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Dear Ms Cameron,

Approach to e-conveyancing industry reform

PEXA thanks ARNECC for the opportunity to respond to issues raised in its letter to PEXA on 21 July 2023, and to provide further detail on shifting the reform agenda for e-conveyancing to a more productive approach than current efforts to introduce interoperability between ELNOs.

PEXA notes that this correspondence is confidential and contains confidential proprietary information about PEXA's business that it does not wish to disclose publicly or to competitors.

This letter sets out:

- The reasons why a 'ladder of investment' approach to e-conveyancing is likely to create more public value than the current approach that prioritises interoperability (section 1);
- The design of a ladder of investment for interoperability to facilitate the early entry of new retail competitors (section 2); and
- The practical steps required to implement a ladder of investment approach for e-conveyancing (section 3).

1 The case for a ladder of investment

1.1 The current approach to e-conveyancing reform

The current approach to reform has assumed a binary choice between two extreme market structure positions – regulating the entire industry as a natural monopoly; or attempting to provide end-to-end competition which is unlikely to be effective or efficient and (as we have previously flagged) will probably lead to an entrenched duopoly.

This interoperability approach has turned out to be much more difficult, costly, and time-consuming to implement than was expected when the reform began, and it is creating substantially greater risk than

was originally foreseen. The currently scheduled date for a fully functional interoperable system is further off today (2 years away in December 2025 in Qld and NSW, and PEXA (and others) believes it will in fact take materially longer) than when all jurisdictions committed to interoperability reform in Sept 2020, expecting an operable system within 15 months by Dec 2021.

PEXA submits that a 'ladder of investment' approach would better achieve ARNECC's policy objectives through the introduction of competition.

1.2 The ladder of investment approach

The ladder of investment approach facilitates new entry into the portion of the value chain where competition is most likely to provide benefits of innovation and cost reduction and evolves the functions in which new entry is facilitated in the light of experience.¹

The ladder of investment approach has been applied in the European telecommunications market since it was introduced in the 2002 regulatory framework, which was revised in 2009 and 2018. The approach has been credited with stimulating competition, innovation, and consumer choice in the telecommunications sector, as well as encouraging the deployment of next-generation networks, such as fibre and 5G.²

A ladder of investment would allow new entrants to e-conveyancing to begin by appropriately using PEXA's established capabilities and integrating this with their own bespoke customer-facing functionality. As they gain market share and experience, new entrants would climb up the ladder of investment by investing in functions that would partially replace PEXA's functionality, typically for services adjacent to the functions they already provide. Over time, the functionality effectively transferred from PEXA to new entrants would grow in areas where there was strong demand from new entrants to take on responsibility for building and operating that functionality and earning the associated fees.

This letter identifies functions transferred at a point in time from PEXA to new entrants as "retail" and those retained by PEXA and not performed by other entities as "wholesale". The "retail" label reflects that the functions most likely to be performed by new entrants integrate more closely with customers. By contrast, PEXA's "wholesale" functions require closer integration with the enablers of conveyancing, particularly titles offices, State revenue offices and financial institutions - "wholesale" functions are typically provided by one or a small number of entities to a larger number of "retailers". A key feature of the ladder of investment is that "retail" functions may change over time.

As is explained below, the ladder approach is necessarily proposed as an alternative rather than an additive to the current sub-optimal approach to interoperability reform.

1.3 The general benefits of a ladder of investment approach

PEXA is confident that the benefits of the ladder of investment approach demonstrated in other markets could be matched in e-conveyancing, including:

- Earlier introduction of new functionality for interactions with subscribers, the part of the value chain where value creation and the demand for differentiation is likely to be largest;
- Prioritisation of reform and new functionality where there is the most demand from industry participants;
- Earlier introduction of genuine competition;
- More vigorous competition with multiple competitors, rather than creating an entrenched duopoly;

¹ See e.g. Baldwin, Cave, and Lodge (2012) *Understanding Regulation – Theory, Strategy, and Practice*, Part VI.

