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Executive summary

PEXA thanks IPART for the opportunity to comment on its Draft Report into Interoperability pricing for ELNOs.

Electronic conveyancing delivers a more secure, reliable, and affordable method of conducting property transactions. The current e-conveyancing system delivers around \$66 in savings per transaction (IPART)¹ and a net economic benefit of more than \$240m a year to the Australian economy.²

While IPART has addressed the e-conveyancing market in general terms, in reality it involves just two players. PEXA, the incumbent ELNO, is a product of the Council of Australian Governments and is now a publicly listed company. The other ELNO is Sympli, jointly owned by ASX (valued at \$13 billion³) and ATI Global,⁴ the dominant provider in Australia of practice management software for lawyers and conveyancers.

1.1 The purpose and reality of interoperability

Interoperability was conceived as a means of enhancing competition between ELNOs, not as an end in itself, but to encourage ELNOs to deliver cheaper, better e-conveyancing. It was believed that efficiencies and innovation encouraged by competing ELNOs would outweigh the assumed modest costs of creating interoperable functionality and replicating the capability created by PEXA.

However, the real world difficulties of trying to create interoperable functionality, and the significant costs of building new ELNOs, have fundamentally undermined these assumptions.

1. Increased cost and prices: Interoperability will be much more expensive than originally thought, imposing unnecessary costs on consumers, subscribers, and market participants. Contributing factors are:

- **The costs of building additional ELNOs are much higher** than assumed, even with PEXA's example in place. Real world evidence of this includes:
 - To build its Australian platform, PEXA has already invested around \$182 million in IT costs, and additional staff costs of over \$7 million to coordinate and negotiate arrangements with third parties;
 - The PEXA Go Platform, an e-conveyancing platform PEXA is building for the UK market. PEXA has invested \$60 million to date in the platform (which currently has limited remortgage capability) and expects to spend another \$100 million to complete the remortgage offering and bring the initial release of transfer transaction functionality to market.

¹ IPART, *Review of the Pricing Framework for Electronic Conveyancing Services in NSW* (November 2019), <https://www.ipart.nsw.gov.au/sites/default/files/documents/final-report-review-of-pricing-framework-for-electronic-conveyancing-services-in-nsw-november-2019.pdf> ('IPART, Review of Pricing Framework Final Report'), p. 60.

² PEXA, *Replacement Prospectus Initial Public Offering of Shares* (2021), https://investors.pexa.com.au/FormBuilder/Resource/module/MKCI5QLROK-78c35b6yPkA/docs/PEXA_IPO_Prospectus.pdf ('PEXA, Prospectus'), p. 43.

³ ASX's market capitalisation as at 28 March 2023 is \$12.69B: <https://www2.asx.com.au/markets/company/asx>.

⁴ ATI Global generated \$586 million in revenue in FY2021 (this figure includes revenue generated in Australia and the UK): ATI Global, *Annual report for FY2021*.

- Sympli (whose parents ASX and ATI Global build and own large sophisticated IT platforms) appears to have spent \$95 million (in nominal terms) so far building its Australian ELNO platform. Its offering is confined to a small subset of ELN functionality (non-settlement lodgements in a small subset of jurisdictions), and Sympli is currently spending in the order of \$30 million per year to build this out. Even if Sympli is ultimately successful, it is many years away from having a fully functional ELN.

With all real world experience demonstrating that building material ELNO system functionality costs around \$200 million, AECOM's estimate that core ELNO capability can be built for between \$4.5 and \$5.2 million is not credible and should be wholly disregarded by IPART.

- **An interoperable system is more complex and expensive** to design than originally expected, with estimated timelines and costs continuing to escalate:
 - For example, in 2019, AECOM estimated that it would cost in the order of \$600,000, and as recently as 2020 it was expected that interoperability would be introduced by 2021 and involve 24 APIs.
 - The latest estimate is that a single demonstration transaction will not occur until September 2023, with material functionality divided into three subsequent releases. PEXA estimates that the first release of "Day 2 interoperability" – refinance transactions in NSW and Queensland with major banks will be available in production from early 2026. There is presently no estimate for the timetable for subsequent releases that would extend interoperability to other jurisdictions, and to transfer of land transactions.
 - Interoperability is now estimated to require a total of 71 APIs.
 - PEXA's costs of building an interoperable system alone are likely to be at least \$25-\$30 million; and the costs for other ELNOs, industry participants and subscribers are likely to be substantial.

The repeated deferral of the timeline for introducing interoperability, along with the rising costs of interoperability, have the hallmarks of an ill-fated IT transformation. Principles of project management for large IT transformations suggest this should prompt a clean-sheet review of the practicality of interoperability, and whether its benefits continue to justify the rising costs.

These additional costs are now leading IPART to forecast that interoperability will result in higher user and consumer prices than a well-regulated wholesale provider market structure.

2. **Inferior functionality:** Interoperability will create an unstable market structure that is likely to discourage e-conveyancing innovation and undermine the objective of universal service coverage. The problems include:

- **Cherry picking:** The outcomes proposed by IPART's draft report provide new ELNOs with strong commercial incentives to cherry pick the highest volume transaction types, which compounds the problem created by the overall market structure which allows ELNOs to cherry pick the highest volume jurisdictions. The cost of building capability for a particular transaction type in a particular jurisdiction is similar, regardless of the volume / revenue that it generates.
 - Cherry picking might be minimised by: requiring every ELNO to build comprehensive functionality; setting up dynamic market incentives; or imposing a USO levy on high volume transactions.

- IPART is relying on ARNECC to require all ELNOs to build comprehensive functionality. But this reliance is misplaced: the MOR do not require comprehensive functionality; ELNOs are allowed to operate while lacking even the functionality to lodge required instruments; clear timeframes for expanded functionality have not been set; and ARNECC is yet to specify the future enforcement mechanisms.
 - IPART's draft report proposes a Default RELNO surcharge that is around 1% of the subscriber revenue, which is a very weak incentive to do anything other than use PEXA's existing infrastructure for lower volume transactions.
 - IPART has not recommended a USO, and ARNECC has indicated that it does not intend to investigate a USO at this stage.
- **Inadequate wholesale pricing:** The regime proposed by IPART will allow Sympli to collect Subscriber fees for a significant number of transactions while free-riding on PEXA's universal capability. This problem is exacerbated because IPART is proposing to set wholesale prices at unjustifiably low levels (as explained below).
 - **Self-preferencing:** IPART's draft report has not taken into account the potential impacts of Sympli's vertical integration. Sympli's 50% owner, ATI Global, is a dominant player in the PMS market and does not face effective regulatory restrictions on leveraging that position to self-preference Sympli. As legal practitioners and conveyancers are the primary determinant of which ELNO is used by a property vendor or purchaser, Sympli may gain market share through this route – rather than by investing in its ELN and competing on the merits.

Apart from the unfairness of precluding a player in the market from earning a reasonable return on its previous investments, cherry picking, inadequate wholesale pricing and self-preferencing would leave all ELNOs reluctant to invest in new transaction capability and functionality, knowing that if they do so, the other ELNO can capture much of the benefit without the costs. The market design and pricing for interoperability will discourage innovation and investment in new services. There would be limited incentives for ELNOs to continue the roll out of national e-conveyancing, which is far from complete.

3. **Reduced security and stability:** Interoperability substantially increases risks to system security and stability.
 - The proposed direct connections model of interoperability increases the overall likelihood of an outage, creates higher risks of fraud and non-repudiation, and raises issues for subscriber authentication.
 - No assessment has been conducted of the full spectrum of risks and costs associated with interoperability. For example, there has been no end-to-end security assessment. These risks are increasing as the cyber-attacks grow in number and seriousness.
4. **Sovereign risk:** Interoperability raises questions of sovereign risk, because arbitrary government intervention may deprive market participants of an opportunity to earn a reasonable return on capital.
 - There is no suggestion that PEXA's historic investments have been inefficient.
 - PEXA has not yet earned back the cash it has expended to create the world first electronic conveyancing system, much less earned a reasonable return on that capital.

The features outlined above may prevent PEXA from ever recovering a reasonable return on its historic investment.

- IPART's Draft Report rejected the suggestion that new ELNOs should pay PEXA a common user charge to assist PEXA to earn a return on the additional costs that it incurred to establish the system. Contrary to the IPART's assertion, such a fee would not be a barrier to competition, as it would only pay for the additional costs incurred by an efficient founding ELNO that are not incurred by subsequent ELNOs. Consequently, it would create a level playing field between PEXA and subsequent ELNOs – any other arrangement would provide an advantage to subsequent ELNOs.

1.2 IPART's response to emerging evidence

Because IPART's terms of reference have a limited scope, IPART has been placed in a difficult position. Its terms of reference focus on the design and quantum of inter-ELNO fees. However, IPART's work in fleshing out the design of interoperability, the obvious issues in setting fees in a way that delivers public benefits and is fair to all industry participants, and its preliminary work in understanding future Subscriber service fees, all contribute to a growing body of evidence that contradicts the rationale for adopting interoperability.

This emerging evidence strongly points to a net public detriment associated with interoperability. Indeed, escalating costs are now leading IPART to forecast that interoperability will result in **higher subscriber and consumer prices** than a well-regulated wholesale provider.

Accordingly, it would be appropriate for IPART to point out to governments the implications of its findings regarding the current choice of market structure and the public interest. Ensuring price regulation and market design are fit for purpose is critical to avoiding adverse economic and consumer outcomes.

We encourage IPART to comment on these issues and not put to one side the medium-term implications of its report – even if these matters fall outside its direct terms of reference.

1.3 Significant pricing issues

Within the methodology that IPART has adopted, and assuming that it does not act on any of the issues identified above, the RELNO fee and Default RELNO Surcharge proposed in IPART's Draft Report should be materially increased because:

- **Issue resolution costs** are higher than IPART has estimated;
- The estimated **capital cost** of \$4.8 million to build an ELNO is manifestly too low, and should be replaced with an estimate of around \$200 million, based on the experience of PEXA and Sympli in Australia, and PEXA in the UK.
- The **pre-tax WACC** for ELNOs of 4.4% is too low and should be increased to 9.0%, mostly because it is inappropriate to use mortgage banks as a comparison for PEXA's business. When more appropriate comparisons such as online trading platforms are used, they suggest an efficient ELNO will have lower gearing than IPART has assumed.

- Assumptions of **future market volumes** are too high, primarily because: historic increases in the penetration of e-conveyancing are reaching limits; and recent growth in refinances will not be sustained because it was driven by the one-off end of COVID-19 low fixed-rate lending.

The circumstances in which the Default ELNO Surcharge is payable should be broadened. A number of other costs should be included in calculating this fee. These changes would go some way to providing appropriate recompense for an ELNO that provides functionality on which other ELNOs rely. However, further consideration is needed to set an appropriate wholesale price that responds to the problems of cherry picking and free riding identified by IPART.

2. Interoperability market design issues

2.1 Relevance of market design issues to IPART's terms of reference

Although IPART's terms of reference focus on the design and quantum of inter-ELNO fees, setting fees without pointing out their potentially significant consequences for market design and the public interest carries a significant risk of detriment to consumers, industry and government.

We strongly encourage IPART to set out its views about the implications of its findings for the broader public interest as this can assist governments and ARNECC to make sound policy decisions.

2.2 The original rationale for interoperability

Interoperability was conceived as a means of enhancing competition between ELNOs, not as an end in itself, but to encourage ELNOs to deliver cheaper, better e-Conveyancing to Australian consumers. It was believed that the additional efficiencies and innovation encouraged by competition between interoperable ELNOs would outweigh the costs of designing and creating interoperable functionality, and the costs of building additional infrastructure that replicated the capability already created by PEXA.

However, the original work investigating potential market structures found that interoperability offered only relatively small advantages compared to alternate market structures, and was subject to significant uncertainties.

The Centre for International Economics (**CIE**) cost benefit analysis, which the Regulatory Impact Statement (**RIS**) supporting interoperability relies on, estimated that the net benefits of interoperability (specifically the phased ESB model) would be \$83.6 million over 10 years in net present value terms using a discount rate of 7%.⁵ This implies an annual benefit of around \$8 million, which is modest relative to industry revenues of around \$280 million in 2021-22.⁶

Dench McClean Carlson (**DMC**) as part of its 2019 Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law (**IGA Review**) found that

*'the direct benefit of price competition in e-conveyancing transaction fees to property buyers and sellers is very small. Australian homeowners on average buy and sell a property every 10.5 years. The existing PEXA fee of \$112 (assuming each transaction involves both selling and buying) translates to \$224 per 10.5 years or \$21 per annum. It is unlikely that homeowners would want to accept a greater risk for this very small potential benefit.'*⁷

Because these benefits are small, small changes in assumptions would result in different conclusions. As shown below, the emerging evidence shows the need for very substantial

⁵ The Centre for International Economics, *Addressing market power in electronic lodgment services: Cost-benefit analysis*, Final Report (1 September 2020), https://www.registrargeneral.nsw.gov.au/_data/assets/pdf_file/0003/927426/Cost-Benefit-Report-Centre-for-International-Economics-Sep-20.pdf ('CIE, Cost Benefit Analysis Final Report'), p.2.

⁶ PEXA, *Annual report*, <https://investors.pexa.com.au/DownloadFile.axd?file=/Report/ComNews/20220826/02558810.pdf>, p.97,

revisions to many of the assumptions that underpinned the rationale for an interoperable market structure.

2.3 Higher costs and prices for consumers and participants

2.3.1 The costs of building ELNOs are much higher than assumed

IPART's estimates of capital costs are based on AECOM's estimates that a benchmark efficient ELNO would incur capital costs between \$3.7m and \$4.3m depending on the number of jurisdictions.⁸ AECOM estimates that these capital costs would cover the core ELNO service of financial settlement and lodgment, IT hardware, and building connections to around 12 financial institutions. In developer time, IPART estimated that the core capability would require 15 days plus 20 days per jurisdiction, and 49 days per connection to financial institution.

