

REVIEW OF THE PRICING FRAMEWORK FOR ELECTRONIC CONVEYANCING SERVICES IN NSW



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1. Executive Summary



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

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

The Australian eConveyancing market is well advanced



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

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

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

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



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



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

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

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

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

Overview of findings and recommendations for this review

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

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

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

Regulators should allow subsequent new entrant ELNOs to choose between:

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

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

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

Competition in the eConveyancing market has emerged

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

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

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

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



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

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

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

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

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



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Maximum prices indexed by CPI annually is appropriate while competition develops

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

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

Interoperability between ELNOs would promote competition

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

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

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



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

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

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



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

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

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

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

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

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

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

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



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

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





We consulted with stakeholders to reach our final recommendations

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

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



List of findings and recommendations



Our final findings are:

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



Our final recommendations are:

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



Recommendations (continued):

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



Structure of this report

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

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