² See e.g. Cave (2006) "Encouraging infrastructure competition via the ladder of investment" *Telecommunications Policy*; Cave (2014) "The ladder of investment in Europe, in retrospect and prospect" *Telecommunications Policy*; Cave, Genakos and Valletti (2019) "The European Framework for Regulating Telecommunications: A 25-year Appraisal" *Review of Industrial Organisation*.

- Maximised value of existing industry investments through re-use, and minimised cost of duplicative investments that add little or no value; and
- A seamless regulatory transition with minimal or no legislative change, and relatively little regulatory intervention required.

A key advantage of the ladder of investment approach is that it is adaptive: it allows industry participants and regulators to evolve and learn from experience. As a result, regulators and participants can have more confidence that changes will in fact deliver substantial net benefits. In addition, change is prioritised where there is strong demand from industry participants. And market entry is facilitated because new entrants can increase their capability gradually rather than pre-committing to a large capital investment with uncertain prospects.

The ladder of investment model would also create incentives for PEXA to prioritise improvements in wholesale functionality and security in the knowledge that it would not be liable to surrender a significant part of the value of these investments through interoperability.

1.4 The current problems with interoperability

By contrast, the current interoperability approach is a “big bang” that pre-commits to competition across the value chain.

- The precommitment is long – on the current ambitious timetable the reform will commence full operation 2 years from today, and over 5 years from when jurisdictions decided to pursue interoperability (noting PEXA’s view that the current timetable is not backed by detailed analysis and is implausible).
- The pre-commitment from new participants is large: the new ELN has already spent over \$95m, and PEXA estimates (based on its own experience) that the IT costs for building a full-service ELNO that can participate in all parts of the e-conveyancing value chain is in the order of \$182 million (noting there are significant other costs involved in establishing a successful ELN business).³
- The pre-commitment from other industry participants is significant: PEXA expects to spend \$25-\$30m building interoperability functionality, and bank participants may need to spend \$10m each building integration infrastructure for the new ELN). PEXA and other stakeholders are incurring significant costs and will continue to incur further costs on non-IT deliverables.⁴ For instance, PEXA estimates that the non-tech costs of negotiating the contractual framework between ELNOs, Subscribers, settlement institutions, Land Registries and Revenue Offices are in excess of \$7 million.⁵

³ PEXA (2023) *Submission to IPART, Draft Report into Interoperability pricing for ELNOs*, p.9-10. While the view expressed in IPART, *Interoperability pricing for Electronic Lodgement Network Operators: Final Report*, p.52-53 is that IPART can rely on theoretical outside-in estimates by Deloitte and AECOM that an e-conveyancing platform can be built for \$8m, this is simply not credible: it is more than ten times lower than the actual costs incurred by PEXA in Australia, PEXA in the UK and Sympli in Australia. And contrary to IPART’s claim that this development cost must be too high because it implies a per-transaction cost roughly half-way between current prices for a transfer and a refinance transaction, this is roughly the average development cost that would be expected in an industry with very high fixed costs. IPART’s analysis also depends on the assumed payback period, which, in IPART (2019) *Review of the Pricing Framework for Electronic Conveyancing Services in NSW, Final Report*, p. 46 was stated to be only 2 years. In this context, PEXA notes that its platform is not cash positive after 10 years, let alone providing a return on capital: PEXA (2023) *Submission to IPART, Draft Report into Interoperability pricing for ELNOs*, p.27.

⁴ Non-IT deliverables will include activities to project manage the IT build, to work with ARNECC to design interoperability technical specifications, to update PEXA’s system for APIs, to develop network stability and governance arrangements, to test and implement each interoperable transaction in each jurisdiction, to develop a new risk and liability allocation regime, and subsequently insurance, to develop and negotiate the interoperability agreement between ELNOs, to develop and implement a new complaint and dispute resolution framework (as interaction is now required with other participating ELNOs), to train and support ELNO staff and subscriber staff to use multiple ELNOs, to assess and monitor broader network’s cybersecurity (because additional APIs create additional points of vulnerability), to undertake incident management (Business Continuity Plans, Root-Cause Analysis, and incident reports) with other ELNOs, to participate in an end-to-end security assessment not conducted to date and which is critical to minimising risks of change such as increased cyber security risks to consumers and industry participants: see PEXA (2023) *Submission to IPART, Draft Report into Interoperability pricing for ELNOs*, p.13-14.

