

Property Settlement in RITS

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Abstract

Property transactions are among the largest and most significant financial undertakings that many Australians enter into. As with other aspects of Australia's economy, innovation and technological change have led to the introduction of electronic solutions for property conveyancing, replacing the traditional paper-based process. To support the shift to electronic conveyancing, in 2014 the Reserve Bank of Australia introduced new functionality in the Reserve Bank Information and Transfer System to enable near real-time settlement of interbank obligations relating to property transactions. This functionality minimises settlement risk for the transfer of property ownership, while also ensuring that the property settlement process remains secure, reliable and efficient.

Introduction

The Reserve Bank of Australia (RBA) owns and operates the Reserve Bank Information and Transfer System (RITS), Australia's interbank settlement system. All non-cash payments in Australia that involve a transfer of funds between banks and other payments service providers are ultimately settled in RITS. This occurs through the debiting and crediting of RITS members' Exchange Settlement Accounts (ESAs) at the RBA. High-value transactions, such as wholesale debt securities transactions, interbank borrowing and lending, and the Australian dollar

leg of foreign exchange transactions, are settled finally and irrevocably in RITS on a payment-by-payment basis. RITS also includes the Fast Settlement Service, which extends real-time settlement to a broad range of retail payments processed through the New Payments Platform. Some other lower-value transactions, such as the cash leg of share market transactions, card payments and pay-anyone bank transfers, are settled periodically throughout the day in batches in RITS.

In 2014, the RBA introduced new RITS functionality to support the near real-time settlement of property transactions. This allows for ESA funds to be 'reserved' for the transaction while the property title transfer is lodged with the relevant state or territory land registry office. Lodgement is then immediately followed by financial settlement, thereby minimising settlement risk. This article describes electronic property conveyancing (e-conveyancing) and how RITS supports this process in Australia. It also analyses property settlement activity in RITS and discusses future developments in e-conveyancing.

The development of e-conveyancing in Australia

Property conveyancing covers a range of property-related transaction types. The 2 most common types are property sales, where ownership of a property transfers from a seller to a buyer, and refinancing transactions, where a borrower chooses to change loan provider (or lender). Other transaction types include the lodgement of caveats, withdrawals, discharges and mortgages. Property transactions can involve a range of parties, including buyers, sellers, lawyers, conveyancers, financial institutions, as well as state- and territory-based land titles and revenue offices. The conveyancing process involves the preparation and exchange of contracts for the property transaction, followed by completion of financial settlement and change of title to deliver on the contract obligations. Historically, property transaction processing has involved time-consuming manual preparation of documents, in-person meetings and the need for coordination of the exchange of title and transfer documents with financial settlement involving the physical exchange of cheques.

Recognising the potential efficiency benefits of an electronic lodgement and settlement system, in 2008 the Council of Australian Governments introduced e-conveyancing as part of the Seamless National Economy deregulation priorities (Prime Minister of Australia 2008). This ultimately led to the creation of National E-Conveyancing Development Ltd (NECDL) in 2010, to develop a national e-conveyancing system.^[1] In 2011, the Australian

Registrars' National Electronic Conveyancing Council (ARNECC) was formed under the Intergovernmental Agreement for an Electronic Conveyancing National Law, to coordinate a national legal and regulatory framework for e-conveyancing operators (ARNECC 2020a). ARNECC also assesses network operators, formally known as Electronic Lodgement Network Operators, ahead of the operators being approved by each registrar to operate in a particular state or territory.

