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Secretariat
Payments Systems Review
The Treasury
Langton Crescent
PARKES ACT 2600

By email: PaymentsReview@treasury.gov.au

Dear Secretary

This is our submission to the review of the regulation of payments systems being conducted by The Treasury.

We are making this submission neither as a payments system regulator nor as a payments system provider but as a frustrated potential user of a payments system. We suspect the cause of our frustration is not unique and we are bringing its nature and origin to your attention because we believe it has significant implications for the future regulation of payments systems.

We are not specifically addressing the consultation questions raised in your Issues Paper. Rather, we are providing a description of our experience, that we believe touches on a number of your consultation questions, and largely leaving the interpretation of our description up to you.

In doing so, we nevertheless recognise the relevance of our experience to the review's over-arching objective of ensuring the regulation of payments systems encourages and fosters innovative developments that deliver efficient, low-cost and secure services while minimising risks – issues that go to the heart of our experience.

Background

We are a legal practice specialising in the perfecting of mortgage securities for real property lenders. We handle 10,000 matters annually involving settlement payments from our trust account of about $50 million every business day. We receive instructions and funds from 20 lender clients and deal with properties in all States and Territories. Our business amounts to about 1% of all the conveyancing settlements conducted throughout Australia.

For the past four years we have been endeavouring to secure approval to operate as an Electronic Lodgement Network Operator (ELNO) under the Electronic Conveyancing National Law (ECNL) first enacted in NSW in 2013. The approving authority is the Australian Registrars' National Electronic Conveyancing Council (ARNECC) made up of the Registrars of Title in each State and Territory.

At the present time there are two approved ELNOs. The first, Property Exchange Australia Ltd (PEXA), was approved in 2015. It started life heavily supported by four State Governments and the major banks and was at that time expected to be the only ELNO. In 2018 a second ELNO, Sympli Australia Pty Ltd (Sympli), was approved and ARNECC embarked on creation of a competitive market for ELNOs in the interests of reducing the fees charged by the first ELNO. Sympli replicated the business model, including the settlement solution, developed by PEXA but has so far struggled to get any traction in the market. Both PEXA and Sympli are technology companies with no experience in property conveyancing.

A significant proportion of conveyancing transactions involve a financial settlement between or among the parties that involves the making of payments. Prior to the introduction of electronic conveyancing (and still in the States and Territories yet to participate or yet to make electronic

lodgement mandatory), payments were made by bank cheques provided by the receiving parties (purchaser and/or incoming lender) and drawn in favour of the relinquishing parties (outgoing lender and/or vendor). Sundry other payments (fees, duties and taxes) are usually also included in settlements for convenience but those payments are not germane to the settlement process.

In electronic conveyancing, settlement payments are necessarily made electronically. At the time agreed for settlement, the necessary funds must be available as cleared funds in nominated accounts from which they are withdrawn once settlement commences and paid to the nominated receiving accounts. Multiple accounts may provide the funding for a settlement and multiple accounts may receive funds from a settlement. Multiple matters may also be linked for settlement at the same time (to avoid the need for bridging finance) by having funds effectively transferred between matters. About one in five settlements involve two or more matters linked for this purpose.

The total value of conveyancing settlement payments is about $5 billion per business day[1]. This includes both electronic payments and those still being made by bank cheque.

Current Situation

There is no publicly-available information on how the two existing ELNOs undertake their electronic settlements. To the best of our knowledge, it involves:

- a connection to the Reserve Bank's Information and Transfer System (RITS)
- approval from the Reserve Bank of Australia (RBA) as a RITS Batch Administrator
- connections to each financial institution using AusPayNet's Community of Interest Network (COIN)
- agreements with each of the financial institutions specifying respective obligations.

The arrangement with the RBA allows the ELNO to:

- confirm sufficient funds are available in the Exchange Settlement Accounts (ESAs) at the RBA of the net paying financial institutions for a batch of matters
- effect net financial settlements between paying and receiving financial institutions for batches of matters.