⁵ PEXA (2023) *Submission to IPART, Draft Report into Interoperability pricing for ELNOs*, p.9.

Because it is hard to predict the impacts of complex change over several years, it now seems likely that any perceived benefits of interoperability will turn out to be negative, and the opportunity cost will be high.

The current interoperability approach has many other problems.

Most fundamentally, interoperability focuses on facilitating a new entrant into parts of the e-conveyancing value chain where there are high barriers to realising the benefits of competition. The only new entrant interoperable ELNO, Sympli, is now indicating that its innovation will be confined to the user interface layer of e-conveyancing, and that functional conformity rather than innovation should be the priority in other layers of the technology stack.⁶ Similarly, the Australian Banking Association has recently made public submissions emphasising the need for consistency and standardisation over innovation in the wholesale layer of e-conveyancing.⁷ Of the theoretical barriers to realising the benefits of competition, every single one applies to e-Conveyancing, as shown in Exhibit 1.

Exhibit 1: Barriers to realising the benefits of competition

Barrier to realising the benefits of competition	Application to e-Conveyancing
<ul style="list-style-type: none">• High fixed costs would be incurred in duplicating the infrastructure required to deliver the wholesale part of the value chain;	<ul style="list-style-type: none">• The e-conveyancing market has high fixed costs. Analysis in IPART's Final Report demonstrates that the efficient cost to serve the market would be much lower if the industry had only one player – whether PEXA or a new entrant. This conclusion would be further strengthened if IPART's analysis is adjusted to reflect the fact that the true fixed costs of building the underlying transaction engine are in the order of \$182 million.
<ul style="list-style-type: none">• Consistency in functionality of the wholesale services has high value relative to differentiation created by multiple wholesalers	<ul style="list-style-type: none">• Consistency in functionality is highly valued by network partners (land registries, revenue offices, ATO, RBA, and the settlement functions of financial institutions) because it minimises their costs of integration, and where they are the sole entity providing a function (as is the case with titles offices, revenue offices and the RBA) they generally aim to minimise differentiation in process.
<ul style="list-style-type: none">• Minimising cyber risks by minimising infrastructure and points of entry has high value relative to the benefits of differentiation created by multiple wholesalers.	<ul style="list-style-type: none">• Reliability and trust are essential pre-conditions for e-conveyancing, and multiple wholesalers require the creation of a large number of additional 'points of entry' which increases cybercrime risk. (As raised in the previous PWC report)

⁶ Joanne Tseng, Chief Product Officer, Sympli (*Sympli's emergence as a new technology network in Australia and progress and learnings to date*, 2023 Registrars of Titles Conference, 11 October 2023).

⁷ ABA Statement regarding the Interoperability program, 25 October 2023, p 1 ('Key success criteria').

- Network effects (where the value of the services to consumers is higher the more other consumers use the same platform);
 - make it difficult to enter, and
 - it would add excessive costs to overcome these network effects through interoperability (i.e. links between wholesale platforms where customers use different wholesalers), as employed in industries such as telecommunications and electronic conveyancing
- The e-conveyancing market exhibits network effects, where the value of services to consumers is higher the more other consumers use the same platform. Current interoperability reforms were intended to reduce the barrier to entry created by network effects on the assumption that otherwise the incumbent would exploit its position. However, the costs to ELNOs and banks to implement interoperability are much higher than originally thought, and on the information now available the additional costs of interoperability would not justify the benefits of wholesale competition.
- There is a policy goal to provide universal access to services for consistent prices (i.e. a universal service obligation, or 'USO'), where:
 - some services, jurisdictions or customer segments are not economic to serve (and therefore must be 'cross-subsidised'); and
 - there is no cost-effective and practical way to regulate to ensure that at least one player provides universal access in an economically viable way.
- It is a policy goal of e-conveyancing, as reflected in the MOR,⁸ that ELNs must enable the lodgement of all registry instruments and other electronic documents capable of lodgement in all jurisdictions, with consistent national pricing. This means that smaller States and participants should not be disadvantaged in terms of coverage or pricing. This USO-type requirement creates incentives for new entrants to cherry-pick the most profitable jurisdictions and transactions.⁹ IPART has acknowledged the problem of cherry-picking, but declined to address it through inter-ELNO pricing, and ARNECC has not yet defined any mechanism that is likely to deter cherry-picking in practice. As set out in PEXA's submissions to IPART, MOR requirements that all ELNOs provide universal coverage are difficult to enforce, and in practice new entrants may seek operate while providing much less than universal coverage for an extended period.¹⁰

