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Commissioner for Productivity
New South Wales

By email

18 September 2020

Productivity Commission Green Paper: Continuing the productivity conversation Submission by Property Exchange Australia Limited (PEXA)

Introduction

PEXA welcomes the opportunity to provide this submission to the NSW Productivity Commission (Productivity Commission) in respect of its Green Paper for 2020 (Green Paper). Set out below is PEXA's response to draft recommendation 4.17: *"To support the implementation of interoperability in the NSW e-conveyancing market as a matter of urgency"*.

PEXA welcomes genuine competition in the e-conveyancing market. However, interoperability (as currently described) would not create a competitive market. Rather, interoperability, and in particular a model of direct connection between two ELNOs, would establish and then entrench a duopoly, creating barriers to entry that preclude effective competition. Already, LEXTECH, owned by Purcell Partners, has indicated it would be prevented from entering the market if interoperability were to proceed. Other potential entrants would also be excluded. Under interoperability, incentives to innovate would also be stifled, since innovation in the duopolistic and interoperable market could progress only at the pace of the slowest participant.

A report prepared by the Centre for International Economics (CIE) commissioned by the NSW government estimates the net benefits of interoperability at \$83.6 million over 10 years in net present value (NPV) terms using a discount rate of 7%.¹ This is equivalent to just \$8.56 per transaction, and there is no certainty that this would be passed to the end consumer. The CIE report concedes that not all costs have been included, and that the costs of interoperability in general are uncertain.² Further, the CIE's sensitivity analysis suggests that if a five-year evaluation period is used instead of a 10-year period, the estimated net benefits fall sharply from \$83.6 million to \$14.8 million,³ equivalent to just a few dollars per transaction. While the CIE report argues a 10-year period is reasonable, the NSW government plans to move from a direct connections model of interoperability to an Enterprise Service Bus (ESB) model of interoperability within five years. This would create costs that have not been included in the CIE report, likely wiping out the estimated per-transaction net benefit of a few dollars entirely.

¹ The Centre for International Economics, 'Addressing market power in electronic lodgement services', Final Report (1 September 2020), p 3.

² Ibid. p 6.

³ Ibid. pp 63-64.

The CIE report cites the ACCC as being concerned about ‘... potentially extending a duopoly or monopoly market structure’⁴ and ‘... there is a risk that a complicated market structure may entrench a duopoly and prevent additional market entrants’.⁵ Like PEXA, the ACCC prefers a competitive model to a duopoly. An entrenched duopoly is not a pathway to competition. Actual and prospective competitors are already emerging and that process should not be stymied by switching to a market structure that carries a legitimate risk of entrenching a duopoly.

PEXA considers that the case for interoperability, as currently described, is extremely weak at this time. Even if there were marginal net benefits in favour of interoperability, which PEXA considers are highly questionable, we are concerned that the potential risks to Australian consumers undertaking property transactions, such as system failure, cyberattack, data breach and fraud, have not been properly evaluated.

Further evidence of the tiny effects of any fee reductions from interoperability is provided in the report prepared by Dench McClean Carlson as part of its Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law:

‘the direct benefit of price competition in e-conveyancing transaction fees to property buyers and sellers is very small. Australian homeowners on average buy and sell a property every 10.5 years. The existing PEXA fee of \$112 (assuming each transaction involves both selling and buying) translates to \$224 per 10.5 years or \$21 per annum. It is unlikely that homeowners would want to accept a greater risk for this very small potential benefit.’⁶

A 5-10 per cent price reduction in ELNO fees due to competition - which would be achieved in any event if it is accepted that Sympli is likely to enter the market as we argue in this paper - would equate to a theoretical consumer benefit of up to \$3-\$4 per annum. This minimal financial benefit does not outweigh the risks of system failure, cybersecurity and fraud which will likely increase with interoperability.

Moreover, PEXA anticipates that effective competition can emerge in the e-conveyancing market without interoperability. This significantly diminishes arguments that interoperability must be introduced as a matter of urgency to improve competition. Sympli is a competitor that is backed by two well-resourced entities: (1) the legal technology and search provider, InfoTrack; and (2) ASX Limited. In this regard we note:

- widely reported company statements⁷ and media reports⁸ that all four major banks will be connected to Sympli this financial year and assurances that the banks are doing development work to connect to Sympli.

⁴ Ibid. p 18.

⁵ Ibid. p 17.

⁶ Dench McClean Carlson, Final report published in connection with ‘Review of the Intergovernmental Agreement for an Electronic Conveyancing National Law’ (18 December 2019), <https://dmcca.com.au/wp-content/uploads/2019/12/IGA-Review-Final-Report-19-12-18.pdf>, para. 5.108, p 102.