The arrangements with each financial institution allow the ELNO to:

- confirm the reservation of funds for each matter from nominated accounts at the relevant financial institution prior to the submission of net batch details to RITS
- advise the relevant financial institutions of individual account debits and credits to be applied for each matter after the net financial settlement at the RBA
- resolve any mis-laid or mis-directed funds claims.

There is nothing particularly remarkable about these arrangements, especially when they were put in place by the first ELNO prior to the development and implementation of the New Payments Platform (NPP).

What is remarkable is that, at the RBA's insistence, a special step has been added between the confirmation of funds availability in the paying financial institutions' ESAs at the RBA and the settlement of those institutions' net obligations to the receiving institutions by way of their respective ESAs. That step has nothing to do with payments processing but a very significant impact on the conveyancing process.

[1] This is about three times the average daily value of share trading on the ASX.

The special step introduced into the settlement process at the insistence of the RBA has to do with submitting the instruments for each of the conveyancing transactions in the batch to the relevant land registries and obtaining from each of those registries confirmation that the instruments have been accepted for lodgement with the Titles Register before proceeding further with the settlement.

The RBA explains the necessity for this step as mitigating the risk of receiving parties in the conveyancing transaction making payment but not receiving their rights as purchaser or mortgagee. The RBA sees the step as ensuring Delivery for Payment (DvP) as recommended for securities settlement systems[2].

The principal issues with this special requirement imposed on the electronic conveyancing settlement process by the RBA are that it:

- does not constitute DvP
- is contrary to the well-established law and practice of conveyancing
- prevents the use of real-time payment systems for conveyancing settlements
- forces non-compliance and jeopardises the integrity of the Titles Register.

For an explanation of each of these issues and their implications, see Attachment A.

Our Frustration

The source of our frustration is the relationship between ARNECC as the regulator of electronic conveyancing and the RBA as the regulator of payments systems.

Because of its acknowledged lack of expertise and authority in payments systems regulation, ARNECC has not imposed any substantive[3] requirements on ELNOs as to how electronic settlements should be conducted. Until recently, ARNECC has not involved itself in assessing the nature of an ELNO's electronic settlement arrangements in granting approval to operate. The approval of the first and second ELNOs involved no assessment of their settlement solutions. This was likely in part because the RBA had been involved in the development of the first ELNO's settlement solution and in part because the second ELNO's settlement solution replicated that of the first ELNO.

As part of our submissions to ARNECC for approval as an ELNO, we have proposed use of the NPP for electronic conveyancing settlements. To do this, we intend to engage an NPP Participant as our Payments Services Provider (PSP) and have our system issue instructions to the PSP for its execution on the NPP on our behalf.

Those instructions would consist of debit instructions to fund the settlement and credit instructions to disburse the funds, with the settlement funds being temporarily held in an account with the PSP when there is a need to consolidate two or more debits to fully fund a settlement's credit disbursements. Each matter would be settled on a gross basis and all funds would be disbursed to nominated receiving accounts prior to the submission of the matter's instruments to the land registry for lodgement and registration.

Our proposed process using the NPP is entirely consistent with the established law and practice of conveyancing and achieves DvP by the receiving parties acquiring equitable interests at settlement. Settlement consists of the relinquishing parties handing over control of electronic instruments to the receiving parties once payment has been received from those receiving parties.

[2] Delivery versus Payment in Securities Settlement Systems, BIS, Basle, September 1992.
[3] There are three requirements that could be construed as settlement requirements. One is hat ELNOs must obtain all regulatory approvals and licences necessary for their operation, another is that registry instruments must not be submitted to the land registry for lodgement until the set lement is irrevocable, and the third is that ELNOs must not do anything that would risk the integrity of the Titles Register.

