TO Director | Payments Licensing Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email:
paymentslicensingconsultation@treasury.gov.au

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Dear Sir/Madam

Response to the Payment System Modernisation: Regulation of payment services providers Consultation Paper

1 Executive Summary

The National Automotive Leasing and Salary Packaging Association (**NALSPA**) appreciates the opportunity to provide a further submission to Treasury in response to the Payment System Modernisation (Regulation of Payment Services Providers) Consultation Paper dated December 2023 (**Second Consultation Paper**).

In June 2023, Treasury published the Payment System Modernisation (Licensing: Defining Payment Functions) Consultation Paper (**First Consultation Paper**), to which NALSPA provided a submission on 19 July 2023 (**NALSPA July Submission**).

Under the First Consultation Paper, Treasury proposed to create a list of seven payment functions that were 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**) to the extent they are not otherwise exempt. In the NALSPA July Submission, NALSPA submitted, among other things, that the Proposed Reforms should not capture the salary packaging industry and such services should in fact be explicitly excluded from the Proposed Reforms.

Under the Second Consultation Paper, Treasury has updated the list of functions underpinning the licensing framework for PSPs and provided additional clarification on all functions, including on the interactions between functions. However, at least three updated payment functions proposed continue to capture salary packaging services, which traditionally and for appropriate reasons are not viewed as PSPs. Treasury also indicates in section 3.2.8 of the Second Consultation Paper that it does not see sufficient grounds for a specific exemption to be granted to salary packaging.

Further to the matters raised in the NALSPA July Submission, NALSPA firmly believes that the Proposed Reforms should not capture the salary packaging industry as the Proposed Reforms would:

- create **significant** regulatory burden for the industry, which is disproportionate to the risks of the service being provided; and
- result in increased costs to employees.

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

- clarify the definition of stored-value facility (**SVF**), payment instruments, payment initiation services and payment technology and enablement services to provide certainty regarding whether salary packaging services are intended to be captured by these payment functions;
- retain the existing credit and single payee exemptions and expand the proposed limited network exemption; and
- reconsider whether to explicitly exclude the salary packaging industry from the Proposed Reforms given the low-risk nature of the service and the integral role it plays in employment arrangements across Australia.

2 Key impacts of Proposed Reforms on salary packaging

2.1 Updated payment functions

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 Second Consultation Paper updates the payment functions captured by Proposed Reforms and provides additional clarity on these functions.

The following are the payment functions that Treasury proposes to regulate:

(a) **Stored-value facilities**: providers of accounts or facilities that store funds and allow customers to direct the movement of these funds for the purposes of paying for goods or services, transferring to another person, or withdrawing the funds;

(b) **Issuance of payment stablecoins**: issuers of payment stablecoins that store value and control the total supply of payment stablecoins through issuance and redemption activities;

(c) **Payment instruments**: issuers of a personalised or individualised set of procedures that allows a payer to instruct an entity with which its funds are held to initiate a transfer of funds to a payee;

(d) **Payment initiation services**: service providers that initiate payments from a payer to a payee, at the request of a customer. The entity initiating a payment is a third party to the payment account where the payer's funds are held;

(e) **Payment facilitation services**: service providers that enter into the possession of funds for the purpose of facilitating a transfer between a payer and payee, including for the purpose of acquiring, disbursing, or otherwise transferring of funds within Australia;

(f) **Payment technology and enablement services**: service providers that enable a transfer of funds to occur but do not enter into possession or control of the funds; and

(g) **Cross-border Transfer services**: service providers that transfer or enable the transfer of funds from Australia to a payee outside of Australia, and/or of funds from outside of Australia to a payee in Australia.

2.2 Potential applicability of proposed reform on salary packaging providers

NALSPA welcomes the additional clarification and updates provided to the payment functions in the Second Consultation Paper, which excludes salary packaging services from most payment functions.

