YOUR ONLINE PROPERTY EXCHANGE

"The future of mortgages and property transactions – Implications for stakeholders"

Financial System Inquiry
PEXA Ltd submission
June 2014

PEXA
Property Exchange Australia

Contents

Executive Summary

The financing, conveyancing and registering of real property in Australian is undergoing the most significant change since the introduction of Torrens titles 150 years ago. Residential property is by far Australia's most valuable asset class estimated at $5.2 trillion and for most people, the family home remains the most significant asset they ever own and biggest financial commitment. Therefore, the public's confidence in the security, integrity and efficiency of the land conveyancing and registering system is paramount to the economy.

The formation of PEXA Ltd and roll-out of electronic conveyancing (e-Conveyancing) and electronic settlement over the next few years will see a major structural change in the mortgage and property transactions industry. e-Conveyancing will be the catalyst to create an entirely paperless mortgage origination and property conveyancing process, including the introduction of electronic mortgages and certificates of title. This is where a mortgage can be established or discharged without the need for face-to-face Verification of Identity (VOI), wet signatures and requirement to store paper documents.

The most fundamental consequence of e-Conveyancing and the move to paperless mortgages is that Land Registries are connected to the Financial Institutions in real time via PEXA and therefore will become a critical part of the financial services infrastructure in Australia, requiring world class security, disaster recovery and response times.

This document describes the current state of the Australian Mortgage and Property Conveyancing market as important background in understanding the significant implications for Financial Systems stakeholders with the introduction of paperless mortgage and property transactions. Properly implemented, the industry will become more competitive and the public will enjoy better service at lower cost. The key implications for stakeholders as described in this document are summarised as:

1. ***Implications for Land Registries and State Governments:***
    - More investment required in Land Registry systems
    - Greater cooperation between jurisdictions required
    - Land Registry fees need review
    - ACT needs to commit to e-Conveyancing
    - Reduced tax revenue leakage
    - Defer any potential sale of Land Registries
    - Establish a standardised VOI procedure

2. ***Implications for Financial Institutions:***
    - All Financial Institutions need to adopt e-Conveyancing to capture full benefit
    - Greater reliance on Land Registries
    - Reduced barriers for non-majors
    - Electronic VOI to drive paperless processes
    - Elimination of cheques
    - Elimination of paper storage
    - Significant improvement in securitising mortgage portfolios

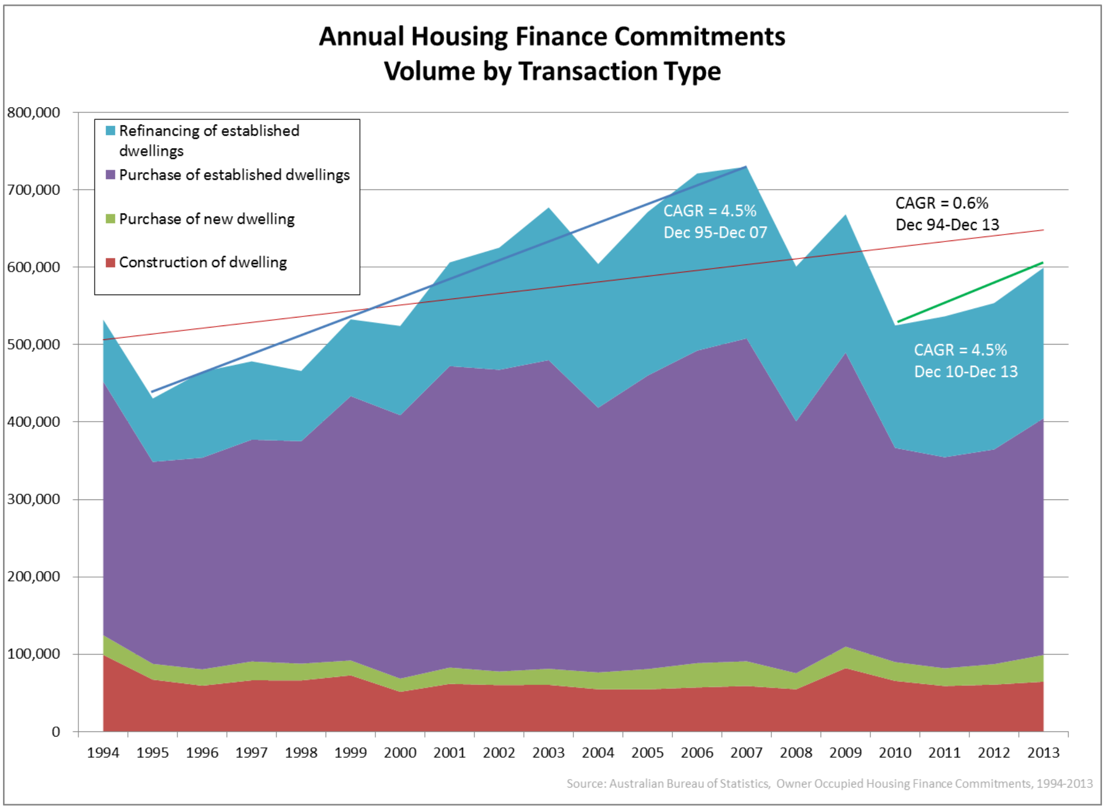
3. ***Implications for the General Public:***
    - Cheaper and quicker property transactions
    - Cleared funds available within 15 minutes of property settlement
    - Better customer experience