Use of the NPP for conveyancing settlements has distinct advantages over the process currently being used by the first two ELNOs. Principal among the advantages are:

- the set-up time and cost as well as the ongoing cost are substantially less, primarily because no arrangements are necessary with the RBA nor with all but one financial institution, lowering both costs to enter the market and cost to compete

- settlements are completed substantially faster, significantly mitigating the risk of a competing matter obtaining land registry priority while settlement is taking place

- with the use of the NPP's PayID function, it is possible to verify one-off receiving accounts prior to settlement, mitigating the principal source of fraud in conveyancing matters[4]

- the NPP has been specifically designed and built to provide a more reliable, more available and more secure payments system than anything else currently available.

We find it incomprehensible in the context of the above and the $1 billion+ public and private investment made in creating the NPP, that the RBA continues to stand in the way of its being used in conveyancing settlements.

We could resolve our frustration by adopting the same settlement solution as the first two ELNOs but this would be wrong in a number of respects. It would require us to replicate the issues with that solution and their implications set out in Attachment A, most significantly breaching of our obligation to comply with ARNECC's regulatory requirements and jeopardising the integrity of the Titles Register. It would also deny our clients and the industry generally the benefits of a less costly, more reliable, more available, more secure, faster and safer service, and it would deny us a competitive advantage against the first two ELNOs.

The Concern

Our concern is with the interaction between two specialist regulators, one of which has significantly more power and influence than the other.

While ARNECC is the regulator of ELNOs, its knowledge and experience in payments regulation is negligible. Because of this it feels unable to challenge the views of the RBA, even when those views impinge upon its own regulatory responsibilities and are distorting the market it is regulating.

We have established through exhaustive discussions over the past year with both regulators, together and separately, that what we have proposed is compliant with all regulations - both ARNECC's and the RBA's. This is particularly so with respect to the RBA which has given us advice in writing that our proposed solution requires neither a licence nor regulatory approval from the Bank.

Nevertheless, the RBA is advising ARNECC that our proposed solution does not, in its view, adequately provide DvP. ARNECC for its part is too timid and ill-equipped to challenge the RBA's imposition of a requirement beyond its authority.

As we set out in Attachment A, the consequences of the RBA's intimidation of ARNECC and ARNECC's inability to exert any balancing influence over the situation is producing several undesirable outcomes that are not only denying our and potentially others' entry into the ELNO market but also potentially threatening the integrity of the process for trading in Australia's largest asset class by value.

[4] There has been one substantive fraud in electronic conveyancing so far and its cause is directly related to the first and second ELNOs' inability in their settlement arrangements to pre-verify the authenticity of one-off receiving accounts.

There is an arrogance about the RBA's influence beyond its authority and in its unwillingness to re-consider its position when presented with the facts.

While we are concerned about this situation for ourselves, for the conveyancing industry and for the trading in real property generally, we are also concerned that such an imbalance and lack of relevant specific industry knowledge between overlapping regulators may be affecting the development of new payments systems applications and solutions elsewhere.

As you undoubtedly appreciate, payments systems technology and application integration is one of the fastest growing aspects of financial services at the present time and, in part due to the current pandemic, is likely to remain so for the foreseeable future.

Our Solution

The solution to our concerns seems relatively simple to us, though defining it adequately in relevant regulatory arrangements and resourcing it effectively may not be so straightforward.

When you are thinking about the future regulation of payment systems you need to have regard for the potential imbalance between overlapping and/or adjacent regulators of different standing and reputation.

Where there is a functional regulator concerned with how a particular industry function is performed and a payment systems regulator that need to co-operate effectively in the best interests of the party being regulated, of the industry concerned and of the public generally, there needs to be a requirement on the payment systems regulator to have regard for the circumstances of the party being regulated and the peculiarities of the industry in which they operate.

This is not to suggest that the payments systems regulator should defer to the functional regulator on payments systems issues, but it should be under an obligation not to distort the industry in which the regulated party intends to operate nor unreasonably prevent the party from entering its market.