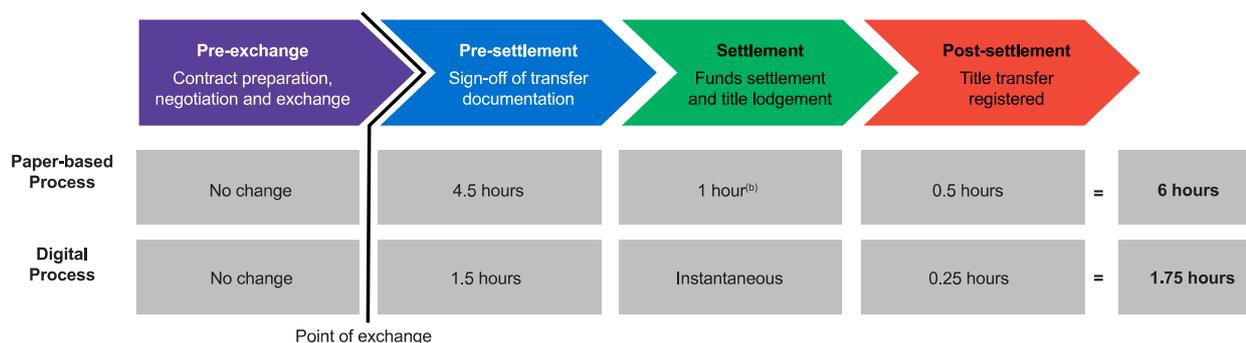
In 2014, NECDL rebranded as Property Exchange Australia Ltd (PEXA), and became the first network operator to provide a digital platform for settlement and lodgement of conveyancing transactions. In 2018, Sympli Australia Pty Ltd (Sympli), a collaboration between InfoTrack and ASX Limited, was assessed by ARNECC and approved as a network operator in some jurisdictions. Sympli is currently undertaking a soft launch in New South Wales, Queensland and South Australia (Sympli 2020). In the future, other entities may also be approved by ARNECC to provide e-conveyancing services.

Benefits of e-conveyancing

The steps in the e-conveyancing process are similar to the traditional paper-based process, but with all key settlement processing occurring electronically in the network operator's system. This makes the settlement of property transactions faster and more efficient as it avoids, for example, preparation and exchange of manual paperwork, in-person meetings and the need to issue and redeem cheques for settlement. However, there is now some additional time spent on pre-settlement data verification processes, which, in addition to the use of data sharing, minimises the risk of failed or delayed settlements. This provides greater certainty around the date of settlement, while having the documentation accessible electronically to all parties also provides greater transparency. Completion of the process digitally, after the exchange of a contract, has been estimated to take around one-third of the time spent on a standard paper-based transaction (Figure 1).

There are also potentially significant cost savings for financial institutions, practitioners and consumers

Figure 1: Comparison of Time Spent on paper and Digital Settlements
Average time of the purchaser's lawyer or conveyancer^(a)



(a) The vendor's lawyer or conveyancer is estimated to save 3.25 hours by completing the digital process compared with a paper-based process

(b) The settlement time for the paper-based process is estimated to be 2 hours on average in regional areas

Source: KPMG (2018)

from the shift to e-conveyancing. The process eliminates the fees associated with the use of cheques, in addition to reduced travel, courier and administrative costs. One study has estimated that the industry would likely realise around \$89 million per annum in net benefits if all property transactions were settled digitally in New South Wales, Victoria, Queensland, Western Australia and South Australia in 2021/22, compared to if no property transactions were settled digitally (Deloitte Access Economics 2018). This study also recognised that there are significant costs to practitioners if they need to revert to the paper process, which may occur if at least one other party cannot use the network operator's system.

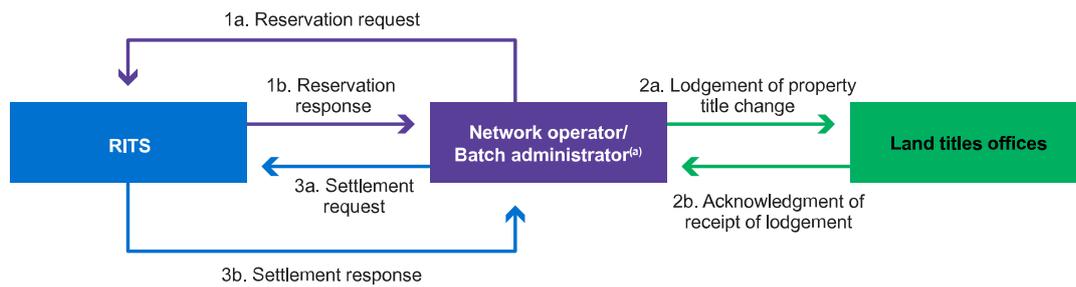
Property settlement in RITS

The functionality in RITS that enables near real-time settlement of interbank obligations relating to property transactions uses a 'reservation of funds' model. A key objective of this model is to integrate lodgement of the title transfer with the financial settlement process to get as close as possible to 'delivery-versus-payment'. Delivery-versus-payment is a settlement model whereby delivery of title occurs if and only if the corresponding payment also occurs. It is aimed at removing principal risk, which is the risk that a party to the settlement does not meet its settlement obligations; either the buyer provides funds but does not receive the title,

or the seller provides the title but does not receive funds.