1. Current State

1.1 Mortgage and Property Market

The residential property market is by far Australia's most valuable asset class estimated at $5.2 trillion[1] as at January 2014. In comparison, the total value of listed equities is $1.52 trillion and national gross domestic product (GDP) over the past twelve months was estimated at $1.53 trillion.

A significant portion of residential property is mortgage financed with private sector credit data showing $1.3 trillion in outstanding mortgages[2] against registered property in Australia. This equates to an average loan to value ratio of 25% nationally. Recent ABS data shows that finance commitments to residential property grew at a compound annual growth rate (CAGR) of 0.6% over the past 19 years since December 1994, however, growth is volatile, with CAGR of 4.5% from 1995 to 2007 before a significant decline due to the GFC. Since December 2010, the market has recovered and is growing at 4.5% CAGR to December 2013.



1.2 Land Registries

The registration of real property ownership, mortgage and other interests is administered by eight state based Land Titles Offices (LTOs) with statutory requirement to maintain a register of land under the

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1 CoreLogic and RP Data property capital markets report 2014 Issue 01

2 *Ibid.*

Torrens Title system in their respective jurisdictions. Robert Torrens first introduced the system of Certificate of Title in the colony of South Australia in 1858 and by 1874 all States and Territories of Australia had adopted the system which remains today. Most of the British Commonwealth and many others states and countries also adopted the Torren's Title system for administering real property.

Under the Torren's system, in order for a land title to be altered, each LTO established a set of paper based instruments (forms), that when correctly completed and lodged with the respective LTOs, result in the details on the Land Title being able to be altered. The Torrens Land Title document is itself a "negotiable" instrument, and each State Government provides a guarantee of "indefeasibility" of title. This means that the LTOs and specifically the Registrar of Titles must guarantee the integrity of the Land Title Register and recognise the Land Title Document as being the single source of truth in determining ownership and interest in land. The owner of the registered title cannot have their interests defeated by an unregistered interest even if that unregistered interest was created before owner's interest, subject to few legal exceptions.

The LTOs combined have approximately 12.5m[3] property titles registered nationally. The majority of these have been converted from paper title records to digital records over the past 10-15 years, however all states except Queensland and the Northern Territory still rely on the Financial Institution holding the mortgage or property owner (for unencumbered titles) to hold a duplicate paper copy of the Certificate of Title as evidence of the "right to deal on title". Queensland and the Northern Territory have only recently progressed to the notion of e-Title, where the paper duplicate certificate of title is no longer valid and respective Land Registry databases are the sole source of truth for registered interests on title.

