



# Review of the pricing framework for electronic conveyancing services in NSW

Issues Paper  
Special reviews

March 2019



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ISBN 978-1-76049-292-2

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## Tribunal Members

The Tribunal members for this review are:

Dr Paul Paterson, Chair  
Mr Ed Willett  
Ms Deborah Cope

Enquiries regarding this document should be directed to a staff member:

Jennifer Vincent (02) 9290 8418  
Jenny Suh (02) 9113 7775  
Alexandra Rush (02) 9290 8494

## Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

### **Submissions are due by 30 April 2019**

We would prefer to receive them electronically via our online submission form <[www.ipart.nsw.gov.au/Home/Consumer\\_Information/Lodge\\_a\\_submission](http://www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission)>.

You can also send comments by mail to:

**eConveyancing Review**  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
Haymarket Post Shop NSW 1240

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our website <[www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)> as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

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If you would like further information on making a submission, IPART's submission policy is available on our website.

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## Abbreviations

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





# 1 Introduction

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is currently reviewing the pricing regulatory framework for electronic conveyancing services in NSW. Electronic conveyancing ('eConveyancing') is a system of settlement of real property transactions via an Electronic Lodgment Network (ELN). An entity that operates and administers an ELN is called an Electronic Lodgment Network Operator (ELNO).

As at 1 March 2019, there is only one ELNO operating in NSW, Property Exchange Australia Limited (PEXA). From 1 July 2019, most types of property documents in NSW will be mandated to be electronic. In view of the highly concentrated eConveyancing market, the removal of paper conveyancing as a source of competition, and the absence of any previous regulatory assessment of ELNO prices, the Premier has asked IPART to conduct this review.

## 1.1 What has IPART been asked to do?

Our terms of reference ask us to review the state of the electronic conveyancing market, and recommend an appropriate pricing regulatory framework which includes:

- ▼ A maximum price or pricing methodology for the provision of services by an ELNO
- ▼ A maximum price or pricing methodology for services provided to ELNOs by NSW Land Registry Services (NSW LRS)
- ▼ A maximum price or pricing methodology for services provided to ELNOs by Revenue NSW.

In reaching our advice, we are to have regard to:

- ▼ Protection of consumers from potential pricing abuses due to the current highly concentrated nature of the eConveyancing market
- ▼ The potential for additional ELNOs to enter the market
- ▼ The cost of providing the services concerned
- ▼ The extent to which PEXA invested capital and developed intellectual property in its capacity as the initial ELNO
- ▼ The possibility of applying the NSW approach as a model for other jurisdictions.

Our full terms of reference are provided in Appendix A.

## 1.2 How will we conduct this review?

For this review, we will conduct a public consultation process and our own research and analysis. We will consult with key stakeholders, including the Office of the Registrar General,

Australian Registrars' National Electronic Conveyancing Council (ARNECC), ELNOs, NSW LRS, Revenue NSW, financial institutions, lawyers and conveyancers.

This Issues Paper is the first step in our public consultation. It describes and seeks comment on our proposed approach for the review. We invite all interested parties to make submissions in response to this paper by 30 April 2019. Details on how to make a submission are provided on page ii at the front of this paper.

We will release a Draft Report by July 2019, and conduct further consultation before making our final recommendations and providing a Final Report to the Premier and the relevant Ministers by October 2019.

Table 1.1 provides an indicative timetable for the review. We will update this timetable on our website as the review progresses.

**Table 1.1 Indicative timetable for the review**

| Key milestone                   | Proposed timing        |
|---------------------------------|------------------------|
| Release Issues Paper            | 12 March 2019          |
| Submissions to Issues Paper due | 30 April 2019          |
| Release Draft Report            | June/July 2019         |
| Hold public hearing             | July 2019              |
| Submissions to Draft Report due | August 2019            |
| Provide Final Report to Premier | September/October 2019 |

### 1.3 How this paper is structured

The rest of this Issues Paper provides more information on the review and our proposed approach:

- ▼ Chapter 2 outlines key contextual information for this review
- ▼ Chapter 3 sets out our proposed approach for making our recommendations
- ▼ Chapters 4 to 7 discuss the key steps in this approach in more detail, including:
  - Assessing the state of the eConveyancing market, including the current level of competitiveness and the possible development of competition in future.
  - Deciding on an appropriate methodology to set prices for ELNO services given findings on the state of eConveyancing market, and applying this method to recommend maximum prices (or a process for determining those prices) for all ELNOs.
  - Deciding on an appropriate methodology to set prices for services provided to ELNOs by NSW LRS and Revenue NSW, and applying this method to recommend maximum prices (or a process for determining those prices) for those services.
  - Considering and recommending the appropriate timeframes for adopting the pricing methodologies, what, if any, transition measures are required, and how often prices should be reviewed.

## 1.4 Issues on which we seek comment

The questions on which we seek stakeholder comment are set out in the chapters that follow. Stakeholders may address all or some of these issues, and are also free to raise and discuss any other issues relevant to the terms of reference. For convenience, these questions are also listed below:

### Proposed approach

- 1 Do you agree with IPART's proposed approach for this review? Are there any alternative approaches that would better meet the terms of reference, or any other issues we should consider? 21

### Assessing the eConveyancing market

- 2 What are your views on the current state of the market? For example, does the continued availability of paper conveyancing in other jurisdictions constrain prices for eConveyancing? What scope is there for new entrants to offer the full range of eConveyancing services? 23
- 3 How important are barriers to entry in constraining competition in the eConveyancing market? Are there other barriers or factors that will influence competition in the market? 26
- 4 To what extent would pricing regulation increase barriers to entry? Should new entrants be exempt from pricing regulation and, if so, what would be an appropriate market share benchmark at which pricing regulation would commence? 26
- 5 What factors influence the effectiveness of potential multi-homing or interoperability solutions in promoting competition? 30
- 6 What are the relative costs of implementing the different potential multi-homing or interoperability solutions between ELNOs? 30
- 7 How will vertical integration or the potential for vertical integration influence competition between ELNOs and the efficiency of the conveyancing process? 31
- 8 How should the pricing regulatory framework for ELNOs address vertical integration or the potential for vertical integration in eConveyancing? 31

### Deciding on and applying pricing methodology for ELNO services

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- 10 If we decide to use an index to adjust the initial regulated prices in the following years of the regulatory period, is CPI an appropriate index? If not, what other index could we use? 33
- 11 What measures will our pricing framework require to enable flexibility and innovation for new entrant ELNOs? 33

|    |   |    |
|----|---|----|
| 12 | Do you consider recommending prices based on the costs of a notional benchmark efficient ELNO is an appropriate way to promote competition in the eConveyancing market? If yes, what is an appropriate set of characteristics for the benchmark efficient ELNO? | 34 |
| 13 | What firms or industries are comparable to a benchmark ELNO in terms of their exposure to market risk? What percentage of debt rather than equity would an efficient ELNO be able to sustain to finance its assets (ie, the gearing level)?                     | 36 |
| 14 | How should we assess the efficient costs of providing eConveyancing services?   | 37 |
| 15 | Should ELNO's assets and costs be shared between states according to the proportion of conveyancing transactions or the number of subscribers in each state? Are there other approaches to sharing ELNO's costs and assets across multiple states?              | 38 |
| 16 | Are there benefits to ELNOs having nationally consistent prices?  | 39 |
| 17 | Should eConveyancing customers in states where ELNOs incur lower costs of providing eConveyancing services pay the same price as states that have higher costs?   | 39 |
| 18 | Are there any other issues relevant for considering whether our recommended NSW pricing regulatory framework could be an appropriate model for a national regime?   | 39 |
| 19 | Who should bear the costs of implementing an interoperability solution and how should the costs be recovered?   | 42 |
| 20 | In an interoperable transaction, should one or multiple ELNO(s) complete lodgment with the land registry and financial settlement with the RBA, and which ELNO(s) should perform these activities?  | 42 |
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#### **Recommending prices for the services provided by NSW Land Registry Services and Revenue NSW**

|    |  |    |
|----|--|----|
| 22 | What is the most appropriate pricing methodology for NSW LRS's services to ELNOs? Are there other alternative approaches we should consider?   | 45 |
| 23 | What firms or industries are comparable to NSW LRS in terms of their exposure to market risk? What percentage of debt rather than equity would NSW LRS be able to sustain to finance its assets (ie, the gearing level)? | 45 |
| 24 | Do you agree with our proposed approach to allocating shared assets and costs? Are there other approaches or issues we should consider?  | 46 |
| 25 | Do you agree with our proposed approach to accounting for any cost savings to NSW LRS arising from the introduction of electronic lodgment services?   | 47 |
| 26 | Should Revenue NSW charge ELNOs for its electronic system?   | 48 |

- 
- 27 If Revenue NSW were to charge for services to ELNOs, on what bases should the fees be set? 48

### **Timeframes and transition**

- 28 When could businesses implement prices recommended by this review? What factors affect that timing and any transitional measures required? 50
- 29 What is the appropriate determination period for ELNO, NSW LRS and Revenue NSW prices? What factors should we take into account when deciding on a determination period? 50
- 30 Should the scope of future reviews be similar to the current review, or focus on particular aspects of pricing? 50

## 2 Context for the review

To provide a context for this review, the sections below explain our understanding of:

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

### 2.1 What is eConveyancing?

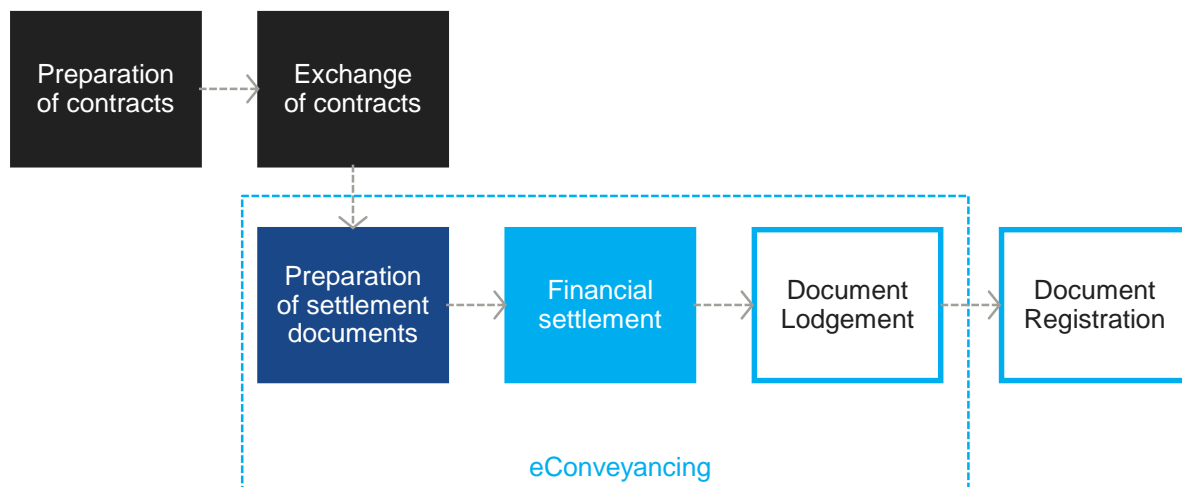
Conveyancing is the process through which title to real property is transferred from one person to another (eg, when it is sold or inherited), and other interests in the property are dealt with (eg, a lessor's or mortgagee's). Typically, it includes the following phases:

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

eConveyancing is an electronic solution for some of the steps involved in this process – from preparation and exchange of documents to document lodgment (see Figure 2.1). It allows lawyers, conveyancers and financial institutions to enter a secure, online workspace via an ELN where they can exchange data and collaborate to prepare documents, settle funds and lodge documents with land registries.

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

**Figure 2.1 eConveyancing covers the steps after the preparation and exchange of contracts**



Source: IPART.

## 2.2 Key participants in eConveyancing

The eConveyancing process involves the following participants:

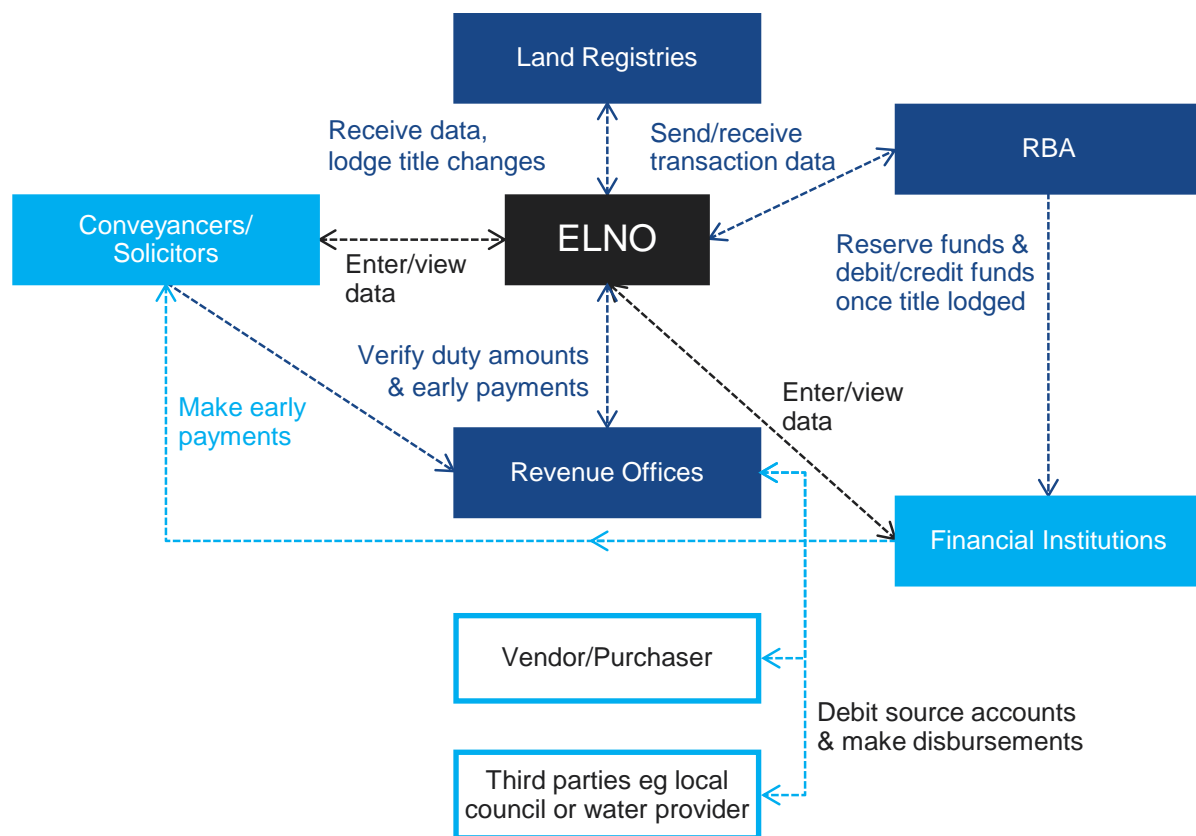
- ▼ **ELNOs.** ELNOs are businesses approved by the relevant state's Registrar General to build and operate ELNs via which documents and funds can be exchanged. As previously noted, currently only one ELNO is approved in NSW – PEXA – although there is potential for more in the future. In Victoria and Queensland, two ELNOs are approved – PEXA and Sympli Australia Pty Ltd (Sympli).<sup>1</sup>
- ▼ **Subscribers.** These are people or businesses authorised by their client to enter and exchange data to complete electronic documents and transactions via an ELN. They include:
  - **Principal subscribers**, who represent themselves - for example, financial institutions and government agencies
  - **Representative subscribers**, such as solicitors and conveyancers who represent other parties to the conveyance – typically, the vendor or purchaser.
- ▼ **The Reserve Bank of Australia (RBA).** The RBA facilitates financial settlement by reserving funds until lodgment is confirmed and transferring funds between financial institutions.
- ▼ **Each state's revenue office.** In NSW this is Revenue NSW. Revenue NSW confirm if duties have been paid and if not, the dutiable amounts are populated in the workspace and paid via the ELN at settlement.

<sup>1</sup> Sympli has demonstrated that it meets the eligibility criteria required by ARNECC under the Model Operating Requirements and, in Victoria and Queensland, it has been granted approval to operate. Sympli, Media releases & news, <https://www.sympli.com.au/media-releases/>, accessed 6 March 2019. Approvals are discussed later in this chapter.

- ▼ **Each state's registry office.** In NSW this is NSW LRS. Documents are lodged with NSW LRS, which then examines the documents and, if acceptable, registers them and updates the land titles register, which is called the Torrens Title Register. Changes to the Torrens Titles Register are based on the transaction: for example, in a sale, NSW LRS replaces the vendor's name on title with the purchaser's name. NSW LRS's primary function is to maintain the Torrens Title Register. The Torrens Title Register contains all information about the ownership of land as well as interests that affect land.<sup>2</sup> The Torrens Title Register is the single source of truth for land ownership in NSW.<sup>3</sup>

Figure 2.2 outlines the participants in the eConveyancing process and how they interact with one another. Appendix B provides more detail on the steps in the eConveyancing process, and how they differ from the paper-based conveyancing process.

**Figure 2.2 Participants in the eConveyancing process and interactions**



KEY:

- = Subscribers
- = Send and receive data
- = Not involved in the workspace

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

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

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



## 2.3 Current prices for eConveyancing services within scope of our review

For this review, we are focusing on the fees for eConveyancing services charged by:

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

The RBA's fees to ELNOs are outside the scope of this review. IPART has also not been asked to review prices that solicitors, conveyancers or financial institutions charge their customers as this is a competitive market.

### 2.3.1 ELNO prices for services to subscribers

As noted above, currently one ELNO (PEXA) operates in all Australian jurisdictions with eConveyancing, and a second ELNO (Sympli) operates in Victoria and Queensland and has announced its intention to commence operating in NSW. ELNOs currently set their own fees, and are obliged to do so "according to a publicly available, equitable and transparent pricing policy."<sup>4</sup>

From 25 February 2019, ELNOs' pricing became subject to some pricing controls via ARNECC's Model Operating Requirements Version 5, including an annual Consumer Price Index (CPI) cap on price increases.<sup>5</sup> In NSW, the Conditions of Approval set the annual price increase cap for ELNOs at CPI minus X, with X set each year by the Registrar General. The Registrar General has set X to zero for 2018-19.<sup>6</sup>

PEXA's fees include a fee for providing digital certificates (to allow secure access to the ELN) to its subscribers (solicitors, conveyancers, financial institutions), and fees per successful conveyancing transaction called "Transaction Service Fees."<sup>7</sup> PEXA charges a different Transaction Service Fee based on the type of conveyancing transaction. For example, the Transaction Service Fee for a transfer affecting a single title is \$112.64 and a mortgage affecting a single title is \$42.24, both including GST. A full list of fees is available at Appendix C.