Network operators connect to RITS via a 'batch administrator', which coordinates the cash leg of financial settlement. The arrangements can differ slightly between network operators; PEXA performs the role of both network operator and batch administrator, while Symplici connects to RITS via a separate batch administrator, ASX Financial Settlements Pty Ltd. The first step in the reservation of funds model is that the batch administrator sends a reservation request with the details of all interbank obligations related to a property transaction to RITS as a batch (Figure 2). If all banks that have paying positions in the settlement have sufficient funds in their ESAs, the funds required for the settlement are reserved within their ESAs. The seller does not have any rights to the funds while they are reserved and the funds can only be used to settle that particular property transaction. The network operator will then electronically lodge the property title transfer with the relevant land titles office. Once receipt of the lodgement is acknowledged, the batch administrator sends a settlement request to RITS. The settlement of funds happens immediately after this settlement request is received, using the funds that were reserved by the earlier reservation request.

Strictly speaking, this is not pure delivery-versus-payment, as lodgement of the title transfer is not the same as successful registration of the

Figure 2: Steps in the ‘Reservation of Funds’ Settlement Model

(a) The network operator can also perform the role of batch administrator, or can connect to RITS via a separate batch administrator

Source: RBA

lodgement. However, lodgement is only made when all documentation is ready and all checks have been performed, meaning that successful completion of title transfer is almost certain.

Batches in RITS

The reservation of funds model allows for simultaneous settlement of a group of payments that have been multilaterally netted externally to RITS, known as a ‘batch’. It is most common for a batch to represent a single property transaction, but it can represent multiple property transactions. Netting of payments might occur because a financial institution in the batch may have a number of roles in the property transaction, for example as both banker to the seller and banker to the buyer, in which case the obligations are netted to a single batch position. The batch administrator sends to RITS the net position (credit or debit) for each bank (or other financial institution) taking part in the property settlement.

Figure 3 shows how a stylised property transaction is converted to a batch for settlement in RITS. In this example, the buyer has funded their purchase using a mortgage with Bank A and savings contributed through their lawyer’s trust account with Bank B. A small part of the buyer’s funds may be used to pay fees such as stamp duty, land title office lodgement fees and council rates. In this example these fees are paid into the bank accounts of the revenue authority, the network operator and council, all held with Bank C. The rest of the funds are deposited into the account of the seller at Bank B. Both Bank B and

Bank C fulfil multiple roles in the batch and their activity is netted to one position each. The net value of each property batch is always zero, as all credits have a corresponding debit, and the total value of each batch is calculated as the absolute sum of debits and credits in the batch.

In 2020, around 6 per cent of PEXA property settlements had only one financial institution in the batch, i.e. the same financial institution was used by the buyer, seller and network operator, and therefore all payments in the property settlement schedule were netted into one zero-value position in the batch. The network operator still sends these batches with a net and total value of zero to RITS for settlement to avoid the need for separate legal rules and operational processes for the particular scenario where there is no interbank cash settlement.

Property settlement activity in RITS

The following analysis of property settlement activity focuses on the activity of PEXA, given the relatively recent launch and limited transactions of Sympli. Since the launch of property settlement in RITS in late 2014 there has been a strong shift to e-conveyancing, with more than 75 per cent of property transfers in Australia being settled electronically in November 2020 (PEXA 2020). Between December 2014 and December 2020, the value of financial institution cheques, which are typically used for relatively large purchases such as property transactions, declined by around 75 per cent (Graph 1).

Figure 3: Netting of Property Settlement Batches

Property Settlement Schedule			Batch in RITS		
Institution	Payment type	Value \$'000	Institution	Netting calculation \$'000	Net positions \$'000
Bank A	Buyer's mortgage	400 DR	Bank A		400 DR
Bank B	Buyer's equity	50 DR	Bank B	445-50	395 CR
Bank C	Stamp duty	3 CR	Bank C	3+1+1	5 CR
Bank C	Lodgement fee	1 CR	Batch net value		0
Bank C	Council rates	1 CR	Batch total value		800
Bank B	Seller's equity	445 CR			