Given these problems in principle, it is not surprising that the original purported benefit of interoperability was marginal, and the assumptions behind this purported benefit, which have been continually questioned, have been contradicted by subsequent experience:¹¹

- The costs of building an additional ELNO are much higher than projected;

⁸ Model Operating Requirements, version 6.2, clause 5.2.

⁹ IPART (2023) *Interoperability pricing for Electronic Lodgment Network Operators, Final Report*, pp. 66-7.

¹⁰ PEXA (2023) *Submission to IPART, Draft Report into Interoperability pricing for ELNOs*, p.19-21.

¹¹ As set out in previous communications to ARNECC: PEXA Letter to ARNECC Re ARNECC *Interoperability timetable*, 28 June 2023. IPART does not appear to have seriously grappled with this issue in its reaffirmation of the interoperability approach in IPART, 2023, *Final Report on Interoperability pricing for Electronic Lodgment Network Operators*, p.12.

- The interoperability system is more complex and expensive to deliver than first expected, and timelines and costs are continuing to blow out;
- The interoperable system will have less, not more, functionality than PEXA's current platform and change requests will also be exponentially more complex requiring ARNECC to oversee and co-ordinate operational aspects of changes across ELNOs;
- Issues with financial settlement regulation have emerged that will be difficult to resolve;
- The interoperable market creates an unstable industry structure not originally identified, including unresolved problems of cherry picking, free-riding and self-preferencing;
- Security and stability will be worse, not better – and a full end-to-end security assessment of interoperability still has not been completed; and
- legal issues have become more obvious, not least that ARNECC's objectives for interoperability will only be workable if ARNECC is prepared to impose obligations on PEXA that go beyond the authorising provisions for interoperability and compel PEXA to surrender its intellectual property without compensation.

In any case, an interoperable model for e-Conveyancing was always an ambitious reform. E-Conveyancing interoperability can only draw on relatively rare historical models that are not obviously applicable. Interoperability has primarily succeeded in fundamentally different industries such as the mobile telecommunications industry where:

- Interoperability requirements are less complex (whereas there are many different types of e-Conveyancing transactions)
- the cost of implementing interoperability is small relative to the value of the market¹² (whereas the cost of interoperability is material relative to industry revenues and the market is small with unique technology)
- the risk and costs to the consumer of a failed interoperable transaction are relatively low (an unconnected phone call typically has fewer consequences than a failed property transaction).

The design of interoperability is creating disincentives to PEXA to invest. IPART's determination of inter-ELNO fees that are only a fraction of the full cost of developing functionality, particularly for relatively lower volume transactions, creates disincentives for PEXA's further investment in additional functionality sought by network partners including titles offices and state revenue offices.

Finally, interoperability requires ARNECC to develop and invest in capabilities it presently lacks and that will be difficult to develop, including;

- technical oversight of standards and interfaces between ELNOs and network partners; and
- regulatory oversight of financial settlement.

2 Designing a 'ladder of investment' for E-Conveyancing

PEXA believes that the general ladder of investment approach can be fruitfully applied to e-Conveyancing. This approach would aim to facilitate new entry to the parts of the value chain where it is more likely that competition will lead to innovation that is valued by customers and lower prices.