In particular, NALSPA is of the view that salary packaging services are not captured by the new categories of payment technology and enablement services and cross-border transfer services. However, it is our conclusion that salary packaging services are still captured by at least three payment functions, being payment facilitation services, payment instrument and payment initiation services. NALSPA is also of the view that the definition of SVFs in the Second Consultation Paper should be further refined and clarified to ensure that salary packaging services are not unintentionally captured.

We address each of the relevant updated payment functions in the Second Consultation Paper in turn below.

SVFs

In the Second Consultation Paper, Treasury proposes to use a "principles-based distinction" to delineate between SVFs and other payment functions. The following characteristics are proposed for describing SVFs:

- involves funds loaded onto an account or facility;
- customers are able to direct the movement of these funds, for the purposes of paying for goods or services, transferring to another person, or withdrawing the funds; and
- includes funds stored on online accounts, or on a physical or virtual device or card.

Whilst the Second Consultation Paper indicates that the SVF function does not intend to capture the holding of funds for a short period of time for the purpose of facilitating a payment, the proposed characteristics do not unequivocally reflect this intention and rule out storing funds in transit as an SVF.

For instance, in a salary packaging context, funds are generally received by salary packaging providers from an employer and are held by the provider (i.e. "loaded onto an account or facility"). The employer or the employee (depending on the particular salary packaging arrangement being provided) would have been able to direct the movement of these funds for the purpose of paying for goods or services. As such, a salary packaging provider may incidentally be captured as a provider of SVF under the proposed characteristics.

To better distinguish SVFs from payment facilitation services, NALSPA submits that the current characteristics are ambiguous as to whether it is Treasury's intention to only capture facilities where instructions to direct funds are given after those funds are loaded into the account or facility, or whether the intention is also to capture facilities where instructions are received prior to the receipt of funds. We recommend Treasury clarifies its intention with this characteristic as this will help clarify the distinction between payment facilitation and SVFs. If, as we understand the intention, it is not intended to include facilities where the instructions are provided in advance, it will be important to clarify that:

- **further instructions:** the provision of further instructions after receipt of funds (for example to clarify or amend the initial instructions) do not convert the facility to being a SVF – this type of additional direction could occur at any time and for a variety of reasons, and should not convert the nature of the facility; and
- **no onward payment instruction or transaction associated with the funds held**: NALSPA supports Treasury's suggestion in the Second Consultation Paper of including "funds that are stored without an onward payment instruction or transaction associated with the funds held" as an additional characteristic of SVFs. It is NALSPA's submission that this additional characteristic will assist delineating payment facilitation services from SVFs. NALSPA submits that it should be clear that an onward payment instruction includes where a client amends a payment instruction, meaning that as long as there is a payment instruction associated with the funds before the funds are loaded onto an account or facility (e.g. through a lease arrangement or a contract providing an advance explicit direction for the disbursement of any funds received), the facility should not be treated as an SVF, even if at a later point in time, the customer changes or withdraws the initial payment instruction.

Payment instruments

The Second Consultation Paper has modified the definition of payment instruments to "a personalised or individualised set of procedures that allows a payer to instruct the entity with which its funds are held to initiate a transfer of funds to a payee". The examples provided in both the First Consultation Paper and Second Consultation Paper clearly indicate that this payment function intends to capture issuers of cheques, debit cards, credit cards, Buy Now Pay Later cards and virtual payment instruments.

NALSPA acknowledges that cards which salary packaging providers may arrange for their customers (e.g. fuel cards, charging cards and wallets) are likely to be considered payment instrument. These cards are already considered non-cash payment facilities and members arranging such services are either appropriately licensed, authorised or reliant on existing exemptions (see sections 2.3 and 2.5 below regarding NALSPA's views on Treasury's proposed amendments to exemptions to allow salary packaging to providers to continue to arrange fuel cards in this manner).