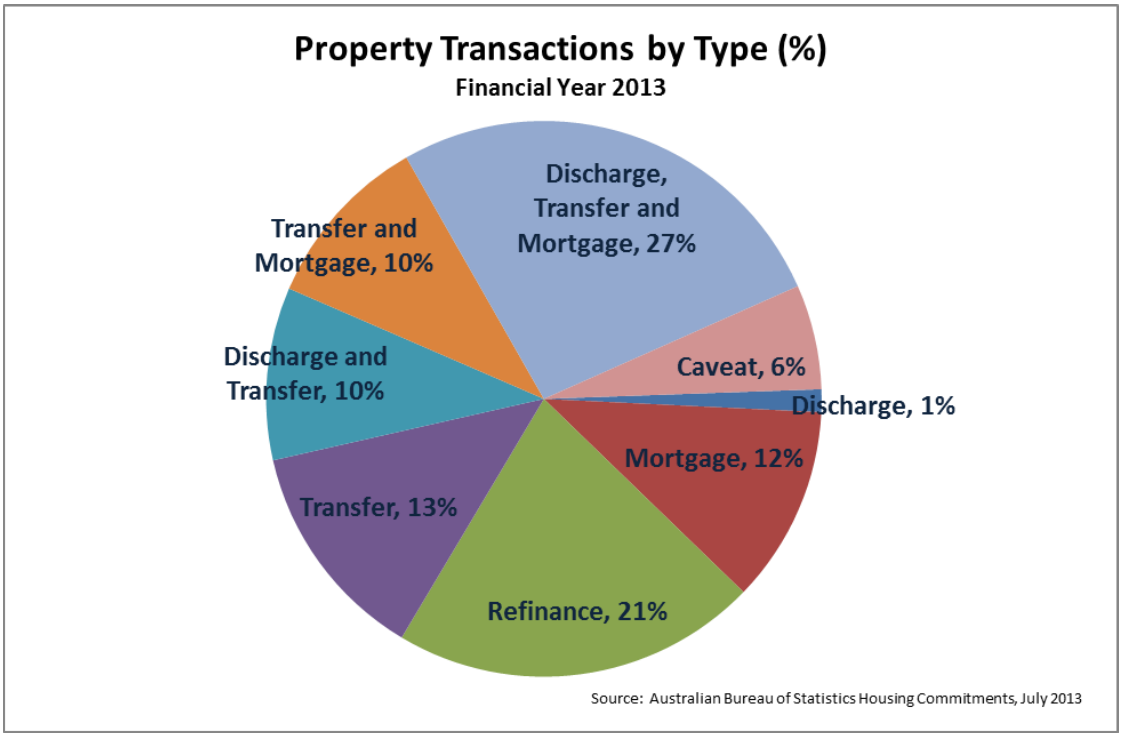
The LTOs are currently in various stages of upgrading their systems in preparation for electronic conveyancing, however their core computer systems are essentially designed for paper based batch and off-line processing. Several LTOs regularly experience systems downtimes and one state, Western Australia, currently has no disaster recovery site in case of a major catastrophe. In the current paper environment, this has not been an issue, since the physical exchange of documents and cheques at settlement can occur, and paper documents lodged at the LTO. The keying of data to register changes on title can be completed at a later date when the systems are back on-line. All participants in the transaction act as if registration occurs at settlement. With the introduction of Electronic Conveyancing (e-Conveyancing), the LTOs will be connected to the Financial Institutions via PEXA in real time, with settlement potentially delayed if the LTO is off-line.

1.3 Land Conveyancing

There are approximately one million land conveyancing transactions worth in excess of $240 billion registered on title each year when commercial, industrial and rural properties are included with residential properties. Sixty percent involve transfer of ownership; 34% involve changes in registered mortgage security on title with no ownership change; and 6% caveats. In total, approximately 81% of land title registrations involve the advance or discharge of a mortgage, with the four major banks involved on one or either side in approximately 96% of these transactions.

Conveyancing remains a predominately paper based transaction whereby documents are prepared by property lawyers and licensed conveyancers on behalf of their clients. These documents require a "wet" signature and physical exchange with a bank cheque to enact settlement. The paper documents are then lodged with the LTO and data keyed into the Land Registry to record the changes on title.

[3] Data from Land Registries and compiled by PEXA



The current manual based process for property conveyancing costs the community approximately $2.4Bn[4] per annum. In addition, an estimated 30%[5] of transactions involving transfer of property have errors identified at settlement. The majority of these are errors occurring in the settlement room including the incorrect spelling of names, cheque amounts and title details are fixed up on the day. This however adds significant cost and inefficiency to the process and a number of these prevent settlement occurring, leaving the purchaser distressed and unable to take possession of their new home.

e-Conveyancing avoids the current need for each conveyancing participant to re-key data, and considerable time lost coordinating and attending a manual Settlement to exchange paper documents and associated funds. It also eliminates settlement failures due to information errors as all participants verify a single source of truth prior to settlement. The requirement of LTOs to manually verify the documents and rekey the data to register on title is also eliminated.

The LTOs have each progressed with their own e-Conveyancing initiatives over the past decade (ECV and NECO), however they were unable to agree on a single national solution. The major banks made it clear they would not support e-Conveyancing unless rolled out nationally, which resulted in Victoria's state-based electronic conveyancing platform, ECV being modestly used by Lawyers and Conveyancers (Practitioners) in Victoria only to electronically lodge and remove caveats on title.

Property Exchange Australia Limited (PEXA Ltd) (formerly NECDL[6]) was formed in January 2010 to fulfil a Council of Australian Government (COAG) agenda item to deliver a national e-Conveyancing solution. The initiative was primarily driven by the major banks pushing for a harmonised electronic solution across all jurisdictions to drive processing efficiencies.