Sympli indicated in a November 2018 media release that its prices will be 15% to 50% lower than PEXA's, though a full pricing schedule has not been publicly released.<sup>8</sup>

PEXA charges the Transaction Service Fee to the participant subscribers in a transaction, who factor this cost in to running their business. Solicitors, conveyancers and financial institutions operate in competitive markets so their fees to their clients for conveyancing services are not within the scope of this review.

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<sup>4</sup> ARNECC, Model Operating Requirements (MOR) Version 5, December 2018, 5.3(e), [https://www.arnecc.gov.au/\\_\\_data/assets/pdf\\_file/0008/1435643/mor-guidance-notes-version-5-clean.pdf](https://www.arnecc.gov.au/__data/assets/pdf_file/0008/1435643/mor-guidance-notes-version-5-clean.pdf), p 58, accessed 6 March 2019.

<sup>5</sup> Ibid, p 73.

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

<sup>7</sup> PEXA, *PEXA System Pricing Policy Version 5.0*, October 2014, p 3.

<sup>8</sup> Sympli, *Sympli receives final ARNECC approval to establish competition in electronic property settlements*, 23 November 2018.

### 2.3.2 Land registry prices for services to ELNOs

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

NSW LRS has recently published the schedule of fees for 2018-19. Currently, the same lodgment fees apply for electronic dealings as for the equivalent paper dealings. For the most common documents such as transfers, mortgages, discharges of mortgage, NSW LRS charges \$141.60 per lodgment, including GST. These fees are collected from subscribers by ELNOs on behalf of NSW LRS. These fees are not within the scope of our review.

The NSW LRS's 2018-19 schedule of fees includes fees charged to ELNOs for electronic lodgment support services (LSS). This is the fee that is charged by NSW LRS to ELNOs for providing data from the Torrens Title Register (such as mortgagee names and numbers). Table 6.1 in Chapter 6 sets out fees for the three types of LSS. PEXA takes into account LSS fees as one of the input costs in setting its Transaction Service Fee.<sup>9</sup> As noted above, this fee is charged to subscribers who then factor it in to their cost of running their business.

Currently NSW LRS does not charge ELNOs fees attributable to the costs of building new systems, testing, ongoing maintenance and more recently, fees related to any proposed interoperability solution (which is discussed in more detail at Chapters 4 and 5). Fees that NSW LRS charges ELNOs are subject to the Registrar General's approval. NSW LRS has indicated that it intends to charge ELNOs for these services<sup>10</sup> and, as such, these proposed fees will form part of our review.

### 2.3.3 Revenue office prices to ELNOs

Revenue NSW provides an Electronic Duties Return service, which is a service that allows an approved holder (Electronic Duties Return client) to electronically assess and endorse a range of duties transactions including transfer duty, and pay duty by weekly remittance.

Clients must register for Electronic Duties Return by engaging an approved Client Service Provider<sup>11</sup> who completes all Revenue NSW transactions on their behalf. Clients then send information to Revenue NSW through their Client Service Provider. For transactions settling via an ELNO, the duty and interest payable (if applicable) is displayed automatically in the ELNO Financial Settlement Schedule. This amount is then paid as an electronic disbursement from the ELNO to Revenue NSW. In the event that duty is paid early, there will be no financial settlement line item; instead, there will be a reference number in the workspace and on the electronic registry instrument indicating that duties have been assessed.

<sup>9</sup> As noted above, the Transaction Service Fee is a fee that PEXA charges its subscribers for their use of the PEXA system to conduct conveyancing transactions. The cost of LSS varies by state, so a weighted average LSS cost is used to determine the Transaction Service Fee. PEXA, *PEXA System Pricing Policy Version 5.0*, 31 October 2014, p 4.

<sup>10</sup> Office of the Registrar General submission to Draft Terms of Reference, December 2018, p 1.

<sup>11</sup> Client Service Providers include GlobalX Legal Solutions, Hazlett Information Services, InfoTrack and SAI Global Property.

Revenue NSW does not charge Client Service Providers any fees; however, Client Service Providers charge clients fees for their services.

Revenue NSW does not currently charge ELNOs any fees, but it intends to for the costs of building new systems, testing and ongoing maintenance. Any such fees will form part of our review.<sup>12</sup>

## 2.4 The legal and regulatory framework for eConveyancing

Any pricing regulatory framework for eConveyancing we recommend must take account of the broader legal and regulatory framework, which includes both national and state elements.

### 2.4.1 National framework

The features of the national framework include:

- ▼ **The Intergovernmental Agreement for an Electronic Conveyancing National Law (IGA)** between all states and territories except the ACT. Conveyancing is subject to state rather than federal legislation. This means consistency across Australia is achieved by way of agreement between the states and territories through an applied law scheme. An applied law scheme is a type of legislative scheme whereby each jurisdiction agrees to enact a model law. To this end, each of the states and the Northern Territory (NT) entered into the IGA in 2011. The IGA sets out the participating jurisdictions commitment to pursue a nationally consistent approach to eConveyancing, including enacting a model law and that the model law would be led by NSW. However, it acknowledges that “National E-Conveyancing may be implemented at different times and at a different pace across each jurisdiction” and that “the National Electronic Conveyancing Law will not prohibit State or Territory based electronic lodgment arrangements”.<sup>13</sup>
- ▼ **The Australian Registrars’ National Electronic Conveyancing Council (ARNECC).** This council was established under the IGA and comprises each participating jurisdiction’s Registrar General or their nominee. Its role is to drive consistency across Australia and develop the legal framework for eConveyancing, it has developed Model Participation Rules (MPRs) and Model Operating Requirements (MORs) for ELNOs and subscribers.
- ▼ **The Electronic Conveyancing National Law (ECNL),** which is the model law. The ECNL empowers the Registrar General in each participating jurisdiction to make the participation rules and the operating requirements for that jurisdiction. However, in exercising this discretion, the Registrar must consider the desirability of maintaining consistency with the MPRs and MORs developed by ARNECC.<sup>14</sup>

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

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<sup>12</sup> Office of the Registrar General submission to Draft Terms of Reference, December 2018, p 1.

<sup>13</sup> Council of Australian Governments, *Intergovernmental Agreement for an Electronic Conveyancing National Law*, December 2011, ss 3.4, 5.1, 8.1.2, pp 9, 11.

<sup>14</sup> *Electronic Conveyancing (Adoption of National Law) Act 2012* (NSW) s 24(2).

- ▼ demonstrate they have met certain eligibility criteria.<sup>15</sup> In practice, a prospective ELNO's eligibility criteria is assessed by ARNECC and is referred to as 'Category One Approval' and 'Category Two Approval'<sup>16</sup>
- ▼ be approved by the Registrar General to begin operating in a particular state under the state or territory version of the National Electronic Conveyancing Model Law.<sup>17</sup>

A key feature of the national framework is that it allows other entities to apply to become ELNOs, although the first ELN was not built to interoperate with competitor ELNs. The first ELNO, PEXA was established in 2010 by the NSW, Victorian and Queensland governments as National Electronic Conveyancing Development Limited, a company limited by guarantee. At the time, ARNECC noted that "the development cost and nature of electronic conveyancing would make it unlikely that there would be other ELNOs especially in the short to medium term."<sup>18</sup>

Competitors have since emerged. A second ELNO, Sympli, has been granted approval to begin operating by the Victorian and Queensland Registrars General only. There is also the prospect of more for example, LEXTECH (a mortgage processing platform owned by law firm, Purcell Partners, Pty Ltd, indicated it intends to expand its services to eConveyancing). It has been given Category One Approval.

At this stage, each of the ELNOs (and in the case of LEXTECH, will) operate entirely separate ELNs from one another, that is, all parties must use the same ELN to complete a transaction.

## 2.4.2 NSW framework

In NSW, eConveyancing is governed by:

- ▼ **The ECNL**, which NSW adopted by passing legislation in 2012 which commenced on 1 January 2013.<sup>19</sup> Among other things, the ECNL provides that the Registrar General's approval is required before a person can become an ELNO, and that the Registrar General may impose NSW-specific conditions on an ELNO's approval. The Registrar General determined a set of conditions that apply to all ELNOs from 1 March 2019, as well as a set to apply to PEXA only.

<sup>15</sup> MOR 15.4(a)-(b).

<sup>16</sup> The different stages of approval are known as Category One Approval and Category Two Approval because the approval criteria is set out in category one and two of schedule 3 to the Model Operating Requirements.

<sup>17</sup> For NSW, see ECNL s 15.

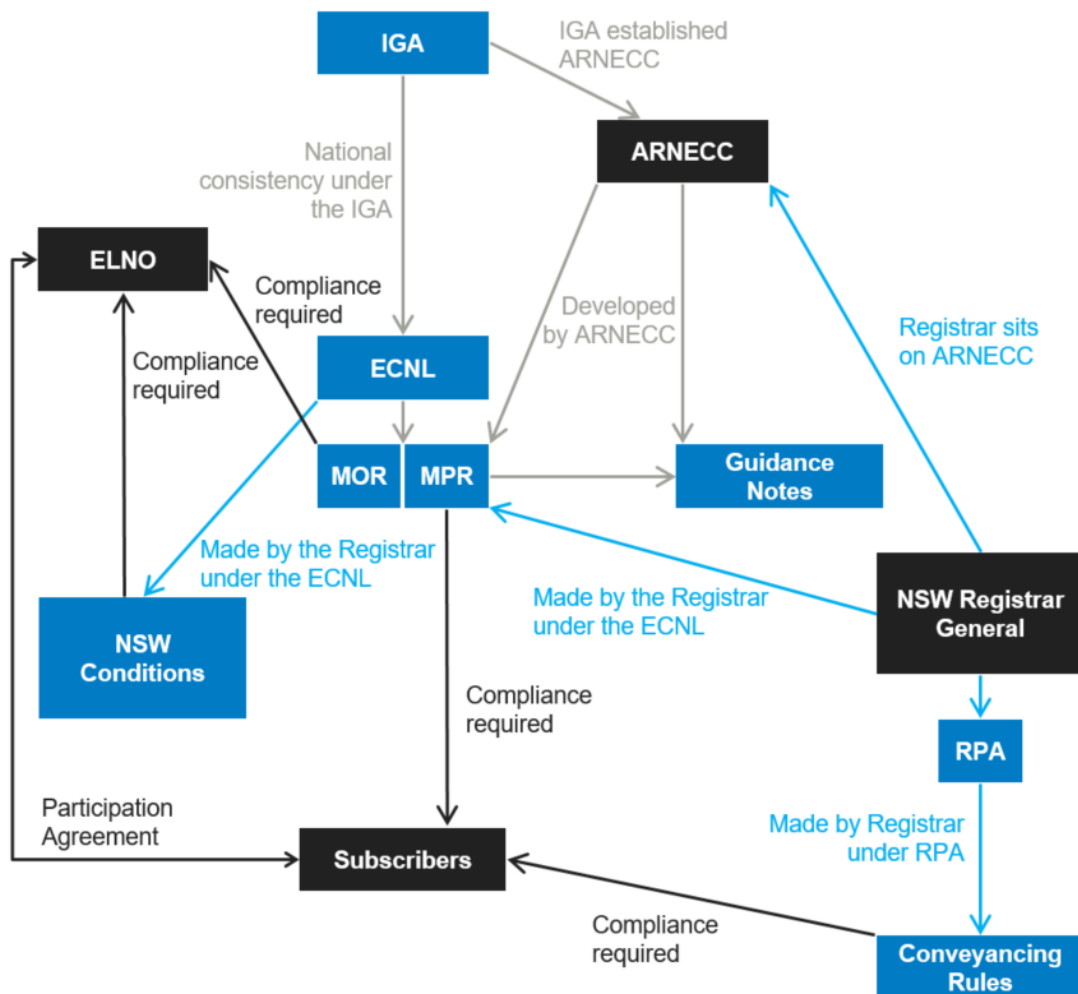
<sup>18</sup> ARNECC, *Proposed Electronic Conveyancing National Law Discussion Paper*, August 2011, p 12.

<sup>19</sup> The ECNL was adopted in NSW by the *Electronic Conveyancing (Adoption of National Law) Act 2012* (NSW). For other States and Territories, see *Electronic Conveyancing (Adoption of National Law) Act 2013* (VIC), *Electronic Conveyancing National Law (Queensland) Act 2013* (QLD), *Electronic Conveyancing Act 2014* (WA), *Electronic Conveyancing National (South Australia) Act 2013* (SA), *Electronic Conveyancing (Adoption of National Law) Act 2013* (TAS) and *Electronic Conveyancing (National Uniform Legislation) Act 2013* (NT), [https://www.arnecc.gov.au/regulation/electronic\\_conveyancing\\_national\\_law](https://www.arnecc.gov.au/regulation/electronic_conveyancing_national_law), accessed 6 March 2019.

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- ▼ **The state's version of the Model Participation Rules (MPR) and Model Operating Requirements (MOR).** The current versions commenced on 25 February 2019, and are consistent with version 5 developed by ARNECC. Version 5 of the MOR includes additional requirements intended to constrain anti-competitive behaviour by ELNOs, and impose pricing controls on the fees that ELNOs can charge for ELN services. For example, version 5 requires ELNOs to maintain structural or functional separation between their ELN functions and non-ELN functions. It also caps pricing increases by CPI.
  - ▼ **The *Real Property Act 1900 (NSW)* (RPA),** which permits the Registrar General to make Conveyancing Rules.
  - ▼ **The Conveyancing Rules** that the Registrar General has made, which are mostly intended to impose the requirements that apply to subscribers electronically to paper conveyancing. However, they also set out which documents must be lodged electronically. They therefore provide the legal mechanism for mandating eConveyancing in NSW by phasing out the paper lodgment channel.

Figure 2.3 shows the legal and regulatory framework at a high level. See Appendix D for more detail.

**Figure 2.3 The eConveyancing legal and regulatory framework in NSW**



Data source: IPART.

### 2.4.3 Other jurisdictions' frameworks

The main difference between the NSW legal and regulatory framework and those in other participating jurisdictions in Australia is that NSW is the only one to have introduced conditions to an ELNO's approval (see Appendix D for more information).

In the other states, each Registrar General has adopted an operating agreement model. Under this model, the ELNO and the Registrar General enter into an operating agreement, which contains all of the terms and conditions that apply to the ELNO in that state. In both Victoria and Queensland, where Sympli has begun operating, an operating agreement is in place. Similarly, PEXA has entered into separate operating agreements with all participating states except NSW, where it has a licence with conditions instead.



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Information on eConveyancing in comparable overseas jurisdictions is provided in Appendix E.

#### **2.4.4 Whilst land registries are state-based, ELNOs are national**

Under the MORs, ELNOs are required to ensure the ELN is available to each land registry in Australia but introduction may be staged.<sup>20</sup>

To further ensure the integrity, consistency and efficiency of land titling across Australia, the MORs require each ELNO to build and operate its ELN to interface with the State and Territory land registries using a common data standard.<sup>21</sup> This standard is called the National Electronic Conveyancing Data Standard (NECDS). Currently, the NECDS is maintained by PEXA in consultation with each of the land registries and where there is an operator/regulator model, with representatives from both the operator and regulator through a working group. Work is currently underway to move the NECDS into a government owned and run regime. This will help ensure all ELNOs have equal opportunity to influence changes made to the NECDS. The proposed solution is expected to include participating and non-participating States.

#### **2.4.5 With mandating, ELNOs become of increased importance to the community**

In recognition of this, the NSW Government has committed to ensuring that a solution exists whereby a subscriber on one ELNO, can transact with a subscriber on another ELNO. This is known as interoperability between ELNOs. Whilst the specific technology solution for how ELNOs will interoperate is not known, the NSW Government has recognised its importance and is looking for a solution. Interoperability and possible fees for interoperability is discussed in more detail in Chapter 5.

### **2.5 eConveyancing practice and progress across Australian jurisdictions**

Since the IGA was signed, NSW, Victoria, Queensland, South Australia (SA) and Western Australia (WA) have introduced eConveyancing. Tasmania and the NT have not yet introduced eConveyancing but regularly attend ARNECC meetings. The ACT was not a signatory to the IGA and has not yet introduced eConveyancing. However, representatives from the ACT regularly attend ARNECC sub-committee meetings,<sup>22</sup> and have begun discussions with PEXA to introduce eConveyancing sometime around 2020.

Although mandating eConveyancing to replace paper conveyancing is not a requirement of the national framework, all the participating states except Queensland are moving towards this. Victoria and WA have made the most progress:

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<sup>20</sup> MOR 5.2(a).

<sup>21</sup> MOR 10.3.

<sup>22</sup> ARNECC's sub-committee is called the Australian Registrars Working Group and comprises technical and legal experts.

- ▼ In Victoria, the largest phase of mandating commenced on 1 October 2018, when the most common document combinations were required to be lodged electronically. This accounted for approximately 90% of all lodgments. The last phase of Victoria's mandate begins on 1 August 2019 and covers the remaining document types. At this time, subscribers will be required to lodge the remaining documents through the ELN in PDF format at which point, land registry staff will examine them manually.<sup>23</sup>
- ▼ In WA, mandating commenced on 1 December 2018 but covers fewer document types, as there are fewer document types available electronically in WA.<sup>24</sup>

NSW will partially mandate eConveyancing from 1 July 2019.<sup>25</sup> The NSW mandate includes all mainstream documents, likely to cover at least eligible transfers, mortgages, discharges of mortgage, caveats and withdrawals of caveat lodged both as a standalone document and any combination thereof. NSW averaged 937,551 total lodgments per year, over the last three financial years.<sup>26</sup> The combination of transfer, mortgages and discharges of mortgage make up around 85% of lodgments in NSW. Figure 2.4 shows the most common lodgment case in NSW. Standalone transfers, mortgages, caveats and withdrawals of caveats are already mandated.

Paper certificates of title are also being gradually phased out and being replaced by an electronic certificate of title.

**Figure 2.4 The most common lodgment case in NSW**



**Note:** this combination is likely to be the minimum of cases that must be lodged electronically from 1 July 2019 (subject to specific exceptions and final updating of relevant rules).

SA has only mandated eConveyancing for mortgages, discharges of mortgage and combinations thereof (ie, refinances). As in other jurisdictions, this is subject to exceptions.<sup>27</sup>

<sup>23</sup> Customer Information Bulletins, <https://www.propertyandlandtitles.vic.gov.au/customer-information-bulletins>, accessed 13 February 2019.