Actual experience

These estimates and assumptions are incorrect and cannot be reconciled with the actual experience of the two ELNOs in the Australian market and with PEXA's experience in the UK market.

- PEXA incurred costs of \$178 million (in \$2022) before it earned any material revenue, or had any material operating costs (Exhibit 3). In total, PEXA has incurred \$182 million in capex to build and deliver the e-conveyancing service that exists today. In addition, PEXA estimates that the non-IT costs of negotiating the contractual framework between ELNOs, Subscribers, settlement institutions, Land Registries and Revenue Offices cost in excess of \$7 million.
- Sympli (whose parents ASX and ATI Global build and own large sophisticated IT platforms) appears to have spent over \$95m (in nominal terms) to 30 June 2022 building an ELNO, and it is continuing to invest about \$30m per year.⁹ As Sympli does not yet have material revenues, essentially all of this expenditure should be considered capital expenditure. Although ASX indicated that Sympli "expects to enter the property settlement market towards the end of this [2018] calendar year",¹⁰ and Sympli claims to have a system that is ready to service customers, Sympli does not yet openly offer a service to subscribers to facilitate transactions that do not require interoperability. To match PEXA's current capability, significant further investment is required as Sympli's system has not demonstrated the ability to service many transaction types, or to operate in most jurisdictions, or to connect to a large number of financial institutions.

⁸ IPART, *Interoperability pricing for Electronic Lodgment Network Operators Draft report* (February 2023), https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Draft-Report-Interoperability-pricing-for-Electronic-Lodgment-Network-Operators-February-2023.PDF ('IPART, *Draft Report*'), p. 41.

⁹ Sympli's 2021/22 financial report indicates that its only business is as an ELNO and that it had immaterial revenues, approximately \$30m in expenditure, accumulated losses of \$59 million, and intangible assets of \$37 million: ASIC disclosure, Document No 7EBW94625. This amount is consistent with Sympli's owners, ASX and ATI, progressively investing \$116 million in Sympli through a series of share issues: ASIC disclosure, Document No 7EBZ30577. Between June and December 2022, ASX and ATI invested a further \$16 million in Sympli: ASIC disclosure, Document No 7EBW33078 and 7EBZ30577.

¹⁰ ASX, *Annual Report 2018*, p.11, https://www.annualreports.com/HostedData/AnnualReportArchive/a/ASX_ASX_2018.pdf

- The Victorian Government attempted to build a stand-alone electronic conveyancing system for Victoria (ECV) and indicated in 2009 that this system would cost it \$80m in development costs by 2013-14.¹¹
- PEXA has invested \$60m to date in developing the PEXA Go Platform in order to enter the UK market. This platform will be much less complex than PEXA's Australian platform because it is not intended that all documents will be completely lodged electronically into the England and Wales land registry, and there is only one land registry (HMLR) and one revenue office in England and Wales (PEXA's first jurisdiction in the UK). To date, this platform only has capability to conduct certain types of remortgage (refinance) transactions. PEXA intends to invest another \$100m over FY24 and FY25 to complete the platform's remortgage functionality and bring the initial release to market of functionality for transfer of land transactions (the equivalent of Australian transfer transactions).

Relative to these real world capital costs to establish an ELNO, AECOM's mid-point estimate that the core capability of an ELNO can be built for \$4.8m appears extraordinarily low.¹² To estimate the costs of establishing a new ELNO, IPART should put far greater weight on current real world experience, rather than consultant assumptions from 2019 which PEXA has never accepted, and which have not been validated.

ELNO System components

One of the critical flaws in AECOM's analysis of the costs of establishing an ELNO is that it disregards material components of the costs required to build an ELNO System. These elements are particularly relevant to the calculation of the default RELNO surcharge.

In broad terms, the components of an ELNO System include:

- The consumer facing interface that receives information input by customers.
- The digital infrastructure / integrations that connect the PEXA exchange with third parties in the ecosystem
- The 'transaction orchestration engine' which does the bulk of the work to process the transaction.

The cost to deliver the transaction orchestration engine for a new transaction type is generally fairly consistent. PEXA has developed the capability to process most instrument types in most jurisdictions, consistent with the directions of the MOR, and its commitment to the social contract and original objectives of delivering national e-conveyancing. Over time, PEXA has invested significantly to extend its baseline capability to cater for additional, typically more complex scenarios.

It became apparent to PEXA in a discussion with IPART on 23 March 2023 that IPART may not have identified that the costs of building an ELNO include the costs of building a transaction orchestration engine. IPART may also have assumed that a new ELNO will build the same transaction orchestration engine as the incumbent ELNO. If so, IPART may not have identified that interoperability fees should have regard to capabilities lacked by a new ELNO's

¹¹ Chris Merritt, The Australian, *Last rites for state's white elephant project* (19 August 2011), <http://www.theaustralian.com.au/business/legal-affairs/last-rites-for-states-white-elephant-project/story-e6frg97x-122611768358> (pexa.com.au).

¹² IPART, *Draft Report*, p. 41.

transaction orchestration engine. An ELNO can build connections with third parties (such as land registries and financial institutions) without a fully functional transaction orchestration engine, such that it would comply with the base conditions for interoperability. Consequently, a new ELNO may be able to interoperate having built connections to all of the relevant third parties, while lacking large parts of the transaction orchestration engine capability that PEXA has developed over 10 years.

Until Sympli develops a transaction orchestration engine with the same level of capability as PEXA, IPART's draft proposal essentially requires PEXA to provide capability access to Sympli as a wholesaler below cost. In these circumstances, the incentives for Sympli to delay or avoid ever building this additional capability are compelling.

It would not maximise economic outcomes for consumers for an enforcement regime to compel Sympli to build out the same capability as PEXA. There are manifest problems in compelling a corporate entity to duplicate existing infrastructure that is uneconomic. The better solution is to set interoperability fees at a rate that provides PEXA a reasonable return (wholesale fee) for the portion of the capability build ('transaction orchestration engine') and infrastructure that has been built by PEXA and has not been built by Sympli. Further detailed analysis is required to set a reasonable fee in this regard.

Since its discussion with IPART on 23 March 2023, PEXA has not had sufficient time to conduct detailed analysis of this issue. PEXA strongly urges IPART to undertake additional analysis in the light of this understanding of ELNO functionality and costs before finalising its recommended approach. This may include a revised approach to defining the trigger for the default RELNO surcharge, calculating the default RELNO surcharge, and its approach to cherry-picking.

2.3.2 Escalating costs of interoperability

The emerging history of the interoperability IT program suggests that the costs of introducing interoperability may be much higher than assumed in IPART's Draft Report. The repeated deferral of the timeline for introducing interoperability, and the rising actual and estimated costs of interoperability have all the hallmarks of an inadequately designed IT transformation where the costs are likely to exceed the benefits.

Delays in interoperability

The timetable for bringing interoperability into operation has been repeatedly delayed, and the estimated cost of interoperability has increased as shown in Exhibit 1.

Exhibit 1

History of interoperability timelines and cost estimates

Source	Date of estimate	Estimated cost (\$m)	Estimated Day 1	Estimated Day 2
IPART Pricing Review 2019 ¹³ based on AECOM Report ¹⁴	November 2019	0.6		

¹³ IPART, *Review of Pricing Framework Final Report*, p. 36.

¹⁴ AECOM, *Estimating costs of electronic conveyancing services in NSW Report*, <https://www.ipart.nsw.gov.au/sites/default/files/documents/consultant-report-aecom-estimating-costs-of-electronic-conveyancing-services-in-nsw-november-2019.pdf>, p. 34.

Centre for International Economics ¹⁵	August 2020	19.7	
Parties to the intergovernmental agreement for an e-conveyancing national law ¹⁶	September 2020		End 2021
Joint government and industry	March 2021	End 2021	
Joint Ministerial and ACCC	July 2021	Q1 2022	
Ministerial, ACCC and peak bodies	October 2021	Q3 2022	H2 2023
ARNECC Ministerial Forum ¹⁷	February 2023	Sep 2023	PEXA estimates early 2026, only for refinances in NSW and Queensland

Note: Day 1 is when a demonstration transaction occurs, and Day 2 is when interoperable capability is available in production to the general public. Estimated cost based on incremental cost of interoperability functionality relative to 2 ELNOs with full capability but not interoperable.

ARNECC, *Regulation impact statement: options for promoting competition in the market for electronic lodgment network operators*, <https://www.arnecc.gov.au/wp-content/uploads/2021/12/Interoperability-RIS-December-2021.pdf>

In understanding the significance of these delays, “Day 2” functionality is the most relevant.

“Day 1” functionality is effectively a one-off pilot demonstration of a refinance transaction that falls far short of a functional electronic transaction system. The latest estimate is that a single demonstration transaction will not occur until September 2023

“Day 2” equates with the start of functionality for mass customers. Due to the complexities of interoperability, in February 2023 Day 2 was phased into three releases.¹⁸ PEXA estimates that the first release of “Day 2 interoperability” – refinance transactions in NSW and Queensland with major banks – will be available in production from early 2026. There is presently no estimate for the timetable for subsequent releases that would extend interoperability to other jurisdictions, and to transfer transactions although it will be some time after early 2026.

Increasing complexity of interoperability

The primary cause of these delays is that implementing interoperability has proven to be much more complex than was assumed.

- In early 2021, it was envisaged that only 24 APIs would be required to implement interoperability. Under this proposal, known as the Lodging ELNO model, completed

¹⁵ Estimated capital costs of establishing direct connections interoperability for ELNOs (\$14.2m for PEXA; \$4.8m for Sympli), banks (\$0.2m) and SRO (\$0.5m): CIE, *Cost Benefit Analysis Final Report*, p. 48.

¹⁶ All parties to the intergovernmental agreement (‘IGA’) for an e-conveyancing national law, represented by their respective ministers and/or delegates, *Ministerial direction on a competitive market structure in the e-conveyancing market* (7 September 2020), <https://www.arnecc.gov.au/wp-content/uploads/2021/08/ministerial-direction-econveyancing-market-structure.pdf>.

¹⁷ ARNECC, *Ministerial Forum: National Electronic Conveyancing – Towards a sustainable, competitive national electronic conveyancing market* (28 February 2023), <https://www.arnecc.gov.au/wp-content/uploads/2023/03/Ministers-Statement.pdf>. (‘ARNECC, Ministerial Forum February 2023’), p. 1.

¹⁸ Ibid.

documents would be prepared independently by ELNOs and their clients, then shared between ELNOs, with registries verifying consistency between them.

- While this was a far simpler model of interoperability, the interoperability working groups determined it would deliver an unsatisfactory customer experience. Accordingly, a revised technical model of interoperability was developed – the current Responsible ELNO model
- However, the Responsible ELNO Model has proven far more complex to develop, requiring approximately three times the number of APIs (ARNECC estimates 71 in total)¹⁹.
- The Responsible ELNO Model also requires significantly more design work – while ARNECC estimated it would take three months to develop 100% of the APIs, the Interoperability Working Groups have spent more than 2 years so far, have only drafted 50% of the APIs, and none of them have been baselined for full interoperability

Increasing cost estimates for interoperability

The complexity and the time needed to design and implement the technical model of interoperability is inevitably reflected in its costs.

AECOM assumed that interoperability would add less than \$600,000 to the costs of building a new e-conveyancing platform.

PEXA's actual costs so far to build, test and deploy interoperability are estimated at over \$7m. Substantial further costs are expected, although they are difficult to forecast given uncertainties in the design and phasing of interoperability. The costs of establishing interoperability are significant. The most recent capital estimate from PEXA is that it will cost PEXA around \$25-30 million. These costs have not been finalised as the technical design is still underway. It is clear that the design is more complex than originally envisaged which is causing cost estimates to be progressively revised higher as the design continues to be progressed.

In addition to this external technical build, PEXA and other stakeholders are incurring significant costs, and will incur significant further costs, to:

- Project manage this IT build
- Work with ARNECC to design the interoperability technical specifications.
- Build interoperability APIs and update PEXA's underlying system architecture and code base to support them
- Maintain network stability while managing significant underlying code re-factoring and change
- Design and implement a new network governance framework
- Testing (both progress and regression) and implement each interoperable transaction type in each jurisdiction.
- Transfer key data standards for e-conveyancing and interoperability to NECDS Ltd

¹⁹ Ibid.

- Develop new network governance arrangements for the management of key data standards by NECDS Ltd.
- Develop and implement a new risk and liability allocation regime, and subsequently a new insurance framework
- Increase insurance premiums (for additional risks created by interoperability)
- Develop and negotiate the interoperability agreement between ELNOs
- Implement measures for compliance with Interoperability agreements
- Assist AusPayNet to develop the e-conveyancing Payments Code
- Renegotiate the existing contractual frameworks with all parties (including titles offices, revenue offices and financial institutions)
- Develop and implement business rules in the platform to accommodate interoperability.
- Develop and implement new complaint and dispute resolution framework (as interaction now required with other participating ELNOs)
- Train and support ELNO staff and subscriber staff to use multiple ELNOs – PEXA will incur much more of this cost than other ELNOs because it will have to support every existing customer, whereas new ELNOs will only incur this cost for each new customer they recruit to their platform.
- Assess and monitor broader network's cybersecurity (because additional APIs create additional points of vulnerability)
- Undertake incident management (Business Continuity Plans, Root-Cause Analysis, incident reports with other ELNOs)
- Participate in end-to-end security assessment, as yet not conducted to date, and which is critical to minimising the risks of change to consumers and industry participants
- Mitigate increased cyber security risks and network resilience issues that are created by interoperability (outlined in further detail below at section 2.5).