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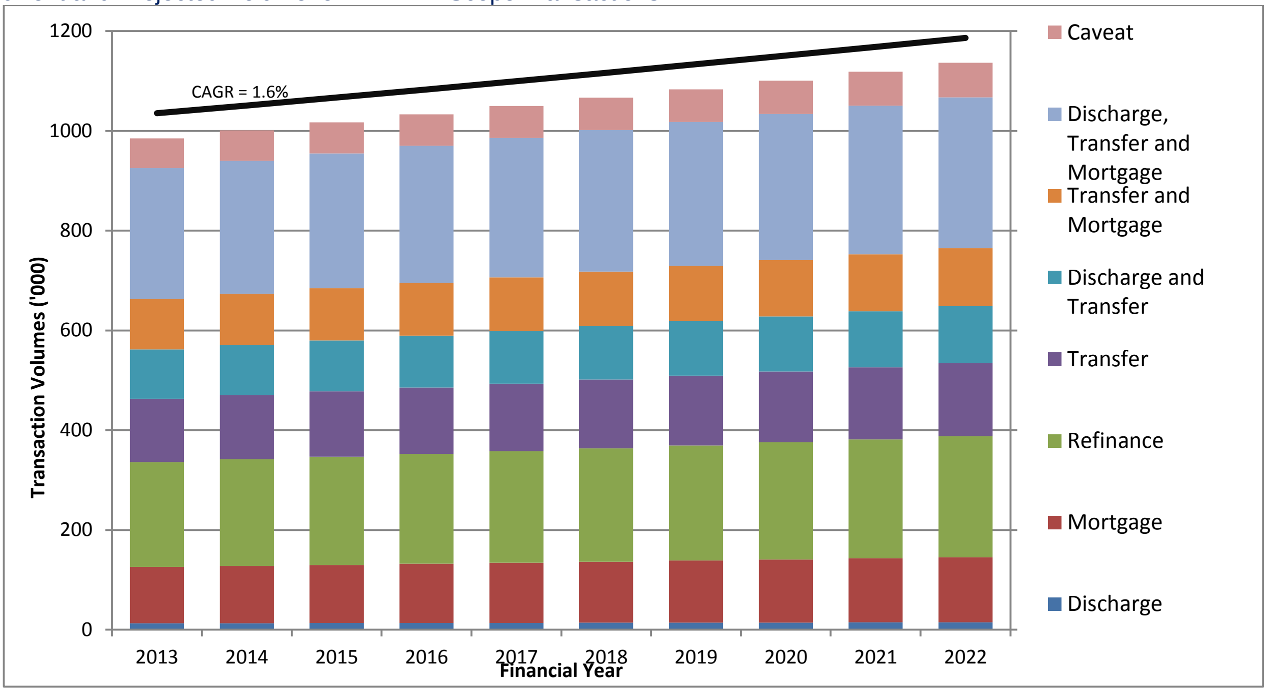
[4] PwC and Property Exchange Australia analysis for 2010 Business Plan

[5] Feedback from Major Banks and Practitioners to PEXA Ltd

[6] Prior to 3 March 2014 Property Exchange Australia Limited was known as National E-Conveyancing Development Limited (NECDL)

PEXA Ltd and its proprietary PEXA Platform will facilitate most property transactions through a network of Practitioners and Financial Institutions on behalf of vendors, purchasers and other market intermediaries. The PEXA Network will allow all participants in a property transaction to lodge and settle those transactions electronically, creating major process and time efficiencies.

Current and Projected Volume for PEXA In-Scope Transactions[7]



PEXA went live in June 2013 with Release 1 for mortgage discharges with Land Victoria and the Commonwealth Bank of Australia. Since then, the other three major banks, three second tier banks and the New South Wales and Queensland Land Registries have started transacting through PEXA, with Western Australia's Landgate scheduled to go live in June 2014.

PEXA Release 2 introduces the ability to complete transfers, caveats, notices, lodgement and Settlement online and will first launch in a limited capacity (caveats only) to existing subscribers of Victoria's ECV platform in June 2014. PEXA will launch its full functionality to Australia's property Practitioners in New South Wales and Victoria in late October 2014. Practitioners in Queensland, Western Australia, South Australia, Tasmania and the Northern Territory will join PEXA in 2015.

To enable e-Conveyancing, National Electronic Conveyancing Law has been passed in all states allowing digital signatures to be recorded on lodgement documents and real property to be electronically lodged and registered.

It is also noted, that the collection of stamp duty from property transactions is a major source of revenue and accounts for 27% of total state government taxes. Each year $12 billion of duty is collected by the states' respective State Revenue Offices (SROs) with the Financial Institution and purchaser's Practitioner leading the collection process. PEXA is working with the SRO in each jurisdiction to ensure that duty is properly calculated and collected before a title can be transferred.