<sup>24</sup> Electronic Conveyancing, <https://www0.landgate.wa.gov.au/for-individuals/legislation-and-reform/electronic-conveyancing>, accessed 13 February 2019.

<sup>25</sup> Exceptions are likely to exist for example, where a mandated document is lodged together with a non-mandated document, it may be lodged in paper.

<sup>26</sup> NSW Land Registry Services, Plan and dealing statistics, [http://www.nswlrs.com.au/plan\\_and\\_title\\_registration/plan\\_and\\_dealing\\_statistics](http://www.nswlrs.com.au/plan_and_title_registration/plan_and_dealing_statistics), accessed 6 March 2019.

<sup>27</sup> Notice to Lodging Parties, [https://www.sa.gov.au/\\_\\_data/assets/pdf\\_file/0006/282615/NTLP-196.pdf](https://www.sa.gov.au/__data/assets/pdf_file/0006/282615/NTLP-196.pdf), accessed 11 February 2019.



SA also recently indicated it will mandate eConveyancing once several issues are resolved, including for example, interoperability (which is discussed later in this paper).<sup>28</sup>

Figure 2.5 shows the relevant points at which eConveyancing becomes mandatory across these jurisdictions.

**Figure 2.5 Documents to be lodged electronically in Victoria, WA and NSW**



**Note:** This figure does not include SA as it has not announced a date for mandating. Queensland has not announced an intention to mandate. Tasmania, Northern Territory and the ACT have not implemented eConveyancing yet.

<sup>28</sup> Customer Information Bulletin, 15 January 2019, Issue 329  
[https://www.sa.gov.au/\\_\\_data/assets/pdf\\_file/0019/493012/Further-mandating-of-e-conveyancing-CIB329.pdf](https://www.sa.gov.au/__data/assets/pdf_file/0019/493012/Further-mandating-of-e-conveyancing-CIB329.pdf), accessed 11 February 2019.

### 3 Proposed approach to the review

We have developed a proposed approach to guide our analysis and decision-making for this review. The approach aims to ensure that we consider all the matters specified in our terms of reference (see Box 3.1), and take account of the contextual issues outlined in Chapter 2.

The sections below set out main steps in this approach, and then outline what we propose to consider at each step. Chapters 4 to 7 discuss each step in more detail and identify the issues on which we seek stakeholder comment.

#### **Box 3.1 Matters specified in our terms of reference**

Our terms of reference ask us to:

- ▼ Review the state of the electronic conveyancing market
- ▼ Recommend an appropriate pricing regulatory framework, which includes:
  - A maximum price or pricing methodology for the provision of services by an ELNO
  - A maximum price or pricing methodology for services provided to ELNOs by NSW LRS
  - A maximum price or pricing methodology for services provided to ELNOs by Revenue NSW.
- ▼ Consider the appropriate timeframe in which the recommended pricing frameworks should be adopted and any transition measures
- ▼ Consider the appropriate scope and frequency for future reviews of the pricing frameworks.

In providing these services, other matters we are to consider are:

- ▼ Protecting consumers from potential pricing abuses due to the current status of electronic conveyancing as a highly concentrated market
- ▼ The potential for additional ELNOs to enter the market over the next 1 to 5 years, the costs and effectiveness of interoperability and how this should be reflected in the pricing framework
- ▼ The cost of providing the services including the implication of differences in costs between jurisdictions for nationally consistent pricing
- ▼ The extent to which PEXA invested capital and developed intellectual property to support its ELN in its capacity as the initial ELNO
- ▼ The possibility of applying the NSW approach to any of the elements of the pricing regulatory framework as a model for other jurisdictions
- ▼ Any other relevant matters.

### 3.1 Overview of our proposed approach

Our proposed approach comprises four main steps:

1. Assess the state of the eConveyancing market, including the current level of competitiveness and the possible development of competition and choice for consumers in future.
2. Decide on an appropriate methodology to set prices for ELNO services given Step 1 findings, and apply this method to recommend maximum prices (or a process for determining those prices) for all ELNOs.
3. Decide on an appropriate methodology to set prices for services provided to ELNOs by NSW LRS and Revenue NSW, and apply this method to recommend maximum prices (or a process for determining those prices) for those services.
4. Consider and recommend the appropriate timeframes for adopting the pricing methodologies, what, if any, transition measures are required, and how often prices should be reviewed.

### 3.2 Assess the state of the eConveyancing market

In line with our terms of reference, the first step in our proposed approach for this review is to assess the current state of the eConveyancing market in NSW. The aim of this step is to understand the current level of competitiveness in the market, and the possible development of competition over the next one to five years. This is because the need for price regulation to protect consumers, and the most appropriate form of that regulation, is largely determined by the extent to which competition – especially the risk of losing customers to competing service providers – creates incentives for market participants to continually improve their services and keep their prices in line with the efficient costs of supply.

For our assessment of the state of the eConveyancing market, we propose to analyse the following issues:

- ▼ The number of ELNOs contesting the market, and other sources of competition or potential competition
- ▼ The barriers to additional ELNOs entering the market and increasing their market share
- ▼ The potential for ELNO interoperability to improve competition and choice for consumers, including the different options for implementing interoperability and their likely impact on competition
- ▼ The extent of ELNO vertical integration and its likely impact on competition and choice for consumers
- ▼ The extent to which pricing practices (eg, bundling, pricing that is not cost-reflective) of a dominant ELNO can have an impact on competition.

### 3.3 Decide on and apply an appropriate pricing methodology for ELNOs

In the second step, we propose to consider the findings from our analysis in Step 1, as well as information obtained from existing ELNOs, to decide on an appropriate 'form of regulation' for ELNOs in the current and likely future market. The 'form of regulation' we adopt is the set of methods we use to regulate prices. These methods differ in how efficient costs are assessed, how prices are controlled, how incentives for efficiency and innovation are provided, and how competition is promoted.

The form of regulation for ELNOs will govern how initial prices are set (as this is the first time their prices have been reviewed by a regulator) and how prices are adjusted from year to year. If our analysis in Step 1 indicates that competition is effective, or will be so in the near future, the form of regulation can be less prescriptive.

We will also decide on the appropriate methodology to use to estimate the cost of providing ELNO services for the purpose of regulating prices. As well as the findings of Step 1, we will consider information about the nature and level of ELNOs' costs and their business models (for example, whether they own or lease assets).

Our standard regulatory approach to estimating the costs of an asset-heavy business uses the 'building block' method to determine a 'notional revenue requirement'. This involves estimating the business's operating costs, and setting allowances for a return of capital, return on capital, tax and working capital.

Alternative approaches we have used in less asset-dominated industries which could be applied to ELNOs include:

- ▼ Cost build-up approach (ie, calculating an operating cost allowance and a profit margin for ELNOs)
- ▼ Benchmarking ELNO prices to paper conveyancing prices discounted by the estimated cost efficiencies of eConveyancing.

Once we have determined a notional revenue requirement, we then have to forecast demand for the services being offered – in this case, the volume of transactions – and decide on the allocation of costs between services.

We have to decide on the form of control – whether to set controls on revenue, average prices or individual maximum prices – and the structure of prices – for example, whether to have a two part tariff with separate fixed and variable charges.

We will also consider an appropriate approach to updating maximum prices annually.

As part of this step, as required by our terms of reference, we will have regard to:

- ▼ The implication of differences in costs between jurisdictions for nationally consistent pricing
- ▼ The extent to which PEXA invested capital and developed intellectual property to support its ELN in its capacity as the initial ELNO

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

### **3.4 Decide on and apply an appropriate pricing methodology for land registries and revenue offices**

Our third step is to decide on an appropriate pricing methodology for land registries and revenue offices and apply that method to set prices for NSW LRS and Revenue NSW. These agencies have incurred (or are incurring) costs to facilitate electronic settlements via ELNOs by building new systems and performing ongoing maintenance. As NSW LRS and Revenue NSW are monopoly service providers with no prospect of competition, our findings with regard to competition will not play a role in determining the pricing methodology. Instead, we will consider information the agencies provide on their costs and cost structure.

As we are not setting prices for all their operations, just those services they deliver to ELNOs, we will first have to consider which prices we should make recommendations for, and then the most appropriate pricing methodology.

For NSW LRS, the same methodology options are open to us as for ELNOs.

For Revenue NSW, we consider that there is a threshold question about whether a taxing agency should charge for its core function, collecting taxes, before considering how those charges should be recovered.

### **3.5 Consider timeframes for adopting proposed prices and decide on transitional arrangements if required**

The final step in our proposed approach involves considering the timeframe for adopting our recommended prices or pricing methodologies in NSW, and what, if any, transitional arrangements would be required. We will also consider the scope and timeframe for future independent review of our recommended prices or pricing methods, to ensure they remain appropriate as the market for eConveyancing and other factors change.

[IPART seeks comments on the following](#)

- 1 Do you agree with IPART's proposed approach for this review? Are there any alternative approaches that would better meet the terms of reference, or any other issues we should consider?

## 4 Assessing the eConveyancing market

As the first step in our approach for this review, we propose to assess the state of the eConveyancing market in NSW, including the current level of competitiveness and the possible development of competition over the next few years. The findings of this assessment will inform our recommendations on the pricing regulatory framework.

Price regulation is more important in monopoly markets, where the lack of competitors (or potential competitors) can lead to poorer services and higher prices for customers. In markets where the level of competition is effective, the risk of losing customers to competing service providers creates incentives for businesses to continually improve their services and keep their prices in line with the efficient costs of supply.

In the market for eConveyancing, two key factors are likely to influence the level of competition in the coming years. The first is the availability of alternative conveyancing services. In NSW, eConveyancing services currently compete with paper conveyancing services. This competition creates an incentive for ELNOs to at least keep the service prices in line with those of the alternative services. However, as Chapter 2 discussed, the NSW Government will mandate that all mainstream conveyancing transactions be completed electronically from 1 July 2019.

The second factor likely to influence the level of competition is the interoperability of ELNs. Currently, there is no interoperability, which means participants of an eConveyancing transaction – commonly the vendor’s and purchaser’s solicitors/conveyancers and their financial institutions – need to use the same ELNO. Industry regulators and market participants have begun to consider how interoperability could be achieved, but no decisions have been made. Without interoperability, competition would require each market participant to subscribe to multiple services, and participants to agree on which ELNO to use for a transaction. This could result in the market converging to a monopoly or a highly concentrated ELNO market structure.

For our assessment of the state of the eConveyancing market, we propose to analyse the following issues:

- ▼ The number of ELNOs contesting the market
- ▼ The barriers to ELNOs entering the market and increasing their market share
- ▼ The potential for ELN interoperability to improve competition, including the different options for implementing interoperability and their likely impact on competition
- ▼ The extent of ELNO vertical integration and its likely impact on competition.

The sections below discuss each of these issues and set out the questions on which we seek stakeholder comment.

## 4.1 Number of ELNOs contesting the market

The eConveyancing market is highly concentrated. As Chapter 2 noted, only one ELNO – PEXA<sup>29</sup> – is operating in NSW. PEXA<sup>29</sup> was formed in 2010 by the governments of NSW, Queensland and Victoria as a private company limited by guarantee. It was converted to a company limited by shares in 2011, with subsequent investments by the WA government, financial institutions<sup>30</sup> and other private investors. In mid-January 2019 it was purchased outright by a group of private investors.<sup>31</sup>

As noted above, PEXA's eConveyancing services currently compete with paper conveyancing services, including those of other intermediaries that provide similar (non-digital) services.<sup>32</sup> This source of competition will be reduced when the NSW Government's eConveyancing mandate takes effect on 1 July 2019. But it will not be entirely eliminated until all jurisdictions have mandated eConveyancing (insofar as PEXA chooses to continue to set uniform nationwide prices).

Two potential new entrants to the NSW eConveyancing market emerged during 2018:

- ▼ Sympli, a company established in a joint venture between the ASX and InfoTrack, was approved by ARNECC to become an ELNO in November 2018. It began offering a limited range of services in December 2018, commencing with lodgment of a priority notice in Queensland and a caveat in Victoria. Sympli is expected to commence operations in NSW and expand its service offering to refinances and transfers during 2019.
- ▼ LEXTECH, which was granted Category One Approval to become an ELNO in May 2018.

The degree of competition posed by these new entrants will depend on the range of services that they offer and their ability to gain market share under the current and future operating environment.

IPART seeks comments on the following:

- 2 What are your views on the current state of the market? For example, does the continued availability of paper conveyancing in other jurisdictions constrain prices for eConveyancing? What scope is there for new entrants to offer the full range of eConveyancing services?

## 4.2 Barriers to entry

The development of competition in the eConveyancing market in future depends on the barriers that constrain new ELNOs from entering the market, and from increasing their market share. If these barriers are low, effective competition is likely to develop over time.

<sup>29</sup> Founded as National E-Conveyancing Development Limited. For further background see: ARNECC, *Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law: Governance Arrangements*, October 2018, pp 4-6, [https://www.arnecc.gov.au/\\_\\_data/assets/pdf\\_file/0015/1411026/IGA-Governance-Arrangements.pdf](https://www.arnecc.gov.au/__data/assets/pdf_file/0015/1411026/IGA-Governance-Arrangements.pdf), accessed 5 March 2019.

<sup>30</sup> CBA, NAB, ANZ, Westpac and Macquarie Group.

<sup>31</sup> CBA, Morgan Stanley Infrastructure and Link Market Services. See: <https://www.pexa.com.au/investor-relations>, accessed 5 March 2019.

<sup>32</sup> Such as SAI Global, InfoTrack, First Mortgage Services and GlobalX Legal.



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But if they are high, competition or the threat of competition may remain insufficient to put pressure on the incumbent to charge efficient prices and offer innovative services.

Our preliminary analysis has identified three likely barriers to entry, including the two-sided nature of the eConveyancing market, the start-up costs for ELNOs, and the regulatory requirements for ELNOs, including that they offer a wide range of services.

#### **4.2.1 Two-sided nature of eConveyancing market**

The eConveyancing market can be characterised as a two-sided market. For many property dealings (such as transfers, and mortgage refinances), ELNOs provide intermediation services between solicitors/conveyancers and financial institutions on behalf of property vendors and purchasers. In these transactions, ELNOs provide services to two distinct sets of users (solicitors/conveyancers and financial institutions). Each set of users faces different costs, which has implications for both competition and pricing.<sup>33</sup>

The competitive dynamics in two-sided markets, including whether they tend to be monopolistic or oligopolistic in the long run, are influenced by the ‘network effects’ in the market.<sup>34</sup> The eConveyancing market exhibits positive network effects, because the value of an ELNO’s services provided to any one user increases as more solicitors/conveyancers and financial institutions use that ELNO’s services. This means that larger and more established ELNOs have a competitive advantage over smaller new entrants, since their users can connect with a larger number of other users to complete transactions.

The competitive dynamics in two-sided markets are also influenced by users’ willingness to use more than one service provider (known as ‘multi-homing’). In the eConveyancing market, several factors may limit users’ willingness to use multiple ELNOs, including:

- ▼ The costs to users of having to learn more than one ELNO’s systems (ie, efficiency losses)
- ▼ The costs to lawyers/conveyancers of obtaining separate security certificates for each ELN
- ▼ The costs to financial institutions of building network connections with each ELNO.

#### **4.2.2 Start-up costs for ELNOs**

ELNOs require initial investments to establish their ELN, including the costs of installing hardware, establishing network connections (with land registries, revenue offices and the payments infrastructure) and developing the network’s software platform. These technological investments must be made before ELNOs can start to earn revenue from their services, and are in addition to typical costs of establishing a business such as hiring staff and the costs of establishing an office, marketing and insurance.

New ELNOs entering the market may also face costs to connect with the existing systems in the industry. For example, some land registries and revenue offices (including those in NSW)

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<sup>33</sup> See Rochet and Tirole, *Two-Sided Markets: An Overview*, March 2004, [http://web.mit.edu/14.271/www/rochet\\_tirole.pdf](http://web.mit.edu/14.271/www/rochet_tirole.pdf), accessed 11 February 2019.

<sup>34</sup> A network effect or network externality is the impact that an additional user of a service has on the value of the service to others.



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built their systems to be highly integrated with PEXA. This means that some technology infrastructure needs to be upgraded or replaced to accommodate multiple ELNOs. Some institutions have proposed that some of the cost of these upgrades be passed on to new ELNOs entering the market (discussed further in Chapter 5).

On the other hand, new ELNOs entering the market are likely to gain a ‘second mover advantage’. Compared to PEXA, they would face lower costs of gaining user acceptance and working with regulators to establish governance arrangements.

Overall, due to the high initial costs, it is likely that ELNOs need to reach a critical mass of users or transactions to gain the economies of scale required for the business to be viable.

### 4.2.3 Regulatory requirements for ELNOs

Regulatory requirements for ELNOs, such as the MORs, may constrain new ELNOs from entering the market. For example, the MORs compel ELNOs to build their services over time to be able to lodge a wide range of documents with the Land Registry.<sup>35</sup> This may constrain entry by ELNOs with a different business model – for example, those who only want to compete on a subset of services.

Introducing a new pricing regulatory framework for ELNOs also has the potential to introduce barriers to entry, such as:

- ▼ In a developing market such as eConveyancing, additional costs can be incurred as new entrants compete to attract customers and increase market share, and incumbents seek to retain customers. Setting maximum prices based on a sole operator’s efficient costs would serve as a barrier to entry.
- ▼ A more prescriptive approach to pricing could unintentionally preclude an innovative pricing structure as part of a new entrant’s business model.
- ▼ Even if maximum prices themselves do not serve as a barrier to entry, ELNOs could face additional costs of price regulation (including staff to conduct compliance or regulatory assurance activities), although the incremental costs are likely to be small compared to other regulatory costs.

The costs of developing a competitive market could be accommodated by setting maximum prices based on a new entrant’s efficient costs that include customer acquisition and retention costs, in order to allow workable competition to develop. Competition then should lead to better outcomes for customers in the longer run. Section 5.3 discusses how we could deal with this in our pricing approach in more detail.

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<sup>35</sup> For example. ELNOs must be capable of performing transfers, mortgages, discharge of mortgages, caveats, withdrawal of caveats, priority notices, extension of priority notices and withdrawal of priority notices. MOR 5.2(b).