Some of these costs are materially higher for PEXA than new entrants because PEXA is retrofitting interoperability to an existing system. In particular, building interoperability APIs and then implementing them while maintaining the existing operational platform will require a great deal of careful design and coding, regression testing, rigorous controls and complex processes to maintain network security and stability, which is crucial to the Australian economy. IPART should not apply a discount to the costs PEXA is incurring, given PEXA is currently the only fully operational ELNO on whose infrastructure the new entrant will rely to participate in interoperable transactions.

The costs of new entrant ELNOs to build interoperability functionality may be lower than for PEXA. However, the additional APIs required to relative to PEXA's existing system imply that other ELNOs will also have substantial costs to build interoperable functionality relative to building a non-interoperable ELNO.

Costs of interoperability to other participants

Other participants in e-conveyancing, such as titles offices, revenue offices and financial institutions, are also incurring additional costs to deal with the additional complexity imposed by interoperability. To date, none of AECOM, IPART or the CIE have sought to quantify or consider the additional costs that will be incurred by other key industry stakeholders.²⁰ PEXA supports the submission by the Australian Banking Association that IPART should have regard to the costs of interoperability for other stakeholders.²¹ Introducing interoperability will require a very large retraining effort as a large number of personnel from PEXA's 10,000 subscribers and over 54,000 users need to learn how to manage a workspace when it becomes interoperable. Interoperability will also affect the processes of large institutions, such as banks and law firms, potentially adversely impairing existing performance measures such as 'Settle on Time', which track how many customers are able to settle on their due date and move into their properties on time. PEXA notes that through consistent industry efforts, this measure has improved to 83% in recent years. Compromising these features may delay consumers from accessing their new homes and create inefficiencies for practitioners and financial institutions. PEXA expects that financial institutions, law firms and PEXA will need to do a lot of re-work to restore network performance to pre-interoperability levels.

The costs of establishing integration infrastructure to financial institutions are significant and they have little commercial incentive to establish a second set of integrations with another ELNO under the current model of interoperability. Indeed, the ABA has previously indicated that at least one bank reported spending more than \$10 million to build their integration infrastructure with PEXA and that financial institutions may be required to build and maintain similar infrastructure for each new ELNO that enters the market.²² As Dench McClean Carlson found in its final report issued in connection with its review of the Intergovernmental Governmental Agreement for a national electronic conveyancing law (IGA Review):

- "Our stakeholder consultation identified that financial institutions had not yet recouped the initial costs due to the ongoing parallel processes (paper and electronic) and the higher than anticipated costs of the original introduction of e-conveyancing. They noted that the costs to implement and manage the required infrastructure and change management processes are significant".²³
- "Costs incurred by facilitators [i.e. banks, land registries and revenue offices] that do not yield any additional benefit are ultimately a cost to taxpayers or consumers."²⁴
- "Stakeholder feedback indicates that apart from the one-off costs of connection, there are significant ongoing costs for the maintenance and management of separate ELN connections".²⁵

²⁰ Financial Institutions, Revenue Offices and Land Registries.

²¹ IPART, *Draft Report*, p.13.

²² Australian Banking Association, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law: Issues Paper Submission* (10 April 2019), <https://dmcca.com.au/wp-content/uploads/2019/07/iga-issues-submission-aba.pdf>, p. 3.

²³ Dench McClean Carlson, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law, Final Report* (18 December 2019), <https://www.arnec.gov.au/wp-content/uploads/2021/08/iga-review-final-report.pdf> ('DMC, *Final Report*'), p. 90, para. 5.53.

²⁴ Facilitators refers to Land Registries, Revenue Offices and Financial Institutions: DMC, *Final Report*, p. 103, para 5.116.

²⁵ Ibid, p. 103, paras 5.116 and 5.117.

- “It is difficult to see how financial institutions could achieve a net benefit through connecting to a second ELNO, even allowing for price competition...”²⁶
- “Most facilitators have indicated that a new ELNO must either pay the facilitator’s costs of connecting to the new ELN or provide some alternate commercial incentive to connect.”²⁷

Failing to acknowledge the costs that the current model of interoperability imposes on all industry stakeholders is likely to understate the true costs that the interoperable market structure design requires.

An ill-fated IT transformation project?

The repeated deferral of the timeline for interoperability, and the rising costs of interoperability have all the hallmarks of an ill-fated IT transformation where the costs are likely to exceed the benefits. Principles of project management for large IT transformations suggest that the latest deferral of key timelines should prompt a clean-sheet review of the practicality of interoperability, and whether its benefits justify the escalating costs. Rethinking the interoperability program now provides an opportunity to avoid further costs for ELNOs, market participants, and subscribers.

It is always difficult to question an IT program once it has begun. Projects inevitably acquire their own momentum. However, once a program’s timeframes and cost estimates are proving to be much higher than the original business case, it is appropriate to reconsider the original decision in the light of additional information. Obviously, if a program is to be abandoned or alternative market structures revisited, then it is better to do so sooner rather than later to minimise unproductive costs. Rethinking the interoperability program now provides an opportunity to reconsider in light of these learnings whether there are other market structures that might better utilise competition to deliver price and innovation benefits to consumers.

Other similar industry transformation projects confronted with complexity, escalating costs / risks, and slipping timetables should have taken the prudent step of reassessing the feasibility of other market structure options before incurring further costs. The ASX’s CHES project failure, which cost approximately \$250 million highlights the issues with technology governance and delivery.²⁸ The failure of the ASX to acknowledge the problems of the CHES replacement project for many years had the result that many other market participants such as brokers incurred substantial costs designing and building integration to a system that ultimately never operated.²⁹

Similarly, a project to introduce interoperability to the cash equities services market, first mooted in 2011, has encountered issues. IPART has explicitly cited it as a model for e-conveyancing,³⁰ although interoperable e-conveyancing is materially more complex than an interoperable cash equities market because an e-conveyancing transaction is typically more complex, and a failed property transaction typically has greater consequences for a consumer. In submissions to the CFR, the ASX noted a number of risks and complexities associated with

²⁶ Ibid, pp. 90 and 103, paras 5.49, 5.50, 5.116 and 5.117.

²⁷ Ibid, p. 103, paras 5.116 and 5.117.

²⁸ Julia Talevski, ARN, *Misaligned views led towards \$250m ASX CHES project failure* (18 November 2022), <https://www.arnnet.com.au/article/703426/misaligned-views-led-towards-250m-asx-chess-project-failure/>.

²⁹ James Eyer, The Australia Financial Review, *ASIC takes aim at ASX CHES hubris*, <https://www.afr.com/companies/financial-services/asx-told-why-its-chess-project-was-a-profound-failure-20221205-p5c3lk>.

³⁰ IPART, *Review of Pricing Framework Final Report*, pp.13-14.

interoperability,³¹ including increased risk exposure, difficulty maintaining market stability, and significant costs to industry. The Council of Financial Regulators acknowledged these concerns in its reports.³² These issues also apply to the interoperable e-conveyancing market.

Over approximately a 10 year period, numerous reviews and stakeholder engagements were carried out by the ACCC and the CFR to facilitate safe and effective competition in the cash equities settlement and clearing market. However, despite extended consultation on the prospect of interoperability for the Australian cash equities industry, it was never implemented. Nonetheless, the absence of interoperability did not prevent effective competition emerging in the broader cash equities services market, with Chi-X entering and competing on the merits in 2011. At present, we understand Chi-X competes across equities, indices and derivatives gaining over 20% market share. Altogether, these outcomes supports PEXA's view that:

- mandated interoperability in complex markets (such as the e-conveyancing market) can result in greater risks and costs than perceived benefits;
- effective competition in small exchange based industries can emerge without interoperability; and
- alternate market structures are often better suited to facilitate competition in complex, high-fixed cost markets (as further discussed at section 2.7 below).

Indeed, after many years, Treasury have just commenced consultation to introduce a wholesale access model whereby a new regulated access / arbitration regime to facilitate competition in the provision of clearing and settlement in Australia will be implemented.³³

2.3.3 IPART preliminary cost analysis

IPART's Draft Report adds evidence to the unsurprising conclusion that building two identical sets of e-conveyancing infrastructure is more costly than a well-regulated single system, and even more costly once the additional costs of interoperability functionality are added.

On IPART's preliminary analysis, the interoperable market can only produce outcomes worse for consumers than a well-regulated wholesale provider market structure.

To illustrate, we assume that the ELNO market has only two players. Consumer prices would need to be even higher to accommodate the fixed costs of three players. As shown in Exhibit

³¹ ASX submitted that "interoperability does not seem to be a feasible option for Australia" and "while linking clearing houses through interoperability may mitigate some of the costs of fragmentation that arise from the introduction of a second clearing house without interoperability, it would introduce significant additional complexity and risks, which would make it more difficult for the clearing houses and regulators to effectively manage systemic risk and maintain market stability": ASX, *Submission to the Council of Financial Regulators Review of Competition in Clearing Australian Cash Equities* (March 2015), https://www.asx.com.au/documents/public-consultations/ASX_submission_to_CFR_on_clearing_competition_public_submission_March_2015.pdf pp 6, 8, 16-18, 39 and 43.

³² Council of Financial Regulators, *Competition in Clearing Australian Cash Equities: Conclusions Report* (December 2012), <https://treasury.gov.au/sites/default/files/2019-03/Competition-in-clearing-and-settlement-of-the-Australian-cash-equity-market.pdf>, pp. 3-4, 13-17; Council of Financial Regulators, *Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia Report* (September 2017), <https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2016/minimum-conditions-safe-effective-cash-equity/pdf/policy-statement.pdf>, pp. 13-14; Council of Financial Regulators, *Review of Competition in Clearing Australian Cash Equities: Conclusions Report* (June 2015), https://treasury.gov.au/sites/default/files/2019-03/C2015-007_CFR-ConclusionsPaper.pdf, pp. 23-24 and 29-32 (in particular para 4.4.4).

³³ Treasury, *Competition in the provision of clearing and settlement services* (23 March 2023), <https://treasury.gov.au/consultation/c2023-367748>.

2, using IPART's own preliminary analysis, three scenarios summarise the potential industry structures and efficient prices:

- **A balanced duopoly**, where both ELNOs have substantial market share, will have total industry costs higher than necessary, and higher than at present, which users and consumers will ultimately bear in the form of higher prices for ELNO Services; or
- **A lop-sided duopoly**, with one weak competitor, will only persist if the customers of the weaker competitor pay much higher prices than at present; or
- **A failed duopoly** where only one ELNO survives, so that there are no lasting benefits from competition, and much larger costs are incurred by the industry overall.

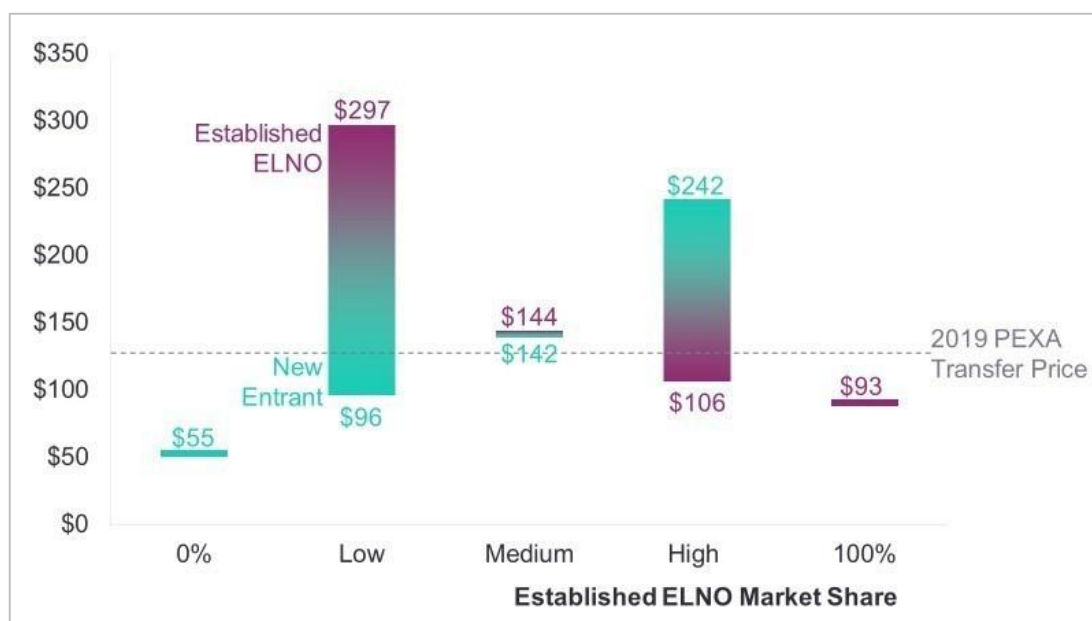
By contrast, under a well-regulated wholesale provider market structure:

- consumer prices are lower and protected under the existing regulatory scheme;
- universal coverage is maintained;
- risks to industry stability are lower; and
- other market structures may still be employed to deliver consumer value through competition, with retail ELNs benefitting from regulated infrastructure access.

Exhibit 2

Illustrative prices for a benchmark efficient ELNO (transfer with financial settlement)

(\$2018-19) including GST, based on IPART Draft report assessment of 2023 WACC and transaction volumes



Source: Based on IPART, Interoperability pricing for Electronic Lodgment Network Operators, Draft report, p.51

PEXA notes that consumer prices will be materially higher than shown in Exhibit 2 because the 2023 WACC will be materially higher and transaction volumes materially lower than the assessment in IPART's *Draft Report*, for the reasons set out in section 5.5.

It follows that on IPART's preliminary analysis, consumer prices will only be sustainably lower if interoperability results in a single player market. Under all other scenarios, at least one, and probably both of the competitors will need to charge higher Service fees than the current fees in order to be sustainable. On this basis, interoperability would not in fact deliver consumer benefits in the form of lower prices.

2.4 Poorer service, undermining universal service coverage

Interoperability is likely to discourage new e-conveyancing functionality and undermine the objective of universal service coverage, rather than encouraging innovation which was a crucial rationale for an interoperable market structure.