2.1 The first rung – a retailer user interface

PEXA suggests that on the first rung of an e-Conveyancing ladder of investment:

¹² While the costs of mobile telephony interoperability are not transparent, mobile telephony revenue in Australia is around \$20b per year (Optus \$5b [hy24mda.pdf \(optus.com.au\)](#); Telstra \$10b [TLS23_19 Analyst Briefing Materials.pdf \(telstra.com.au\)](#); TPG \$5m [TPG Investor Presentation \(tpgtelecom.com.au\)](#))

- Retailers and large subscribers (such as banks) would replace PEXA's user interface with their own interface;
- The retailer interface would typically integrate with Practice Management Software (PMS) used by subscribers (currently subscribers must transcribe information from their PMS into PEXA's interface);
- Retailer systems would integrate electronically with PEXA's system through APIs provided by PEXA; and
- Large subscribers would typically integrate their customer management systems (such as mortgage processing systems) electronically with PEXA's system through API's provided by PEXA.

Retailers would also provide "first line support" – i.e. answering basic subscriber queries about how to enter information in the system, and how to interpret system queries.

The effect of these changes would be that conveyancer and financier personnel would not have to enter information into both their firm's general system and PEXA's system; instead, information entered into a PMS or bank system would be automatically and electronically transferred to PEXA's system, reducing handling time and minimising errors.

PEXA would continue to handle functions such as performing checks and calculations for transactions, and shepherding transactions to completion that includes transaction orchestration, lodgement of registry instruments, stamp duty documentation, and financial settlement. PEXA would retain sole responsibility for interacting with network partners (land registries, revenue offices, ATO, RBA, and the settlement functions of financial institutions) for the purposes of e-Conveyancing.

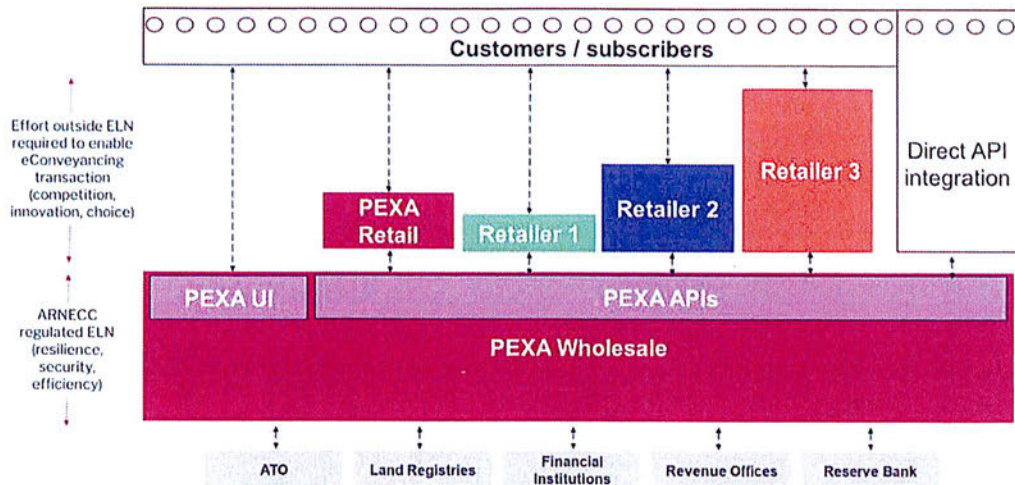
2.2 The second rung

It is a feature of the ladder of investment approach that it allows for changed assessments over time as to the appropriate next rung in the ladder. If experience demonstrates that it is more or less difficult to realise the benefits of competition for particular functions, then they would be reprioritised accordingly.

Once competition is successfully established on the first rung of the ladder, this approach would encourage the consideration of including additional functions in the competitive retail space of e-conveyancing, such as management of the subscriber relationship and their user experience. Features that could be explored in this context could potentially include:

- Identifying subscribers and end transactors and managing subscriber compliance
- Authenticating, authorising, and managing access for users to specific transactions
- Guiding subscriber workflow and decisions (e.g. alerts, next best action)
- Creating documents for lodgement using workspace data objects and signing document counterparts
- Managing subscriber support and billing
- Creating and verifying financial line items

Exhibit 2: High level overview of proposed retail and wholesale functions.