Other activities that salary packaging providers undertake do not specifically appear to be activities intended to be captured by this payment function. However, NALSPA submits that the phrase "personalised or individualised set of procedures" is too broad and may inadvertently capture pre-purchased services that salary packaging providers offer to their customers. An example of these pre-purchased services is the issuing of personalised quotes for maintenance or repairs, where the quotes are often pre-approved and the salary packaging provider is later instructed to pay the costs of the maintenance or repairs with the salary packaged deductions that are held by the salary packaging provider.

It is clear that these pre-purchased services are not in the same nature whatsoever as the activities that Treasury is rightly intending to capture, such as issuing a credit card or cheque, but can fall under the proposed definition of payment instruments. NALSPA submits that this definition should be narrowed and clarified so that it specifically does not capture these pre-purchased services.

Payment initiation services

NALSPA welcomes the clarification provided for payment initiation service, which is now proposed to be defined as:

> *"the initiation of payments for a payer to a payee by a third-party entity, at the request of a customer.* ***The entity initiating a payment is a third party to the payment account where the payer's funds are held****" (emphasis added).*

The additional requirement that the person providing a payment initiation service be a third party to the payment account where the payer's funds are held means that salary packaging providers would no longer be providing such payment function where funds are held in, and paid from, an account operated by the salary package provider.

However, NALSPA notes that in a number of instances, salary packaging providers are authorised to transact on accounts that are in the name of the employer. However, often the payments made by salary packaging providers from those accounts are restricted to being made exclusively to the provider itself rather than directly to a lessor or other provider of the services being packaged. In those scenarios, NALSPA acknowledges that the salary packaging providers could be providing payment initiation services. Nonetheless, such arrangement is likely to fall under the existing single payee exemption under s 763D(2). As discussed below in section 2.5, NALSPA supports the retention of such exemption and/or proposes the expansion of the limited network exemption to cover payment initiation services. This sort of arrangement is directly analogous to the situation of a retailer (e.g. a telecommunications or energy company) who holds a direct debit authorisation to debit the customer's bank account for monthly bills. Including these kinds of arrangements would extend the legislation to a range of unintended situations. Alternatively, it could be clarified that it is not a payment initiation service when the entity initiating the payment initiates the payment to itself.

Payment facilitation

In the Second Consultation Paper, Treasury proposes "Payment Facilitation Services" to mean "*services that enter into the possession of funds for the purpose of facilitating a transfer between a payer or payee … This includes through accounts held at other financial institutions or service providers but controlled by the PSP*". NALSPA is of the view that this definition appears likely to capture salary package service providers.

Treasury indicated in the Second Consultation Paper that the purpose of introducing Payment Facilitation Services as a payment function is to address the "operational risks" and "financial risks" that these service providers pose, including loss of customer funds, loss of data, or failed payment transactions. However, it is NALSPA's submission that the funds held by salary packaging providers are already sufficiently protected against these risks in the following ways:

- the funds are all held in accounts with registered ADIs;
- the funds are considered salary and wages under the *Fair Work Act 2009* (Cth) regime, which means there are strict prohibitions against and consequences for the failure to pay salary and wages to employees. Salary packaging providers are typically appointed as agents of the employers under salary packaging arrangements for specific purposes and may be subject to these obligations to ensure sufficient protections are in place for the funds; and
- salary packaging providers also operate under the *Fringe Benefits Tax Assessment Act 1986* (Cth), which also contains strict operational requirements for the treatment, distribution and reporting of funds flow.

As such, it is NALSPA's submission that there is little "operational risks" and "financial risks" around the funds that salary packaging providers handle.

Payment Technology and Enablement Services

Similar to the submissions on payment initiation services, it is NALSPA's view that the new "Payment Technology and Enablement Services" function does not capture salary package providers. The key characteristic of this function is that the service provider "*does not enter into possession of, or control of the funds*". As stated above, salary packaged deductions are deposited to a salary packaging provider's account are subsequently distributed to third party service providers in accordance with a client's instructions, or are deducted to pay the salary packaging provider in respect of salary packaging services provided. Accordingly, this function will not apply as salary packaging providers will generally come into possession of the funds. However, for completeness, NALSPA submits that Treasury should clarify in the definition that this function only captures service providers that "do not **at any time** enter into possession of, or control of the funds". This is because there are instances where salary packaging providers may enable payments to be made to third parties with their own funds and are subsequently reimbursed for payments made. The proposed functions should not capture service providers that come into possession, or control, of the funds at any time, regardless of whether the funds arrive before or after the payment to the third party.