2.4.1 Cherry picking

IPART has acknowledged the problems of an ELNO delaying the build of comprehensive capability in order to cherry pick the most profitable jurisdictions and transactions.³⁴ However, it asserts that it would not be appropriate to recover costs associated with the Universal Service Obligation (**USO**) through interoperable transaction fees, because USO costs are driven by market design and not by the model of competition chosen.³⁵

However, interoperable transaction fees (particularly the default RELNO surcharge) are a feature of the "model of competition chosen". They affect the viability of USO investments, and therefore the incentive to make them. If the default RELNO surcharge does not reflect the problem of recovering costs for relatively low volume transaction types and jurisdictions, it is hard to see how else they would be addressed.

The outcomes proposed by IPART's draft report provide other ELNOs with strong commercial incentives to cherry pick the highest volume transaction types and jurisdictions, while ARNECC expects that PEXA will continue to build out its platform to provide an e-conveyancing solution for all transaction types in all jurisdictions. The cost of building capability for a particular transaction type or jurisdiction is largely similar, regardless of the volume of transactions (and revenue) that it generates.

Cherry picking might be minimised either by:

- requiring every ELNO to build comprehensive functionality,
- setting up dynamic market incentives, or
- imposing a USO levy on high volume transactions.

Regulatory requirements to build comprehensive functionality

IPART's draft report accepts ARNECC's assertions that "appropriate enforcement mechanisms" will prevent ELNOs from "cherry picking" through MOR requirements that all ELNOs must provide universal coverage.³⁶ However, this reliance is misplaced.

³⁴ IPART, *Draft Report*, p. 53.

³⁵ Ibid.

³⁶ Ibid, p. 54.

- The MOR **do not require comprehensive functionality**. The MOR only require integrations with land registries to prepare land registry instruments (i.e. the lodgement component of e-conveyancing).³⁷ There is no regulatory obligation under the MOR to establish financial settlement capabilities with revenue offices or financial settlement institutions. This is because the regulation of financial settlement in e-conveyancing is beyond the legislative ambit of ARNECC's jurisdiction.
- ELNOs are allowed to **operate while lacking the functionality** to lodge required instruments. Indeed, the MOR enables ELNOs to operate as they work towards comprehensive functionality if the implementation of that functionality is 'reasonably staged in accordance with the ELNO's Business Plan'.³⁸ Consequently an ELNO is allowed to operate even when it has much less than comprehensive capability.
- The MOR have **not set clear timeframes** for ELNOs to have comprehensive functionality.³⁹ Instead, that timeframe is **set by the ELNOs themselves**. There is no penalty or enforcement mechanism whereby ARNECC or the Registrars could require an ELNO to comply with commitments made under an ELNO's business plan, nor is there a definition in the MOR (or elsewhere) for the phrase 'reasonably staged'. This is inherently a vague requirement, and it is unclear how ARNECC would be able to establish that an ELNO had failed to comply. The result is that the MORs leave the timing of the development of comprehensive functionality to ELNOs to determine in accordance with market incentives.
- ARNECC has **not yet specified** how future enforcement mechanisms will work. Consequently it is hard to be confident that they will be effective, particularly when there are powerful commercial incentives to ignore these requirements.
- Enforcement **mechanisms are inherently weak** in this situation unless there are "intermediate level" penalties. If sanctions are too severe relative to the regulated conduct, they are generally unusable in practice. ARNECC's primary sanction is to withdraw the licence of an ELNO that fails to provide universal coverage. In practice, it is unlikely that a regulator would apply this sanction merely because particular functionality was lacking given the disruption that withdrawing a licence would cause to the market.

Market incentives

Rather than relying on regulatory intervention, it would be better regulatory practice to lean more on dynamic pricing incentives to deliver appropriate market structure and public interest outcomes.

IPART asserts that the Default ELNO surcharge will provide incentives to the new entrant to invest in infrastructure.⁴⁰ However, these incentives are unlikely to be sufficient:

³⁷ MOR 5.2 requires an ELNO to ensure that its ELN is available to each Land Registry in Australia capable of receiving electronic Registry Instruments and other electronic Documents from an ELN and to Subscribers in all States and Territories in Australia. However, the MOR do not require integrations with revenue offices or financial settlement institutions. Further, there is no penalty for failing to establish universal service, or to evidence that steps are being taken to achieve universal service coverage.

³⁸ MOR 5.2(c) requires an ELNO's Business Plan to set out its timings for the commencement of operations and anticipated level of service. Clause 5.2 states that 'the implementation of Operating Requirements 5.2(a), (b), (c) and (d) may be reasonably staged in accordance with the [ELNO's] Business Plan...'. This in effect means that there is no mandated timetable for the implementation of comprehensive functionality: ARNECC, *Model Operating Requirements Version 6.1*.

³⁹ Ibid.

⁴⁰ IPART, *Draft Report*, pp. 23 and 38.

- The level of the RELNO fee and Default RELNO surcharge that IPART has proposed – only about 1% of the total Service Fees earned for a transaction – is far too low to drive ELNO behaviour.
- Incentives will be inadequate to invest in transaction types and jurisdictions with lower than average volumes because IPART proposes a similar fee for all transaction types and jurisdictions
- Incentives will be inadequate unless an ELNO has a market share approaching 50% because IPART's methodology apportions costs across the entire market volume, and ELNO Service fees from transactions will not be sufficient to recover total costs unless an ELNO has close to 50% market share (See Exhibit 2).

IPART should also question Sympli's claim that it will have sufficient commercial incentives to build connections to all financial institutions and revenue offices. With very low interoperability fees relative to subscriber fees, Sympli's commercial incentives appear to be to either avoid the RELNO role, or to default on it.

Consequences

Consequently, there are strong incentives for a new entrant to engage for an extended (or even indefinite) period to develop functionality only for high volume transaction types and geographies and to rely on the incumbent's infrastructure for the rest.

Accordingly, IPART should rethink its assumption that concerns about cherry picking are not relevant to setting interoperable transaction fees, and rethink its approach to interoperable transaction fees so that they provide greater incentives to provide comprehensive functionality, and an appropriate reward for creating functionality that is used by other ELNOs. This would go some way to reducing incentives to cherry pick. However, the overall market structure would still discourage ELNOs from investing in new functionality, particularly for lower volume transaction types and jurisdictions.

2.4.2 Irrecoverable fixed costs

The regime proposed by IPART will effectively allow Sympli to collect Subscriber fees for a significant number of transactions while free-riding on PEXA's capability to execute many of these transactions.

As discussed above, IPART's approach also allows the new entrant to free-ride on PEXA's fixed costs of: (i) building 'the pipes' (the automated connections to Revenue Offices, financial institutions and land registries); and; (ii) developing 'the transaction orchestration engine' that delivers the automation essential to delivering an efficient e-conveyancing system. Without this capability, Sympli would be unable to complete many transactions automatically, and interoperability would not be possible in practice.

IPART's analysis may have assumed that a new ELNO will build the same transaction type capability 'transaction orchestration engine' as the incumbent ELNO. However, a new ELNO can begin interoperating when it has only built a small portion of the transaction orchestration engine that PEXA has built over its 10 years of development.

The survivorship transaction type illustrates the flaws in IPART's proposed approach to interoperability pricing that will enable the new entrant to free ride on PEXA's investment. If an interoperable transaction involves a survivorship, such as a transaction involving a discharge, survivorship and transfer, Sympli would only be able to participate in the transfer

portion of that transaction (for which it would recover ELNO Service Fees) because PEXA had incurred the costs to establish the capability to conduct the survivorship portion of the transaction.

AECOM's analysis, cited in IPART's draft report, appears to assume that a RELNO will default because it does not have the right pipes. However, it is more likely that a RELNO will default because it has avoided the more significant cost of building the transaction type capability ('the transaction orchestration engine') to process low volume transaction types. If Sympli does not build transaction type capability, then it may not be able to accurately deliver the appropriate information to the other parties to the transaction.

Under the minimal RELNO fee and default RELNO surcharge proposed by IPART, Sympli would have powerful commercial incentives to focus its non-interoperable business on a few core high volume transaction types. With its interoperable business, Sympli would be able to charge Subscribers for a comprehensive service, while it only provides relatively simple user interfaces and relies on PEXA's comprehensive capability, paying only a fraction of PEXA's costs of providing that capability.

The regime that IPART proposes would do little to deter free-riding, and would result in PEXA being unable to recover the capital costs of infrastructure from those who use it.

- These capital costs will not be recoverable through the RELNO fee because IPART has calculated the RELNO fee to only recover marginal costs and exclude all capital costs on the basis that all RELNOs must incur these capital costs.
- However, it is a fiction that Sympli will incur these capital costs in the foreseeable future – as discussed in the previous section, the requirements to do so are weak, not comprehensive, unlikely to be enforced, and not backed by material commercial incentives.
- The Default RELNO surcharge will not recover the capital costs of infrastructure because it is only 1% of transaction revenue.

It is not easy for IPART to design a fee regime that can resolve these issues.

- The RELNO fee can only be meaningful if IPART abandons its approach of excluding infrastructure costs, and includes the costs of developing transaction type capability, recognising that this functionality is core to the RELNO role, and much less important to PELNOs.
- The Default RELNO surcharge would need to be much higher than IPART proposes in order to create incentives to create transaction type capability or provide PEXA with a reasonable return on the capital costs of its infrastructure
- The default RELNO surcharge would need to be payable whenever a participating ELNO lacks any of the transaction type capability required to complete a transaction in an automated way. This would reduce the opportunity to free-ride on the transaction type capability created by other ELNOs.
- To avoid free-riding, the default RELNO surcharge would need to take into account that transaction type capability for more unusual situations typically costs more to build (on a per transaction basis).

Unless IPART substantially modifies the fee regime, its opportunity for free riding will be a disincentive for PEXA to develop capability for new low-volume transaction types.

2.4.3 Self-preferencing

IPART has acknowledged that 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.⁴¹ ATI Global – the 50% owner of Sympli (alongside ASX) – appears to have the ability and incentive to leverage its dominant position in the upstream market for legal practitioner and conveyancer practice management software (**PMS**) to channel consumers to its ELNO, Sympli. For example, by providing enhanced integration between the two services, once interoperability is implemented, ATI Global together with Sympli can lock many consumers into its vertically integrated technology stack, insulating its products and services from effective price and quality competition.

At present, ATI Global faces no regulatory restrictions on using its dominant position in PMS to self-preference Sympli. This is because the MOR only applies to ELNOs.

This is problematic in circumstances where:

- Interoperability will enable Sympli to participate in interoperable e-conveyancing transactions at a very low price using PEXA's proven infrastructure and network (if IPART's draft recommendations were to come into effect).
- Once interoperability is implemented, ATI Global will emerge as the controller of the only fully vertically integrated conveyancing workflow technology stack in Australia.
- ATI Global, through its various owned and affiliated entities, has market power in the upstream PMS market. PEXA estimates that ATI Global has a share of around **65-70**

⁴¹ Ibid, p. 18.

per cent⁴² in the PMS market⁴³ and **74 per cent of the property search** segment of the broader Information Search Services market.⁴⁴

- The importance of PMS to a legal practitioner's business means that ATI Global has many opportunities to influence their choice of ELNO, including to:
 - cross promote its services, including by requiring that practitioners use one ELNO (such as Sympli) to the exclusion of any other (such as PEXA); and
 - offer discounts that are cross-subsidised across its vertically integrated product lines, such as cross-subsidised subscriptions to PMS and ELNO services to gain share and support retention across markets.
- By contrast, as PMS is an inherently 'sticky' upstream product to e-conveyancing, ELNOs cannot influence a practitioner's choice of PMS provider.

Accordingly, interoperability could result in Sympli gaining market share in e-conveyancing (while entrenching ATI Global's position in the upstream markets) – without having to compete on the merits. Having regard to the risks of cherry picking that IPART has acknowledged (discussed above at section 2.4.1), Sympli will be able to free ride on PEXA's RELNO capability while collecting ELNO Service fees. This in turn is likely to undermine PEXA's ability to recover costs, which will stymie its incentives and ability to deliver further innovative functionality and universal service coverage.

2.4.4 Interoperability is not delivering much innovation

The combination of cherry picking, irrecoverable fixed costs and competitor-self-preferencing would substantially reduce the incentives of PEXA and other ELNOs to innovate. This is problematic when innovation was one of the core rationales for introducing interoperable e-conveyancing.

⁴² PEXA, *PMS & Search Market Survey Data (2021 and 2022)*: PEXA's estimates of ATI Global's shares of supply are based on two surveys it has conducted, which asked PEXA's practitioner firm customers what PMS provider they utilised. The first survey, conducted in May 2021, obtained responses from 2,307 subscribers, the second survey, conducted in April/May 2022, received responses from 1,254 individual firms. The findings of each survey indicated that ATI Global, via its owned and affiliated entities, accounts for around 70 per cent of all PMS subscriptions. The survey PEXA conducted in 2022 also included a question regarding PEXA's practitioner customers' choice of property certificate search provider. Based on responses to this survey, ATI Global via InfoTrack and TriSearch have 74 per cent share of the property certificate segment of the broader Information Search Services market. Respondents to these surveys were practitioners from medium, small, and micro sized firms. These surveys did not cover PEXA's 200 top practitioner firm customers (i.e. the largest firms), but PEXA estimates that around 89 of these firms also utilise ATI Global's PMS offerings. Coupling this data with PEXA's 2022 market survey, PEXA estimates that ATI Global accounts for around 65 per cent of all PMS subscriptions.

