have a positive impact on financial leverage as long as they are identifiable and separately quantifiable (because they function similarly to collateralizable tangible assets). We consider an ELNO's intangible assets are separately identifiable and quantifiable, and therefore, and can support debt well. In addition, Fintech companies and exchanges often face substantial uncertainty about the future size of the market they can address and this would have a negative impact on their debt capacity. This contrasts with ELNOs who, while uncertain about their future market shares, have substantial certainty about the size of their addressable market as that is synonymous with the real property transaction market. Therefore, we consider a gearing ratio of 60% is appropriate for a benchmark ELNO based on the findings from Mortgage Banks. Lim, S.C, Macias, A.J. and T., Moeller, 2017, *Intangible assets and capital structure*, Working Paper, <https://pdfs.semanticscholar.org/4437/e3bb9680f7f39887882a463baa90b6ba8796.pdf>

¹⁹¹ Damodaran, R., *Estimating Risk Parameters*, available at <http://people.stern.nyu.edu/adamodar/pdfiles/papers/beta.pdf>

appropriate considering the developing nature of eConveyancing market and current uncertainty in the Australian property market. Currently, there is only one ELNO operating at scale- PEXA -in the NSW eConveyancing market, and competition is currently developing with Sympli expected to commence its operation in the second half of this year. Several models for interoperability, which is one key factor likely to influence the future competitiveness of the eConveyancing market, are being considered, but at this stage, there is no certainty about what model will be used.

In addition, contrary to the sample using all available data, the sample using the last three years of data excludes the global financial crisis between 2007 and 2010, which had a significant impact on betas for many financial securities, especially banks and mortgage stocks.¹⁹² By excluding those years, the estimated betas are unlikely to include abnormal downside risks, and would provide more accurate forward looking beta estimate for Mortgage Banks.

Comparison to other asset betas published by IPART

The recommended asset beta of 0.48 for a benchmark ELNO is close to the upper end of the range of asset betas previously adopted by IPART.

Since betas measure the risk of a firm relative to the market, the more sensitive a business is to overall market conditions, the higher its beta. This implies that firms in cyclical industries (eg, automobile, mining, consumer discretionary and real estate) can be expected to have higher betas than firms in noncyclical industries (eg, utilities and tobacco). In addition, the degree to which a product's consumer demand is discretionary will affect the beta of the firm selling the product. Airports, ports and cruise lines would be considered to be cyclical. We consider our recommended asset beta appropriate reflects these relative risks.

Table C.5 below shows the range of asset beta values we have previously adopted.

¹⁹² This is important as the global financial crisis had an abnormal negative impact on particularly banks and mortgage banks in the US, and the majority of the stocks in our Mortgage Banks sample are from the US market.

Table C.5 Range of asset beta values previously adopted by IPART

Industry	Asset beta adopted by IPART
Cruise terminal	0.60
Electronic Lodgment Network Operator (2019 proposed for Final Report here)	0.48
Private ferries, Sydney ferries	0.45
Rural and regional buses	0.43
Rail access (freight rail)	0.38
Land Registry Service (2019 proposed for Final Report here)	0.37
Sydney and NSW Trains (passenger rail)	0.36
Light rail	0.35
Valuer General (2014, implied from equity beta and gearing)	0.34
Water industry	0.28
Valuer General (2019)	0.28
Election Costing (2019)	0.28

Note: Equity beta values will be higher than these asset betas because they also reflect financial risk. The conversion between the two depends on each firm's gearing and the prevailing corporate tax rate.

Source: IPART analysis.

D Steps in eConveyancing process compared to paper-based process

Table D.1 outlines the steps involved in the eConveyancing process for a typical conveyance and how it differs from a paper-based conveyance.