A starting point from the current situation is to recognise the RBA's significant conflict of interest in being the primary payment systems regulator while also being a principal participant in all payments systems. The time is well past that payments systems can be impartially regulated by one of its principal participants.

But this is just a starting point. The next truly independent payment systems regulator must have a charter that restricts its authority to payments systems regulation in a process-independent and technology neutral framework and its influence over other regulators of operations with payment systems components.

We trust you find this revealing of our frustration helpful in your deliberations about the future regulation of payment systems. If there is any aspect you think would benefit from further explanation, please don't hesitate to get in touch.

For the avoidance of doubt, we are happy for you to publish this submission in its entirety.

Yours sincerely

SIMON PURCELL
Director

Attachment A

Issues and their implications with the RBA-imposed special step in the electronic conveyancing settlement process

The special requirement imposed by the RBA on the electronic conveyancing settlement process:

- does not constitute Delivery for Payment (DvP)
- is contrary to the well-established law and practice of conveyancing
- prevents the use of real-time payment systems for conveyancing settlements
- forces non-compliance and jeopardises the integrity of the Titles Register.

Does not constitute DvP
The special requirement is that the registry instruments for the matter be submitted for lodgement with the land registry once adequate funds have been reserved in the ESAs of the net paying financial institutions for the batch of matters and that confirmation of lodgement be received from each of the involved land registries before continuing with the settlement.

Acceptance for lodgement by a land registry does not change the Titles Register. It does not change the status of any party to the matter or make it inevitable that the Titles Register will be changed in the way intended by the instrument. The Registrars in all States and Territories have legislated discretion over what gets registered and when it gets registered.

All confirmation of lodgement does in the main is confirm that the instruments are in registrable order[5]. This is no more than is available on request during preparation of the instruments prior to settlement commencing when the land registry advises whether each instrument is in registrable order. This reality is recognised in the settlement being allowed to continue in the event that the land registry system is not available at the time required and the confirmation of lodgement cannot be obtained.

This situation has come about because the RBA and others involved in the development of the first and second ELNOs' settlement solution had insufficient understanding of conveyancing and, in particular, the difference between the equitable interests obtained at settlement (which allow purchasers to move in to their new premises and new lenders to demand mortgage repayments) and the legal interests subsequently obtained on optional registration of the instruments in the Titles Register (which ensures their priority over all other competing interests).

The RBA and others seem to have taken their lead inappropriately from the situation in securities trading where there are no instruments handed over for monies at settlement, no competition for the same asset[6] and ownership rights only transfer on registration[7].

Contrary to the well-established law and practice of conveyancing
The law and practice of conveyancing has a long history. Land transactions have had to be in writing since the mid-17th Century and the current Torrens System of title registration applying most commonly in Australia was developed in the mid-19th Century.

The fundamentals of a conveyancing settlement are that prescribed instruments relinquishing and granting interests are handed over for the monies agreed to in prior

[5] In the rela ively rare occurrence of competing instruments, lodgement also assigns a priority for registration.
[6] Securities, such as shares, bonds, options and futures, are fungible goods within their class whereas each real property asset is unique.
[7] s.1072F(1) Corporations Act 2001 requires inclusion on the company's share register before ownership of shares are considered transferred.

executed contracts for sale and/or loan agreements. The relinquishing parties must be satisfied with the monies being received and the receiving parties must be satisfied with the instruments being received. A failure in any respect to complete the matter in this way renders the settlement defective and the respective interests not transferred or granted.

A settlement is not complete until the relinquishing parties have received the monies due to them for the instruments they have handed over to the receiving parties. At that point, the receiving parties acquire equitable interests that take priority over any competing but unnotified interests. The subsequent optional registration of the instruments at the land registry perfects the receiving parties' equitable interests as legal interests.