[7] Source: ABS data December 2013 projected using PwC anticipated growth rate

1.4 Mortgage Processing and Registration

Mortgage processing is currently a manual paper based process. Each Financial Institution has their own set of unique but similar mortgage documentation which requires face-to-face verification of identity of a borrower and their wet signature to secure and discharge a mortgage.

As mentioned previously, the documents to lodge and register the Financial Institution's interests on title are also paper based and vary by jurisdiction. The Financial Institutions must also hold a duplicate Certificate of Title with the mortgage documents as evidence of security and right to deal on title (except QLD and Northern Territory where only the mortgage documents are held). This set of documents (or packets) is typically stored at a highly secure 3rd party document storage facility (e.g. Iron Mountain) at significant cost to store and retrieve when required.

The Financial Institutions and particularly the Major Banks have nationalised and automated the mortgage process, however, due to inherent requirements of the paper process, variability across jurisdictions, and the lack of protocols between banks, the process is relatively long, inefficient and costly. The extended time and inefficiency effects the ease of which customers can switch lenders to refinance a mortgage. The current paper process takes several weeks and creates the opportunity for paper documents to be lost or incorrectly completed, causing switching barriers, delays, and significant customer angst.

2. Future State

2.1 Land Registries

By end of 2015, all state LTOs (except ACT) will all be integrated in real time to PEXA and have completed systems upgrades that allow the electronic lodgement, verification and registration of changes in interests on title.

All states will introduce e-Titles over the next few years which eliminates the need of mortgagee (or purchaser for unencumbered property) to hold a duplicate paper copy as evidence as right to deal on title. In a move towards e-Titles, the LTOs are currently working on a plan with the major banks to "Bulk" convert existing paper certificates of title and is expected to be completed in the next 18 months.

The most efficient way to deliver Land Registry services is to combine the existing eight state and territory registries into a single national database. Significant economies of scale can be captured through building and operating a single world class registry system rather than eight separate systems costing an estimated $20m-$50m each to build. Annual savings are estimated at $121m[8] nationally from reduced overhead and IT costs, and process improvement. The Registry database could be operated under a Business Process Outsourcing (BPO) commercial arrangement, while land administration and regulatory functions would remain the responsibility of each jurisdiction.

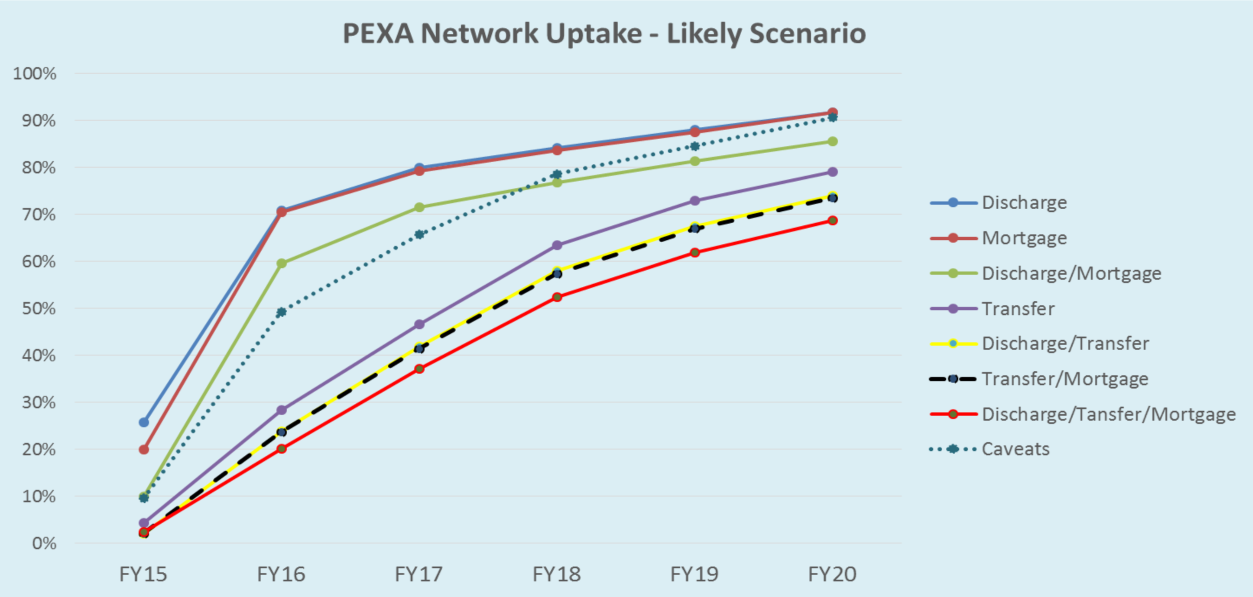
With a single national Land Registry, the next step would be the introduction of a national standard e-Title and associated conveyancing instruments to capture further efficiencies from simplifying the process.