Cross-border Transfer Services

NALSPA does not believe that cross-border transfer services will be relevant to its members as salary packaging providers do not permit the cross-border transfer of funds.

2.3 Proposed narrowing of credit facility exemption

NALSPA does not support Treasury's proposal in section 3.1 of the Second Consultation Paper to the narrowing of the credit facility exemption. Where services are provided on credit as part of a credit facility, there is no "stored value" in the facility and as such, the only relevant payment function captured by the Proposed Reforms would be payment facilitation. As stated in section 2.2.6 of the Second Consultation Paper, the key issues surrounding payment facilitation are the loss of funds and failed payment transactions. In a credit context, the loss of customer funds is irrelevant because "customer funds" are provided and paid to third parties on credit. If there is a failed payment transaction, no credit is provided and there will not be a loss of a customer's funds.

Furthermore, where payment facilities are coupled with credit, NALSPA submits that the most significant risk to the customer is almost always the credit aspect of the facility. This is reflected by the current exclusion for payments linked to a credit facility from being financial products in the *Corporations Act*. The reasoning for the current exclusion was not due to an equivalent regulatory policy under the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**).

Rather, it was because payment risk is not a substantial risk in a credit contract when compared to the credit risk. In fact, almost all credit facilities would include some aspects of payment services under the Proposed Reforms, as it would be unusual for a commercial credit facility to not involve a payment instruction (e.g. instruction on how to disburse mortgage funds). However, it would be a strange result if a credit facility which is so simple that it is not captured by the NCCP Act would, due to the inevitable payment aspect, is required to navigate and comply with the burdensome licensing and conduct requirements of the AFSL regime. As such, it is NALSPA's submission that the exemption should not be modified.

2.4 Proposed amendment/removal of single payee exemption

NALSPA does not support the removal of or amendments to the single payee exemption set out in section 3.1 of the Second Consultation Paper. As foreshadowed in our comments above regarding payment facilitation services, salary packaging providers may be authorised to transact on accounts that are in the name of the employer in order to manage payments made to the salary packaging providers (rather than holding these funds in accounts in their own name). They are often only authorised to make payment to one person (themselves), allowing them to rely on the existing single payee exemption. This is a simple facility / service provided to the employer for their convenience and reduced administrative burden. Without the expansion of the proposed network exclusion to payment initiation services (see section 2.5 below), the removal of, or amendments to, this exclusion would mean a number of salary packaging providers will no longer be able to offer these services without appropriate licensing.

2.5 Proposed introduction of limited network exclusion

NALSPA supports Treasury's proposal to introduce a new limited network exclusion for Payment Instruments as set out in section 3.2.3 of the Second Consultation Paper, but supports this exemption applying to all payment functions, including payment initiation services. Where the single payee exemption is amended or removed to prohibit salary packaging providers to rely on the exemption to manage payments made via an employer's bank account, the limited network exemption should be drafted broadly enough to capture these circumstances so that they remain exempt from the new regime.

3 Responding to comments in Second Consultation Paper

In section 3.2.8 of the Second Consultation Paper, Treasury comments that it is unclear what policy justification there is to warrant specifically excluding salary packaging providers from holding an AFSL.

As submitted in the NALSPA July Submission, the salary package industry has traditionally been excluded from other financial regulatory regimes, such as the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) and the licensing regime in the NCCP Act. These exemptions recognise that the products offered by salary packaging providers are generally very simple and do not require protections offered by those regimes. The payment facilitation function that a salary packaging provider offers is an ancillary component of the overall service provided, but must be performed due to a practical reality. NALSPA submits that it would be a disproportionate and inefficient regulatory response to apply the extensive regulatory obligations under the AFSL regime to salary packaging providers merely as a result of an ancillary component of their business operations.