⁴³ ATI Global services the key segments of the PMS market through four primary offerings: (1) **Leap Legal Software (owned by ATI Global)** is the market leader for PMS and dominates the supply of services to small to medium practitioner firms with ~5000 customers. Leap is fully integrated with the products of InfoTrack (another ATI company), including the full suite of conveyancing products such as WebVOI for digital verification of identity, eCOS electronic contracts for sale SignIT electronic signing, and secure exchange (SecureXchange) and settlement (SettleIT); (2) **Practice Evolve (owned by ATI Global)** services mid-tier practitioner firms and offers fully integrated legal practice management software and conveyancing workflow functionality to its clients. In addition to a presence in Australia, it also services New Zealand; (3) **Smokeball (affiliate of ATI Global)** provides specialised PMS to smaller conveyancing and law firms, including conveyancing workflow functionalities alongside broader legal project management tools; and (4) **triConvey (affiliate of ATI Global)** provides PMS with integrated search and conveyancing tools and provides its software at no charge when practitioners also conduct searches through their triSearch integration.

⁴⁴ ATI Global owns and operates market leading InfoTrack, as well as alternative Information Search Service providers - TriSearch and Creditor Watch. Through these entities, ATI Global is able to provide a full suite of Information Search Services (i.e. company, property and personal information searches). Practitioner firms generally favour full-service Information Search Service providers, such as those provided by ATI Global. However, unlike ATI Global, alternative service providers are not fully integrated across the entire conveyancing workflow technology stack.

In theory, interoperability was designed to encourage innovation by all market participants. After commencing operations four years ago, it appears that it will be many years before Sympli can replicate PEXA's existing capabilities, let alone innovate substantially new capability. All of the innovations over the last four years have been the consequence of functionality implemented by PEXA.

Rather, interoperability is likely to provide incentives for surface-level innovation (such as the user interface) to attract customers, but dis-incentivise substantive innovations as to the 'pipes' or the 'transaction orchestration engine' of ELNO capability where much innovation has occurred in this nascent industry. This is because, under the model proposed, entrant ELNOs can readily free-ride on PEXA's capability.

PEXA is also concerned that certain features presently available in PEXA's non-interoperable system, would not be available under the proposed model of interoperability. PEXA is currently aware of at least two features that it believes will not work or cannot be made available under the proposed model of interoperability:

- **Auto-balancing to correct small errors that would otherwise cause a settlement to be delayed.** PEXA conceived and developed an innovation that provides automated calculation and optional auto balancing of both surplus funds and shortfall as they relate to settlement. This solution has resulted in approximately a 10% uplift in on-time settlement in monitored trials. PEXA has deployed this feature on an 'opt in' basis to subscribers and continues to work with subscribers to drive adoption to improve on-time settlement for end-consumers (purchasers and vendors of real property). The automated features which drive this solution rely upon certain events being triggered across participants in the workspace. However, none of the events highlighted in the above description are captured by the ARNECC ELNO Interoperability specification. It is also unknown if any other ELNO will rely upon the same event triggers for the purpose of developing their own automated calculation of surplus and shortfall function. For these reasons, PEXA will have to disable this capability for interoperability workspaces.
- **Integration with ATO to withhold GST.** PEXA has digitised an Australian Taxation Office GST withholding process to automatically fulfil a vendor's obligations when a real property transaction is taxable: Since 1 July 2018, if the supply of real property is taxable, the ATO requires purchasers to withhold GST from the contracted sale price and remit GST withheld to the ATO. To make this process more efficient for its subscribers, PEXA built an integration to the ATO to pass GST withholding information and remit payments of GST to the ATO. ATO reporting generated by PEXA also assists property developers to reconcile GST payments made to the ATO via PEXA workspaces. Unlike lodgement of Land Registry dealings where the orchestration of verification and lodgement of land registry instruments is defined in the National e-Conveyancing Data Standard (i.e. the NECDS), the orchestration for the ATO GST withholding has been designed by PEXA for its subscribers using PEXA's workspace. In circumstances where another ELNO does not have the same ATO GST withholding orchestration capabilities, PEXA will be required to disable its GST withholding capability for interoperable workspaces.

PEXA is yet to understand the full effects of interoperability on its products and offerings because the technical model of interoperability is still being built and additional amendments to the ECNL are contemplated.

2.5 The risks of interoperability

ARNECC has ensured that independent readiness assessments have been incorporated into the interoperability reform process.

In a recent report for PEXA, PWC identified that interoperability creates substantial additional risks.

- The cyber risks inherent in direct connections interoperability are uncomfortably high.
- Bilateral connections interoperability require larger number of technical integrations and involves the decentralisation of the source of truth, source of identity and certification authorities, which increase its complexity and cyber-attack surface.
- Interoperability leads to higher risks of outage, fraud, non-repudiation and subscriber authentication issues.
- Interoperability would result in significant increases to privacy and data protection risks, which in turn raise significant reputational risks for both conveyancers and ELNOs.

PEXA remains concerned that interoperability could erode the integrity of e-conveyancing, and in turn property transactions, while also sitting outside the risk appetite for most organisations. Recent high profile data breaches, such as the widespread Optus data breach in 2022,⁴⁵ and the corresponding legislative response to substantially increase penalties for poor privacy / data handling practices,⁴⁶ support our view that there is little appetite amongst industry participants for a market structure that would increase cyber security risks to industry participants or consumers who rely on e-conveyancing to safely convey property.

As of the date of this submission, no assessment has been conducted of the full spectrum of risks and costs (including to industry and consumers) associated with interoperability. In particular, industry has not conducted an end-to-end security assessment of the risks involved with interoperability.

2.6 Sovereign risk

The design and pricing of interoperability may prevent PEXA from recovering a reasonable return on its historic investment to establish the e-conveyancing market, which has delivered very large productivity benefits.

IPART has accepted the regulatory outcome that there is no specific means for PEXA to recover higher first-mover costs on the basis that it has countervailing advantages as a first

⁴⁵ In September 2022, Optus announced that it had been subject to a cyber-attack and that close to 10 million current and former customer accounts and information (such as names, dates of birth, passport numbers and addresses) had been disclosed: <https://asic.gov.au/about-asic/news-centre/news-items/guidance-for-consumers-impacted-by-the-optus-data-breach/>.

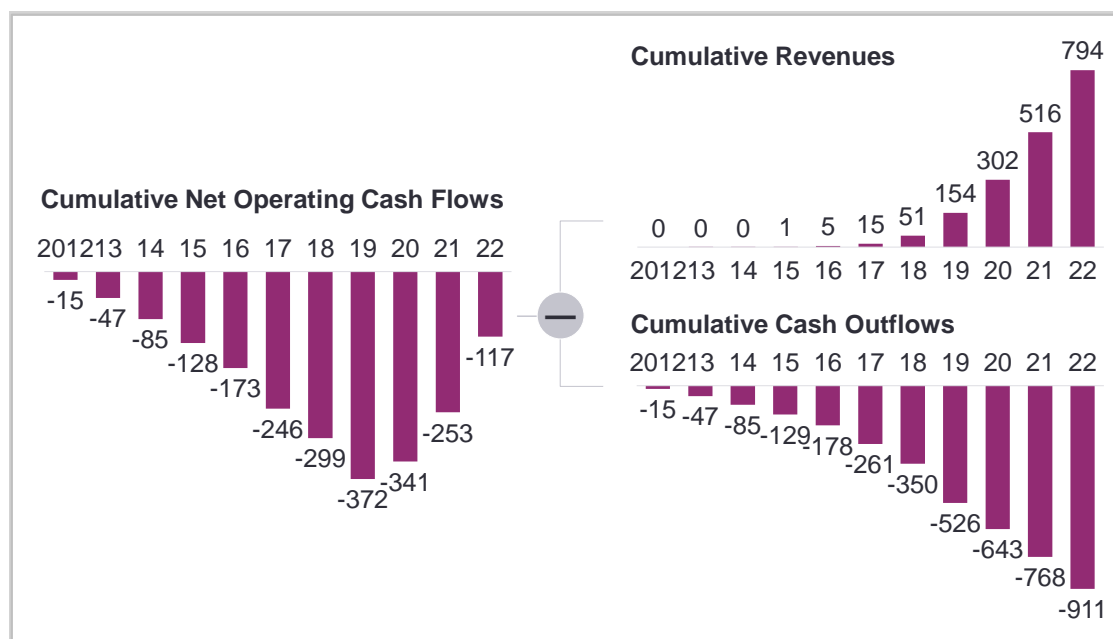
⁴⁶ In November 2022 the government passed the *Privacy Legislation Amendment (Enforcement and Other Measures Act 2022)* (Cth) which increased the maximum penalty for serious or repeated privacy breaches by companies from \$2.22 million to whichever is the greater of \$50 million, three times the value of the benefit obtained from the contravention or 30% of the adjusted turnover for the company during the breach turnover period: <https://www.legislation.gov.au/Details/C2022A00083>. In February 2023, the government also flagged that it was considering introducing a new Cyber Security Act which would impose new obligations and standards across industry: <https://www.abc.net.au/news/2023-02-27/national-cyber-office-to-be-established-in-wake-of-optus-hack/102026156>.

mover.⁴⁷ However, as shown in Exhibit 3, PEXA has not yet recovered its initial capital expenditure, much less earned a return on the capital deployed.

Exhibit 3

PEXA cumulative net operating cash flows (Australian ELNO business only)

\$m real 2022\$



Note: Financial years ended 30 June

Source: PEXA Finance; ABS CPI

PEXA notes that this analysis has merely adjusted historic cash flows by inflation. In fact, a cost of capital should be applied, and once this is taken into account, PEXA is many years from earning a positive return on the capital that has been invested in its ELNO. PEXA is reasonably entitled to a higher return on the cash expended in its early years when it was a highly speculative technology business with uncertain prospects of success.

PEXA incurred substantial costs as the first mover in establishing e-conveyancing. It incurred the costs of designing and developing business systems, contracts, and interfaces with titles offices, revenue offices, financial institutions and conveyancing practitioners that other ELNOs can largely copy. It expended considerable effort convincing a large number of participants to change from paper-based transaction systems to electronic transaction systems.

There is no suggestion that PEXA's historic investments have been inefficient – they are estimated to have resulted in substantial productivity gains. At a practitioner level, the current e-conveyancing system delivers around \$66 in savings per transaction compared to paper conveyancing (IPART).⁴⁸ At an industry level, PEXA estimates the annual benefit of the e-conveyancing system is more than \$240 million annually.⁴⁹ Beyond the extensive benefits to participants, e-conveyancing is an exemplary example of a successful private-public partnership and is a national achievement that provides essential, safe and reliable services supporting the Australian property industry. IPART's pricing review found that PEXA's existing

⁴⁷ IPART, *Interoperability pricing for Electronic Lodgment Network Operators Issues Paper 2* (October 2022), p. 16. "PEXA has had first mover advantages. Private businesses in a competitive market are not guaranteed a return on their investment".

⁴⁸ IPART, *Review of Pricing Framework Final Report*, p. 60.

⁴⁹ PEXA, *Prospectus*, p. 43.

prices were reasonable and fair compared to modelled prices for a benchmark efficient ELNO.⁵⁰ The costs already expended by Sympli to part build an ELNO (see above section 2.3.1) also suggest that PEXA's capital costs were reasonable, particularly in the context that Sympli had the benefit of two co-owners which have built and operate large and sophisticated IT systems.

Therefore, PEXA has not yet had a reasonable opportunity to earn a return on its investment to bring the electronic conveyancing market into existence.

Originally a product of the Council of Australian Governments, the government interests have sold their interests in PEXA for more than \$480 million in 2018, and PEXA is now a listed company with thousands of private and individual shareholders who invested in good faith. If PEXA were deprived of a reasonable opportunity to earn a return on its invested capital, it would raise sovereign risk issues, potentially deterring investors from undertaking similar innovations in future.

2.7 Alternative market structures

The combined impact of the issues outlined above would be an electronic conveyancing system that would provide less consumer benefit than the existing system. The interoperable model will impose significantly greater costs on subscribers and on industry participants such as titles offices and revenue offices. It would be significantly less functional and less secure. Even the possibility of this outcome suggests that regulators should reconsider their approach as a matter of priority. More broadly, these issues and IPART's preliminary analysis demonstrate that the small (notional) benefit that the RIS found in favour of interoperability is incorrect.

Many of the problems identified to date with interoperability would not arise if a different structure were adopted for the ELNO market. Some potential alternate structures would still preserve key elements of competition that deliver benefit to consumers, while avoiding the complexity, risks and increased ELNO service fees that consumers will be burdened with under an interoperable market structure. For example, IPART's previous report discussed a highly regulated "infrastructure ELNO" model whereby there would be an entity regulated access for the new entrant ELNO to its connections with the underlying participants (such as titles offices, revenue offices and RBA).⁵¹ IPART found that this model would have the lowest additional capital costs, particularly if there are more than two ELNOs.⁵²

The Infrastructure ELNO model is analogous to the structure of other industries with high fixed costs where the dead-weight cost of infrastructure duplication is avoided through a regulated wholesaler required to provide open access to a wide range of competitors who compete in their ability to service end users of the service, in industries such as rail, telecoms and coal terminals.

IPART did not prefer the Infrastructure ELNO model on the basis that the infrastructure ELNO would have little incentive to develop innovative infrastructure services such as for lodgment

⁵⁰ IPART, *Review of Pricing Framework Final Report*, p. 45.

⁵¹ Ibid, p. 30.