2.3 Benefits of the e-Conveyancing ladder of investment

The initial rung of the ladder of investment should provide substantial benefits. Electronically integrating conveyancer and financial institution systems with PEXA's systems should substantially improve productivity and reduce costs. The integration would potentially enable better subscriber workflow management and management control. It should reduce processing time and reduce errors and risks through double handling and re-keying of information.

A possible second rung of the ladder of investment (to be considered after competition is successfully introduced at the first rung) would allow retailers to build their own tailored workflows and user experiences. By providing user interfaces specifically tailored to particular market segments, such as family law, probate administration or mortgage lending, retailers could align e-Conveyancing processes more precisely with the processes required for specific market segments. Retailer innovation might design better workflows than PEXA has developed on its platform.

The potential productivity gains from integrating PEXA's system with new entrants are likely to be much larger than any improvements in ELNO efficiency as a result of interoperability. Conveyancer revenues (typically around \$950 per transaction per party¹³) are around seven times PEXA revenues (\$133 for a transfer). Whereas conveyancer costs include substantial labour for each transaction, PEXA is a straight-through electronic processor in which the marginal labour for a routine transaction is minimal. Consequently, there is substantial opportunity to compress conveyancer labour costs through increased electronic processing, whereas PEXA has far less cost than can be compressed in this way.

2.4 Demand for the e-Conveyancing ladder of investment

Reflecting the size of the opportunity, PEXA been directly approached by a number of organisations who believe they could offer greater value to their customers by providing retail e-Conveyancing services if they could integrate better into PEXA's system. These organisations include PMS providers, panel law firms and providers of banking software. This suggests there is substantial latent demand to enter the market for retail e-Conveyancing services.

¹³ Quotations from Conveyance.pro for handling a property sale of \$1.2m with a \$600,000 mortgage in Victoria identified 25 conveyancers with a median indicative price of \$950.

2.5 Costs of the e-Conveyancing ladder of investment

PEXA's costs to facilitate the ladder of investment depend on the precise level of integration required. To enable the first rung, PEXA needs to create APIs that allow electronic integration between PEXA's system and PMS and other subscriber software. To date, PEXA has created this integration ad hoc, and a more systemic approach would yield benefits. PEXA's initial estimates suggest that enhancing and expanding its suite of APIs to enable additional features and functionality supporting new retail propositions and business models would take between 3-6 months to develop, depending on geographical and functional scope.

To enable a second rung, PEXA would need to invest more. For example, it may require PEXA to provide lower-level APIs that allow retailers to build their own tailored workflows and user experiences. To allow retailers to alter the order in which information is input to PEXA's system, PEXA may need to implement different systems to minimise input errors and inconsistencies.

Depending on its design and market feedback once the first rung competition is established, a second rung might also enable retailers to take responsibility for onboarding subscribers and managing the associated risk of end-user fraud. Again, this would require material change to PEXA's system, and would also require regulatory cooperation as this model is prohibited under current e-conveyancing rules.

However, these costs are likely to be substantially less than PEXA's further costs of implementing interoperability, currently estimated at \$25-30 million.

2.6 Further development of the e-Conveyancing ladder of investment

The future contours of the ladder of investment for e-Conveyancing are uncertain. The whole point of the approach is that which functions are identified as suitable to be performed by other parties rather than PEXA depends on the experience gained from previous transfer of functions, and future retailer demand. Candidate market entrants have already suggested further developments to PEXA that could be part of future steps up the ladder.

3 Implementing the e-Conveyancing ladder of investment

3.1 Functional separation

If the ladder of investment approach is adopted, PEXA would perform both wholesale and retail functions. Over a decade PEXA has established a broad base of customers and would compete to retain their custom based on quality and price in a competitive retail market. In the transition from the current market structure, PEXA will need to continue its retail activities in their current form to ensure continued service to all segments. In the long-term, PEXA will probably need to maintain a retail offering as a "retailer of last resort" to segments of the market that are less commercially attractive to new retail entrants. In this capacity, PEXA would also be required to provide equal access to retail APIs for retailers on the first rung of the ladder. Other retailers could also offer such services, but only PEXA would be required to do so as 'retailers of last resort'.