One approach to minimising the effects of pricing regulation on new entrant ELNOs more broadly would be to exempt new entrants from pricing regulation until they reach a sufficient market share. This type of approach has been used in some financial markets.<sup>36</sup>

IPART seeks comments on the following:

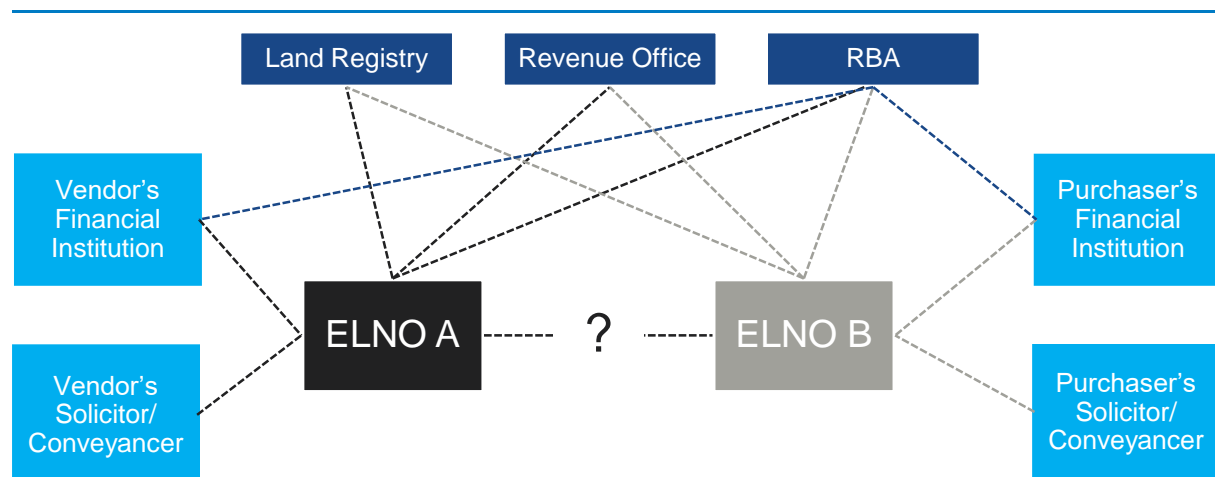
- 3 How important are barriers to entry in constraining competition in the eConveyancing market? Are there other barriers or factors that will influence competition in the market?
- 4 To what extent would pricing regulation increase barriers to entry? Should new entrants be exempt from pricing regulation and, if so, what would be an appropriate market share benchmark at which pricing regulation would commence?

### 4.3 Potential for interoperability to improve competition

As noted above, one key factor likely to influence the future competitiveness of the eConveyancing market is whether or not ELNs are interoperable. Interoperability refers to ELNOs' systems being able to communicate with each other, so that users can use different ELNOs to complete a property transaction together. Introducing interoperability would reduce the network effects in the eConveyancing market (discussed in section 4.2.1 above), making it more viable for ELNOs with smaller user bases to compete.<sup>37</sup>

Currently, ELNs are not interoperable: there is no means for one ELNO's systems to exchange information with another's, and only one ELNO per transaction can make the lodgment with a land registry office and instruct the RBA to complete financial settlement (Figure 4.1).

**Figure 4.1 Current constraints on interoperability for settlements with multiple ELNOs**



**Note:** this figure illustrates one possible combination of solicitors/conveyancers and financial institutions using different ELNOs to complete a transfer of title.

**Data source:** IPART

<sup>36</sup> For example, ASIC exempts operators of financial markets from licensing requirements (Part 7.2 of the *Corporations Act 2001*) if it is a low-volume market, which is defined as having no more than 100 transactions per year and a value less than \$1.5 million. See: <https://asic.gov.au/regulatory-resources/markets/market-structure/licensed-and-exempt-markets/exempt-markets/licensing-relief-for-low-volume-financial-markets/>

<sup>37</sup> The ACCC has also expressed the view that interoperability would reduce network effects and facilitate entry of new ELNOs (ACCC letter to Office of the Registrar General, 13 February 2019, p2).

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To illustrate the impact of interoperability on competition, consider the effect a lack of interoperability would have in other two-sided markets. For example, without network interoperability in the telecommunications industry, two mobile phone users would not be able to phone each other unless they use the same phone provider. This would give them a strong incentive to choose a phone provider that would allow them to communicate with most other users (ie, the largest provider).

We understand that ARNECC and the NSW Government are both considering interoperability. However, at this stage, there is no certainty about what model will be used. Therefore, to assess the future competitiveness of the market, we will need to consider the alternative models being considered, and the likely effectiveness of each in fostering competition. These models broadly include establishing multi-homing instead of interoperability, a central infrastructure or information hub approach, an access regime, and direct information sharing between ELNOs.<sup>38</sup>

#### **4.3.1 Multi-homing**

Where there are multiple ELNOs in the market but no interoperability, users would have to agree which ELNO to use for a transaction involving multiple users (such as a property transfer). To solve this coordination problem and allow these transactions to occur in an orderly way, market practices around which ELNO to use for each transaction would need to be established by the industry.

In the absence of interoperability, multi-homing would become important to maintaining effective competition in the market. That is, users (conveyancers, solicitors and financial institutions) would need to subscribe to the services of multiple ELNOs, which would require financial institutions to connect their systems to multiple ELNOs and for all users to obtain security certificates for multiple ELNOs. However, if users prefer not to multi-home (for example, if multi-homing involves high costs), the lack of interoperability could lead to a single or small number of ELNOs being used for transactions that involve multiple users. This could result in competition being concentrated on transactions that involve a single user (such as lodging caveats on title).

#### **4.3.2 Central infrastructure**

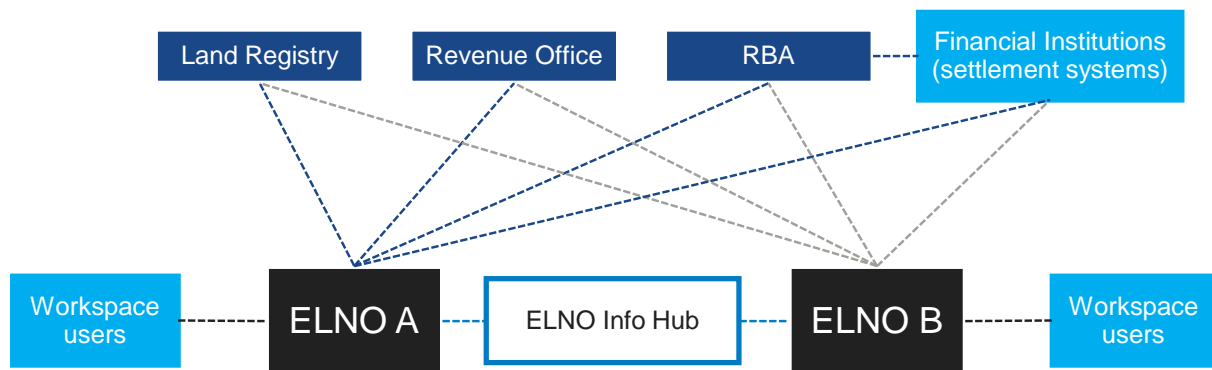
We have identified two possible models for a central infrastructure or information hub.<sup>39</sup> In the first model, an ELNO information hub could be developed to facilitate information sharing between ELNOs. The hub would receive all necessary information on a property transaction entered into an ELNO's system and distribute this information to any other ELNO being used by a party to the transaction (see Figure 4.2).

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<sup>38</sup> These options have been considered in Appendix II of the IGA Review Issues Paper. See Dench M<sup>c</sup>Clean Carlson, *Review of the InterGovernmental Agreement for an Electronic Conveyancing National Law*, Issues Paper, 13 February 2019, pp 81-86, <http://dmcca.com.au/wp-content/uploads/2019/02/IGA-Review-Issues-Paper-19-02-13.pdf>, accessed 19 February 2019.

<sup>39</sup> There are a number of examples of central infrastructures and networks that have been established in financial markets to allow parties to complete transactions. One such example is SWIFT, which operates systems and sets messaging standards used by financial institutions across more than 200 countries to complete foreign exchange transactions. See: <https://www.swift.com/about-us/discover-swift>, accessed 6 March 2019.

**Figure 4.2 Possible network structure with an ELNO information hub**

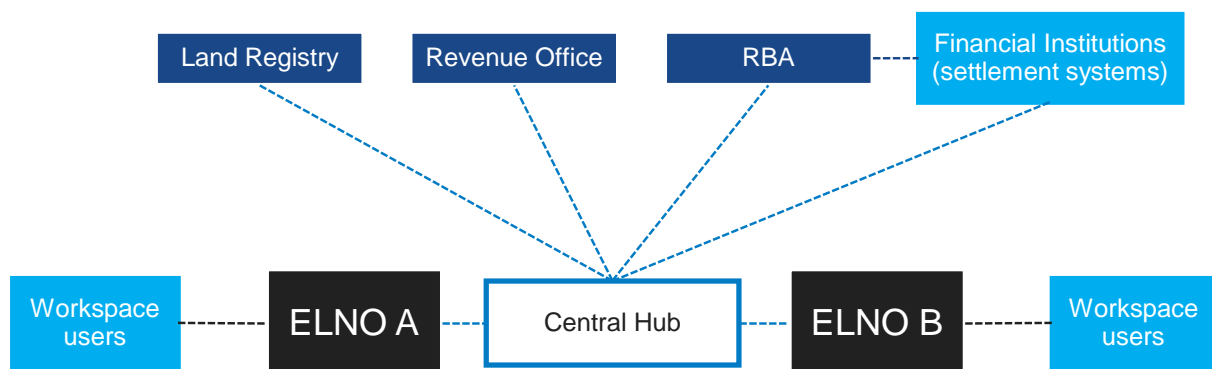


**Note:** Workspace users include the staff of solicitor/conveyancing firms and financial institutions.

**Data source:** IPART.

In the second model, only subscribers (solicitors/conveyancers and financial institutions) would connect directly to ELNOs, in order to access a workspace. The IT systems of the land registry, revenue office, RBA and financial institutions could directly connect to the central hub (see Figure 4.3). This approach would reduce the costs of establishing network infrastructure between all relevant entities. However, it would be more costly to develop the central services required to support a larger range of institutions and it would introduce a single point of failure (ie, all transactions would be affected if the central hub experienced an outage).

**Figure 4.3 Possible network structure with a central hub**



**Data source:** IPART.

These two forms of central infrastructure effectively create a monopoly supplier. However, they could be developed under several different ownership structures, which could have different implications for competition and prices. For example, a corporation (including an existing industry stakeholder, such as the land registry or an ELNO) could be appointed to develop, operate and earn a regulated rate of return on the central infrastructure. Alternatively, a new corporation owned by a group of industry participants (or a public-private partnership) could be established to recover efficient costs.<sup>40</sup> Setting up such an

<sup>40</sup> This would be similar to the establishment of NPP Australia Limited as an industry utility by financial institutions and the RBA to operate the fast payments infrastructure (known as the New Payments Platform).

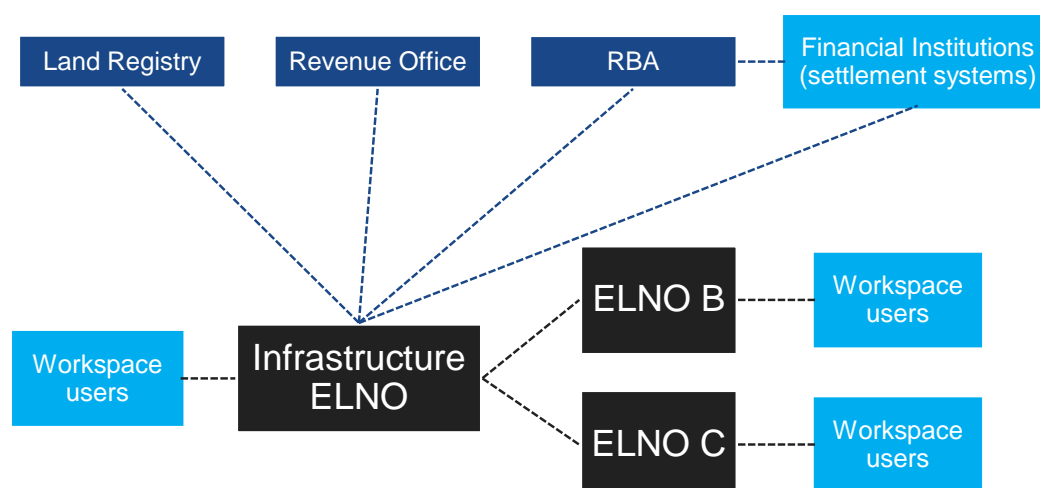
industry utility would require cooperation between industry stakeholders and input from the ACCC.

### 4.3.3 Access regime

An access regime, as shown in Figure 4.4, could be considered a variant of the central infrastructure in Figure 4.3, where one ‘infrastructure ELNO’ provides lodgment services, settlement services and network infrastructure to the other ELNOs. The difference is that the infrastructure ELNO provides these services for all transactions, rather than only for transactions that involve more than one ELNO. This model would minimise the number of network links between stakeholders, and is likely to cost less than other central infrastructures because it makes use of the existing infrastructure of one of the ELNOs.

On the other hand, because one ELNO controls the core infrastructure, competition is less likely to result in innovation around the core lodgment or settlement functions of an ELNO and more focused around the contestable retail elements. To ensure fair treatment of competitor ELNOs, this model would need to be regulated under an access regime.

**Figure 4.4 Possible network structure with an access regime**



Data source: IPART

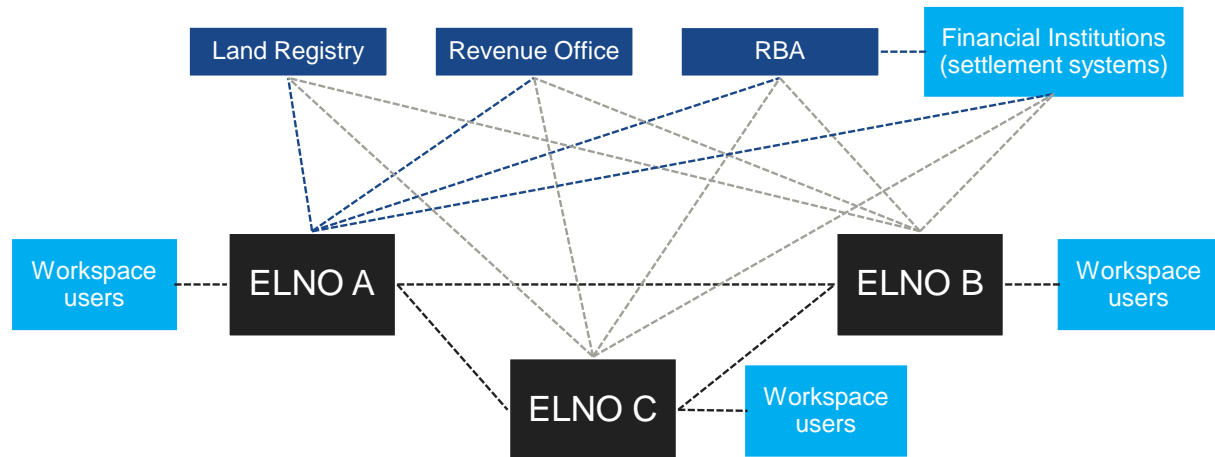
### 4.3.4 Direct connections between ELNOs

Direct connections between ELNOs could be established to allow for information sharing, as shown in Figure 4.5. This model of interoperability has been used in other markets.<sup>41</sup> It would require the establishment of a business rulebook, messaging standards and network connectivity. While there are few ELNOs in the market, this method may be more cost-

<sup>41</sup> For example, in Europe, payments are processed by Automated Clearing Houses in each country and banks may be members of one (or more) Automated Clearing House. A non-profit industry association sets out open standards for business processes and messaging between Automated Clearing Houses so that they can coordinate and recognise each other's members to process payments across Europe quickly and efficiently. See European Automated Clearing House Association, *EACHA Interoperability Framework*, May 2016, <http://www.eacha.org/downloads/EACHA%20Framework%20v9.0%2019%20May%202016.pdf>, accessed 9 January 2019.

effective and have greater resilience than a central infrastructure. However, it would become increasingly costly and complex as additional ELNOs enter the market.

**Figure 4.5 Network structure with direct connections between ELNOs**



Data source: IPART

Ideally, the same interoperability solution would be adopted across all jurisdictions. Without a coordinated national approach, there would be duplication of investment as well as lower savings in terms of network infrastructure costs for participants including ELNOs and financial institutions.

There are also a range of other more detailed design considerations that could have an impact on competition. For example, if the interoperability data standards are owned by one of the ELNOs, it could create a new barrier to entry. Another example, is that the industry appears to be considering interoperability models that retain independent workspaces in each ELNO involved in a transaction (rather than a shared workspace), which should give greater scope for innovation or specialisation around the services provided to solicitors, conveyancers and financial institutions.

IPART seeks comments on the following:

- 5 What factors influence the effectiveness of potential multi-homing or interoperability solutions in promoting competition?
- 6 What are the relative costs of implementing the different potential multi-homing or interoperability solutions between ELNOs?

## 4.4 Extent of ELNO vertical integration

The extent of vertical integration in the eConveyancing market could also influence the development of competition. ELNOs are likely to have different degrees of vertical integration with upstream and downstream services. For example:

- ▼ PEXA is now offering property information search functionality known as 'PEXA Plus Marketplace' by partnering with other businesses
- ▼ Some information brokers and conveyancing software providers, such as InfoTrack, SAI Global and GlobalX, have integrated their downstream services with PEXA's services to offer end-to-end conveyancing systems.

ARNECC's latest version of the MOR outlines some ring-fencing requirements for ELNOs that want to integrate other services, including requirements to not give unfair or commercial advantage to related upstream or downstream service providers.<sup>42</sup> However, there are some questions around how these requirements will be enforced in practice, including what would be considered a breach.

It will be important that the pricing regulatory framework we recommend ensures that eConveyancing prices do not cross-subsidise complementary services in other competitive markets.

[IPART seeks comments on the following:](#)

- 7 How will vertical integration or the potential for vertical integration influence competition between ELNOs and the efficiency of the conveyancing process?
- 8 How should the pricing regulatory framework for ELNOs address vertical integration or the potential for vertical integration in eConveyancing?

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<sup>42</sup> MOR 5.5-5.6.