⁵² Ibid, p. 32.

and financial settlement.⁵³ It also found that Sympli's sunk investments in building the infrastructure required for financial settlement and title lodgment would be redundant.⁵⁴

IPART's reasons for preferring an interoperable market structure rather than an "infrastructure ELNO" structure are not tenable in view of the emerging evidence and understanding about interoperability, particularly its substantially higher costs:

- The additional cost of interoperability involving direct connections has proved to be much larger than initially anticipated, and may well escalate further.
- The Responsible ELNO interoperability model will in practice provide even weaker incentives for the new entrant to develop innovative infrastructure services or even to replicate the new entrant ELNO to replicate the innovative capability already built by PEXA for lower volume transaction types and jurisdictions. For the reasons discussed at sections 2.4.1 and 2.4.2, the incentives will be even weaker to be the first ELNO to build new lodgment and settlement capability.
- Sympli's investments in building infrastructure for financial settlement and title lodgment have proven much slower than initially planned. Although it has completed a "demonstration" transaction, over three years after IPART's report, it appears that Sympli still only performs refinances by arrangement for non-interoperable transactions, in which all subscribers use its own system. However, Sympli does not appear to regularly execute transfers. We understand it is operating on a very small scale with revenues in 2021-22 of less than \$100,000.⁵⁵

The fact that Sympli has sunk significant costs trying to build ELNO capability is not sufficient reason to persist with the interoperable market structure. After four years, offering is confined to a small subset of ELN functionality (non-settlement lodgements in a small subset of jurisdictions). Sympathy for Sympli's sunk costs is not sufficient reason to impose higher ongoing costs on consumers and other system participants. In any case, if an Infrastructure Model were to be pursued, Sympli would still have the option of becoming a wholesale ELNO (meaning its investments to date would not be wasted), while also having the option of being a retail ELNO utilising PEXA's existing infrastructure.

Alternative market structures would provide a more secure, reliable, and affordable method of conducting property transactions for all Australians. Their advantages include:

- Avoiding the significant costs of duplicating existing ELNO infrastructure / capability and higher prices for uses and consumers.
- Avoiding incurring further significant costs to establish and maintain interoperability, which given the history of ongoing delays and escalating costs are probably still underestimated.
- Maintaining incentives to invest in and maintain universal coverage.
- Maintaining national pricing for all transaction types.
- A single interface for titles offices and revenue offices.

⁵³ IPART, *Review of Pricing Framework Final Report*, p. 31.

⁵⁴ Ibid, p.35

⁵⁵ Sympli, *Financial Report 2021-22*, ASIC disclosure, Document No 7EBW94625.

- Lower cyber security risks as there are fewer points of entry, and a reduced cyber-attack surface.
- More incentive for specialised retail ELNOs to serve particular customer types, such as the owners of commercial property or greenfield releases, or particular subscribers such as small or large financial institutions.

3. Interoperability fee framework

Whether or not IPART accepts PEXA's submissions above, PEXA suggests that IPART should reconsider crucial aspects of the proposed RELNO fee and Default RELNO surcharge.

3.1 Issues that are largely agreed or accepted

PEXA accepts some of the high level principles that IPART has applied to interoperability fees. In particular, PEXA agrees with the Draft Report that:

- A Responsible ELNO fee should be payable;⁵⁶
- The costs of interoperability should be recovered from all subscribers through Service Fees;⁵⁷
- The same subscriber fee should be payable, whether or not a transaction is interoperable;⁵⁸
- Interoperability fees should be set directly by IPART,⁵⁹ and IPART should set fee levels rather merely setting a methodology;⁶⁰
- Lodgment support service fees should not be recovered through interoperable transaction fees;⁶¹
- There should be a separate RELNO fee and a Default RELNO surcharge;⁶²

However, PEXA disagrees with the level and basis for setting the RELNO fee and the Default RELNO surcharge,⁶³ as discussed below at sections 4 and 5.

PEXA accepts IPART's conclusion that fees should be set for a two year period commencing 1 July 2023.⁶⁴

PEXA accepts IPART's conclusion that in indexing fees, capital costs should not be indexed,⁶⁵ provided that WACC is calculated appropriately (discussed further below at section 5.6).

3.2 Common user charge

PEXA does not agree with IPART's conclusion that inter-ELNO charges should not include a common user charge to recover the cost to create the existing e-conveyancing system on

⁵⁶ IPART, *Draft Report*, p. 12, para 3.1.

⁵⁷ Ibid, p. 13, para 3.2.

⁵⁸ Ibid, pp. 13-14, para 3.3.

⁵⁹ Ibid, p. 14, para 3.4.

⁶⁰ Ibid, p. 15-15, para 3.7.

⁶¹ Ibid, p. 14, para 3.5.

⁶² Ibid, pp. 16-17, para 3.8.

⁶³ Ibid.

⁶⁴ Ibid, pp. 19-20 para 3.9.

⁶⁵ Ibid.

which interoperability is built.⁶⁶ A common user charge would be a mechanism to assist PEXA to earn a return on the additional costs that it incurred to establish the system, which subsequent ELNOs do not need to incur.

IPART's reasons for rejecting a common user charge are unconvincing.

- IPART asserts that the role of an interoperable transaction fee is to recover only those costs which relate to an ELNO acting as a RELNO, and a common user charge does not fit this definition. However, the draft definition of an Interoperability Service Fee is that it is a fee charged to another ELNO in relation to "establishing and maintaining Interoperability with the other ELNO and carrying out the functions of the Responsible ELNO".⁶⁷ PEXA's actions to create a system of e-conveyancing fall within this definition. PEXA's creation of a system of e-conveyancing is a necessary part of establishing Interoperability, and the functions of the Responsible ELNO could not be carried out without this system.
- IPART asserts that participation in an interoperable transaction is not the same as providing access to monopoly infrastructure. However, interoperability effectively compels PEXA to provide the new entrant ELNO with the ability to use its transaction orchestration engine, which it has built through extensive investment. This is the digital equivalent of providing access to monopoly infrastructure. As at the date of this submission, Sympli has not demonstrated the capability or infrastructure to provide e-conveyancing services for many transactions or jurisdictions. Until Sympli is able to evidence that it is able to provide universal service coverage, for the transaction types and jurisdictions in which it is unable to be the RELNO, it is in effect accessing PEXA's existing infrastructure and capabilities.
- IPART asserts that a founding ELNO fee would constitute a barrier to entry and inhibit competition. However, a common user charge would not be a barrier to competition, as it would only pay for the additional costs incurred by a reasonable efficient founding ELNO that are not incurred by subsequent ELNOs. Consequently it would be consistent with a level playing field between PEXA and subsequent ELNOs – indeed any other arrangement by definition would provide a regulatory advantage to subsequent ELNOs relative to PEXA.

If IPART does not include a common user charge as part of the inter-ELNO charges, then the imposition of interoperability, and the precise way that this is implemented by IPART, may have the result that government regulation precludes PEXA from earning a reasonable return on its investment. As discussed above at section 2.6, this would raise sovereign risk issues, potentially deterring investors from undertaking similar innovations in future. It may also preclude those who purchased PEXA from government from having an opportunity to earn a reasonable return on their investment.

3.3 Data reporting

In principle, PEXA agrees that data reporting requirements under the MOR would support future reviews of interoperable transaction fees.⁶⁸ In particular, PEXA considers that data reporting requirements will be important as an ongoing check regarding the key assumptions

⁶⁶ Ibid, pp.14-15, para 3.6.

⁶⁷ Model Operating Requirements 7.1, cl 2.1.2 (definition of Interoperability Service Fee).

⁶⁸ Ibid, pp. 20-21, para 3.10.

underpinning the IPART analysis (such as all ELNOs developing full functionality) and to ensure industry sustainability.

Under IPART's envisioned approach for implementing this recommendation, ARNECC would consult with industry to develop a standardised information template to ensure a consistent approach to reporting in order to assist with future reviews.

PEXA largely agrees with IPART's recommendations on reporting requirements,⁶⁹ and that ELNOs should be required to report on:

- The number of interoperable transactions in which the ELNO participated, and whether they were the RELNO or the PELNO in that transaction
- The number of interoperable transaction fees paid and received
- The number of transactions in which an ELNO was unable to perform the designated RELNO role and the reasons why
- The number of interoperable transactions that require support activities or issue resolution from the RELNO on behalf of all PELNOs in a transaction.

3.4 Payment of interoperable transaction fees

PEXA agrees that arrangements for payment of interoperable transaction fees should be negotiated by ELNOs rather than set by regulators.⁷⁰

ELNOs are sophisticated and well-resourced corporate entities that are well placed to discuss and agree upon practical matters relating to the payment of interoperability transaction fees, including the frequency and method of payment.

PEXA submits that IPART should clarify in its final report that any requirement in the MORs for practical arrangements for payment of interoperable transaction fees through Interoperability Agreements should be principle based (leaving the detailed mechanisms to be negotiated between the ELNOs). This would allow commercial parties the necessary flexibility to negotiate suitable and practical payment arrangements for interoperability fees.

3.5 MOR requirements

PEXA agrees with the proposed consequential amendments to the MOR identified by IPART,⁷¹ but considers them insufficient in some critical respects.

PEXA notes IPART's view that ARNECC should consider an enforcement regime for the default RELNO surcharge, in its development of a compliance and enforcement regime for interoperability.⁷² This regime will be important, and IPART should highlight these requirements further. For the reasons outlined in sections 2.4.1, 2.4.2 and 5, unless IPART materially changes its approach to the default RELNO surcharge, it will not create material

⁶⁹ Ibid.

⁷⁰ Ibid, p. 21, para 3.11.

⁷¹ Ibid, pp. 22-23, para 3.12.

⁷² Ibid, p. 23.

incentives for ELNOs to develop or maintain capability. Regulation and implementation that provides for effective, useable and practical enforcement and sanctions will be necessary to ensure all ELNOs build comprehensive capability within a reasonable period, thereby avoiding cherry-picking and free-riding.

However, IPART has only suggested that ARNECC should *consider* an enforcement regime for interoperability fees.⁷³ PEXA submits that IPART should highlight that such an enforcement regime, backed by useable and material sanctions, is imperative for the market design to succeed. Even if IPART does not recommend a specific enforcement mechanism – the need for such a mechanism should be included as a recommendation for the amendment of the MORs.

PEXA also submits that careful drafting is required to define **the trigger mechanisms for the payment of the interoperability fees**. IPART's recommendation should be more specific, and should state the exact circumstances in which it is envisioned that these fees are payable.

PEXA reiterates its submission in its response to Issues Paper 2 that the MOR should include a process for independent verification of assertions regarding RELNO capability and an enforcement regime for inaccurate claims. IPART should recommend that the MORs are updated to ensure there is an avenue for ARNECC to receive complaints about, and appropriate powers to investigate and apply appropriate regulatory penalties for, inaccurate claims of RELNO capability. In terms of enforcement, compensation should be payable to the aggrieved RELNO that would receive lower ELNO Service Fees as a result of the inaccurate claim of capability by the ELNO.

⁷³ Ibid.

4. RELNO fees

PEXA agrees with IPART that the RELNO fee should reflect costs incurred by RELNO and avoided by PELNOs.⁷⁴ PEXA agrees with IPART's summary of the actions performed by RELNOs.⁷⁵

PEXA also agrees with IPART that the RELNO fee should reflect the costs incurred by the RELNO that completes lodgment and financial settlement, based on the typical activities and costs incurred by the lodging RELNO.⁷⁶

4.1 Insurance costs

PEXA accepts that insurance costs should not yet be included in the RELNO fee.⁷⁷ IPART's reasoning is that all ELNOs are required to have minimum levels of insurance cover. However, these requirements are for minimum annual aggregate amounts. As a matter of basic insurance practice, the premiums charged to insure for these amounts are significantly influenced by the volume of transactions handled, and the insurer's assessment of the likelihood and extent of loss. However, insurer assessment of the probability of loss is not in practice sufficiently fine-grained to distinguish between the level of risk incurred by a RELNO relative to a PELNO, particularly for a new market design when there is no claims experience of loss. Until this claims history emerges, and there is evidence of insurers setting premiums with regard to the proportion of transactions in which a participant plays the RELNO role, PEXA accepts that insurance costs should be recovered through Subscriber Fees rather than the RELNO Fee.

4.2 Financial settlement costs

PEXA accepts that at present there is insufficient data to show that the RELNO would incur materially greater bank fees than a PELNO.⁷⁸ Until such evidence emerges, PEXA accepts that financial settlement costs should be recovered through Subscriber fees rather than interoperability fees.

4.3 Hosting costs

PEXA accepts that webhosting costs for a RELNO will not be materially higher than for a PELNO on a per transaction basis. Consistently with IPART's general approach to the RELNO fee, this implies that they should not be included in the calculation of the RELNO fee, but should be included in the Default RELNO surcharge.

⁷⁴ Ibid, p. 25, para 4.2.

⁷⁵ Ibid, p. 26.

⁷⁶ Ibid, pp. 26-27, para 4.3.

⁷⁷ Ibid, p. 28, para 4.4.1.

⁷⁸ Ibid, p. 29, para 4.4.3.

4.4 Issue resolution costs

PEXA agrees that issue resolution costs are a substantial RELNO cost and that PEXA agrees that Revenue NSW costs used by IPART are a reasonable starting point for estimating RELNO issue resolution and support costs. However, IPART should note fundamental differences between issue resolution costs for Revenue NSW and a RELNO.

Issue resolution costs for a RELNO, particularly in an interoperable system, are inherently higher than the costs for Revenue NSW. Typically Revenue NSW only needs to resolve issues affecting itself and a single party. Many e-conveyancing issues will require a RELNO to interact with a variety of entities, including statutory authorities (including both Revenue NSW and the Titles Office) and a variety of Subscribers. Furthermore, the probability of an issue arising per transaction is materially higher for an ELNO than for Revenue NSW – by definition, every issue that requires resolution by Revenue NSW will also require resolution by the RELNO, but the RELNO will also have to resolve many other issues that do not involve Revenue NSW. Consequently, PEXA submits that it is likely that issue resolution costs for a RELNO in an interoperable system would be at least double those experienced by Revenue NSW.

PEXA's actual experience suggests that RELNO-specific subscriber support costs would be around \$6 per transaction.