Table D.1 Key steps in eConveyancing process compared with paper conveyancing

Step	Who takes	How differs from paper conveyancing
1. Initiate transaction		
▼ Collect information and prepare contract	Vendor's legal practitioner	Additional contract terms are required for eConveyancing
▼ Verify identity	Vendor's and purchaser's legal practitioners	Verification of identity requirements are the same in paper and eConveyancing
▼ Complete Client Authorisation Form	Vendor's and purchaser's legal practitioners	This additional form is required for eConveyancing so legal practitioners can sign documents of their clients' behalf
2. Exchange contracts		
No difference		
3. Prepare for settlement		
▼ Create eConveyancing workspace and invite the other parties	Usually vendor's legal practitioner, but can be purchaser's legal practitioner or mortgagee	Land title details are pre-populated in the workspace. ELN conducts periodic title activity checks to make parties aware of any title changes
▼ Communicate and coordinate between parties	All parties	Parties can coordinate and communicate through the workspace, rather than phone calls and emails (although they may also choose to phone or email)
▼ Schedule settlement	Party that creates the workspace nominates the date, which may be changed any time prior to settlement, if all parties agree	Coordinated in the workspace
▼ Discharge mortgage	Vendor's legal practitioner and mortgagee	Outgoing mortgagee creates and signs discharge of mortgage document digitally
▼ Create new loan documents	Purchaser's mortgagee	Incoming mortgagee creates and signs mortgage document digitally
▼ Prepare documents including transfer document, discharge, mortgage and notice of sale	Purchaser's legal practitioner	Vendor's legal practitioner can view documents in the ELN, so no need for physical exchange

Step	Who takes	How differs from paper conveyancing
▼ Transfer/stamp duties	Purchaser's legal practitioner and mortgagees	Duties are populated in the workspace when the purchaser's legal practitioner enters a transaction ID from Electronic Duties Return. The ELN checks that duties have either been paid early or are included in the financial settlement.
▼ Enter financial settlement details	Source funds entered by purchaser's legal practitioner and mortgagee. Destination accounts generally entered by legal practitioners.	Legal practitioners and mortgagees can coordinate in the workspace. Financial institutions have access to financial forecasting and reconciliation tools to help with treasury management.
▼ Signoff	All parties in the workspace	All parties check and digitally sign-off details in the workspace to confirm property is ready for settlement
4. Settlement	All parties	Rather than all parties physically meeting to exchange documents and cheques, settlement is completed digitally
▼ Check for title activity	ELN does final check for activity. Based on results, legal practitioners decide to continue or delay settlement	ELN checks that documents are capable of being lodged with land registry. PEXA provides "lodgment gap" insurance cover to purchasers for title activities that occur between the last successful check (within 2 days of settlement) and lodgment, to cover differences in land value, additional legal fees and expenses. There is no equivalent step in paper conveyancing
▼ Reserve funds	ELNO and RBA	ELNO sends a "Reservation Request" to RBA's financial settlement system with details of the property transaction. RBA reserves funds in the relevant financial institution's account to guarantee availability for settlement. There is no equivalent step in paper conveyancing
▼ Lodge title changes and settle funds	ELNO, land registry, RBA and financial institutions	Once funds are reserved, the title changes are lodged with the land registry. Once lodgment is successful, reserved funds are debited and credited across the financial institutions' accounts at the RBA. Financial institutions then credit or debit their client's accounts With paper conveyancing, cheques are exchanged and settlement completed first, then documents are lodged physically with the land registry. Delays in this process can mean intervening transactions prevent the land registry from registering the documents. This creates risk for the purchaser as they have paid for the property but legal title has not transferred to them. eConveyancing reduces this risk as the ELN checks that documents are capable of being lodged prior to lodgment

E Contestability of Infrastructure and Activities under Interoperability

Figure E.1 Contestability of Infrastructure

Interoperability Model	Direct connections	Information hub	Full central hub or Infrastructure ELNO
Infrastructure required by each ELNO	User interface	User interface	User interface
	Cyber security	Cyber security	Cyber security
	Connections between all ELNOs		
	Lodgement, financial settlement and duty payment infrastructure	Lodgement, financial settlement and duty payment infrastructure	
	Connections to legal software providers	Connections to legal software providers	
Infrastructure required by one ELNO or hub		Connections from hub to all other ELNOs	Connections from infrastructure ELNO or hub to all other ELNOs
			Lodgement, financial settlement and duty payment infrastructure
			Connections to legal software providers
Infrastructure options exist	New entrants could rent lodgement, financial settlement and duty payment infrastructure	New entrants could rent lodgement, financial settlement and duty payment infrastructure	

Data source: IPART.