## 5 Deciding on and applying a pricing methodology for ELNO services

In the second step of our proposed approach, we will decide what methodology should be used to set the prices ELNOs can charge their users (solicitors / conveyancers and financial institutions), and then apply this method to recommend maximum prices (or a process for determining those prices) for all ELNOs in NSW. To do this, we will consider:

- ▼ What ‘form’ of price regulation is appropriate for ELNOs
- ▼ What costs should be recovered by regulated prices and what approach should be used to estimate the efficient level of these costs
- ▼ How any future costs of implementing an ELNO interoperability solution should be recovered.

As required by our terms of reference, we will also consider whether our recommended approach to any element of the NSW pricing regulatory framework could be an appropriate model for other jurisdictions.

Each of these matters is discussed below, including our preliminary thinking and the issues on which we are seeking stakeholder comment.

### 5.1 We will consider a number of forms of regulation for ELNOs

The ‘form of regulation’ is the set of methods used to determine regulated prices initially (ie, the first time they are reviewed), and to adjust prices over time. These methods vary in terms of how prescriptive they are, and the extent they contribute to improving efficiency or promoting competition.

The options we propose to consider for the form of regulation for ELNOs are listed below, ordered from most prescriptive to least prescriptive:

- ▼ Setting maximum prices for the individual regulated services ELNOs provide for each year of the regulatory period
- ▼ Setting maximum prices for the individual regulated services for the initial year of the regulatory period, and adjusting these prices by the change in an index (such as CPI or an industry-specific index) in each of the following years of the period.
- ▼ Setting maximum prices for the individual regulated services ELNOs provide for the initial year of the regulatory period, and allowing ELNOs to adjust these prices within the limits of a weighted average price cap<sup>43</sup> in each of the following years of the period.

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<sup>43</sup> A weighted average price cap would limit the average change (%) in an ELNO’s regulated prices (weighted by the relevant quantity), rather than the change in an ELNO’s individual regulated prices.



- ▼ Setting the total revenue each ELNO is permitted to generate from all the regulated services it provides in each year of the regulatory period, and allowing the ELNOs to set its prices for individual services within the limits of this revenue cap each year.

In deciding on the appropriate form of regulation, we will consider the current and future state of the eConveyancing market, and information from existing ELNOs on costs. If we find in Step 1 that competition in the market is effective, or will be so in the near future, it may be appropriate to use one of the less prescriptive forms of regulation. As Chapter 4 noted, in markets with effective competition, the risk of losing customers to competing firms protects consumers. The threat of competition creates incentives for service providers to continually improve their services and to keep their prices in line with the efficient costs of supply.

We will also consider the extent to which the different forms of regulation provide ELNOs with the flexibility to vary their pricing models. Currently, PEXA prices include variable Transaction Service Fees (based on the type of conveyancing transaction) and a fee for the provision of digital certificates (as discussed in Chapter 2).<sup>44</sup> However, other ELNOs may choose to offer subscription or membership fees, or another pricing model. We consider the form of regulation should allow for different pricing models to encourage pricing innovation, as this is a characteristic of a competitive market.

Of the common forms of regulation listed above, only the two least prescriptive options – a weighted average price cap or a revenue cap – provide some flexibility for ELNOs to vary the structure and levels of individual product prices over the regulatory period, subject to broader constraints on price or revenue increases.

#### IPART seeks comments on the following

- 9 What form of regulation for ELNO pricing do you support? Why?
- 10 If we decide to use an index to adjust the initial regulated prices in the following years of the regulatory period, is CPI an appropriate index? If not, what other index could we use?
- 11 What measures will our pricing framework require to enable flexibility and innovation for new entrant ELNOs?

## 5.2 IPART will recommend prices that recover efficient costs

Whichever form of regulation we use, we will need to decide the following:

- ▼ Whether we should estimate these costs for individual ELNOs or for a 'benchmark efficient ELNO'
- ▼ What costs should be recovered through the prices ELNOs can charge for regulated services and what approach should we use to estimate the efficient level of these costs
- ▼ How we should account for any assets and costs that are shared across jurisdictions.

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<sup>44</sup> PEXA currently has an offer where the first digital certificate is free and subsequent digital certificates are priced at cost. PEXA, *Pricing*, <https://www.pexa.com.au/pricing>, accessed 1 February 2019.

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New entrants will join a more mature market and may benefit from basing their systems on the established market practices. Our framework will need to consider advantages for new entrants and weigh these up against any relevant and offsetting incumbent advantages.

### **5.3 We propose to estimate costs for a ‘benchmark efficient ELNO’**

Although only one ELNO is currently operating in NSW, eConveyancing is a developing market and additional ELNOs are expected to enter in the near future (see Chapter 2 and 4). Therefore, in recommending prices, we need to ensure that the maximum prices reflect the costs of providing services by an efficient ELNO. We propose to consider how the costs of the incumbent ELNO may differ from those of future ELNOs.

For example, the incumbent ELNO (which has significant market share) may have cost advantages that arise from their economies of scale. However, new entrant ELNOs (with smaller market share) may incur higher costs in attracting new customers. As a consequence, setting prices based on the incumbent ELNO’s cost structures would not necessarily reflect the costs that new ELNOs incur.

In this situation, setting prices to recover the costs of a notional benchmark efficient ELNO would ensure that our pricing framework promotes competition, ie does not deter new ELNOs (with different cost structures from the incumbent) from entering the market. IPART has previously set prices for benchmark efficient firms in other markets that we regulate where competition is developing. For example, when IPART previously regulated retail electricity prices in NSW, we determined prices based on the efficient costs of a ‘standard retailer’, rather than for individual electricity retailers.

If we were to adopt this approach, we would need to consider the characteristics of the benchmark efficient ELNO so we can estimate its costs. For example, we would need to decide:

- ▼ The market share and number of transactions serviced by the benchmark efficient ELNO, and to what degree it has achieved some economies of scale
- ▼ Whether the benchmark efficient ELNO operates in NSW and other jurisdictions
- ▼ The benchmark efficient ELNO’s level of vertical integration
- ▼ The maturity of the benchmark efficient ELNO’s customer base – for example, whether it has an existing customer base to defend and (or) seeks to acquire new customers.

[IPART seeks comments on the following](#)

- 12 Do you consider recommending prices based on the costs of a notional benchmark efficient ELNO is an appropriate way to promote competition in the eConveyancing market? If yes, what is an appropriate set of characteristics for the benchmark efficient ELNO?

#### **5.3.1 We have identified three approaches to estimating efficient costs**

We propose to consider at least three approaches for estimating the efficient costs to be recovered in regulated prices. These include:

- ▼ Using a 'building block' method to determine a 'notional revenue requirement' for ELNOs
- ▼ Using a 'cost build-up' approach
- ▼ Benchmarking ELNO prices to paper conveyancing prices, discounted by the estimated cost efficiencies of eConveyancing.

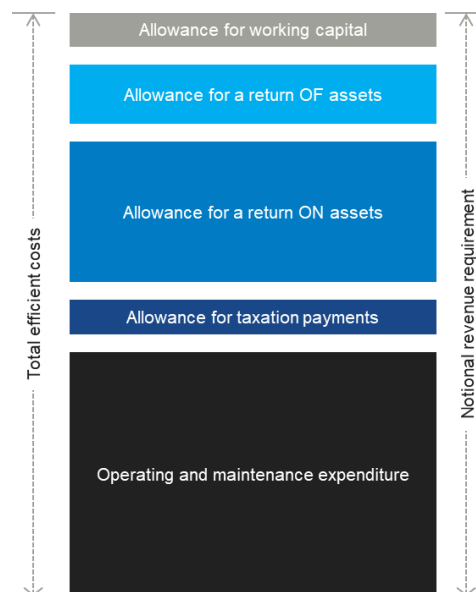
Once we have determined a notional revenue requirement, we then have to forecast demand for the services being offered – in this case, the volume of eConveyancing transactions – and decide on the allocation of costs between services (see Appendix F for more information). We will consider the cost structure of a benchmark efficient ELNO and the nature of its assets in order to decide on the most appropriate approach to estimating costs and recommending prices.

### Using a building block approach

Our standard regulatory approach to estimating the costs of an asset-heavy business uses the 'building block' method to determine a 'notional revenue requirement'. Figure 5.1 shows that with this approach for ELNO prices, we would estimate an ELNO's total efficient costs, or its notional revenue requirement (NRR). For further information on the steps in the building block approach see Appendix F. In broad terms, for each year of the regulatory period by calculating and summing five 'cost blocks':

1. **Operating expenditure.** This is our estimate of the efficient level of forecast operating, maintenance and administration costs of providing the regulated services.
2. **An allowance for a return on the assets the ELNO uses to provide the regulated services.** This is our assessment of the opportunity cost of the capital an ELNO invests to provide eConveyancing services. It is included in the NRR to ensure that the ELNO can continue to make efficient capital investments in the future. IPART uses a standard method for determining the weighted average cost of capital (WACC). This involves estimating the appropriate industry specific parameters including, the equity beta and gearing ratio for the ELNO. For further information see Appendix F.
3. **An allowance for a return of those assets (regulatory depreciation).** This allowance recognises that, through the provision of services to customers, capital infrastructure wears out over time, and revenue must recover the cost of maintaining the notional regulatory asset base (RAB). Calculating the notional RAB for a benchmark efficient ELNO is discussed further in Appendix F.
4. **An allowance for meeting tax obligations,** which reflects the forecast tax liability for a comparable commercial business.
5. **An allowance for working capital,** which represents the holding cost of net current assets.

**Figure 5.1 Building block method**



**Note:** Proportions are illustrative.

#### IPART seeks comments on the following

- 13 What firms or industries are comparable to a benchmark ELNO in terms of their exposure to market risk? What percentage of debt rather than equity would an efficient ELNO be able to sustain to finance its assets (ie, the gearing level)?

#### Using a cost build-up approach

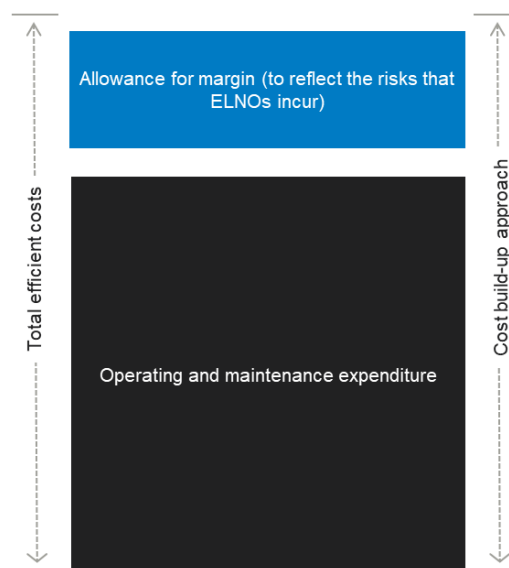
Figure 5.2 shows an alternative to the building block method is to recommend prices based on a 'cost build-up' approach. The cost build-up approach is more appropriate for businesses that do not own substantial capital assets. In contrast to the building block approach where we estimate a RAB (and allow for a return **on** and **of** capital), the cost build-up involves the following:

- ▼ Estimating the efficient operating and maintenance costs of providing eConveyancing services
- ▼ Allowing for an efficient margin.

The purpose of the margin allowance is to compensate ELNOs for committing capital. The margin required to attract capital depends on the level of systematic risk an ELNO faces in providing eConveyancing services<sup>45</sup>. For example, ELNOs are exposed to external economic factors, such as the risk that the number of eConveyancing transactions may be lower than expected. One way of establishing a reasonable margin allowance is to benchmark it to comparable listed companies that share similar market characteristics to ELNOs.

<sup>45</sup> Systematic risk is the result of exposure to overall economic or market conditions. Non-systematic risk is the variability in the returns to equity holders resulting from factors uncorrelated with overall economic conditions. Non-systematic risk is also referred to as diversifiable or firm-specific risk and this is not compensated for via the margin.

**Figure 5.2 Cost build-up method**



**Note:** Proportions are illustrative.

### Benchmarking ELNO prices to paper conveyancing prices

An alternative to a bottom-up approach would be to compare eConveyancing prices with paper conveyancing prices, and to make an adjustment to reflect any cost savings due to the transition to eConveyancing, such as a reduction in labour costs. We consider that if it is less costly to conduct an eConveyancing settlement, then the reduction in costs should be reflected in lower prices for consumers.

However, it would also be necessary to consider any quality improvements from the transition to eConveyancing. For example, eConveyancing has likely reduced the number of settlement errors due to pre-population and automated checking of purchaser and vendor details on key documents. Under paper conveyancing, errors resulting from incorrect information on key documents often resulted in a property settlement being delayed, or additional fees charged by the NSW LRS to uplift and re-lodge documents.<sup>46</sup> As a result, if users of eConveyancing are benefiting from a higher quality product, then a quality adjustment may need to be reflected in a higher price.

[IPART seeks comment on the following:](#)

- 14 How should we assess the efficient costs of providing eConveyancing services?

<sup>46</sup> Under paper conveyancing, if key documents in a property transaction contained errors that were detected at settlement and were not able to be fixed, then the settlement would likely have been cancelled and re-scheduled. If key documents lodged with the NSW LRS contained errors, then a requisition fee would typically apply to uplift and re-lodge the documents. eConveyancing allows participants in a property transaction to view and amend documents in a shared workspace prior to settlement taking place, and so this has likely reduced the rate of error.

### 5.3.2 We propose to recommend maximum prices that allow for pricing innovation

While competition is developing in the eConveyancing market, we are likely to recommend maximum prices (based on one of the approaches described above), which will allow ELNOs to set their prices at or below the maximum level for a benchmark efficient ELNO. As discussed in Section 5.1, we prefer to use a regulatory approach that allows for pricing flexibility, and while PEXA currently offers a bundled price per document type which includes a bundled service for both lodgment and financial settlement,<sup>47</sup> new ELNOs may choose to price these services separately. Our pricing framework will consider the cost drivers of both lodgment and financial settlement and determine a framework that allows ELNOs some flexibility in charging unbundled prices. Particularly, as new entrants enter the eConveyancing market, we consider that ELNOs pricing their products in different ways is a characteristic of a competitive market.

### 5.3.3 How assets and costs shared across states should be taken into account

While ELNOs incur some state-specific input costs (such as the lodgment service support fee in each jurisdiction), many operating costs are not directly linked to a particular jurisdiction. For example, the PEXA platform is a national asset that provides eConveyancing services to users in multiple states, and so it incurs some national operating costs, such as the costs of maintaining or upgrading central IT infrastructure.<sup>48</sup>

To allocate the appropriate proportion of shared assets and costs to NSW, we propose to identify a cost driver and isolate the costs that relate to providing eConveyancing services in NSW. For example, we could split costs and assets based on the following:

- ▼ The proportion of eConveyancing transactions that occur in each jurisdiction
- ▼ The number of subscribers in each jurisdiction.

We invite stakeholders to propose an alternative cost driver or approach for allocating shared assets and costs across multiple states.

IPART seeks comment on the following:

- 15 Should ELNO's assets and costs be shared between states according to the proportion of conveyancing transactions or the number of subscribers in each state? Are there other approaches to sharing ELNO's costs and assets across multiple states?

### 5.3.4 ELNOs have requirements to offer services that will impact efficient costs

As discussed in Chapters 2 and 4, ELNOs are required by the Model Operating Requirements to:

- ▼ Offer eConveyancing services in all jurisdictions
- ▼ Offer a minimum range of documents to be lodged with the Land Registry in each state.

<sup>47</sup> PEXA, *Pricing*, <https://www.pexa.com.au/pricing>, accessed 28 February 2019.

<sup>48</sup> New entrants such as Sympli, have also indicated that they intend to offer eConveyancing services in multiple states.



However, ELNOs can meet these requirements taking a staged approach in accordance with the ELNO's Business Plan.<sup>49</sup> This implies that as new ELNOs enter the market, they are likely to offer varying degrees of services in each jurisdiction and document types.

Although IPART is recommending prices for NSW, we will need to consider the costs that an ELNO incurs through its requirement to operate in multiple jurisdictions. Because each jurisdiction has its own land registry infrastructure and revenue office, the costs of connecting to these agencies may vary, and so ELNOs may incur higher costs operating in certain jurisdictions and lower costs in others. The number of transactions will also vary by jurisdiction, impacting the ELNOs ability to recover costs.<sup>50</sup> As a result, it may be more profitable for ELNOs to operate in some jurisdictions than others. For example, if an ELNO offers a single national set of prices (as is the case with PEXA's current national pricing policy),<sup>51</sup> those prices may be above efficient costs in some jurisdictions and below efficient costs in others.

As required by our terms of reference, we will also consider whether our recommended approach for the pricing regulatory framework could be an appropriate model for a national regime. In doing so, we will consider whether it would be more efficient to have different prices in each jurisdiction, to reflect differences in efficient costs.

#### IPART seeks comment on the following

- 16 Are there benefits to ELNOs having nationally consistent prices?
- 17 Should eConveyancing customers in states where ELNOs incur lower costs of providing eConveyancing services pay the same price as states that have higher costs?
- 18 Are there any other issues relevant for considering whether our recommended NSW pricing regulatory framework could be an appropriate model for a national regime?

Similarly, our framework will consider differences in the cost of an ELNO providing services for various document types (for example mortgage, transfer and discharge of mortgage etc). Some document types may be more costly to provide than others, and so we will consider any differences in efficient costs that arise from an ELNO's requirement to offer a minimum range of documents.

## 5.4 We propose to recommend pricing principles for ELNO interoperability

As Chapter 4 discussed, although there is currently no interoperability between ELNO networks, an interoperability solution is required to encourage competition and to deliver better outcomes for consumers. Both ARNECC and the NSW Government are considering possible solutions. However, a solution is unlikely to be implemented before our Final Report is delivered to the Premier and the relevant Ministers.

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<sup>49</sup> Section 5.2 of the MOR.

<sup>50</sup> Some jurisdiction may be low profit (ie, high cost/low transaction volume) and others may be high profit (ie, low cost/high transaction volume).

<sup>51</sup> For example, PEXA currently applies a weighted average of the Lodgment Service Support fee that each land registry charges it to smooth any differences in jurisdiction-specific costs. PEXA, *PEXA System Pricing Policy*, [https://www.pexa.com.au/images/uploads/page\\_parts/Pdfs/PEXA\\_System\\_Pricing\\_Policy.pdf](https://www.pexa.com.au/images/uploads/page_parts/Pdfs/PEXA_System_Pricing_Policy.pdf), p4, accessed 1 February 2019.

Given this uncertainty, we cannot accurately estimate the costs of interoperability and recommend how these costs should be recovered. Instead, we propose to recommend a set of economic and pricing principles for recovering the potential costs of interoperability. These principles can be revisited once a solution has been defined and costs are known.