4 Potential impacts of proposed reform on salary packaging providers

4.1 Additional regulatory burden

NALSPA notes that a number of salary packaging providers who provide salary packaging services to employees in the government, health, education and related sectors, do not currently hold an AFSL. These salary packaging providers estimate that to develop or adjust existing processes and procedures to comply with the AFSL regime will take a minimum of two years (and a minimum of three years where APRA authorisation is required). This would create a significant hurdle for these salary packaging providers to continue to provide these services to employees and may disrupt existing remuneration arrangements.

NALSPA members are particularly concerned about the interaction between the client money provisions and the restriction this may have on the functional operation of salary packaging arrangements. To establish each account maintained for employers as regulated trust accounts would be a significant undertaking which could impact on the ability to effectively perform salary packaging services.

Further, given the way in which the client monies rules apply, there is a real possibility that some payments from an employer may comprise client funds, for example where paid in advance of the underlying package expense, whereas other may not (e.g. where unexpected expenses have meant that the credit has been provided to the employer in respect of a particular employees payments). Performing this sort of analysis on inbound funds (which would be necessary for the purpose of identifying and separating out mixed or unidentified money) would be enormously administratively burdensome on members given the large number of transactions processed daily.

In addition, NALSPA is also concerned about the potential of inappropriate outcomes from the application of regulation to salary packaging services given the unique nature of the interaction between the employer and employee with the salary packager. As noted above, the employer is likely to be the client for many packaged services, depending of course on the particular nature of the arrangements. However, the kind of reporting (e.g. statements and confirmations) required by the regime could involve the mandatory provision of various employee information to the employer. This would be a significant issue from a privacy perspective and would also make salary packaging arrangements much less attractive. NALSPA is concerned about other similar unintended and problematic consequences which may well emerge as any amendments are detailed and then implemented.

4.2 Risk disproportionate to regulatory requirements

NALSPA further submits that the regulatory burden is disproportionate to the risks associated with the products that salary packaging providers offer. As stated in section 3 above, the existing regulatory exemption in the NCCP Act recognises that the products that salary packaging providers offer are simple and straightforward enough that they do not require the imposition of licensing in order to protect an employer or employee. NALSPA submits that the same recognition should be offered in the

Proposed Reforms. This is particularly evident when comparing salary packaging products against other products that the Proposed Reforms seek to regulate (e.g. payment stablecoins), which clearly have a different and higher risk profile.

NALSPA also notes that the employer entities, who are the primary contracting entities when engaging in salary packaging services, are often medium to larger sized corporations, or generally are from the government, health or education related sectors. These entities are sophisticated and capable of assessing the risks involved with a particular salary packaging provider, meaning there is a higher degree of diligence applied by the customers of salary packaging providers compared to other payment facilities. As such, the regulatory burden is disproportionate to the risks associated with the product that salary packaging providers offer.

4.3 Additional costs to consumers

NALSPA also submits that salary packaging services are often provided at a very low fee in a highly competitive environment. The fees that salary packaging providers receive are paid directly by the employees rather than the employers. The additional compliance costs that the Proposed Reforms add would therefore likely need to be passed through to employees via a fee increase. This would impact the take home salary amount for individual employees who are already facing the challenge of the increased cost of living, as well as reduces the advantage/attractiveness that salary packaging services can provide (particularly in key sectors such as healthcare and education where salary packaging plays a major role in retaining employees).

It is NALSPA's submission that the tax relief which underpins salary sacrificing reflects a deliberate policy decision by government to allow employees the opportunity to maximise the value of their after-tax compensation in certain circumstances. The Proposed Reforms seem to undercut this policy rationale by imposing additional compliance costs in a sector where there is no clear evidence of failures, poor conduct or other issues requiring additional regulation of the scope required.

Yours sincerely

Rohan Martin
Chief Executive Officer