If a wholesaler competes with retailers that it supplies, there would need to be appropriate regulation so that all retailers have equal access to wholesale services, preventing the wholesaler from leveraging its position in the wholesale market to unfairly capture retail share. This can include a degree of operational separation between a provider's wholesale and retail operations.

On the first rung of the ladder of investment the services that PEXA provides to them would be very similar to the services that it provides directly to subscribers as the retailer of last resort. The major difference is that retailers would input information to PEXA's system electronically from their own system, rather than through PEXA's graphical user interface. The primary difference in business model between such a retailer and PEXA as retailer of last resort is that the retailer's operations and systems would probably be integrated more tightly into practice management and other software downstream of e-conveyancing transacting.

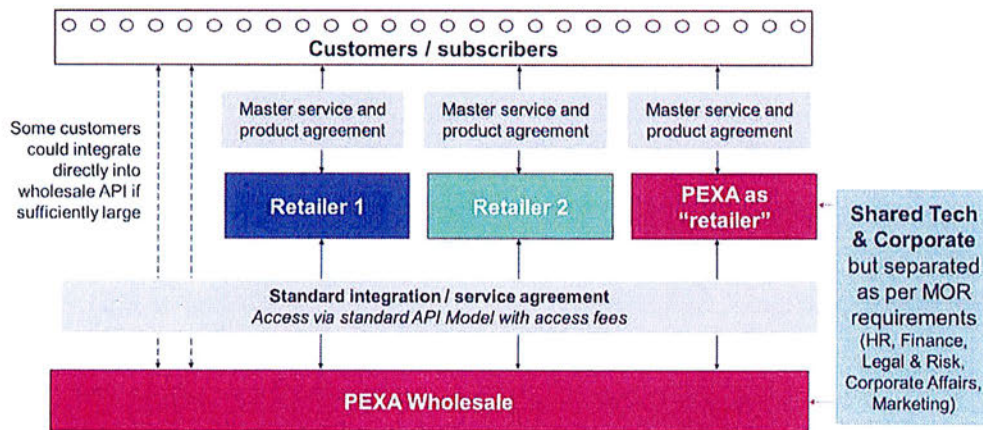
There is unlikely to be substantial direct competition between PEXA as retailer of last resort and retailers on the first rung of the ladder because the MOR prevent PEXA from providing practice management software. To enable effective entry of such retailers, all that is required is that PEXA provide rigorous accounting for the graphical user interface and front-line inquiry support that retailers would supply to their subscribers instead of PEXA. This accounting would be the basis for regulated pricing from PEXA to them.

PEXA does, however, accept that the ladder of investment would probably require PEXA to functionally separate the parts of PEXA that perform wholesale functions from those that perform retail functions.

ARNECC could utilise its existing framework to deliver this separation. Under clause 5 of the Model Operating Requirements (MOR), an ELNO is prohibited from supplying upstream or downstream services, unless minimum separation arrangements are in place including the development and independent approval of a Separation Plan. This model could be used to establish a functional separation framework analogous to that developed in other industries that facilitates fair equivalent access to all e-conveyancing retailers.¹⁴

It is premature to set out the separation arrangements in detail at this stage. However, PEXA has commenced work on the parameters for a Separation Plan for the purpose of clause 5.6.3 of the MOR and a simplified outline of our current working approach is set out in Exhibit 3.

Exhibit 3: Simplified outline of potential PEXA separation model



¹⁴ Prior to the NBN, Telstra was required to put in place a Structural Separation Undertaking (SSU) that was approved by the ACCC and governed the separation of its monopoly network from its retail and wholesale businesses. Following the NBN, a similar model is used for other players that have regulated fibre activities and that must therefore have in place an approved Functional Separation Undertaking.

