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Dear Sir/Madam

## Response to the Payment System Modernisation (Licensing: Defining Payment Functions) Consultation Paper

### 1 Executive Summary

The National Automotive Leasing and Salary Packaging Association (**NALSPA**) appreciates the opportunity to provide a submission to Treasury in response to the Payment System Modernisation (Licensing: Defining Payment Functions) Consultation Paper dated June 2023 (**Consultation Paper**).

Under the Consultation Paper, Treasury is proposing to create a list of seven payment functions that are intended to underpin a new licensing framework for payment service providers (**PSPs**). PSPs that undertake any activities falling under one of the seven payment functions will be subject to the new licensing framework (**Proposed Reforms**).

NALSPA believes that the broad definitions given to some of the payment functions may inadvertently capture the salary packaging industry, who are traditionally not viewed as PSPs and NALSPA believes are not the intended subject of the Proposed Reforms. NALSPA believes that the Proposed Reforms should not capture the salary packaging industry as:

- (a) the payment transactions that salary package providers engage in are administrative in nature and incidental to the main business of salary package providers;
- (b) the customer of salary packaging is the employer (rather than the employees) and therefore the risk of consumer detriment is low;
- (c) the salary package industry is tightly regulated under the *Fringe Benefits Tax Assessment Act 1966* (Cth) (**FBTA Act**) and the *Fair Work Act 2009* (Cth) (**FWA**);
- (d) the salary package industry has traditionally been excluded from other financial services regulatory regimes (including the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**), the licensing regime in the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**)) and therefore should be excluded in the Proposed Reforms to ensure regulatory consistency; and
- (e) additional regulatory burden would be deter new entrants into the salary packaging industry and may result in existing participants exiting the market.

In this response, NALSPA sets out its recommendations to Treasury, being to:

- (a) clarify the applicability of the frameworks and explicitly exclude the salary packaging industry from the Proposed Reforms;

- (b) apply the incidental product exemption to the Proposed Reforms; and
- (c) clarify how the Proposed Reforms will interact with existing framework for non-cash payment (NCP) facility providers under the Australian financial services licence (AFSL) regime.

## 2 About NALSPA

NALSPA is the peak industry body for the salary packaging and novated lease sector.

NALSPA's members help over 800,000 Australian employees utilise their pre-tax salary to package a number of different employment-related benefits. These services are predominantly provided across the Not-for-Profit, Health, Government and Corporate sectors. NALSPA members currently administer over 190,000 novated leases for Australian employees, driving significant economic value through the Australian economy.

One of the key employer-provided benefits that employees salary package under Australian taxation law is a motor vehicle via a novated lease arrangement.

With a novated lease, the costs associated with the finance and operation of a vehicle are packaged into a single, regular, fixed, payroll deduction, generally comprising a mix of pre-tax and post-tax dollars. Over the past two decades novated leasing has become a popular method for employees in the health, charitable, public and private sectors to cost effectively finance and operate a motor vehicle. NALSPA members currently administer around 425,000 vehicles, including over 190,000 employer-provided salary packaged vehicles.

Given the potential impact of the Proposed Reforms to the many employers across Australia who provide salary packaging benefits and their employees who utilise the benefits to procure and tax effectively operate a vehicle or to otherwise tax effectively maximise their post-taxation salaries, we have outlined our concerns and proposed solutions in this submission and we would welcome the opportunity to engage further with Treasury in relation to such matters.

## 3 What is salary packaging

Salary packaging services generally relate to an arrangement between an employer and an employee, whereby the employee requests their employer to apply part of their pre-tax salary to the payment of certain approved benefits on behalf of that employee. This is often done in the context of an employee seeking to maximise their entitlement to their salary packaging "cap". The salary packaging cap is the approved tax-free amount that employees who work in certain industries can package each year (being \$15,900 for employees of not-for-profit organisations and \$9,010 for hospital and healthcare employees). Given the taxation compliance associated with administering such arrangements, many employers chose to outsource this to a third-party salary packaging provider.

Under these arrangements, most importantly, salary packaging providers are considered to be providing these services to the employer, rather than the employee.<sup>1</sup> The salary packaging provider is contracted by the employer and acts as the agent of the employer in providing these services.