Figure E.2 Contestability of Activities

Interoperability Model	Direct connections or information hub	Full central hub or Infrastructure ELNO
Activities that can be performed by each ELNO	<div data-bbox="616 439 909 510">User interface</div> <div data-bbox="616 519 909 591">Cyber security</div> <div data-bbox="616 600 909 725">Communication between workspace users</div> <div data-bbox="616 734 909 806">Title information and activity checks</div> <div data-bbox="616 815 909 887">Duty payment confirmations</div>	<div data-bbox="928 439 1235 510">User interface</div> <div data-bbox="928 519 1235 591">Cyber security</div> <div data-bbox="928 600 1235 752">Communication between workspace users (via hub or infrastructure ELNO)</div>
Activities performed by hub or only one ELNO	<div data-bbox="616 967 909 1146">Lodgment and financial settlement (but different ELNOs across transactions)</div>	<div data-bbox="928 967 1235 1066">Lodgment and financial settlement</div> <div data-bbox="928 1075 1235 1173">LRS title information and activity checks</div> <div data-bbox="928 1182 1235 1326">Duty payment confirmation with Revenue NSW</div>
Unclear who performs role	<div data-bbox="616 1361 909 1583">Each ELNO could gather title and duty information or it could be shared across ELNOs in a transaction</div>	

Data source: IPART.

F The legal and regulatory framework for eConveyancing

F.1 National framework

The features of the national legal framework for eConveyancing include:

- ▼ The **Intergovernmental Agreement for an Electronic Conveyancing National Law (IGA)** between all states and territories except the ACT. Conveyancing is subject to state rather than federal legislation. This means consistency across Australia is achieved by way of agreement between the states and territories through an applied law scheme. An applied law scheme is a type of legislative scheme whereby each jurisdiction agrees to enact a model law. To this end, each of the states and the Northern Territory (NT) entered into the IGA in 2011. The IGA sets out the participating jurisdictions commitment to pursue a nationally consistent approach to eConveyancing, including enacting a model law and that the model law would be led by NSW. However, it acknowledges that “National E-Conveyancing may be implemented at different times and at a different pace across each jurisdiction” and that “the National Electronic Conveyancing Law will not prohibit State or Territory based electronic lodgment arrangements”.¹⁹³
- ▼ The **Australian Registrars’ National Electronic Conveyancing Council (ARNECC)**. This council was established under the IGA and comprises each participating jurisdiction’s Registrar or their nominee. Its role is to drive consistency across Australia and develop the legal framework for eConveyancing, it has developed Model Participation Rules (MPRs) and Model Operating Requirements (MORs) for ELNOs and subscribers.
- ▼ The **Electronic Conveyancing National Law (ECNL)**, which is the model law. The ECNL empowers the Registrar in each participating jurisdiction to make the participation rules and the operating requirements for that jurisdiction. However, in exercising this discretion, the Registrar must consider the desirability of maintaining consistency with the MPRs and MORs developed by ARNECC.¹⁹⁴

The national framework provides for the electronic lodgment of documents with land registries by means of ELNs operated by ELNOs. Before operating, ELNOs must:

- ▼ Demonstrate they have met certain eligibility criteria.¹⁹⁵ In practice, a prospective ELNO’s eligibility criteria is assessed by ARNECC and is referred to as ‘Category One Approval’ and ‘Category Two Approval’.¹⁹⁶
- ▼ Be approved by the Registrar to begin operating in a particular state under the state or territory version of the National Electronic Conveyancing Model Law.¹⁹⁷

¹⁹³ Council of Australian Governments, *Intergovernmental Agreement for an Electronic Conveyancing National Law*, December 2011, sections 3.4, 5.1 and 8.1.2.