PEXA's subscriber support costs (such as call centre staffing costs) cost \$5.5 million per year in 2021-22. This cost should be inflated to \$7.3 million by applying PEXA's 17% actual and forecast volume growth (see section 5.5) and 13% inflation cumulative from 2021-22 to 2023-24. Across 486,000 transactions, this implies an average cost of \$14.90 per transaction for subscriber support costs in 2023-24. It is likely that support costs will be higher in an interoperable system due to the increased complexity of the system.

It is reasonable to estimate that the RELNO would be responsible for 40% of all queries in its capacity as RELNO. Between January and May 2022, 9% of all PEXA transactions required subscriber support services, with 72% of calls regarding set up and preparation, 1% regarding lodgment and settlement, 10% regarding post-lodgment and settlement, and 17% not specified.

In practice, the RELNO would be responsible almost all lodgment and post-lodgment queries. It would also be responsible for many set up and preparation queries, as many of these relate to inconsistencies and non-conforming entries that would be identified by the RELNO as it applies business rules to the collaborative workspace to ensure internal consistency and compliance. While the RELNO can change through the course of transaction, in practice it is likely that the RELNO at the time of lodgment will be the RELNO for most of the transaction. Consequently, dealing with queries before lodgment is generally a cost that the RELNO will incur, and the PELNO will not.

4.5 Single RELNO fee for all transaction types

PEXA notes IPART's view that there should be a single RELNO fee that does not vary by jurisdiction or transaction type,⁷⁹ on the basis that the number of subscribers (and therefore the number of RELNO fees payable) is a reasonable proxy for the complexity and frequency of issues that drive RELNO costs.

⁷⁹ Ibid, p. 34.

PEXA accepts that this is a reasonable basis for the early stages of interoperability, provided (as suggested in IPART's report) that the RELNO fee is calculated per subscriber. However, PEXA submits that IPART should explicitly note that whether there should be different RELNO fees for particular transaction types should be reconsidered once there is more evidence from the experience of an interoperable system in practice.

5. Default RELNO surcharge

PEXA agrees that there should be a default RELNO surcharge, but for the reasons below, submits that it should be significantly larger than proposed to be set by IPART.

5.1 When surcharge payable

IPART's draft report finds that the surcharge should only be payable if there is an actual default,⁸⁰ not if a PELNO has previously defaulted for that kind of transaction. PEXA accepts that the administrative costs of applying the latter regime may not be workable. However, the outcome enables other ELNOs to free-ride on PEXA's fixed costs of building automated connections to Revenue Offices and financial institutions, and building transaction type capabilities, even though these are essential to providing an efficient e-conveyancing system for all participants and subscribers. If these costs are not recoverable through the Default RELNO surcharge, then they should be incorporated into the RELNO fee (see section 4).

Consequently, PEXA submits that the default RELNO surcharge should also be payable whenever a participating ELNO lacks any of the transaction-type capability required to complete a transaction in an automated way. This would help to ensure that an ELNO cannot free-ride on creating transaction type capability, which is one of the most expensive components of an ELN (see section 2.3.1)

PEXA support's IPART's draft recommendation that a single default RELNO surcharge should be payable, irrespective of the circumstances that led to the default.⁸¹ Any other approach would regularly lead to discussion about the cause of the default, and its costs, overwhelming the actual cost of the default RELNO surcharge.

PEXA also agrees that the default RELNO surcharge should be payable per transaction, not per dealing.

5.2 Overall surcharge calculation

IPART attempts to calculate the RELNO surcharge through a bottom-up calculation of costs rather than as a proportion of subscriber fees. While this is a theoretically justifiable approach, the overall outcome demonstrates its problems.

The overall inadequacy of the default RELNO surcharge suggested by IPART is manifest by comparison to Subscriber fees. The default RELNO surcharge is payable when an ELNO lacks functionality to complete a transaction. Full-service functionality – particularly for relatively small volume and otherwise uneconomic transaction situations – is a substantial part of the fixed cost of ELNO capability. However, the default RELNO surcharge suggested by IPART of \$2.90 would only be 1% of the total Subscriber fees collected for a typical transfer.⁸² If the RELNO is only acting for one of the parties, it would receive on average just 26% of the total revenue even though it provides most of the functionality for the transaction.

⁸⁰ Ibid, p. 4.

⁸¹ Ibid, p. 42-43.

⁸² Based on PEXA and Sympli's published pricing as at 4 August 2022: total Subscriber fees would be \$284.24 for a typical transfer where PEXA acts for one financial institution and Sympli acts for the three other parties: PEXA, *Submission to IPART Issues Paper 1*, [Online-Submission-Property-Exchange-Australia-Ltd-\(PEXA\)-A.-Gerraty-12-Aug-2022-204110148.PDF](https://www.pexa.com.au/Online-Submission-Property-Exchange-Australia-Ltd-(PEXA)-A.-Gerraty-12-Aug-2022-204110148.PDF) ([nsw.gov.au](https://www.nsw.gov.au)), p. 23.

If the default RELNO surcharge is too low, there is little basis for the assertion in IPART's draft report that the Default RELNO surcharge will provide material incentives to invest in infrastructure.⁸³ Instead, it will encourage other ELNOs to cherry pick the most profitable jurisdictions and transactions (see above section 2.4.1) and to free-ride on the fixed costs of functionality built both PEXA (see above section 2.4.2)

As explained at section 2.4.1 (Cherry picking) above, the default RELNO surcharge should also be payable whenever a participating ELNO chooses not to be the RELNO because it lacks any of the transaction-type capability required to complete a transaction in an automated way. This would go some way to ensuring that an ELNO cannot free-ride on the transaction type capability created by other ELNOs.

Consequently, IPART should rethink its assumption that concerns about cherry picking are not relevant to setting interoperable transaction fees, and rethink its approach to interoperable transaction fees so that they provide greater incentives to deliver universal service coverage and functionality.

5.3 Capital costs

As discussed at sections 2.3 and 2.4.2 (Costs of establishing an ELNO and irrecoverable costs), IPART's estimates of capital costs are based on AECOM's estimates that a benchmark efficient ELNO would incur capital costs between \$3.7m and \$4.3m depending on the number of jurisdictions.⁸⁴ AECOM estimates that these capital costs would cover the core ELNO service of financial settlement and lodgment, IT hardware, and building connections to around 12 financial institutions. AECOM assumed an average developer cost of \$200/hr, which PEXA accepts is reasonable. However PEXA does not accept AECOM's estimates that core capability could be project managed, built, and tested by a small team in 15 days plus 20 days per jurisdiction, and 49 days per connection to financial institution.

Relative to these real world capital costs to establish a full service ELNO with today's level of capability is around \$182 million (see section 2.3.1), AECOM's mid-point estimate that the core capability of an ELNO can be built for \$4.8m appears extraordinarily low. To estimate the costs of establishing a new ELNO, IPART should put far greater weight on current real world experience, rather than consultant assumptions from 2019 which PEXA has never accepted.

It appears that AECOM's estimate has disregarded material components of the costs required to build an ELN, particularly the development of transaction-type capability (see section 2.4.2).

5.4 Webhosting costs

PEXA agrees with IPART's conclusion that webhosting costs should be included in the default RELNO surcharge (DR p.44). Webhosting costs are driven by the complexity of the platform and the number of interactions it performs. As an ELNO adds additional functionality, it incurs additional webhosting costs.

IPART's estimates of webhosting costs are far too low. IPART estimates that a benchmark efficient ELNO would incur webhosting costs of around \$10,000 per year. PEXA's experience

⁸³ IPART, *Draft Report*, p. 23 and 38.

⁸⁴ *Ibid*, p. 41.

is that annual hosting costs were \$6.0 million in 2021-22, and are expected to be \$7.5 million in 2022-23.

In the absence of other reliable evidence, PEXA's webhosting costs are the best available proxy for the costs incurred by an efficient ELNO, and should be incorporated in the calculation of the Default RELNO surcharge.

5.5 Conveyancing volumes

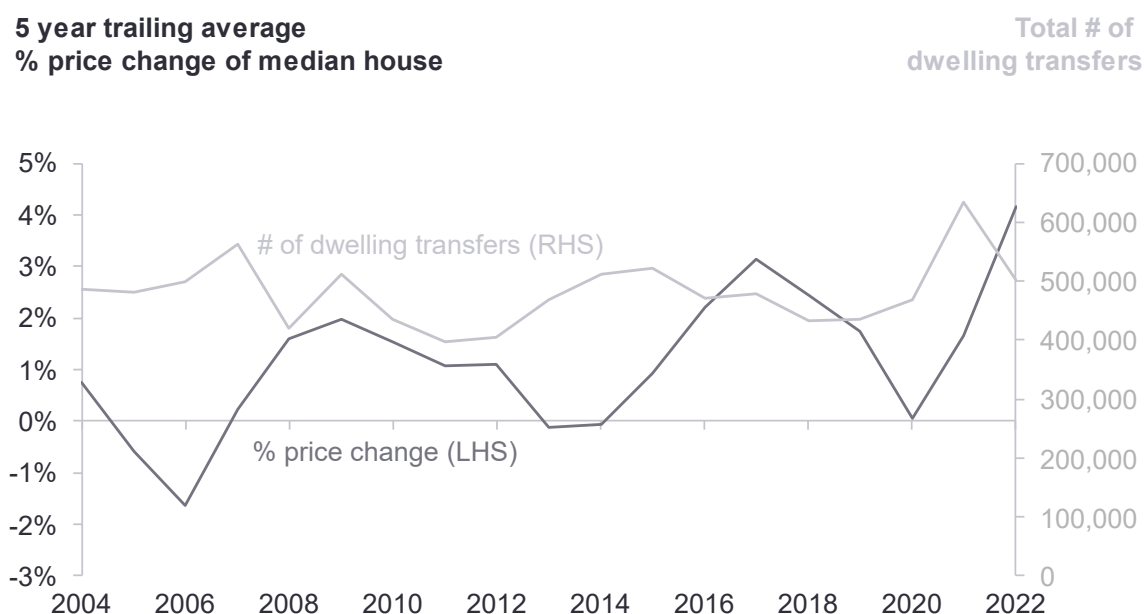
PEXA does not agree with IPART's methodology for forecasting e-conveyancing volumes, which has simply assumed that the average growth rate for the past three years continues.

Growth rates in e-conveyancing transactions should be built up by:

- Understanding the underlying average volume of all conveyancing transactions, based on long-term trends, and abstracting one-off factors
- Adding an expected long-term growth rate
- Converting to the number of e-conveyancing transactions, based on plausible increases in penetration

Forecasting overall property transfer volumes is inherently difficult. As shown in Exhibit 4, over the very long term, the total number of transfers does not change much, but the year-to-year volatility is much greater than the volatility in house prices. The volume of transfers is correlated with changes in house prices, so that volumes tend to be higher when house prices are rising.

Exhibit 4 House price changes and transfer volumes

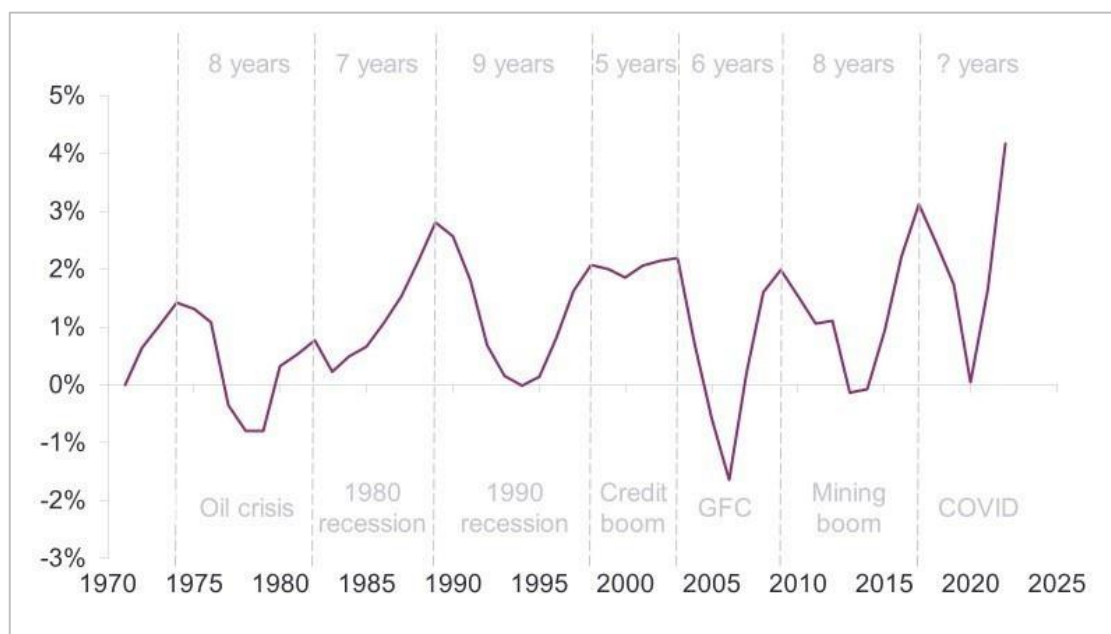


Source: ABS 2004-2022 median price and number of transfers, ABS population growth, IPART forecast methodology; PEXA 1H23 results

The Australian property market appears to have a cycle approximately 7 years long, as illustrated in Exhibit 5.