3.2 Price regulation

In a ladder of investment approach, wholesale functions are provided by one or a limited number of entities. Consequently, there needs to be effective price and quality regulation of the wholesale segment of the market to prevent overcharging, incentivise investment and ensure stability of the essential infrastructure.

PEXA intends to maintain its existing pricing model and philosophy, underpinned by principles of consistency and uniformity, ensuring fees do not differ based on location, organisation type or volume of transactions being processed.

In the absence of a second (or subsequent) wholesaler providing full service at scale, it is reasonable to regulate prices at the level required to provide a reasonable return to a single wholesaler. According to IPART, this price is likely to be lower than the price required to provide a reasonable return to multiple wholesalers,¹⁵ because with more than one wholesaler, industry revenues must cover the costs of multiple sets of infrastructure required to provide wholesale services.

In the initial phases of a ladder approach, it is not anticipated that new entrant retailers would require any regulation. If the ladder of investment leads to retailers taking on regulated activities (for example Subscriber onboarding), then some minimum level of regulation may be required.

3.3 Implementing a ladder of investment simultaneously with interoperability

The ladder approach is necessarily proposed as an alternative rather than an additive to the current sub-optimal approach to interoperability reform. Even if interoperability were a high-quality reform proceeding according to plan, it would not make sense to press ahead with it while simultaneously pursuing a ladder of investment approach.

Firstly, the two approaches are incoherent:

- The ladder of investment approach assumes that some retail competition is worthwhile, but whether more extensive competition should be pursued will be determined over time in the light of experience; by contrast interoperability assumes that full wholesale competition should be pursued immediately;
- The ladder of investment focuses regulatory effort and participant investment where it is most likely to work and adapts over time; interoperability commits in advance to large regulatory effort and participant investment.

Second, it is difficult in practice to deliver both reforms at once.

- ELNs would simultaneously have to build interoperability functionality (requiring interactions with back-end participants and other ELNs) and build new functionality in parallel so that all ELNs meet requirements to interact with new retail entrants.
- A new entrant ELN would have to do this while simultaneously also replicating PEXA's end-to-end functionality.
- Regulators, including ARNECC, would have to build simultaneously the regulatory framework for interoperability and the regulatory framework for the ladder of investment.

¹⁵ IPART *Interoperability pricing for Electronic Lodgment Network Operators, Final Report*, p.64. While IPART goes on to assert that competition would ultimately induce two ELNOs to reduce their prices below the level of a single efficient monopoly ELNO, it provided no analysis for this conclusion beyond the observation that competition in other industry has tended to reduce prices. And by definition, if ELNOs compete to reduce prices below those that can be sustained by an efficient provider, effectively failing to recover some of their fixed costs, the industry will not be sustainable.

4 Next step

If ARNECC indicates that it would like to progress with a ladder of investment approach, then PEXA would support developing this model further.

The immediate next steps would be to:

- define the functionality of the first rung of the ladder of investment in more detail; and
- identify any regulatory enablers required.

PEXA believes that the ladder of investment approach could be introduced through the MOR, which already provides for separation, equal access, and non-discrimination.

However, for the reasons outlined above in section 1.4, the ladder approach is necessarily proposed as an alternative rather than an additive to the current sub-optimal approach to interoperability reform. PEXA is reluctant to make substantial investments in its system to facilitate the ladder of investment if interoperability continues in parallel. There is a significant possibility that PEXA would be asked to share its know-how in such a development with other ELNOs to replicate the equivalent access regime developed by PEXA, exacerbating the concerns PEXA has separately raised in relation to the unjustifiable appropriation of PEXA's intellectual property rights.

5 Confidentiality

PEXA reiterates its view that except where expressly stated otherwise, the material contained in this submission is confidential, and contains information about PEXA's business that it does not wish to disclose publicly or to competitors.

If ARNECC agrees to explore the ladder of investment model, we would be pleased to work with you to prepare documents that could be made public in order to test industry's interest in the opportunity.

Sincerely,

Simon A Y Smith

Group Advocate