The employer is responsible for agreeing with their employee for an alteration of their remuneration package. Under this alteration, the employer will reduce the cash component of the employee's remuneration and then retain these funds (normally held in a segregated bank account) to cover the cost of providing the employee with the benefit. The employer will normally rely on the salary packaging provider to provide details of the cost or the value of the benefit that the employee has

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<sup>1</sup> Explanatory Statement, Amendment of the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)*, 2.

selected to include in their package. However, the responsibility to remunerate an employee in line with the agreed remuneration arrangements remains with the employer. This responsibility is never outsourced to the salary packaging provider.

In terms of the funds flow, the employer in effect purchases or arranges a benefit (such as a vehicle using a novated lease) using a salary packaging provider, and the employer then provides that benefit for the use of the employee through the salary packaging provider as part of their remuneration. Funds flow from the employer to a salary packaging provider either under a traditional invoicing structure, a secure file transfer or in some instances, using an API (or like technology) linked with the employer's accounting infrastructure.

Employer funds received by salary packaging providers are held in a variety of ways, depending on the provider and the employer. However, in all cases, funds received are treated as segregated monies for accounting purposes and are not comingled with the salary packaging provider's funds or otherwise recognised as an asset of the provider.

Importantly, until the funds are applied to a benefit on behalf of the employee, they remain the property of the employer and are considered to be unpaid salary and wages regulated under the FWA. The employer and the salary package provider must comply with the requirements of the FWA in ensuring the funds are paid in accordance with the requirements of the FWA.

## 4 Key impacts of Proposed Reforms on salary packaging

### 4.1 Proposed Reforms

The regime currently set out in the *Payment Systems (Regulation) Act 1998 (Cth) (PSRA)* will be expanded significantly to accommodate new technology in the changing payments landscape. The current law defines a payment system as “a funds transfer system that facilitates the circulation of money, and includes any instruments and procedures that relate to the system”. Treasury, in the PSRA, proposes that this be revised to focus on the concepts of “transfer of value” and “payments”. This is intended to bring within scope the full suite of arrangements involved in facilitating or enabling payments, including those that the current definition covers.

In addition, Treasury proposes that the definition of a “participant” be amended to be capable of being applied to all entities that play a role in the payments value chain, including entities that facilitate or enable payments. This extends to services such as digital wallets (including those storing digital representations of payment cards or other payment devices), certain closed loop payments providers, three party systems and cash in transit services.

Consistent with approaches taken in jurisdictions such as the UK, Singapore and Canada, the overarching principle is that the new licensing framework will regulate the broad and diverse population of PSPs involved in a payments value chain based on the specific payment function(s) that they perform.

The following are the payments functions that Treasury proposes to regulate (although the precise language to describe these functions will be refined as part of the legislative process).

- (a) Stored value facilities
  - (i) **Issuance of payment accounts or facilities:** Providers of payment accounts or facilities that store value for more than two business days and can be used for the purpose of making payments.
  - (ii) **Issuance of payment stablecoins:** Issuers of payment stablecoins that store value and control the total supply of payment stablecoins through issuance and redemption activities.

- (b) Payment facilitation services
- (i) **Issuance of payment instruments:** Issuers of a payment instrument that is unique to a customer and can be used to make a transaction or provide instructions on their account or facility.
  - (ii) **Payment initiation services:** Services that allow the instruction of a payment transaction at the request of the customer (payer or payee) with respect to a payment account or facility held at another PSP, or from some other source of value or a credit facility.
  - (iii) **Payment facilitation, authentication, authorisation and processing services:** Services that enable payment instructions to be transferred (facilitation), provide the verification of customer credentials (authentication), payment authorisation, and/or processing of payment instructions.
  - (iv) **Payments clearing and settlement services:** Services for clearing or settlement of payment obligations or for the exchange of payment messages for the purposes of clearing or settlement of payment obligations, including clearing and/or settling account to account payments.
  - (v) **Money transfer services:** Services that send or receive money overseas or within Australia for a customer, including through the creation of a payment account or without a payment account.

In addition, whilst some of the commonly used exemptions currently set out in class orders are likely to remain, there is a proposal for many others to be removed, such as exemptions for electronic funds transfers and payments debited to a credit facility.