Source: RBA

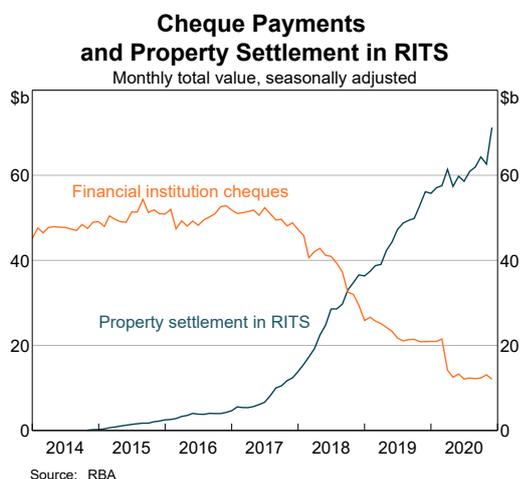
Growth in the number and value of property settlements in RITS was particularly strong from mid 2017 onwards, which coincides with the introduction of mandates to convert to e-conveyancing in New South Wales, Victoria and Western Australia. Since mid 2018, fewer new mandates for e-conveyancing have come into effect and the migration of property settlements to e-conveyancing platforms in most states now nears completion. Accordingly, growth in the number and value of property batches in RITS has moderated from the initial very high growth rates to around 25 per cent over the year to December 2020 (Graph 2).

Growth of property settlements in RITS has continued through 2020, despite the impact of the COVID-19 pandemic on housing market activity. A reduction in property settlements in March, due to the suspension of real estate auctions and open

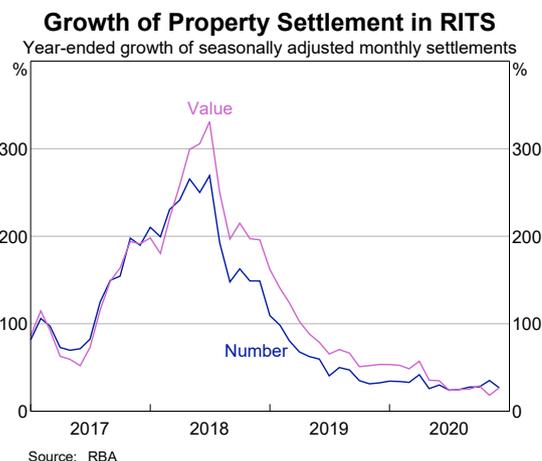
house inspections as the first lockdown started, appears to have been offset by pandemic restrictions accelerating the transition to e-conveyancing in some states. Since face-to-face settlement meetings were limited, some solicitors chose to move online to complete transactions. In addition, South Australia mandated e-conveyancing for most transaction types in August, resulting in the number of electronic transfers in the state in December 2020 growing to more than 4 times the number in December 2019 (Graph 3).

Patterns in settlement activity are not only driven by mandates for migration to e-conveyancing, but also seasonal patterns in housing market activity. Typically, a large spike in settlement value in December has been followed by a drop-off of up to 25 per cent of value settled in January. After factoring in the typical settlement period of between 30 to 90 days, this is consistent with strong

Graph 1



Graph 2



housing market activity in November followed by a slowdown over the Christmas period. A pick-up in activity is also observed before other national public holidays, such as the Easter long weekend, as well as towards the end of the financial year.

Value of property batches

In 2020, the median batch value was around \$640,000 (Graph 4). Due to batch netting effects and the range of transaction types that property batches represent, including mortgage refinancing, this is not a direct reflection of the median value of Australian property. The highest property batch value settled in RITS to date was over \$1 billion.

The average batch value has grown strongly over recent years, up from around \$660,000 in early 2018 to a peak of nearly \$1 million in late 2019. This

is consistent with a change in the composition of e-conveyancing settlements from predominantly residential transactions in the early years of operation, to a mix of residential and commercial transactions, as mandates for the electronic processing of commercial property transactions came into effect

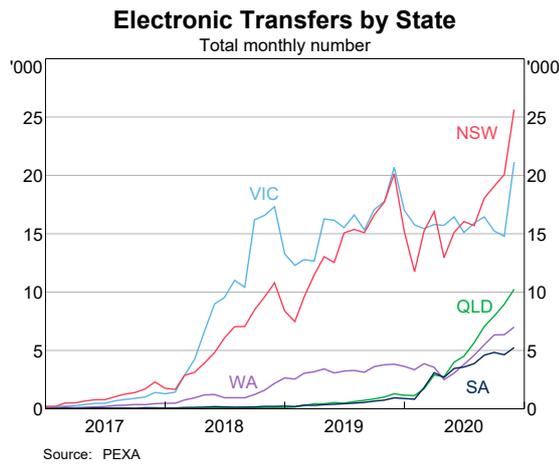
(Graph 5). A dip in the average batch value is noticeable during 2020, potentially reflecting a reduction in commercial property transactions and an increase in refinancing transactions during the pandemic, but has since returned to levels similar to late 2019.