⁷ ASX, ‘ASX Full Year Results Presentation’, ASX annual results announcement (19 August 2020), see slide 28, <https://www.asx.com.au/documents/investor-relations/4-asx-full-year-results-presentation-august-2020.pdf>

⁸ James Eyers, ‘Major banks prepare to connect to Sympli to compete with PEXA, Australian Financial Review (24 August 2020), <https://www.afr.com/companies/financial-services/major-banks-prepare-to-connect-to-sympi-to-compete-with-pxa-20200823-p550dy>

- By the start of CY 2021, Sympli may have capability to lodge registry instruments - mortgage registrations, transfers, discharges, caveat registrations and withdrawals and it expects to have full registry instrument coverage by the end of CY2021.⁹

In PEXA's view, a far better outcome for the e-conveyancing market would be to allow the competitive processes now underway to take their course, enabling Sympli to enter the market while also allowing the entry of LEXTECH and other prospective market participants. The implementation of direct connection interoperability will likely entrench a duopoly, in which incentives to innovate are stifled and the risks of fraud, error and system failure are elevated, and would not be in the interests of consumers.

Interoperability will stymie innovation while eroding current efficiencies

PEXA agrees with the Productivity Commission's findings that *'By far the biggest long term driver of productivity growth is the stock of advances known as technological innovations'*¹⁰ and that *'Overly complex and burdensome regulations stifle innovation and slow down productivity growth. New South Wales needs smarter, more flexible regulations that support innovation, competition and economic growth.'*¹¹ However, the Productivity Commission's draft recommendation 4.17 to support a mandate to introduce interoperability as a matter of urgency is inconsistent with these findings and the other recommendations the Productivity Commission makes with regard to reducing and relaxing regulation to boost productivity.

[REDACTED]

[REDACTED] Interoperability would introduce requirements to standardise data fields, core back-end infrastructure capabilities, and associated work processes to enable data synchronisation and information transmission in an interoperable transaction. This will require a high degree of uniformity between ELNO capabilities at the infrastructure level (i.e. lodgement and settlement capabilities). This will significantly reduce the ability and incentive of all ELNOs to innovate core-back-end infrastructure. For example, if one ELNO has the ability to accept payment from or enable payment to a credit card, unless the counterparty ELNO to a transaction were also able to do so, the credit card payment would not be possible. This means any innovative feature in terms of lodgement or settlement would need to be shared with industry for it to be functional in a transaction. This would in turn remove any competitive advantage / incentive to invest in such innovation in the first place.

In many ways, the core back-end settlement and lodgement functions are the critical innovative elements of e-conveyancing – where enormous industry innovation has recently occurred, and where further innovation in a nascent industry is highly likely without regulatory intervention. For these reasons, PEXA is of the view that the introduction of interoperability is not an example of the kind of *'pragmatic, pro-innovation policies'* that will provide *'the institutional infrastructure that is crucial for innovation.'*¹² Rather, PEXA believes that a mandate to introduce interoperability and the standardisation of core back-end offerings of ELNOs will instead kill PEXA's and other stakeholders'

⁹ Ibid.

¹⁰ Productivity Commission, Green Paper, p 20.

¹¹ Productivity Commission, Green Paper, p 20.

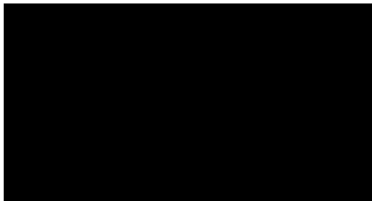
¹² Ibid, p 30.

pipeline of investment in R&D / innovation for settlement and lodgement capabilities, technologies and associated processes.

We also have evidence that demonstrates the significant economic value and innovation delivered to date through the current open market structure. A structure not constrained with direct connect interoperability which would enforce a duopoly and therefore limit competition.

To the extent effective further competition does not emerge, reforms regarding interoperability can be revisited at a time where industry and society are not dealing with more pressing issues. We agree with the Commission's view that *'flexible, outcomes-focused regulation will speed up the recovery from COVID-19'*.¹³ However, PEXA is of the view that a mandate to implement direct connect interoperability as a matter of urgency does not meet this criteria. Rather, it may compromise the existing e-conveyancing system that is now an important piece of national infrastructure that supports the \$7 trillion property industry. We are happy to speak with you and respond to any information requests in a timely manner.

Yours sincerely,

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¹³ NSW Productivity Commission, Productivity Commission Green Paper, (August 2020), p 20.