#### 4.2 Potential applicability of proposed reform on salary packaging providers

Out of the seven proposed payment functions in the Consultation Paper, NALSPA is of the view that due to the broad language used to describe each function, salary packaging services may inadvertently be captured by four of the payment functions, being:

- (a) issuance of payment accounts or facilities ('traditional stored-value facilities' (**SVF**));
- (b) payment initiation services;
- (c) payment facilitation, authentication, authorisation and processing services; and
- (d) money transfer services.

We address each of these in turn below.

##### **Issuance of payment accounts of facilities**

In the Consultation Paper, "traditional SVFs" are defined as "*providers of payment accounts or facilities that store value for more than two business days and can be used for the purpose of making payments*".

As described in section 3 above, all funds received by salary packaging providers from an employer are treated as segregated monies for accounting purposes and remain the property of the employer until the funds are applied to a benefit provided to an employee. In the event that funds are held by the salary packaging provider for more than two days before they are applied to a benefit provided to an employee (for example, a delay of being able to give effect to a payment, or a time gap between the day salary deduction is transferred and the day of payment to third-party service providers), the salary packaging provider may incidentally be captured as an issuer of payment accounts or facilities.

It is NALSPA's express view that Treasury's intention is not to capture salary packaging providers as providers of traditional SVFs. The potential entities that Treasury indicated are traditional SVFs include ADIs, issuers of pre-paid accounts, entities currently regulated as purchased payment facilities and issuers of digital wallets that store value. The common feature of the above stated entities is that the customer intended for those entities to store funds on their behalf. In contrast, salary packaging providers may only store funds due to a practical reality (such as delays and gaps between payment due dates). They do not offer the storing of funds as a service. As such, a salary packaging provider should not and cannot be seen as issuing payment accounts or facilities.

### **Payment initiation services**

In the Consultation Paper, 'payment initiation services' are defined as "*services that allow the instruction of a payment transaction at the request of the customer (payer or payee) with respect to a payment account or facility held at another PSP, or from some other source of value or a credit facility.*"

In the salary packaging industry, it is not uncommon that the employer deposits an employee's packaged salary deductions to the salary packaging provider's account (which is segregated from the salary packaging provider's own moneys) and the employer then instructs the salary packaging provider to make regular recurring payments to a third-party service provider that provides services to the employee on the employee's behalf (such as for the payment of an employee's rent or mortgage, or for the payment of their novated lease). As such, the broad definition above suggests that salary packaging activities might be seen as a payment initiation service and therefore, subject to the Proposed Reforms.

However, it is NALSPA's view that it is not Treasury's intention to capture services such as salary packaging services, but rather to capture entities whose business function is to be a financial institution, such as direct debit providers. This is supported by the fact that Treasury identified that the potential entities captured under this category are "recurring payment services and third-party payment initiation services". This should only capture institutions that are directly facilitating recurring payment services and third-party payment initiation services. Salary packaging providers engage financial institutions to perform these recurring payment services and third-party payment initiation services. As such, a salary packaging provider's involvement is the intermediary between the employer and the financial institution that actually engages in the recurring payment and should not be captured under this category.

### **Payment facilitation**

In the Consultation Paper, 'payment facilitation services' are defined as "*Services that enable payment instructions to be transferred (facilitation), provide the verification of customer credentials (authentication), payment authorisation, and/or processing of payment instructions*". Examples provided in the Consultation Paper for these types of services are pass through digital wallet providers, merchant acquirers and payment gateways and processors.

Although the Consultation Paper suggests that Treasury's intention is to capture back-end payment facilitators that action payment instructions, the definition is broad enough to inadvertently capture salary packaging services. NALSPA is of the view that it is not Treasury's intention to capture salary packaging services as the definition refers to "enabling payment instructions to be transferred", which we would consider in this scenario to relate to the underlying financial institution that is directly actioning payment instructions made by salary packaging providers on behalf of their customers. The role of salary packaging providers is simply to give the instruction rather than actioning or carrying out the payment transfer. Thus, the activities of a salary packaging provider should definitely not be considered as providing payment facilitation services.