Our preliminary view is that a transfer arrangement could be used to recover these costs, and that market conventions (ie, rules that determine the role and activities to be performed by each ELNO in an interoperable transaction) will be required to support this approach.

#### 5.4.1 Transfer arrangements are common in other interoperable markets

In developing the principles for recovering the potential costs of interoperability, we propose to consider what factors are likely to drive these costs, and who benefits from interoperability. We also propose to consider regulatory approaches to recovering the costs of interoperability in other two-sided markets where a four-party transaction occurs, such as telecommunications. These approaches typically involve a transfer arrangement, where one network operator pays another network operator for facilitating a customer transaction on their network (see Box 5.1 for some examples).

Regulators in these interoperable markets have typically set transfer fees using either a cost build-up approach or a cost-based international benchmarking approach. We are likely to take a cost-build up approach for eConveyancing interoperability, as an international benchmarking approach is not likely to be appropriate. Although eConveyancing has been adopted in several countries and states, its implementation has taken various forms. For example:

- ▼ In New Zealand, eConveyancing involves lodgment with the land registry, but **not** financial settlement. This means network operators in New Zealand perform different functions, and therefore incur different costs compared to ELNOs in Australia.<sup>52</sup>
- ▼ In Ontario, eConveyancing is more similar to in Australia, in that the network operator completes both electronic lodgment and financial settlement.<sup>53</sup> However, these activities are undertaken exclusively by a sole network operator, and so there are no interoperable transactions.

These differences mean that international benchmarking is unlikely to accurately reflect the costs that ELNOs in Australia incur in an interoperable transaction.

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<sup>52</sup> In New Zealand eConveyancing has been in place since around 2000. In contrast to Australia the Landonline system only caters for the title registration aspect of the conveyancing process, and not financial settlement. Arrangements for funds transfer occur independently of Landonline and are often provided by third party providers. Land Information New Zealand, New Zealand Law Society, Auckland District Law society Incorporated, New Zealand Bankers Association Joint Working Group report, *Conveyancing 2020*, p23.

<sup>53</sup> Teranet, *Teranet Ontario*, <https://www.teranet.ca/registry-solutions/teranet-ontario/>, accessed 12 February 2019.



### Box 5.1 Regulatory approach to interoperability in another two-sided market

#### Mobile terminating access service (MTAS) fees

MTAS fees are charged by mobile network operators for the wholesale service they provide to other mobile network operators and to fixed line network operators to terminate voice calls and SMS messages on their networks.

In Australia, these fees are regulated by the ACCC. In its last determination, the ACCC used an international benchmarking approach to setting mobile voice termination rates, as opposed to a cost model. It benchmarked regulated mobile voice termination rates in comparable jurisdictions and applied adjustments for factors such as differences in network usage, currency conversion and level of the WACC. The ACCC considered regulated prices that were based on a Total Service Long Run Incremental Cost Plus model (TSLRIC+ model), which measures the incremental cost of wholesale termination services provided to total network traffic, as well as organisational costs (such as overheads).

**Source:** ACCC, Mobile terminating access service FAD inquiry 2014, <https://www.accc.gov.au/regulated-infrastructure/communications/mobile-services/mobile-terminating-access-service-fad-inquiry-2014/final-decision> accessed 1 March 2019.

### 5.4.2 Market conventions to support an interoperability pricing framework

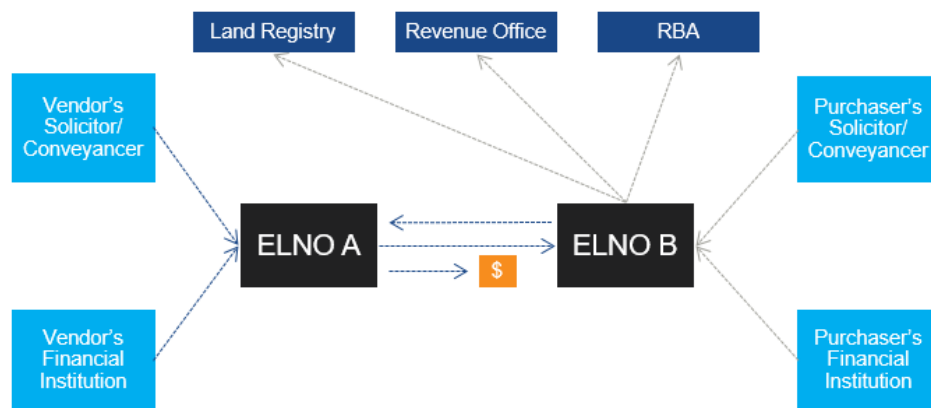
To determine the cost (and therefore the price) of providing an interoperable service, market conventions will be required to delegate each ELNO's role in an interoperable transaction, and the activities they will perform. For example, these conventions include:

- ▼ Whether one or multiple ELNO(s) can complete lodgment and financial settlement with the RBA and NSW LRS on behalf of all the parties to the transaction, and which ELNO(s) should do this
- ▼ How the costs an ELNO incurs on behalf of other parties can be recovered from them (for example, through a transfer arrangement).

Figure 5.3 shows one potential scenario for an interoperable eConveyancing transaction that involves two ELNOs. However, there may be up to four ELNOs involved in a typical property transfer if each party uses a different ELNO.

In this scenario, ELNO B (representing the purchaser's solicitor and financial institution) lodges the documents with NSW LRS and completes the financial settlement with the RBA. ELNO A is notified that this has taken place and issues a transfer payment to ELNO B for completing these activities. The transfer payment recovers the costs that ELNO B incurs for completing a transaction on its network, and represents the benefits that ELNO A receives from accessing ELNO B's network.

**Figure 5.3 Possible transfer scenario for interoperability**



**Note:** This scenario is for illustrative purposes, we will not necessarily recommend that the purchaser's ELNO receives the transfer payment for interoperability. There may also be more than two ELNOs involved in a property transaction.

**Data source:** IPART.

IPART seeks comment on the following:

- 19 Who should bear the costs of implementing an interoperability solution and how should the costs be recovered?
- 20 In an interoperable transaction, should one or multiple ELNO(s) complete lodgment with the land registry and financial settlement with the RBA, and which ELNO(s) should perform these activities?
- 21 What are the likely cost drivers of an interoperable transaction?

## 6 Recommending prices for the services provided by NSW Land Registry Services and Revenue NSW

As Chapter 3 discussed, the third step of our proposed approach is to decide on and apply an appropriate pricing methodology to recommend maximum prices that NSW LRS and Revenue NSW can charge to ELNOs for the services they provide. These agencies have incurred (or are incurring) costs to facilitate electronic settlements via ELNOs by building new systems and performing ongoing maintenance.<sup>54</sup>

To form our recommendations, we propose to review cost information provided by LRS and Revenue NSW and conduct additional analysis to assess the efficient costs of providing services to ELNOs. The issues we propose to consider and our preliminary thinking are outlined below.

### 6.1 Land Registry Services

NSW LRS is a monopoly provider of titling and registry services. These services include accepting documents for lodgment. NSW LRS was operated by the NSW Government until 1 July 2017. NSW LRS is now operated by a private consortium, Australian Registry Investments, under a 35-year concession that commenced on 1 July 2017.

Most of NSW LRS's prices were established by regulation at the time its operation moved to a concession model and regulation provides that those prices cannot increase by more than CPI each year. If NSW LRS introduces new services, the prices must be approved by the Registrar General.<sup>55</sup>

For the pricing methodology for NSW LRS, we must consider which prices we are regulating and then the appropriate form of regulation.

#### 6.1.1 Which prices are we regulating?

NSW LRS offers a range of registry services. As we noted in Chapter 2, registration fees are charged to the parties to the property transaction, collected by ELNOs and passed on to NSW LRS. Setting these fees is not within the scope of our review.

In terms of services to ELNOs, NSW LRS currently charges lodgment support service (LSS) fees and plans to charge new entrant ELNOs for establishing and maintaining any new systems required to connect them.<sup>56</sup>

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<sup>54</sup> Office of the Registrar General submission to Draft Terms of Reference, December 2018, p 1.

<sup>55</sup> Ibid.

<sup>56</sup> Ibid.

NSW LRS has recently published the schedule of fees for 2018-19, which includes fees charged to ELNOs for electronic LSS. Table 6.1 sets out fees for three types of LSS. PEXA takes into account LSS fees as one of the input costs in setting its Transaction Service Fee.

**Table 6.1 Lodgment support service fees to ELNOs (2018-19)**

| Category | Electronic services   | Fees (including GST) |
|----------|---|----------------------|
| LSS 1    | Initial supply of title data, verifications that documents are in an appropriate form for electronic lodgment and automated checks for changes in title data initially supplied | \$14.60              |
| LSS 2    | Initial supply of title data, verifications that documents are in an appropriate form for electronic lodgment   | \$9.73               |
| LSS 3    | Supply of updated title data following changes in title data initially supplied   | \$4.87               |

**Source:** Land Registry Services, *2018/19 Fees*, June 2018; *Real Property Regulation 2014*, Schedule 1 Fees, [http://www.nswlrs.com.au/land\\_titles/current\\_nsw\\_land\\_registry\\_fees](http://www.nswlrs.com.au/land_titles/current_nsw_land_registry_fees) accessed on 5 March 2019.

The LSS fees were set around the time PEXA commenced its operation in NSW in 2013, and since the NSW LRS concession, these fees have increased annually by the change in the CPI.

As part of this review, we propose to recommend appropriate fees and fee structure that NSW LRS can charge ELNOs for building a system for connection and performing ongoing maintenance, which NSW LRS would recover separately from the current LSS fees. We also propose to look at whether the LSS fees reflect the efficient costs of providing lodgment support services to ELNOs.

We consider it important to review the LSS fees as part of setting prices for NSW LRS's services to ELNOs. If some of the ongoing maintenance and service costs associated with an ELNO's connection to NSW LRS is recovered through the LSS fees, fees that NSW LRS can charge ELNOs for building a new system for connection and performing ongoing maintenance would need to be adjusted accordingly to avoid double counting of the costs.

The Office of the Registrar General's submission to the draft terms of reference for this review indicated NSW LRS's intention to introduce fees for ELNOs attributable to costs of building new systems, testing and ongoing maintenance.<sup>57</sup> We understand that NSW LRS's costs to connect to the first ELNO, PEXA, were not recovered in this way. We propose to consider the level of efficient costs that NSW LRS incurs in providing services to ELNOs in terms of both set up costs and on-going system maintenance costs. To ensure competitive neutrality, it will be important that LRS charges ELNOs on a consistent basis.

### 6.1.2 What pricing methodology should be used for NSW LRS's services to ELNOs?

Prices that a regulated business charges should allow recovery of its efficient costs (or appropriate users' share of these costs). We have considered two approaches – a building block or cost build-up approach – for determining the efficient costs associated with the services provided by NSW LRS.

<sup>57</sup> Office of the Registrar General submission to Draft Terms of Reference, December 2018

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As discussed in Chapter 5, the building block approach ‘builds up’ the revenue required by the business to cover its efficient costs of providing services, using forecasts of efficient operating and maintenance costs and an allowance for prudent and efficient capital costs, in the form of return of capital (depreciation) and return on capital.

Another way of determining a business’s revenue requirement is through a cost build-up approach. This approach is used where a business is less capital intensive and its costs consist of independent known components. For example, we applied a cost build-up approach to setting retail electricity business which is less capital intensive, and has distinct cost components (eg, energy purchase costs, network costs, retail costs and margin etc). Under a cost build-up, a return on and of capital would be incorporated into a margin allowance.

To the extent that assets and investment required for NSW LRS to develop, build and operate a system to connect new ELNOs are significant, our preferred approach is a building block approach as it explicitly includes an allowance for a return on and of assets. Appendix F provides a description of IPART’s building block approach and discusses how we propose to implement it, including our proposed approach for valuing NSW LRS’s assets and determining the equity beta and gearing ratio for a benchmark entity operating in a competitive market facing similar risks to NSW LRS for the purpose of estimating the cost of capital.

There may be issues around establishing efficient costs since NSW LRS’s costs and assets may be shared between services to ELNOs, and other NSW LRS’s services – this is discussed further in Section 6.1.3.

#### IPART seeks comments on the following

- 22 What is the most appropriate pricing methodology for NSW LRS’s services to ELNOs? Are there other alternative approaches we should consider?
- 23 What firms or industries are comparable to NSW LRS in terms of their exposure to market risk? What percentage of debt rather than equity would NSW LRS be able to sustain to finance its assets (ie, the gearing level)?

### 6.1.3 How should we allocate NSW LRS’s shared assets and costs to services for ELNOs?

NSW LRS provides a range of services including accepting documents for lodgment, managing the Torrens Title Register, plan examination and plan registration.<sup>58</sup> NSW LRS also maintains the Water Access Licence register.

We are only required to review the efficient costs of NSW LRS providing lodgment services to ELNOs, as opposed to broader services provided by NSW LRS. Where assets are utilised for providing services for both lodgment services for ELNOs and other NSW LRS’s services, we will need to consider the level of shared assets and costs associated with lodgment services

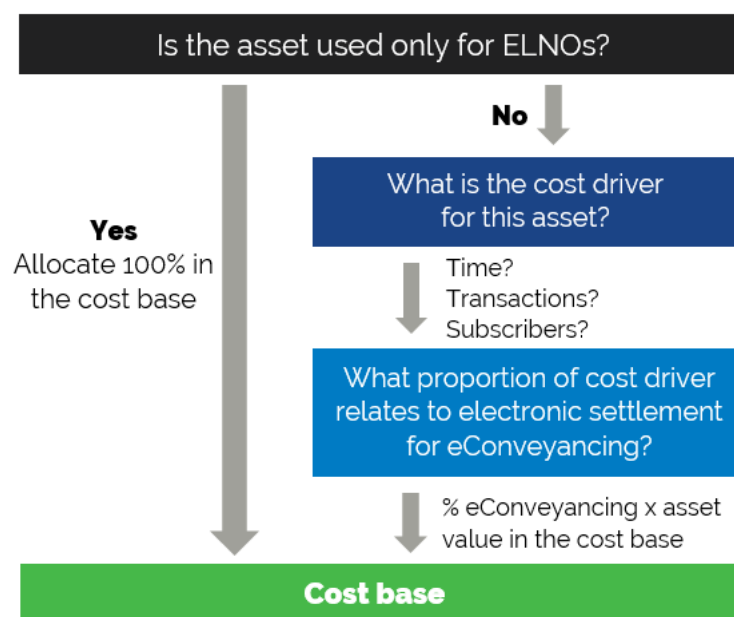
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<sup>58</sup> Before being registered, a plan is examined by NSW LRS to ensure that legal boundaries have been established and correspond with the boundaries as marked on the ground. The plan examination process ensures existing interests are preserved from one generation of title to the next.

for ELNOs. Further, we propose to ensure that the total efficient costs of NSW LRS providing services to ELNOs are only recovered once either via the LSS fees or via a new fee.

Figure 6.1 shows our proposed approach for allocating shared assets and costs. To allocate shared assets to lodgment services provided to ELNOs, we propose to identify an appropriate cost driver for each shared asset and cost, and estimate what proportion of the cost driver relates to providing lodgment services to ELNOs. Then, we propose to allocate an appropriate proportion of the shared asset into the cost base. We will use consistent approach in allocating shared costs.

**Figure 6.1 Allocating assets to electronic settlement for eConveyancing**



IPART seeks comments on the following

- 24 Do you agree with our proposed approach to allocating shared assets and costs? Are there other approaches or issues we should consider?

#### 6.1.4 Should we consider any cost savings to NSW LRS resulting from electronic settlement services?

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

Electronic lodgment can provide improved efficiency for NSW LRS. Electronic processing will allow automatic updates to the Torrens Title Register, reducing labour costs due to fewer employees required to update the database and reducing the risk of human error in the current manual data entry process. It would also reduce staff training costs. Current paper-based processes require the training and up-skilling of new employees in NSW LRS given the

manual nature of their work program. Having an electronic checking process will substantially reduce the training needed for new NSW LRS employees.

In assessing NSW LRS's cost information, we propose to consider whether its projected costs reflect potential cost savings arising from electronic lodgment services.

#### IPART seeks comments on the following

- 25 Do you agree with our proposed approach to accounting for any cost savings to NSW LRS arising from the introduction of electronic lodgment services?

## 6.2 Revenue NSW

Revenue NSW is a division of the NSW Department of Finance, Services & Innovation, which administers State taxation and revenue. In property transactions, Revenue NSW collects transfer duties (previously known as stamp duty). In 2017-18, there were around 220,000 property transactions and Revenue NSW collected around \$8.5 billion of transfer duties.<sup>59</sup>

### 6.2.1 Should Revenue NSW charge ELNOs for electronic system?

As the current Revenue NSW system was set up for a single ELNO (ie, PEXA), for any new ELNOs to enter the market, Revenue NSW will have to update its system to accommodate multiple ELNOs (and ELNOs will have to build their own gateway system to interrogate the Revenue NSW system). Titles and revenue offices estimate that the costs of connecting to a new ELNO would range from a few hundred thousand dollars to seven million dollars.<sup>60</sup>

However, as Revenue NSW's role is to collect transfer duties it may not be appropriate to charge ELNOs fees for a system which assists Revenue NSW to perform its primary function of collecting a range of taxes, duties and levies.<sup>61</sup> As ELNOs would most likely pass through Revenue NSW fees to their customers, charging ELNOs a fee for connection to the Revenue NSW system would be equivalent to charging property buyers a fee for paying transfer duties.

In other jurisdictions, state revenue offices have entered into an agreement with ELNOs to recover costs of setting up (or updating) their system. For example, the State Revenue Office of Victoria introduced Duties Online, similar to Electronic Duties Return by Revenue NSW, and most transaction types must be processed electronically using PEXA. The State Revenue Office of Victoria charges ELNOs for ongoing costs. It has already charged Sympli for some costs associated with updating its electronic platform.

We are seeking stakeholders' view on whether Revenue NSW should recover its efficient costs from ELNOs and if so, what would be the most appropriate cost recovery structure – whether

<sup>59</sup> Revenue NSW Land Related Transfer Duty (data as at 1 February 2019), <https://www.revenue.nsw.gov.au/help-centre/resources-library/statistics> accessed 5 March 2019.

<sup>60</sup> Dench M<sup>c</sup>Clean Carlson, *Review of the InterGovernmental Agreement for an Electronic Conveyancing National Law*, Issues Paper, 13 February 2019, p 61.

<sup>61</sup> We note that while not making a distinction between titles and revenue offices, ARNECC's Issues Paper expressed a view that public sectors monies that are expended to support a business sector investment should be recouped from the business (p 61).