¹⁹⁴ *Electronic Conveyancing (Adoption of National Law) Act 2012* (NSW) s 24(2).

¹⁹⁵ MOR 15.4(a)-(b).

¹⁹⁶ The different stages of approval are known as Category One Approval and Category Two Approval because the approval criteria is set out in category one and two of schedule 3 to the Model Operating Requirements.

¹⁹⁷ For NSW, see ECNL s 15.

A key feature of the national framework is that it allows for competition, though at the time, ARNECC noted that “the development cost and nature of electronic conveyancing would make it unlikely that there would be other ELNOs especially in the short to medium term”.¹⁹⁸

ARNECC also publishes useful guidance notes containing advice on how ELNOs and subscribers can comply with their respective obligations under the MORs and MPRs. They are not legislative instruments, rather, guidance notes are developed by ARNECC on behalf of all the Registrars to assist ELNOs and subscribers.¹⁹⁹

F.2 NSW framework

In NSW, eConveyancing is governed by:

- ▼ The **ECNL**, which NSW adopted by passing legislation in 2012 which commenced on 1 January 2013.²⁰⁰ Among other things, the ECNL provides that the Registrar General’s approval is required before a person can become an ELNO, and that the Registrar General may impose NSW-specific conditions on an ELNO’s approval.
- ▼ The state’s version of the **Model Participation Rules (MPR)** and **Model Operating Requirements (MOR)**. The current versions commenced on 25 February 2019, and are consistent with version 5 developed by ARNECC.
 - Version 5 of the MOR includes additional requirements intended to constrain anti-competitive behaviour by ELNOs, and impose pricing controls on the fees that ELNOs can charge for ELN services. For example, version 5 requires ELNOs to maintain structural or functional separation between their ELN functions and non-ELN functions. It also caps pricing increases by CPI.
 - The MPRs set out strict legal requirements, for example, about who can become a subscriber and what insurances they must have. Under the MPRs, subscribers are also audited by the ELNOs and the Registrar General to ensure they continually meet the requirements of the MPRs. This helps to keep the ELN secure.
- ▼ The **Real Property Act 1900 (NSW) (RPA)**, which permits the Registrar General to make Conveyancing Rules.
- ▼ The **Conveyancing Rules** that the Registrar General has made, which are mostly intended to impose the requirements that apply to subscribers electronically to paper conveyancing. However, they also set out which documents must be lodged electronically. They therefore provide the legal mechanism for mandating eConveyancing in NSW by phasing out the paper lodgment channel.

¹⁹⁸ ARNECC, *Proposed Electronic Conveyancing National Law Discussion Paper*, August 2011, p 12.