Exhibit 5 Australian house price cycles

Annual % price change for median house, 5 year trailing average



Source: ABS 2004-2022 median price and number of transfers; Stapledon 1971-2004

Consequently, the underlying expected transfer volume should be assessed by looking at volumes averaged over a period at least 7 years long to capture the full length of the typical property cycle

Some secular growth in transfer volume is expected, primarily driven by growth in the total number of dwellings, which are primarily a function of population growth, marginally influenced by changes in average household size. The ABS projects population growth of 1.7% per annum over the next few years.⁸⁵

E-conveyancing transfer volumes are likely to grow faster than overall property transfers as the penetration of e-conveyancing increases. This increasing penetration has been a significant driver of transaction growth for PEXA over the past decade. However, this effect will have less influence over growth rates in future as e-conveyancing approaches 100% penetration. PEXA estimates that e-conveyancing volumes were 83% of all transactions in 2021-22, and will increase to 88% in 2022-23.⁸⁶ By definition, growth due to increasing penetration cannot average more than 6.6% over the following two years. Growth due to increasing penetration is likely to be materially less than this because the last remaining electronic transactions are likely to be those that are most difficult to convert. Projecting a 4% growth rate for the next few years would be reasonable

ELNO revenues depend on both transaction and refinance volumes. Over the long run, there is no reason for refinance volumes to grow any faster than transaction volumes. Nor is there

⁸⁵ ABS, *Population projects, Australia* (2018) <https://www.abs.gov.au/statistics/people/population/population-projections-australia/latest-release>.

⁸⁶ PEXA, *1H23 Results Presentation* (23 February 2023), slide 7.

any reason to expect that falls in transaction volumes will necessarily correlate with increases in refinance volumes.

Current refinance volumes are greater than the underlying trend, but this is likely to be a one-off anomaly. In 2020, the RBA provided the Term Funding Facility to Australian banks in response to the COVID-19 pandemic, lending them substantial sums at low fixed rates for three years. Banks on lent this money to home-owners, also at low fixed rates for three years. As these fixed rates expire in 2023, may home-owners are facing big increases in mortgage repayments, so they are more motivated than normal to look for a better mortgage rate with another bank.⁸⁷ This is driving an unusually high level of refinances. However, there is no reason to believe that this level of refinances will continue once this effect has worked through the system.

Consequently, PEXA does not agree with IPART's assumption that e-conveyancing transaction volumes will grow at 15% annually over the two-year forecast period.⁸⁸ IPART appears to be basing this estimate on growth rates over the past few years. However, these growth rates have been boosted by one-off factors including rapidly rising property prices, increasing e-conveyancing penetration; and refinance activity induced by the roll-off of COVID-19 loans. Growth in transaction volumes is likely to be slower for the next few years, when these factors will be much weaker.

Instead, PEXA believes that it would be more reasonable to estimate transaction volume growth rates by:

- Calculating the seven-year average of ABS total transfer volumes (2015-2022) to simulate an end-to-end property cycle, amounting to an average of 486,000 transactions per year
- Applying secular growth rate forecasts for total transfer volumes of 1.7% per year based on forecast annual population growth from 2019, the mid-year of the 7 year average, implying "expected long-term" volumes of 513,000 transfers in 2022
- Adjusting actual 2022 transaction volumes (613,000) by the ratio between expected long-term transfer volumes and actual 2022 transfer volumes (513,000/501,000), implying 628,000 transactions "expected" for 2022
- Applying a population growth rate of 1.7% per year to expected volumes for 2022
- Applying a growth rate for e-conveyancing penetration of 4% per year, given that PEXA's penetration rate for 2022-23 is forecast to be 88%, implying expected e-conveyancing volumes of 664,000 in 2023 and 702,000 in 2024.⁸⁹
- Assuming that a benchmarked ELNO has 50% market share, implying it would have 332,000 transactions in 2023, and 351,000 transactions in 2024

⁸⁷ AFR, *Record home loan refinancing as new mortgages plummet*, 12/01/23. <https://www.afr.com/policy/economy/record-home-loan-refinancing-as-new-mortgages-plummet-20230113-p5cccd>

⁸⁸ IPART, *Draft Report*, p. 45.

⁸⁹ Note that these calculations do not reconcile to the number of transactions publicly reported by PEXA because IPART calculates e-conveyancing transactions based on the number of electronic land registry transfers and refinances, whereas PEXA has historically reported the volume of Subscriber transactions with PEXA.

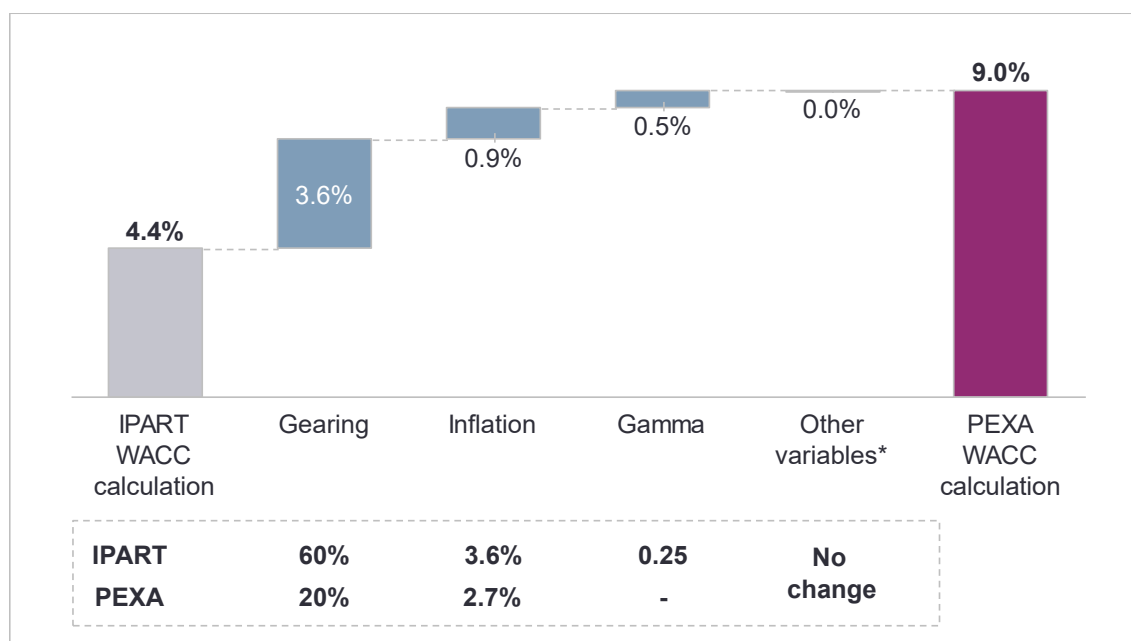
5.6 WACC

PEXA does not accept IPART's WACC calculation.

The estimated WACC for a benchmark ELNO adopts assumptions that do not reflect the risk profile of PEXA given the nature of its business, or the current macroeconomic environment.

PEXA's view is an appropriate WACC providing a basis for price-setting is 10.3%, not 4.4% as proposed by IPART, as illustrated in Exhibit 6.

Exhibit 6 Recalculating WACC %



Note: * Impact of nominal risk-free rate, inflation, gamma, and effective tax rate calculated based on a gearing ratio of 60% (i.e. IPART's estimate). Each impact represents an approximation, noting each WACC variable is interdependent

* Other variables includes market risk premium, debt margin, and equity beta.

Source: PEXA Financial Statements, Bloomberg, RBA, EY PJP analysis

IPART's WACC methodology identifies a debt funding ratio and cost of debt and equity beta based on the average for the industry with which the relevant company is most closely identified.

In selecting an appropriate proxy industry for a WACC calculation, the key aim is to find an industry with comparable levels of risk, which is the primary driver of the cost of capital. In Issues Paper 2, IPART proposed using a sample of mortgage banks to estimate equity beta and debt funding ratio for a benchmark efficient ELNO.⁹⁰ As illustrated in Annexure B, PEXA does not accept that mortgage banks are a useful benchmark for an ELNO as they have a significantly lower business risk, reflected in much higher debt funding ratios, lower cost of debt and lower equity beta. Although both PEXA and mortgage banks have businesses that interact with housing assets, their business models have little else in common, and different levels of risk.

⁹⁰ IPART, *Interoperability pricing for Electronic Lodgment Network Operators Issues Paper 2* (October 2022), p. 29.

The key drivers of risk in PEXA's business are:

- Highly volatile revenues, which are primarily driven by property transaction volumes that have varied by an average of 11% from year to year over the past 17 years, with 4 years that varied by more than 20%, as illustrated in Exhibit 4.
- Relatively high fixed costs, which are typical of businesses whose services are primarily provided by a sophisticated IT platform.
- Highly variable levels of profitability, as a consequence of the interaction between highly volatile revenues and high fixed costs
- A product that primarily depends on the functionality provided by a sophisticated IT platform, creating substantial business execution risks
- Few assets that are readily securitised by lenders.

By contrast, mortgage banks have

- Stable revenues, which are primarily driven by the “back book” of the volume of loans written in previous years
- Moderately high fixed costs, although recurrent costs are a greater proportion of costs because their business is less automated than PEXA
- Stable levels of profitability
- Assets that are readily securitised by lenders.

IT businesses that enable customers to trade would be a much better proxy for PEXA's business. Bloomberg's Industry Classification Standard (BICS), classes 'mortgage finance' as a level 4 – sub industry. At that same level of categorisation, security and commodity exchanges, data and transaction processors and online marketplaces would be better comparators for PEXA's business. All of them, like PEXA, have businesses that are essentially a straight-through service provide by an IT platform. All of them have revenues driven by transaction volumes, although PEXA is probably exposed to more volatile trading volumes because of the peculiar dynamics of property markets, in which volumes tend to be related to the direction of prices.

Exhibit 7 **Comparable industries WACC analysis**

Bloomberg Classification (BICS)	Industry Standard	Median debt funding ratio*	Median credit rating**	Median WACC
Security & commodity exchanges		17%	A-	9.5%
Data & transaction processors		49%	BBB-	10.7%
Online marketplaces		37%	N/A	10.6%

Note: *Calculated as total debt / (total debt + total equity).

**Agency-equivalent credit rating implied by the current estimated forward 1-year probability of default from the StarMine Combined Credit Risk Model.

Source: Bloomberg accessed on 27 March 2023, Refinitiv; EY PJP analysis

If this peer group does not generate a debt funding ratio similar to PEXA, then IPART should consider modifying its usual methodology. Unlike the industries for which IPART developed its methodology, PEXA has a novel business model and is not yet part of a meaningful peer group. Instead IPART should adopt PEXA's actual gearing ratio, on the basis that this ratio aims to minimise PEXA's WACC. PEXA notes that comparable technology platforms such as Real Estate Australia Group and Carsales.com have comparable gearing ratios of 21% and 35%, respectively.

Consequently, the key inputs to IPART's modelling of PEXA's WACC should be altered as follows.

- **Debt funding ratio should be 20%, not 60%.** The gearing ratio adopted by IPART does not accurately reflect the borrowing capacity of PEXA, does not reflect the underlying risk profile of a technology platform business, and appears to be based on a non-comparable peer set
- **Cost of debt (nominal pre tax) of 2.1% long, and cost of equity (nominal post tax) of 8.5% long are reasonable** – provided that the Debt funding ratio is 20%: both cost of debt and cost of equity would be materially higher if an IT company with volatile revenues such as PEXA had a debt funding ratio of 60%.
- **Nominal risk-free rate should be 3.4%, not 2.7%.** The risk-free rate assumed by IPART does not accurately reflect the current (or likely future) interest rate environment. Government bonds (10-year), which are an appropriate proxy for risk-free rate, currently yield 3.35%+, as at 15-Mar-2023. This is ~70bps higher than IPART's average current and long-term estimates. IPART's use of long-term trailing averages may be appropriate for the large utilities that IPART typically regulates with stable revenues and borrowings, but it is inappropriate for an IT business much more exposed to current interest rates. PEXA notes that the Australian Energy Regulator is now calculating risk free rates using the spot yield on 10-year Commonwealth bonds.
- **Inflation should be 2.7% not 3.6%,** consistently with the latest Market-based WACC parameters issue by IPART in February 2023
- **Gamma** should be zero, not 0.25. Because eConveyancing is a nascent industry, players inherently have very large and recent capital costs relative to revenue. As a result, (like PEXA) they are unlikely to pay tax, and therefore their shareholders do not benefit from imputation credits.
- **The equity beta of 1 is too low because** PEXA is now exposed to the uncertainty introduced by interoperability and other regulatory interventions increases uncertainty for investors.

Cumulatively, these adjustments imply a WACC of 9.0%, an increase of about 5.0% over IPART's assessment. Although this seems large, it reflects the revisions needed to adapt IPART's methodology, primarily developed for the regulation of utilities with substantial fixed assets, to the regulation of an IT platform.

This overall conclusion is substantially closer to published buy side analysts that calculate PEXA's nominal WACC as between 7.4% and 8.8%.

6. Service fee review

6.1 Timetable

PEXA agrees that service fees should be reviewed on the timetable suggested by IPART.⁹¹

While IPART suggests regular reviews of Service fees, PEXA submits that a review should also be triggered if there is a rapid shift in market shares. As IPART recognises in figure 6.1, a critical factor in setting the ELNO Service Fee is market shares. Under IPART's modelling, single provider market structures have lower overall prices than other environments.⁹² Consequently, if market shares shift, then participant viability changes. As PEXA outlined in Annexure A and Exhibits 13 and 19 to its submission to Issues Paper 2, inadequate ELNO Service Fees can imperil the long-term viability of industry participants.

Consequently IPART must ensure there are mechanisms in place to monitor significant shifts in market shares, and to adjust Service Fees accordingly.

6.2 Service fee calculation

For the reasons outlined above in section 5.6, PEXA submits that in the indicative modelling conducted by IPART, the WACC is too low, and forecast transaction volumes are too high. Consequently, the illustrative prices presented by IPART⁹³ are probably significantly lower than what is appropriate for a benchmark efficient ELNO.

PEXA supports IPART's view that the additional costs of interoperability – significantly larger than originally anticipated when the model was first proposed (see section 2.3.2) – should be incorporated in calculations of ELNO Service Fees.⁹⁴

⁹¹ IPART, *Draft Report*, p. 49, para 6.1.1.

⁹² Ibid, p. 51, figure 6.1.

⁹³ Ibid, pp. 50-51, para 6.1.3.

⁹⁴ Ibid, pp. 51-52, para 6.1.4.