Settlement patterns

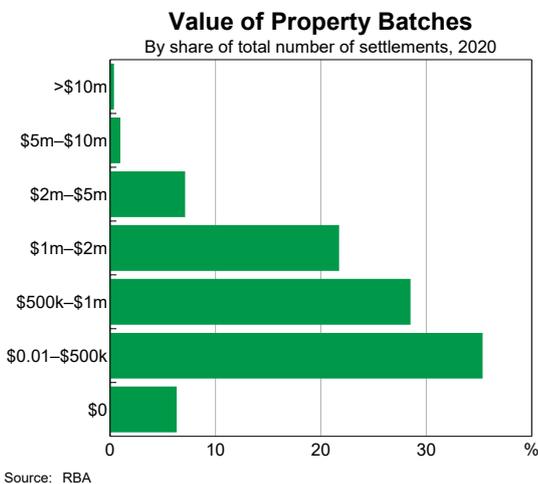
Property batches are able to settle in RITS during the period set aside for general daily processing, from 9.15 am to 6.30 pm AEST (or 8.30 pm AEDT). The distribution of settlements over the day has remained fairly consistent over the history of the property batch. The peak typically occurs between 2.00 pm and 3.00 pm, with this period accounting for around 30 per cent of daily settlements (Graph 6). There is a drop in the number of settlements between 1.00 pm and 2.00 pm, which may be due to solicitors and property conveyancers choosing to schedule settlements when they are available to monitor them and notify their clients on completion.

The profile of property settlements through the week shows a strong peak on Fridays, which accounts for around one-quarter of the number

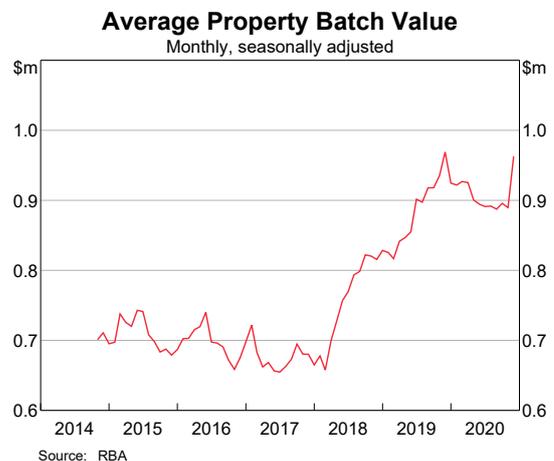
Graph 3



Graph 4



Graph 5



and value of all batches (Graph 7). In part, this could be driven by consumer behaviour, with some property purchasers aiming to finalise settlement towards the end of the week in order to pick up keys and move in over the weekend.

Liquidity management

The RBA monitors settlement of property batches in RITS to ensure that the system is operating efficiently and not introducing risks to other settlements in RITS. If liquidity is reserved for property settlements for long periods, this could potentially delay settlement of other transactions in RITS and might also be relevant for the RBA's open market operations, which are used to manage the total amount of liquidity in the system. While liquidity concerns have not been an issue recently,

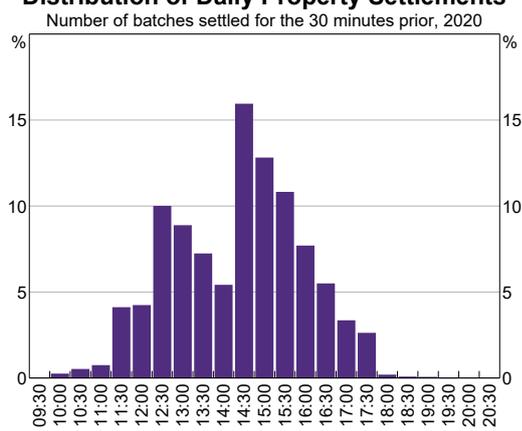
as ESA balances have risen to record levels during the COVID-19 pandemic, this is something that the RBA will continue to monitor as patterns in system liquidity evolve.

To mitigate potential liquidity risks, ESA holders need to ensure that adequate funds are available for both the expected property batches and other RITS settlements. To assist ESA holders in managing their funds, the network operators provide them with access to reports on each day's expected settlements. In most cases, settlement values and times are known well in advance, but late changes can occur, requiring monitoring and adjustment of funding needs. The network operators also aim to minimise the amount of time that funds are reserved by only sending the reservation request when all documentation is ready for settlement, and by monitoring for delays in lodgement. The network operator will cancel the settlement if there is a problem that is preventing timely completion.