2.1 Land Conveyancing

With the introduction of e-Conveyancing, PEXA Ltd expects that 80-90% of property conveyancing transactions will be electronically lodged and registered by June 2020. PEXA avoids the current need for each conveyancing participant to re-key data, and attend a manual Settlement to exchange paper

[8] PwC and Property Exchange Australia analysis 2013

documents and associated funds, typically in the form of bank cheques. The PEXA Platform will effectively become an essential piece of national infrastructure, relied upon in a similar manner as the Australian Securities Exchange (ASX) CHESS platform, delivering expected annual savings to the real property conveyancing industry of between $220m - $248m[9].



To remain competitive, the Practitioners and Banks will need to pass savings onto customers. It is therefore expected that the conveyancing costs associated with buying or selling a property will reduce by $120 to $150 per transaction based on direct reductions in disbursements and the increased efficiency of service provision.

As part of PEXA Release 2 in October 2014, PEXA has developed an electronic Settlement solution in partnership with the RBA using their COIN network and ESA accounts, enabling electronic financial settlement of the majority of property transfers. This service eliminates the need for bank cheques and allows funds to be deposited in the vendor representative's account within 15 minutes of settlement in the majority of cases (Tier two financial institutes will settle the following day).

With the introduction of PEXA, the time between lodgement and registration of interest on title is almost immediate, with a real time connection between the LTO, PEXA and the Banks. The current operating model of Land Registries see registration occurring often days after documents lodged with the respective LTOs. Participants currently behave as though registration occurs at time of settlement and keys are exchanged, however, legal ownership is not transferred until registered on title.

e-Conveyancing represents the beginning of a large reform agenda. Land Registries will develop new innovative products and services via digital connection to customers. Land Registries will provide more value to business users and the public through: Information services; Fraud detection; Alerts; Other value added services.

Land Registries are likely to follow the global trend for private information held on public record to become free to the individual relating to the record. The prevailing view is that the public has a right to access information relating to themselves to ensure its accuracy and integrity, for example ownership details on Certificate of Title. Land Registries will have to adjust their fee structures on other value-add services to maintain income.

[9] PwC and Property Exchange Australia analysis for 2010 Business Plan

2.2 Mortgage Processing and Registration

The Major Banks are working on projects to allow electronic settlement of funds for PEXA Release 2. They also have projects planned over the next few years to integrate their core mortgage and customer management systems with PEXA to eliminate re-keying of data and maintain view of customer.

This is a vital step which will see the development of a national paperless e-Mortgage process using digital VOI. This is where a mortgage can be established or discharged without need for face-to-face VOI, wet signatures and the requirement to store paper documents.

As a move towards e-Mortgages, the Major Banks are currently working with PEXA on the introduction of a national electronic standard mortgage discharge authority form and response protocols. Currently each Financial Institution has their own paper form requiring wet signature from a customer to discharge an existing mortgage. The Financial Institutions also try to delay the process and "game play" to make it difficult for customers to refinance with another lender. At the end of the day, this is a zero sum game, where banks are on both sides of this behaviour, so a pragmatic approach is likely to develop which significantly improves the customer experience and ease to refinance.

The technology and sufficient third party databases are currently available to cross reference the vast majority of the working population's identity without face-to-face contact. Online links can be established into a multitude of agencies, for examples: Drivers Licence; Births, Death & Marriages; ATO; Medicare; Social Security; utilities; and credit bureaus. In built cameras in most devices and technology are also available to take a facial scan and compare to photo on Passport or Drivers Licence databases. Once identity is established, all other parties in the transaction should be able to rely on the "single source" VOI to the extent they wish, given their risk appetites.

In the future electronic environment, mortgages will become transportable between lenders with nationally agreed standard terms and conditions. All borrowers will be subject to the same general terms and conditions, with variable financial components such as; loan amount and term, interest rate, fixed or variable etc. The LTOs could hold a generic contract, and the mortgagee and customised terms recorded with the specific title. The customer need only agree to new financial terms when refinancing with details modified on title.