### Money transfer services

Under the Consultation Paper, ‘money transfer services’ are intended to capture services that send or receive money overseas or within Australia for a customer. As noted above, a salary package provider will, under the employer’s instruction, remit an employee’s packaged salary deductions to a third-party service provider. In addition to novated leasing arrangements, some salary packaging providers will also:

- remit an employee’s packaged salary deductions for other services such as payments to a mechanic for repair;
- use the salary package deductions to make repayments for the acquisition of a vehicle; or
- remit an employee’s lease payments in the event that their novated lease and salary packaging arrangements are terminated.

As such, a salary package provider may be seen as providing money transfer services under the regime.

However, the Consultation Paper states the intent of this payment function is to capture remittance service providers under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**). The Consultation Paper states that the definition of “designated remittance arrangement” under the AML/CTF Act is broader than the proposed “money transfer services”, and therefore it is not intended that all remittance providers under the AML/CTF Act will require licensing under the Proposed Reforms.

Under the AML/CTF Rules, “salary packaging administration services” are specifically exempt from being a “designated remittance arrangement”.<sup>2</sup> The Explanatory Memorandum for the AML/CTF Rules recognises that together with payment of wages and salaries, the remittance in a salary packaging arrangement is provided by a bank and the payment is a direct transfer from a payer to a payee.<sup>3</sup> The administrative roles of salary packaging providers, payroll companies and superannuation clearing houses, whilst technically caught under the definition of designated remittance arrangement, should not be considered one.<sup>4</sup> It is often the case that employers engage salary packaging providers, outsourced payroll companies and superannuation clearing houses for reasons of efficiency and convenience. These providers are non-financiers and therefore are not considered remittance service providers. NALSPA is of the view that since Treasury’s intention is to capture remittance service providers under the AML/CTF Act and salary packaging providers are not captured as remittance service providers, Treasury should explicitly exclude the activities of salary packaging providers from the definition of ‘money transfer services’.

#### 4.3 Potential impact of proposed reform on salary packaging providers

Given the unclear ambit to the current proposal in the Consultation Paper, salary packaging providers will need to consider whether they are captured under the Proposed Reforms. If captured, this will add additional regulatory burden on salary packaging providers, who have traditionally not been seen as financial services entities, as policy objectives have not been to regulate salary packaging.

Salary packaging providers have for several decades been engaged by employers to outsource the burden of salary packaging taxation compliance, which is a complex regime. Salary packaging providers provide services that are closely regulated under the FBTA Act. Salary packaging providers are engaged by the employer under direct contractual relationships with the employer, to act as the

<sup>2</sup> *AML/CTF Rules 2007* (Cth), Chapter 48.

<sup>3</sup> Explanatory Statement, *Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2021 (No.3)*, [13]

<sup>4</sup> Explanatory Statement, *Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2021 (No.3)*, [14]

employer's agent in administering salary packaging benefits to their employees. The application of the Proposed Reforms would create unnecessary regulatory burden on salary packaging providers given the existing regulatory framework and the current regulatory treatment of salary packaging in other legislation, as well as imposing further barriers to entry into the market (each of which are discussed in further detail in 5.1 below)

## 5 Recommendations

NALSPA makes the following recommendations in relation to the proposal in the Consultation Paper. NALSPA believes that by adopting these recommendations, the reforms will better achieve its six key objectives and allow NALSPA's members to better comply with the regulatory regime.

### 5.1 Clarifying the applicability of the framework

One of the key objectives of the proposed regulatory framework is "improving regulatory certainty for PSPs". As section 4.2 above demonstrated, the language in the Consultation Paper fails to do so for the salary packaging industry. The Consultation Paper, which appears to target other industry and PSPs, could be construed as applying the Proposed Reforms to salary packaging providers due to the broad definitions of payment function. We recommend that when Treasury releases draft legislation for consultation, it clarifies that services such as those specifically provided by salary packaging providers are not captured by the Proposed Reforms.