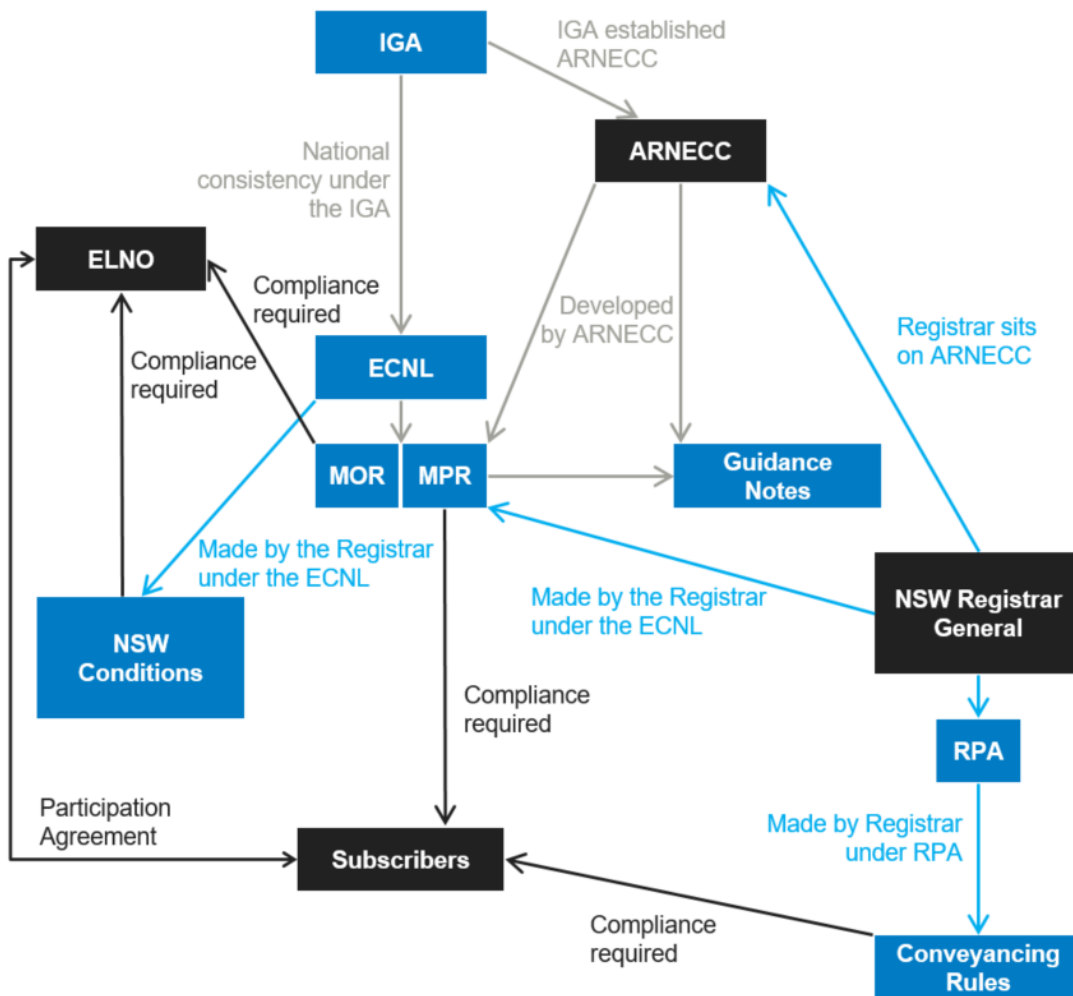
¹⁹⁹ In practice, Guidance Notes are developed by ARNECC’s sub-committee called the Australian Registrar’s Working Group and published by ARNECC.

²⁰⁰ The ECNL was adopted in NSW by the *Electronic Conveyancing (Adoption of National Law) Act 2012* (NSW). For other States and Territories, see *Electronic Conveyancing (Adoption of National Law) Act 2013* (VIC), *Electronic Conveyancing National Law (Queensland) Act 2013* (QLD), *Electronic Conveyancing Act 2014* (WA), *Electronic Conveyancing National (South Australia) Act 2013* (SA), *Electronic Conveyancing (Adoption of National Law) Act 2013* (TAS) and *Electronic Conveyancing (National Uniform Legislation) Act 2013* (NT), https://www.arnecc.gov.au/regulation/electronic_conveyancing_national_law, accessed 6 March 2019.

- ▼ **Conditions on ELNO Approval.** In NSW, the Registrar General has determined a set of conditions that will apply equally to all ELNOs beginning 1 March 2019, called the ELNO General Conditions. The Registrar General may also determine special conditions which will apply only to a specific ELNO.

Figure F.1 shows the legal and regulatory framework at a high level.

Figure F.1 The eConveyancing legal and regulatory framework in NSW



Data source: IPART.

Other legislation and regulations also impact ELNOs' operations. For example, the *Duties Act 1997 (NSW)* requires that duties be paid prior to transfer of title, which has led to ELNOs requiring duties verification services.