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Revenue NSW should recover efficient costs by charging an initial set up fee, an annual maintenance fee or both.

[IPART seeks comments on the following](#)

26 Should Revenue NSW charge ELNOs for its electronic system?

### **6.2.2 What prices are we regulating and what is the most appropriate pricing methodology for Revenue NSW's services to ELNOs?**

If Revenue NSW were to charge ELNOs, we would recommend appropriate fees that it can charge ELNOs for building a system for connection and performing ongoing maintenance. We would review cost information provided by Revenue NSW and assess efficient costs, and consider how these costs should be recovered. We consider a cost build-up approach would be the most suitable approach for determining the efficient costs of Revenue NSW's services.

Revenue NSW collects taxes, duties, levies, royalties, fine and fees, and manages, among other things, grants and schemes for small businesses and first home buyers and owners. As Revenue NSW's assets and costs would likely be shared across its various tax administration functions, it would be difficult to isolate assets and costs that only relate to transfer duty collection. And, even if we were able to allocate assets and costs to transfer duty collection, only a small portion of those assets and costs would relate to Revenue NSW's services for new ELNOs.

Given this, we propose to adopt a cost build-up approach. This approach does not require establishing an asset base and allocating shared assets and costs. Under this approach, we propose to analyse costs for building or upgrading to a new system for new ELNOs, and associated maintenance costs, and consider what would be the most appropriate cost recovery structure for Revenue NSW – whether it should recover costs by charging an initial set up fee, an annual maintenance fee over a period or both.

[IPART seeks comments on the following](#)

27 If Revenue NSW were to charge for services to ELNOs, on what bases should the fees be set?



## 7 Timeframes and transition

The final step in our proposed approach involves considering the timeframe for adopting our recommended prices or pricing methodologies in NSW, and what if any transitional arrangements would be required. We will also consider the scope and timeframe for future independent review of our recommended maximum prices or pricing methods, to ensure they remain appropriate as the market for eConveyancing and other factors change.

The sections below discuss how we propose to undertake these steps.

### 7.1 We will consider the timeframe for adopting our recommended prices

The timeframe for adopting our recommended maximum prices will depend to some extent on the form of regulation chosen. For example, if the form of regulation is consistent with the current form of regulation in the MOR, that is a CPI index-based approach from year to year, it could be implemented from, for example, 1 January 2020. However, if our form of regulation requires change to elements of the regulatory framework to implement, it may only be feasible to implement recommended prices from 1 July 2020.

Depending on how different our proposed prices are from current prices, there may also be a need for transitional arrangements such as a price path to the new prices, to minimise impacts on stakeholders.

### 7.2 We will consider the scope and timeframe for future reviews of prices

Finally, we will decide when maximum prices should be periodically reviewed, and what should be the scope of the periodic reviews.

Our typical determination period for regulated maximum prices is usually between three and five years. In general, we consider the following factors when deciding on the length of determination period:

- ▼ The confidence we can place in the business's forecasts of costs and demand
- ▼ The scope and level of potential competition
- ▼ The likelihood of structural changes in the industry
- ▼ The need for price flexibility and incentives to increase efficiency
- ▼ The need for regulatory certainty and financial stability.

Longer determination periods have several advantages over shorter periods. For example, a longer period provides greater stability and predictability (which may lower business risk and assist investment decision making), strong incentives for the business to increase efficiency and reduced regulatory costs.

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However, longer determination periods also have disadvantages. These include increased risk associated with inaccuracies in the data used to make the determination, possible delays in customers benefiting from efficiency gains, and the risk that changes in the industry will impact the effectiveness of the determination.

Given the developing nature of the eConveyancing market, our preliminary view is that a shorter rather than a longer determination period is appropriate. In particular:

- ▼ The market will transition from a sole ELNO operating in competition with paper conveyancing to a mandate for eConveyancing on 1 July 2019
- ▼ The number and market share of additional ELNOs in a mature market is currently unknown
- ▼ The level of competition and costs for ELNOs is dependent on decisions about interoperability that have yet to be made
- ▼ The level and structure of costs in a mature market are likely to be different from the level and structure of costs in a developing market so forecasting them is more challenging than in a mature market (such as retail electricity).

Our preliminary view about the scope of future reviews is also influenced by the developing nature of the market. We consider that reviewing the level of competition in the market as it develops is an essential part of any price review, as it affects decisions about the form of regulation. Therefore our preliminary view is that future reviews should have a similar scope to the current review.

#### IPART seeks comments on the following

- 28 When could businesses implement prices recommended by this review? What factors affect that timing and any transitional measures required?
- 29 What is the appropriate determination period for ELNO, NSW LRS and Revenue NSW prices? What factors should we take into account when deciding on a determination period?
- 30 Should the scope of future reviews be similar to the current review, or focus on particular aspects of pricing?

## A Terms of reference

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

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

#### Context

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

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

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

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

#### The task

IPART is requested to:

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

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

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

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

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

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

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

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

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

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

vi) Any other matter the Tribunal considers relevant.

#### **Process and timeframe**

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

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

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

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

## B Steps in eConveyancing process compared to paper-based process

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

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

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

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

## C Current PEXA prices

**Table C.1 PEXA's fee schedule from 2 July 2018 (including GST)**

| Conveyancing Transaction   | Single Title | Multiple Titles <sup>a</sup>            |
|--|--------------|---|
| Transfer Title or Transfer by Third Party  | \$112.64     | \$129.03                                |
| Caveat or Withdrawal of Caveat   | \$15.84      | \$27.61                                 |
| Caveat with Financial Settlement   | \$30.47      | \$46.86                                 |
| Mortgage   | \$42.24      | \$58.52                                 |
| Discharge Mortgage   | \$20.46      | \$32.23                                 |
| Discharge with Financial Settlement  | \$41.69      | \$53.35                                 |
| Mortgage with Caveat Withdrawal  | \$42.24      | \$58.52                                 |
| Mortgage (with Financial Settlement or Express Refinance)  | \$56.43      | \$72.60                                 |
| Discharge Mortgage (Express Refinance)   | \$41.69      | \$53.35                                 |
| Priority Notice or Priority Notice Withdrawal  | \$9.02       | \$9.02                                  |
| Priority Notice Extension  | \$4.51       | \$4.51                                  |
| Transfer of Interest   | \$75.02      | \$91.08                                 |
| Transfer of Interest with Settlement   | \$112.64     | \$129.03                                |
| Encumbrance or Withdrawal of Encumbrance   | \$35.75      | \$47.41 introductory offer <sup>b</sup> |
| Survivorship or Transmission   | \$35.75      | \$52.14 introductory offer <sup>b</sup> |
| Lease  | \$42.24      | \$58.52                                 |
| Lease with Settlement  | \$56.43      | \$72.60                                 |
| Title Information Re-Supply  | \$5.50       | \$5.50 per title                        |
| Nomination to paper dealing  | \$19.36      | \$30.91                                 |
| Nomination to electronic dealing, Consent, Form 24, Form 25, Notice of Sale, Notice of Acquisition | \$0.00       | \$0.00                                  |

<sup>a</sup> Related to multiple titles on the same registry instrument.

<sup>b</sup> Introductory pricing available until 31 December 2018 unless extended by PEXA. Regular price for multi-title Survivorship and Transmission is \$35.75 plus \$16.39 per title, while multi-title Encumbrance and Withdrawal of Encumbrance are \$35.75 plus \$11.66 per title.

**Source:** PEXA, *Pricing*, <https://www.pexa.com.au/pricing>

**Note:** Not all of these fees are applicable in NSW.



## D Rules, requirements and conditions for ELNOs and other participants under the NSW legal and regulatory framework

### D.1 Model Participation Rules for subscribers

The MPRs are a uniform set of rules for subscribers when participating on an ELN in each jurisdiction. In NSW, the Registrar General has adopted version 5 of the MPRs developed by ARNECC, which commenced on 25 February 2019.

The MPRs set out strict legal requirements, for example, about who can become a subscriber and what insurances they must have. Under the MPRs, subscribers are also audited by the ELNOs and the Registrar General to ensure they continually meet the requirements of the MPRs. This helps to keep the ELN secure.

The MPRs cover many other things, some of which are:

- ▼ For the subscriber
  - Eligibility criteria: for example, that subscribers must have an ABN and that they must be of good fame and character
  - Minimum levels of professional indemnity and fidelity insurance
  - Requirements to take reasonable steps to verify the identity of their clients
  - System security obligations
  - Requirements to enter into a client authorisation, before documents are signed in the workspace.
- ▼ That subscribers can be restricted, suspended or terminated.

### D.2 Participation agreements for subscribers

Subscribers are also required to enter into an agreement with ELNOs before they can access the ELN.<sup>62</sup> Prior to entering into the participation agreement, subscribers must also have their identities verified. This helps to ensure that every subscriber that accesses the eConveyancing workspace is who they say they are.

These agreements set out obligations that apply to both the ELNO and subscribers as well as other matters such as the terms and conditions for financial settlement.

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<sup>62</sup> MOR 14.1(c) and ECNL s 3 definition of 'Participation Agreement' and 'Subscriber'. See also ECNL s 22(2)(b)(i).



### D.3 Model Operating Requirements for ELNOs

The MORs are the equivalent of the MPRs for ELNOs. They set out requirements that apply to ELNOs. In NSW, the Registrar General has adopted version 5 developed by ARNECC, which commenced on 25 February 2019.

The matters covered by the MORs include:

- ▼ For the ELN:
  - Technical and operational requirements
  - Minimum document capability
  - System security and integrity requirements.
- ▼ For the ELNO
  - Eligibility criteria
  - Requirements to encourage wide spread industry use
  - Requirements to make ELNs available to all Australian land registries
  - Insurances and reporting requirements.
- ▼ Circumstances in which a Registrar General may suspend or revoke ELNO approval.

Version 5 of the MORs contain additional requirements intended to constrain anti-competitive behaviour by ELNOs. For example, it requires ELNOs to maintain structural or functional separation between their ELN functions and non-ELN functions. As previously noted, Version 5 also imposes pricing controls on the fees that ELNOs can charge for ELN services.

### D.4 Conditions on ELNO approval

In NSW, the Registrar General has determined a set of conditions that will apply equally to all ELNOs beginning 1 March 2019, called the ELNO General Conditions.<sup>63</sup> The Registrar General may also determine special conditions which will apply only to a specific ELNO.

A separate set of special conditions that apply only to PEXA are due to commence on 1 March 2019. The PEXA special conditions are generally transitional, which reflect that PEXA is already operating in NSW. For example, General Condition 1(a)(i) and (ii) together require an ELNO to have in place an agreement with Revenue NSW prior to commencing operations. However, PEXA is already operating which would put PEXA in breach immediately from 1 March 2019. Accordingly, Special Condition 1(a) modifies this obligation to give PEXA more time to enter into an agreement.

### D.5 Guidance notes and waivers

ARNECC publishes useful guidance notes containing advice on how ELNOs and subscribers can comply with their respective obligations under the MORs and MPRs. They are not

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<sup>63</sup> Conditions of Approval, <https://www.registrargeneral.nsw.gov.au/eConveyancing/legal-framework/approval-conditions>, accessed 12 February 2019.

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legislative instruments, rather, guidance notes are developed by ARNECC on behalf of all the Registrars General to assist ELNOs and subscribers.<sup>64</sup>

The Registrar General may also issue waivers of the MORs, the MPRs<sup>65</sup> and the Conveyancing Rules<sup>66</sup> if it is reasonable to do so. There are several waivers in place in NSW for example, Conveyancing Rule 8.5.1 provides that all transfers signed after 1 July 2018 must be lodged electronically, subject to some exceptions. There is a current waiver in place that applies to transfers with a consideration amount equal to or greater than \$100 million. These transfers are not capable of being lodged electronically and thus the waiver provides an exception to Conveyancing Rule 8.5.1 for these transfers to be lodged in paper.<sup>67</sup>

The Registrar General may also conduct compliance examinations of ELNOs and subscribers under the ECNL.<sup>68</sup> The purpose of which is to ensure compliance by the ELNO with the MORs and the subscribers with the MPRs.

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<sup>64</sup> In practice, Guidance Notes are developed by ARNECC's sub-committee called the Australian Registrar's Working Group and published by ARNECC.

<sup>65</sup> ECNL s 27(1).

<sup>66</sup> RPA s 12E(10).

<sup>67</sup> Office of the Registrar General, Conveyancing Rules Waiver No: CR 7/2018, [https://www.registrargeneral.nsw.gov.au/\\_\\_data/assets/pdf\\_file/0004/390154/Conveyancing-Rules-Waiver-CR-7-2018-Monetary-Consideration-exception.pdf](https://www.registrargeneral.nsw.gov.au/__data/assets/pdf_file/0004/390154/Conveyancing-Rules-Waiver-CR-7-2018-Monetary-Consideration-exception.pdf), accessed 6 March 2019.

<sup>68</sup> ECNL s 33.

## E eConveyancing in comparable overseas jurisdictions

eConveyancing is not only used in Australia but in some overseas jurisdictions. As is the case in Australia, many industry transitions have evolved over time with small changes to legislation.<sup>69</sup>

### E.1 Ontario, Canada has the most developed land registration system in the world

Automation in Ontario began in the 1980s through development of the Province of Ontario Land Registration Information System (POLARIS) which digitised the land registry system. Search services were then made electronic, following which, the electronic conveyancing system was created by Teranet Inc (Teranet).<sup>70</sup>

Much the same as Australia, under the Canadian system documents are created, modified and submitted using online software. The platform reaches into the POLARIS database to retrieve data depending on the type of document being prepared. Given that the land registry data is electronic, the platform is able to check and verify data inputted into the workspace. Documents are then signed using encrypted digital signatures. Once signed, documents are submitted to the relevant land registry. If successful, a POLARIS number is generated.

The Canadian system also provides for user communication, online searches, online mapping and allows users to deal with financial institutions as well as providing the means for taxes to be paid with the revenue authorities.<sup>71</sup>

Unlike in Australia, Teranet exclusively provides electronic registration services to the provinces of Ontario and now, Manitoba.<sup>72</sup>

### E.2 New Zealand has had eConveyancing for some time

New Zealand introduced electronic conveyancing in around 2000<sup>73</sup> and started mandating in 2009.<sup>74</sup>

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<sup>69</sup> PricewaterhouseCoopers and PEXA Ltd, *PEXA Digital Property Report, Economic Impact of E-Conveyancing*, 2015, p 12.

<sup>70</sup> Christensen, S, 'Electronic Land Dealings in Canada, New Zealand and the United Kingdom: Lessons for Australia', *Murdoch University Electronic Journal of Law*, Vol 11, No. 4, December 2004, p 1.

<sup>71</sup> GhostDigest, LexisNexis, *Comparative study of e-conveyancing – 2*, 8 September 2011.

<sup>72</sup> Teranet, Registry Solutions, <https://www.teranet.ca/registry-solutions/>, accessed 14 February 2019.

<sup>73</sup> Office of the Minister for Land Information, Chair, Cabinet Government Administration and Expenditure Review Committee, *Modernizing NZ's Land Information Platform & Services Programme Business Case*, December 2018, p 5.

<sup>74</sup> GhostDigest, LexisNexis, *Comparative Study of e-conveyancing – 4*, 22 September 2011.

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In New Zealand, eConveyancing started with the creation of Landonline by Land Information New Zealand (LINZ).<sup>75</sup> LINZ is a government owned and run department. Like Australia, Landonline only encompasses some parts of end-to-end eConveyancing but it is different in that, it offers less conveyancing services but at the same time also offers surveying related services. It allows for document registration, plan lodgment, plan certification and land related data searches.<sup>76</sup> It does not offer financial settlement or funds transfer solutions.<sup>77</sup>

In New Zealand, contract preparation, financial settlement and funds transfer occur independently to Landonline.<sup>78</sup>

Initially, a conveyancing task force was created to investigate the possibility of introducing full end-to-end conveyancing in New Zealand. It was later concluded that such a project was too ambitious given the number of stakeholders involved.<sup>79</sup> Landonline is instead being upgraded to better interface with other websites. For example, it will notify lenders when mortgages are registered, but it will not offer financial settlement, funds transfer or payment of tax facilities.<sup>80</sup>

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<sup>75</sup> GhostDigest, LexisNexis, *Comparative Study of e-conveyancing* – 4, 22 September 2011.

<sup>76</sup> Landonline allows for searches of the titles register, survey data and supporting documents. It also allows spatial survey data to be viewed.

<sup>77</sup> GhostDigest, LexisNexis, *Comparative Study of e-conveyancing* – 4, 22 September 2011.

<sup>78</sup> Land Information New Zealand, New Zealand Law Society, Auckland District Law Society Incorporated, New Zealand Bankers Association Joint Working Group report, *Conveyancing 2020*, p 23.

<sup>79</sup> GhostDigest, LexisNexis, *Comparative Study of e-conveyancing* – 4, 22 September 2011.

<sup>80</sup> Land Information New Zealand, Rebuilding Landonline, <https://www.linz.govt.nz/land/landonline/rebuilding-landonline>, accessed 14 February 2019. See also Land Information New Zealand, *Programme Business Case, Modernising New Zealand's Land Information Platform & Services*, October 2018, p 37.

## F IPART building block approach

As discussed in Chapter 5 and Chapter 6, one option we propose to estimate the total efficient costs of a benchmark ELNO's and NSW LRS's services is using a building block approach. We would use a separate building block model for a benchmark ELNO and NSW LRS.

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

The building block approach typically includes the following components:

- ▼ An efficient level of operating expenditure (operating, maintenance and administration expenses)
- ▼ An allowance for a return on assets
- ▼ An allowance for a return of those assets (depreciation)
- ▼ An allowance for tax and working capital.

### F.1 Efficient operating expenditure

The allowance for operating expenditure reflects our view of the efficient level of operating costs a business will incur in providing its services over the review period.

Operating costs commonly include labour costs, utilities and communication costs, administration costs (eg, audit, training, travel, insurance, rent, etc). Some costs would be business-specific. For example, ELNOs may incur additional operating costs including (but not limited to) land registry fees, revenue office fees, RBA fees, other licences and membership fees, digital certificate management and operation costs.

We will estimate these costs based on detailed information provided by PEXA, Sympli and NSW LRS on their historical and projected operating expenditure and consider the required operating expenditure of a benchmark ELNO and an efficient land registry office. Only efficient costs will be included in the allowance for operating expenditure. Efficient costs represent what an efficient service provider would incur in providing the services at the quantity and level demanded by the industry.