When doing so, we recommend Treasury consider the following features of the salary packaging sector and the services it provides:

- **remittance / payment transaction is incidental to the main business of the salary packaging industry:** as discussed further in section 5.2 below, the payment transactions that a salary packaging provider undertakes is incidental to their business and administrative in nature. By not explicitly excluding salary packaging activities from the list of payment functions, this will add unnecessary regulatory burden to the industry.
- **Salary packaging has a low-risk of consumer detriment:** another objective of the proposed payment licensing framework is to "balance protections for consumers and businesses with regulatory burden". As explained above, the customer of salary packaging is the employer (not the employee). We would consider most employers that offer salary packaging to be sophisticated businesses (or government entities) with less safeguarding and protection necessary from a regulatory framework. This view is consistent with other regulatory regimes. For instance, a novated lease, which is a common form of salary packaging instrument, is excluded from the licensing regime in the NCCPA.<sup>5</sup> Furthermore, salary packaging activities are already subject to the FBTA Act and the FWA, sufficiently protecting the customer of salary packaging business (being the employers). As such, NALSPA is of the view that there are sufficient protections already contained within the existing salary packaging regime given the low risk of retail consumer detriment associated with salary packaging and the high regulatory burden that comes with the licensing framework, it is unnecessary for the Proposed Reforms to apply to salary packaging providers.
- **consistency with existing regulatory approach:** one of the underlying principles when creating the list of payment functions is to ensure a harmonised regulatory approach. As discussed in section 4.2 above, the AML/CTF Act explicitly excludes salary packaging activities as designated remittance arrangements. Furthermore, as mentioned above, novated leases are also exempted from the licensing regime in the NCCPA. This shows that the regulatory approach has been not to regulate employment benefits as a credit or financial product, but

<sup>5</sup> National Credit Code, s 171(2).

rather regulate through the FBTA Act and the FWA. To ensure consistency across the regulations, Treasury should consider excluding salary packaging activities from the list of payment functions.

- **potential barrier to entry:** one of the objectives of the proposed payment licensing regime is to “promote greater competition, diversity and innovation within the ecosystem”. The unexpectedly broad application of the framework would mean that salary packaging providers would be required to demonstrate organisational competence and licensing experience from key personnel. This will have the effect of potentially prohibiting existing providers from continuing to operate their business if they do not have such experience, and also limit the ability for new players to enter the market.

## 5.2 Applying the incidental product exclusion to the proposed list of payment functions

As part of the consultation process, Treasury has sought feedback as to whether the ‘incidental exemption’ under section 763E of the *Corporations Act 2001* (Cth) (**Incidental Exemption**) should apply to the new licensing regime.

The Incidental Exemption provides licensing relief for products that are incidental components of a facility that does not have a financial product purpose, or a facility that is incidental to one or more other facilities that do not have a financial product purpose.

If NALSPA’s understanding of the Proposed Reforms as set out in this letter is not correct and it is the intention of Treasury to capture any person or entity involved in the payments chain, NALSPA is of the view that the Incidental Exemption should be extended to the Proposed Reforms. To remove such an exemption would have unintended consequences on a number of industries that rely on the exemption to operate their business, which the government would not typically seek to regulate (e.g., salary packaging, telecommunications, outsourced payroll and superannuation providers, charities and online retailers).

## 5.3 Licensing duplication

It is currently unclear from the Proposed Reforms how the licensing framework will interact with the existing framework for NCP facility providers under the AFSL regime. NALSPA is of the view that any legislative drafting should clarify the licensing position for persons or entities who engage in activities that constitute both a PSP and a NCP facility. This is crucial to ensure these entities have clarity on which licensing regime applies and where there is divergence in obligations under each regime, which obligations they are required to comply with.

## 6 Conclusion

It is NALSPA’s view that the activities of salary packaging providers should not be captured under the Proposed Reforms, nor is that the intention of such reforms. However, the definitions of some payment functions are drafted broadly and may capture activities of salary packaging providers.

If captured, this would result in additional regulatory burden on the salary packaging industry and may limit competition in the market. NALSPA believes it is not Treasury’s intention that the activities of salary packaging providers should be captured under the Proposed Reforms. NALSPA recommends that Treasury clarifies the applicability of the framework, includes the Incidental Exemption in the Proposed Reforms and clarifies the interactions between the Proposed Reforms and the existing AFSL regime for NCP facility providers.



Yours sincerely



**ROHAN MARTIN**  
Secretary and Director