DvP takes place, and has always taken place, when the relinquishing parties are satisfied with the monies received from the receiving parties, at which time they hand over the relevant instruments. At that point, the relinquishing parties have been paid and the receiving parties have obtained their equitable interests.

These long-standing practices have been described as satisfying "concurrent and mutually dependent obligations" entered into by the parties prior to settlement and as "simultaneous acts to be performed interchangeably" with each party's obligation conditional on performance by the other[8].

The special requirement being imposed by the RBA - that confirmation of lodgement be obtained (when possible) before the relinquishing parties receive the monies due to them - is both unnecessary and inappropriate. It is at odds with the well-established law and practice of conveyancing.

Prevents use of real-time payment systems

The pausing of the settlement process once funds have been reserved in the net paying institutions' ESAs at the RBA until the RBA's special requirement has (when possible) been complied with is incompatible with a real-time fast payment system.

Not only is there no provision for such a pause, it makes no sense to contrive one. Such a pause waiting for a response from the land registry takes away one of the prime characteristics of a real-time fast payment system.

By imposing its special requirement, the RBA is effectively denying the conveyancing industry the benefits of Australia's real-time fast payments system – the New Payments Platform (NPP). In particular, the conveyancing industry is being denied the benefits of the particular characteristics of the NPP – real-time payments, contemporary system resilience and cyber security, 24/7/365 availability and pre-verification of receiving accounts.

The performance of the NPP in these areas significantly exceeds that of its legacy payment systems and particularly the payment arrangements being deployed by the first and second ELNOs.

Forces non-compliance and jeopardises the integrity of the Titles Register

ELNOs are required to not submit any instruments to the land registry for lodgement until the settlement is irrevocable and to not in any way jeopardise the integrity of the Titles Register. These requirements stem from the traditional requirement of Registrars that settlements be properly completed before they are asked to exercise their statutory discretion and consider the registration of the matter's instruments.

[8] See, for example, Settlement Group Pty Ltd v Purcell Partners [2013] VSCA 370 (17 December 2013)

In a legal sense, a conveyancing settlement is never irrevocable because it can always be wound back under court order or agreement among the parties. In an operational sense, however, a settlement is only irrevocable when it is complete and there is something to revoke.

By insisting on ELNOs submitting a matter's instruments for lodgement prior to the completion of settlement, not only are ELNOs being forced by the RBA into non-compliance with their regulatory requirements but the integrity of the Titles Register is being jeopardised.

Since the introduction of electronic conveyancing, land registries have developed automated registration. This means that each instrument is no longer examined by a specialist clerk to ensure it is in order for registration. Instead, the land registry system applies particular business rules to the instrument's data to ensure its registrability and, if it is in order, registers it immediately. Unlike lodgement, registration alters the Titles Register. It has become common-place in the last few years for registration in the great majority of instances to occur within milliseconds of lodgement.

The combination of the RBA's unnecessary and inappropriate special requirement and the advent of automated registration at the land registries has resulted in its now being common-place for the Titles Register to be changed prior to the completion of settlement. This means that in each of those instances, the Titles Register is not reflecting the true position with regard to property ownership and encumbrance on which reliable trading in real property depends and it becomes possible for third parties to make significant economic decisions based on an incorrect Register.

The period in which such unsatisfactory circumstances persist in any instance can be significant. In the normal course of matters settled by the first ELNO, the Titles Register is commonly incorrect for 10 minutes while the settlement is being completed. However, in instances where any one of the settlement disbursements is delayed for any reason by a financial institution, the Titles Register could remain incorrect for hours or even days.

This is a situation no Registrar should tolerate. It goes to the very heart of their legislated responsibilities to maintain a Titles Register that can be relied upon for the safe conduct of economic activity involving real property.

The fact that ARNECC is not able to address the non-compliance and dangerous practice being forced upon ELNOs by the RBA demonstrates the disproportionate influence of the RBA over something outside of both its authority and its expertise.