We propose to engage an external consultant to assess the level of forecast operating expenditure for a benchmark ELNO and an efficient land registry office over the regulatory period.

### F.2 Efficient capital expenditure

Under the building block method, there is no explicit allowance for capital expenditure in the notional revenue requirement. Instead, efficient capital expenditure is added to the asset base

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and recovered through the allowances for a return on assets and depreciation (discussed below).

To decide the level of prudent and efficient capital expenditure to add to the asset base in each year of the review period, we propose to consider the level of capital expenditure required to provide the required services by a benchmark ELNO and the NSW LRS. We propose to engage a consultant to assess the required level of capital expenditure for a benchmark ELNO and an efficient land registry office that ensures services are delivered efficiently.

### **F.3 Estimating the allowance for a return on assets**

The allowance for return on assets represents the cost of capital invested in a benchmark efficient business through equity and debt investments. Including a return on assets ensures that efficient investment continues into the future to meet growth in demand and maintain the business's long term viability. For a capital intensive business, this allowance typically represents a large proportion of the total revenue requirement.

To estimate the allowance for a return on assets, we propose to:

- ▼ Determine the value of the initial asset base
- ▼ Decide on an appropriate rate of return
- ▼ Multiply the value of the asset base by the rate of return.

#### **F.3.1 Valuing the initial asset base**

The asset base refers to the value of a business's assets used to provide the relevant services, which are funded by shareholders. If we were to use a building block to determine maximum prices for either a benchmark ELNO or an efficient land registry office, we would establish the value of an initial asset base. The asset base would be valued in real terms and adjusted for CPI annually. Once the value of the initial asset base is established, this value is 'rolled forward' at the end of each year in a price setting period. That is, it is adjusted to reflect capital expenditure, asset disposals, depreciation and CPI over the year.

The primary assets associated with providing the services are likely to include general office plant and equipment, furniture and fixtures, electronic data processing equipment (hardware) and intangibles such as software, etc.

We propose to consider a number of different valuation techniques, depending on whether the asset is a tangible asset or an intangible asset. We would also consider several market valuations for PEXA and firms of a similar nature such as InfoTrack which provides property, company and personal search services and electronic conveyancing services (eg, verification of identity, electronic signing, contract of sale) through proprietary Software as a Service platform.

The acquisition of PEXA by CBA, Morgan Stanley Infrastructure Partners and Link Administration Holdings (Consortium) concluded in mid-January 2019 and implied an

enterprise value for PEXA of at least \$1.5 billion.<sup>81</sup> Financial analysts' valuation based on a long-term discounted cash flow model suggest an enterprise value for PEXA of between \$1.6 billion and \$2.3 billion.<sup>82</sup>

One of the key issues in establishing the initial asset base will be in relation to valuing intangible assets, and whether and how research and development costs should be capitalised for ELNOs. Given the nature of software & IT services, intangible assets such as intellectual property are likely to represent a substantial proportion of ELNOs' assets and these businesses could incur large research and development costs.

There are various techniques that can be used to estimate the value of an intangible asset. For example, to value intellectual property, we could consider:

- ▼ **Capital invested:** to value intellectual property, we could look at research and development costs, capitalising these expenses and look at the balance of these expenses today that remains unamortised.
- ▼ **Discounted cash flow valuation:** we can estimate expected incremental cash flows generated to the firm by intellectual property. This will require separating out the portion of the aggregated cash flows of a firm that can be attributed to intellectual property and discounting back these cash flows at an appropriate discount rate.
- ▼ **Relative valuation:** we can estimate the value of intellectual property by looking at how the market values the firm with intellectual property and comparing it with how the market values otherwise similar companies without intellectual property. This approach could be difficult as there is no ELNO operating without intellectual property.

In valuing NSW LRS assets for lodgment services, we propose to consider market tested evidence in addition to NSW LRS's asset valuations. In April 2017, the NSW Government granted a private concession of the registry and titling functions of the then, Land and Property Information, the predecessor of NSW LRS, to a private consortium (Australian Registry Investments Pty Ltd) for \$2.6 billion through a competitive tendering process.<sup>83</sup>

As discussed in Chapter 5 and Chapter 6, we will also consider an appropriate method for allocating shared assets:

- ▼ Between NSW and other states for ELNOs
- ▼ Between NSW LRS's lodgment services and other services for NSW LRS.

### F.3.2 Deciding on the appropriate rate of return

We propose to decide on the appropriate rate of return by using our standard approach for calculating the WACC, which we undertook extensive public consultation on and reviewed in 2018.<sup>84</sup>

<sup>81</sup> <https://www.pexa.com.au/news/update-on-dual-track-sale-process> accessed on 1 March 2019.

<sup>82</sup> <https://www.afr.com/street-talk/pexa-worth-up-to-23b-morgan-stanley-20180926-h15vax> accessed on 1 March 2019.

<sup>83</sup> NSW Government Media Release, *NSW receives massive infrastructure boost*, 12 April 2017.

<sup>84</sup> IPART, Review of our WACC method – Final Report, February 2018.



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The parameters underlying the WACC calculation can be grouped into two categories:

- ▼ **Market-based parameters**, which include risk-free rate, debt margin, inflation rate and MRP. These parameters are common to businesses in all industries.
- ▼ **Industry-specific parameters**, which include equity beta and gearing ratio. These parameters are specific to the business's particular industry.

## Estimating the market-based parameters

### Risk free rate

The risk-free rate is used as a point of reference in determining both the cost of equity and the cost of debt within the WACC. It is used as a base rate to which an equity or debt risk premium is added to reflect the riskiness of the specific business for which the rate of return is being derived.

In line with our updated WACC methodology, we will use the 10-year Commonwealth Government Security yields published by the RBA and estimate the historic risk-free rate as a 10-year trailing average and the current risk free-rate as a short-term trailing average with the length of this term matching the regulatory period.

### Debt margin

The debt margin represents the cost of debt a company has to pay above the nominal risk-free rate.

In line with our WACC methodology, we will use the 10-year corporate bonds rated as BBB, and estimate the historic debt margin as a 10-year trailing average and the current debt margin as a short-term trailing average with the length of this term matching the regulatory period.

### Inflation rate

The inflation rate is used to convert the nominal post-tax WACC into a real post-tax WACC. We use the expected rate of inflation over the regulatory period. For this parameter we will use a 10-year geometric average of the 1-year RBA inflation forecast and the middle of the RBA's target band of inflation (currently at 2.5%) for the remaining years of the regulatory period.

### Market risk premium

The market risk premium (MRP) is the expected rate of return over the risk-free rate that investors would require for investing in a market portfolio. The MRP is an expected return and is not directly observable. Therefore, it needs to be estimated through proxies. In line with our WACC methodology, we will use both current market data and long-term averages. For the:

- ▼ Current market data: we will establish an MRP range using our six MRP methodologies to estimate the cost of equity



- ▼ Long-term averages: we will use an MRP range of 5.5% to 6.5% with a midpoint of 6.0%, based on the historical arithmetic average of the excess market return over the risk-free rate, to estimate the cost of equity.

## Estimating industry-specific parameters

### Equity beta

The equity beta measures the extent to which the return of a particular security varies in line with the overall return of the market. It represents the systematic risk of a security that cannot be avoided by holding it as part of a diversified portfolio. The equity beta does not take into account business-specific or diversifiable risks.

In each price review we conduct, we determine the value of the equity beta for the relevant business. We do this by estimating the equity betas of (listed) comparable firms, and considering the equity betas that other regulators have applied to comparable businesses.

For this review, we will need to estimate a separate equity beta for a benchmark ELNO and land registry office.<sup>85</sup> ELNOs' businesses involve development and maintenance of a platform used to facilitate electronic settlement of property transactions. Reflecting this nature of the business, we could consider looking at listed firms in the IT & software and real estate industries as comparable companies when estimating the equity beta for a benchmark ELNO. We could also consider firms in the financial services industry, including mortgage finance businesses (which have similar exposures to the property industry), as well as securities depositories, derivative exchanges and clearing houses (which operate similar IT infrastructures to clear and settle investment transactions).

Transfer, mortgages and discharges of mortgages account for approximately 83% of total dealing lodgments with NSW LRS. While it would be difficult to find a set of proxy companies which derive revenue similar to NSW LRS, it is reasonable to expect that a benchmark land registry office's revenue would be highly correlated with those of mortgage businesses. On this basis, we could consider looking at listed firms in the mortgage market when estimating the equity beta for a benchmark land registry office.

### Gearing ratio

The gearing ratio is the proportion of debt to total assets in the business's capital structure. Regulators commonly adopt a benchmark capital structure rather than the actual capital structure of the regulated entity, to ensure that customers do not bear the costs associated with an inefficient capital structure.

Similar to our proposed approach for determining the equity beta, we propose to estimate the gearing ratios for a benchmark ELNO and land registry office by considering gearing ratios of comparable businesses.

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<sup>85</sup> If we were to recommend prices for Revenue NSW to charge ELNOs, we would also need to determine an appropriate rate of return on any assets used to provide services to ELNOs. As Revenue NSW is a State government agency collecting tax, we would consider that an efficient rate of return on these assets would be a risk-free rate based on the 10-year NSW Treasury Corporation bond.

## F.4 Estimating the allowance for depreciation

The allowance for a return of assets, or depreciation (amortisation in the case of intangible assets), and is intended to ensure that the capital the business (or its owner) invests in the assets is returned over the useful life of each asset. To estimate this allowance, we need to decide on the appropriate:

- ▼ Asset lives
- ▼ Depreciation method.

One of the key issues in estimating the allowance for depreciation will be in relation to determining appropriate useful lives of intangible assets for a benchmark ELNO (and land registry, if applicable). We propose to review information provided by PEXA, Sympli and NSW LRS on expected and remaining asset lives in the first instance, and consider advice from an expert consultant on the reasonableness of these assumptions based on those of comparable businesses.

We propose to use the straight-line depreciation method to calculate the depreciation for non-land assets. This means that the total value of the asset base is recovered evenly in each year over the expected life of the assets.

## F.5 Estimating the allowance for meeting tax obligations

Under our building block model, the forecast tax liability of the businesses is estimated as a separate building block component.

Typically we calculate the tax allowance for each year by applying a 30% statutory corporate tax rate adjusted for gamma to the business's (nominal) taxable income.<sup>86</sup> In March 2017, the Commonwealth enacted legislation that introduced different rates of corporate income tax for businesses of different sizes. Under the legislation, from 1 July 2018 a business with an aggregated turnover of less than \$50 million (base rate entities) will pay 27.5% tax, while companies with a higher turnover must pay 30% tax on all their taxable income.<sup>87</sup> If a benchmark ELNO or benchmark land registry service's taxable income were less than \$50 million, we would consider whether we should apply the lower tax rate.

For this purpose, taxable income is the notional revenue requirement (excluding tax allowance) less operating cost allowances, tax depreciation, and interest expenses. As part of calculating the appropriate tax allowance, the business is required to provide forecast tax depreciation for the determination period. Other items such as interest expenses are based on the parameters used for the WACC, and the value of the asset base.<sup>88</sup>

The tax allowance is one of the last building block items we calculate, due to its dependence on other items such as operating cost allowances and WACC parameters.

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<sup>86</sup> Under a post-tax framework, the value of franking credits (gamma) enters the regulatory decision only through the estimate of the tax liability. Our current estimate of gamma is 0.25.

<sup>87</sup> Treasury Laws Amendment (Enterprise Tax Plan) Act 2017.

<sup>88</sup> The nominal cost of debt is the sum of the nominal risk free rate and nominal debt margin.

## F.6 Estimating the allowance for working capital

The allowance for a return on working capital recognises that some businesses incur costs in funding the short-term capital required for day-to-day activities of the business (such as accounts payable, inventories and accounts receivable). If the business's net working capital is positive, it has invested capital to facilitate its day-to-day activities and should earn a return on that capital. However, if it is negative, then its trade creditors are providing working capital to the business and it should earn a negative return to offset the returns being earned on the capital provided by other parties.

Our standard approach to calculating an allowance for working capital is:

- ▼ Receivables = 20 days of required revenue.
- ▼ Inventory = 6 days of operating expenditure plus capital expenditure.
- ▼ Payables = 30 days of operating expenditure plus capital expenditure.

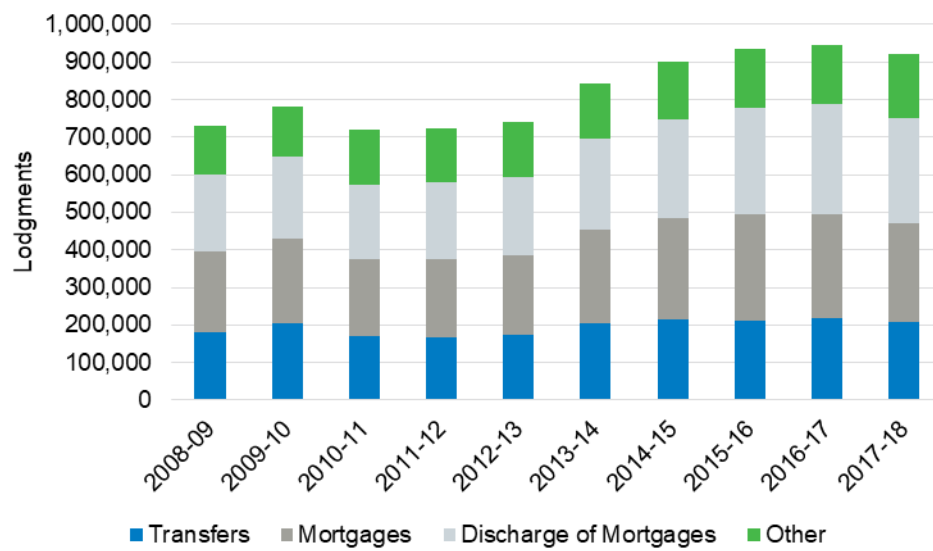
However, we will consider whether these measures are appropriate, given the nature of the ELNOs and land registry businesses.

## F.7 Forecasting demand

Once we have estimated efficient costs we will need to decide on a benchmark ELNO and land registry office's forecast number of transactions over the review period. We use these forecasts to determine price levels that should apply to recover a benchmark ELNO's and NSW LRS efficient costs.

To decide on the annual number of transactions for a benchmark ELNO and the NSW LRS we propose to consider historical data on eConveyancing transactions for PEXA and the number of dealings for NSW LRS. Figure F.1 shows total dealings lodged with the NSW LRS from 2008-09 to 2017-18. We do not currently have information on PEXA's historical data.

**Figure F.1 Dealings lodged with NSW Land Registry Services from 2008-09 to 2017-18**



**Data source:** Land Registry Services NSW, [http://www.nswlrs.com.au/plan\\_and\\_title\\_registration/plan\\_and\\_dealing\\_statistics](http://www.nswlrs.com.au/plan_and_title_registration/plan_and_dealing_statistics) accessed on 18 January 2019.

## G Weighted Average Cost of Capital (WACC)

To determine the WACC, our current WACC methodology is:

1. Establish a WACC range and midpoint by:
  - a) Estimating a feasible range based on long-term average and a feasible range based on current market data
  - b) Using the midpoints of these two feasible ranges as the upper and lower bounds of the WACC range
  - c) Using the average of the upper and lower bounds as the midpoint of the WACC range.
2. Choose a WACC point estimate from within the final WACC range based on our WACC decision rule. Our default position is to select the midpoint. However, we consider whether it is appropriate to choose a point other than the midpoint having regard to the level of economic uncertainty.

We use our uncertainty index<sup>89</sup> as a measure of economic uncertainty, and select the midpoint if the uncertainty index is within or at one standard deviation from the long-term average of zero. If the uncertainty index is more than one standard deviation from the long-term average of zero, we consider selecting a point other than the midpoint within our final WACC range.

We established this framework as part of our review of the WACC methodology in 2013 and made several changes regarding how we estimate the cost of debt and expected rate of inflation in our 2017 review.<sup>90</sup> We publish biannual market updates in February and August, which show our estimated WACC ranges for the industries we regulate such as water, transport and retail gas. We also publish a spreadsheet containing our WACC calculations.<sup>91</sup>

### G.1 Calculating the real post-tax WACC

We use a real post-tax WACC to estimate the allowance for a return on capital and incorporate tax directly as a separate cost building block in the revenue requirement.

We estimate the post-tax WACC using the following formula:

$$WACC = E(R_d) \times \frac{D}{V} + E(R_e) \times \frac{E}{V}$$

where:

- ▼  $E(R_d)$  is the expected cost of debt,
- ▼  $E(R_e)$  is the expected cost of equity, and

<sup>89</sup> [http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/WACC/Uncertainty\\_Index\\_Model](http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/WACC/Uncertainty_Index_Model) accessed on 28 February 2019.

<sup>90</sup> IPART, Review of our WACC method – Final Report, February 2018.

<sup>91</sup> <https://www.ipart.nsw.gov.au/Home/Industries/Special-Reviews/Regulatory-policy/WACC> accessed on 28 February 2019.

- ▼  $\frac{D}{V}$  and  $\frac{E}{V}$  are the proportions of debt and equity in the entity's capital structure, respectively.  $\frac{D}{V}$  is referred to as a "gearing ratio".

We adjust the resulting post-tax WACC for expected inflation to obtain the real post-tax WACC.

## G.2 Calculating the cost of debt

The cost of debt is the rate that a business is expected to pay debt holders to fund its assets through debt financing, and is calculated as follows:

$$E(R_d) = R_f + \text{Debt margin}$$

where:

- ▼  $R_f$  is the risk-free rate, which is the rate of return an investor would require on a risk-free investment, and
- ▼ *Debt margin* is the compensation above the risk-free rate required by debt holders for credit, liquidity and maturity risks.

We apply a target term-to-maturity of 10 years and a BBB credit rating. Our cost of debt includes a debt raising cost allowance of 12.5 basis points.

## G.3 Calculating the cost of equity

The cost of equity is the rate of return required by shareholders on an equity investment. We estimate the expected cost of equity using the following Capital Asset Pricing Model:

$$E(R_e) = R_f + \beta_e \times MRP$$

where:

- ▼  $R_f$  is the risk-free rate as described above,
- ▼  $\beta_e$  is the beta of a stock  $e$ , and
- ▼ *MRP* is the market risk premium, which is expected rate of return over the risk-free rate that investors would require for investing in the market portfolio.

We estimate ranges for the expected cost of equity using current market data and long-term averages. As discussed in Appendix F, we will review and determine the value of the equity beta for a benchmark ELNO and land registry office as part of our price review.