3. Implications for Stakeholders

3.1 Implications for Land Registries

More investment required in Land Registry systems: Land Registries will be the digital custodian and single source of truth on real property ownership and interests and a critical part of the financial services infrastructure in Australia, requiring world class security, disaster recovery and response times. Currently most Land Registries experience regular systems downtime which has no significant customer impact in the current paper process, however this will potentially stop transactions completing in the e-Conveyancing process. Given the importance of real property to the Australian economy and for most people, the family home remains the most valuable asset they ever own, confidence in the security, integrity and efficiency of the land conveyancing and registering system is paramount. Systems response times, security and reliability needs to be consistent with other financial infrastructure systems such as the ASX.

LTOs will be required to provide a different class of service. Analogous to the replacement of passbooks with internet banking and subsequent changes in customer expectations, the LTOs have to ensure their systems, support and infrastructure can accommodate the changing needs of customers.

Most LTOs need to replace or upgrade core systems to enable these changes at considerable cost.

Greater cooperation between jurisdictions: The LTOs need to work together to investigate the merits of creating a single national Land Registry and standardising e-Titles and conveyancing instruments, e-Mortgages and mortgage documentation.

To protect interests on title from fraud or other error, an appropriate liability insurance scheme needs to be established which is nationally consistent (e.g. premium based national standard supported by Torrens Assurance Fund in each jurisdiction)

Land Registry Fee review: Title searches generate an estimated $180m per annum nationally for LTOs and ultimately, State Treasuries, so any move to make title searches free will require increased charges on other LTO services to maintain revenue base.

ACT needs to commit to e-Conveyancing: to enable a truly national harmonised and efficient system for participants, particularly Financial Institutions operating nationally.

3.2 Implications for State Governments

Reduced tax revenue leakage: PEXA Release 2 will assist the SRO's current program to streamline collection of stamp duty and minimise the variability in process through automated calculation and payment and as a part of a Transfer Settlement. This will create value for the SROs through the reduction of tax revenue 'leakage'.

More investment required in Land Registry systems: State Governments need budget to invest in Land Registry infrastructure and technology and potentially cooperate to build single national land registry database. Federal Treasury may need to assist to enable optimal national outcome.

To create the optimal national efficiency for all participants and maximise value for the states, a new initiative to COAG (or similar body) should be established to ensure appropriate cooperation between the states

Defer any potential sale of Land Registries: The optimal delivery service model of a single national Land Registry may be jeopardised by the privatisation of one or more Land Registries. Lack of funds has seen increased pressure on State Governments to monetise non-core government assets. The NSW Government recently flagged the sale of their LTO, WA Government commercialised Landgate and other states are also considering sales. All states should defer any sale until e-Conveyancing is widely adopted and the potential merger of registries into a single database is fully explored. Value is likely to significantly increase when efficiency gains are captured.

Establish a standardised VOI procedure: Critical to the establishment of e-Mortgages will be a viable standardised VOI procedure being used by all sectors, for all transactions across paper & electronic transactions. Lawyers and Conveyancers in particular are concerned around their liabilities given no paper title to verify holder of title. State Government cooperation and legislation will be required to enable this.

3.3 Implications for Financial Institutions

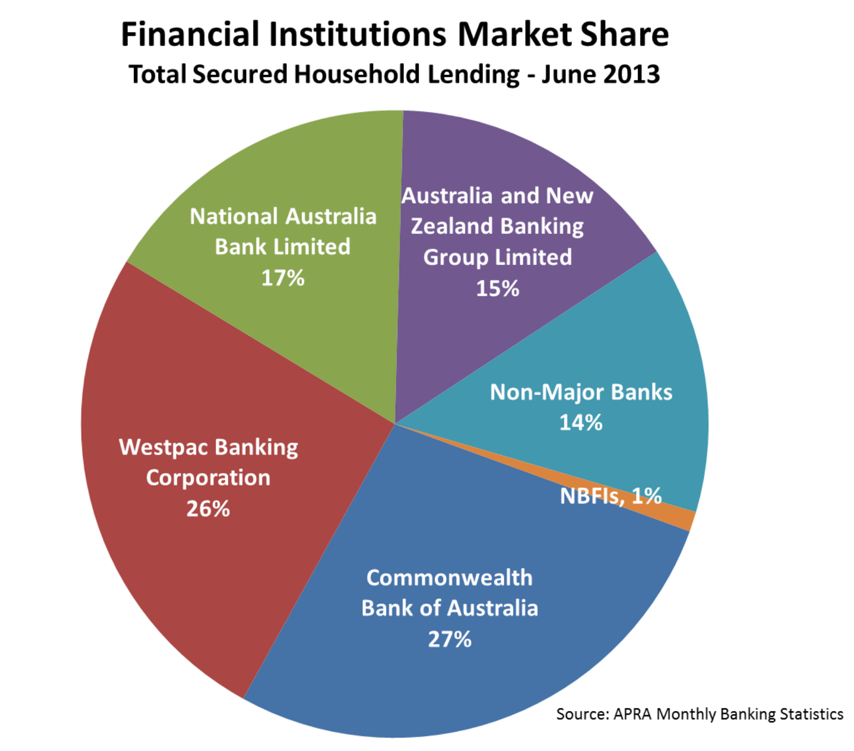
All Financial Institutions need to adopt e-Conveyancing to capture benefits: Major Banks will only capture efficiency benefits from e-Conveyancing if all Financial Institutions use PEXA. If any participant in a multi-party transaction is not using PEXA, the transaction will have to be completed using the current paper based process. The Major Banks also recognise the transition period from paper to e-Conveyancing is a costly and complex issue, both in managing dual processes, and the likely significant increase in cost of processing paper transactions as volume falls and scale economies diminish. It is therefore in everyone's interest to transition quickly to paperless process.