An analysis of the reservation times in RITS suggests that the system has generally run smoothly and liquidity risks have been well managed. The average reservation duration in 2020 was around 6½ minutes, and less than 1 per cent of transactions had a reservation duration over 15 minutes (Graph 8, top panel). In addition, the time that funds were in reservation was not impacted by the value of the batch, with less than 1 per cent of PEXA batch value tied up in reservation for longer than 15 minutes (Graph 8, bottom panel).

Graph 6

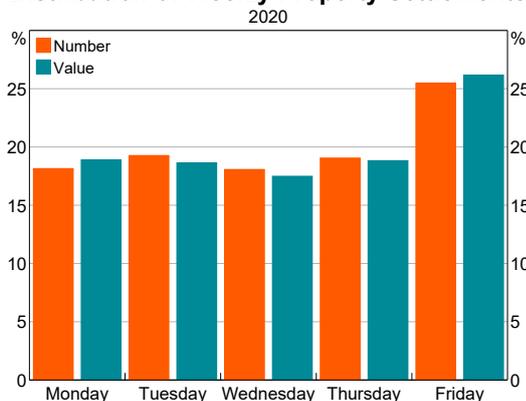
Distribution of Daily Property Settlements



Source: RBA

Graph 7

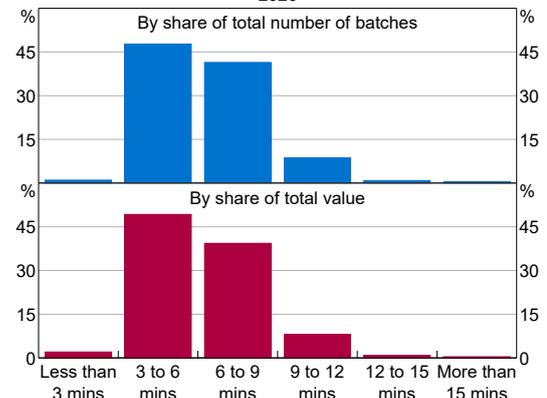
Distribution of Weekly Property Settlements



Source: RBA

Graph 8

Reservation Duration of Property Settlements



Source: RBA

Future developments

The Australian states and territories are likely to continue the transition to e-conveyancing and add to the list of transaction types that can be processed digitally. While New South Wales, Victoria and Western Australia have largely adopted e-conveyancing for all common property transaction types, mandates for settling property transactions electronically have only recently come into effect in South Australia, and Queensland is taking a more gradual approach. Electronic lodgements are expected to start in the Australian Capital Territory in 2021, with the Northern Territory and Tasmania expected to follow in subsequent years.

E-conveyancing markets, similar to payments systems, tend to exhibit network effects, as the value of a network operator's services provided to any one user increases as more solicitors/conveyancers and financial institutions use that service. This means that larger and more established network operators may have a competitive advantage over smaller new entrants, since their users can connect with a larger number of other users to complete transactions (IPART 2019). To facilitate competition, the states and territories have recently agreed to mandate interoperability between network operators in the Electronic Conveyancing National Law (ARNECC 2020b). Interoperability would enable a user (conveyancer,

lawyer or financial institution) to be a subscriber to one network operator and transact with a user of another network operator, without having to subscribe to both. In practice, this occurs by delegating one of the network operators to complete lodgement and settlement of the property transaction. Interoperability is expected to reduce the barriers for market entrants as it would become more viable for network operators with smaller user bases to compete.

Conclusion

Property transactions are significant financial undertakings for many Australians, and the systems and processes that have been developed for settlement reflect this importance. The conversion of paper-based processes into electronic methods is consistent with the digitalisation of the economy more generally, but through this transition the RBA has sought to ensure the security and reliability of the settlement process, while enabling improvements in efficiency and reduction in paper handling and manual processes. As systems and practices evolve, it will be important to ensure that the property settlement process remains secure, reliable and efficient, as well as being open to innovation and competition. ✎

Footnotes

[*] The authors are from the Payments Settlements Department. The authors would like to thank ASX Limited, Property Exchange Australia Ltd and Sympli Australia Pty Ltd for their contributions to this article.

[1] NECDL was established in January 2010 by the New South Wales, Victorian and Queensland governments, with the Western Australian Government, large Australian banks and other investment companies later joining as key shareholders (Council of Australian Governments 2011).

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