It must be noted, that the Major Banks have been very supportive and actively encouraging cooperation and use by all Financial Institutions, as they do not view e-Conveyancing as a competitive issue and understanding it is mutually beneficial to all participants.

The Major Banks and Australian Bankers Association need to continue to drive change and coordinate the states into evaluating a national standardised Land Registry with harmonised processes.

Greater reliance on Land Registries: Financial Institutions will have a much greater reliance on the Land Registries in the future. The Land Registries will be the single source of truth for the mortgagee's interests on title and with real time connection via PEXA, their reliance on Land Registries systems to be reliable is critical to ensure settlements proceed with no adverse impact to customers.

Reduced barriers for Non-majors: Currently the Major Banks control 85% of the secured household lending market, however, with reduced barriers and adoption of new technologies, the smaller lenders will be able to compete more aggressively with the major banks and capture a greater share of the market.



Smaller Banks and Non-Bank Financial Institutions (NBFIs) see e-Conveyancing, standardised mortgage discharge authorities and e-Mortgages, with the appropriate protocols agreed, as solutions to reduce the barriers to lending and increase competition for mortgages. Electronic forms and appropriate protocols eliminate current problems with lost or incorrectly filled forms, and other delays and "game play" used by incumbent mortgagees to restrict customers refinancing their loans. As part of PEXA's e-Conveyancing solution, Financial Institution's will be monitored and measured against agreed protocols such as response and completion times which will make the process more transparent and make all users far more accountable for their actions.

Electronic solutions also reduce any scale cost advantages that the Major Banks have in processing mortgages and the introduction of electronic Mortgages with standardised terms and conditions will allow greater transportability of mortgages and further reduce switching barriers.

Electronic Verification of Identity (VOI): Ultimately, there is no requirement for face-to-face VOI or paper documents, however, the potential for fraud must be appropriately balanced with efficient processes.

Elimination of Cheques: Electronic settlement moves another step closer to the elimination of cheques which is a significant cost to the financial services industry.

Elimination of paper storage: The costs and complexity of paper processing, storage and retrieval from 3rd party document storage facility will be eliminated with the introduction of e-Titles and e-Mortgages.

Significant improvement in securitising mortgage portfolios: The introduction of e-Mortgages will see fundamental changes to banking processes in regards to securitisation and electronic mortgage transportability. The move to standard mortgage contract terms and instruments which are electronically registered on title will allow greater ease for Financial Institutions to package and securitise portfolios. The requirement to physically remove from storage and review and audit mortgage documentation will be eliminated.

3.4 Implications for the General Public

Cheaper and quicker property transactions: The conveyancing cost associated with buying or selling a property is expected to reduce by $120 to $150[10] per transaction. Technology and lower barriers creating competition between lenders and practitioners will drive cheaper and quicker property transactions.

For unencumbered property purchases with available funds, a property could be purchased and settled within days rather than months, while standardised discharge authorities with appropriate protocols and transferrable e-Mortgages would also allow refinances to be completed in days rather than weeks as currently. Refinancing will be considerably easier and rates likely to be more competitive from smaller Financial Institutions.

Cleared funds available within 15 minutes of property settlement: Rather than waiting 4 business days for a bank cheque to clear, funds will be available within 15 minutes of property settlement in the majority of cases (Tier two financial institutes will settle the following day).

Better customer experience: e-Conveyancing will also significantly reduce the occurrence of failed settlements that currently impact some purchasers. Purchasers will also be able to track their property and mortgage transaction online using an app that PEXA is developing, which will significantly reduce anxiety and improve the customer property purchasing experience.

[10] PEXA estimates based on industry cost structures