

Submission

to the

Reserve Bank of
New Zealand

on the

Consultation paper: Review
of the outsourcing policy for
registered banks

4 December 2015

Submission by the New Zealand Bankers' Association to the Reserve Bank of New Zealand on the Consultation paper: Review of the outsourcing policy for registered banks

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.
2. The following fifteen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - Bank of Tokyo-Mitsubishi, UFJ
 - Citibank, N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - JPMorgan Chase Bank, N.A.
 - Kiwibank Limited
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited.

Background

3. NZBA is grateful for the opportunity to submit to the Reserve Bank of New Zealand (**RBNZ**) on the Consultation paper: Review of the outsourcing policy for registered banks (**Consultation Paper**).
4. We provide below responses to the issues and questions posed in the Consultation Paper where we consider there to be industry consensus. We appreciate your consideration of our submission.
5. If you would like to discuss any aspect of the submission further, please contact:

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Executive summary

6. As RBNZ will be aware, outsourcing is an issue of significant importance for the banking industry. As such, the industry wishes to remain closely involved with RBNZ's development of the new outsourcing policy.
7. NZBA and its members appreciate the consultative approach RBNZ has taken with consultations such as the Regulatory Stocktake of the Prudential Requirements Applying to Registered Banks. NZBA recommends that RBNZ adopt a similar consultation approach with its review of the outsourcing policy, including a series of consultative industry workshops and bilateral engagements.
8. We appreciate your consideration of this recommendation and the opportunity for the industry to meaningfully engage with proposals for regulatory change.

Issues identified

9. NZBA and its members have identified concerns with RBNZ's proposed outsourcing policy, including:
 - a. It blurs third party outsourcing with both bank parental separation and failure resolution policies.
 - b. It does not recognise that banks will always have a greater interest in preventing and effectively managing outsourcing failures than the regulator.
 - c. It does not contain a regulatory impact assessment.
 - d. It does not effectively analyse the issue of outsourcing supplier monopoly (i.e. where there is only one supplier to choose from).
 - e. It does not include robust definitions to support consistent interpretation.
10. NZBA and its members:
 - a. Submit that, where possible, RBNZ should give consideration to aligning its outsourcing policy with APRA's.
 - b. Submit that the proposed outsourcing policy outcomes should be limited to the extent to which they apply to the provision of basic banking services.
 - c. Support an amended definition of outsourcing, which includes a materiality threshold.
 - d. Submit that there should not be any blanket restrictions on the outsourcing of a function, and the proposed list of prohibited functions as currently drafted is inappropriate, confusing, and/or unclear.

- e. Submit that the proposed outsourcing arrangement compendium should not form part of a bank's conditions of registration or be included as a board compliance requirement.
- f. Submit that the requirement to include certain contractual terms in outsourcing arrangements needs to be applied flexibly, and it should be recognised that some proposed required terms will not always be able to be applied.
- g. Support option two over option one for engagement with RBNZ, however also have a number of issues with option two.
- h. Do not support the proposed assessment of outsourcing proposals, as there are no set timeframes within which RBNZ must consider/respond to an application.
- i. Submit that two years is not sufficient to reach compliance with the policy, some banks will require at least a two year planning timeframe alone.

Question 1: Do you agree with the analysis of the problem? Do you agree that the issues identified in paragraph 21 appropriately identify the potential problems with the banks' use of outsourcing?

Consistent with international precedent, NZBA and its members consider that a core tenet of a sound outsourcing policy is recognition of the role outsourcing plays in the service proposition a financial institution provides to customers while at the same time requiring financial institutions to consider, develop and implement a robust risk management framework to manage risks arising from outsourcing.

Requirements typically imposed by regulators in outsourcing policies focus on:

- the requirement for a bank to have an outsourcing policy, approved by the Board;
- the requirement for a bank to have a robust outsourcing governance and risk management framework in place to ensure that risks arising from outsourcing arrangements are appropriately identified and managed. This framework would be approved by the Board and RBNZ and include:
 - assessment of whether outsourcing/the outsourcing supplier is appropriate (i.e. due diligence);
 - identification of solutions to manage failures associated with that outsourcing arrangement/supplier; and
 - ongoing monitoring of the outsourcing arrangement/service provider;
- the requirement to have robust legal arrangements governing outsourcing arrangements in place; and
- bank notification to the regulator of entry into material outsourcing arrangements and informing the regulator as soon as practicable about any issues that have arisen in respect of a material outsourcing arrangement.

NZBA and its members understand that such an approach aligns with:

- The Basel Committee's recommendations in the Joint Forum Outsourcing in Financial Services paper (2005);

- The Committee of European Banking Supervisors' Guidelines to Outsourcing (2006); and
- The International Organisation of Securities Commissions' (IOSCO) Principles on Outsourcing by Markets (2009).

NZBA and its members have identified the following main concerns with RBNZ's proposed outsourcing policy:

- (a) Blurs third party outsourcing with both bank parental separation and failure resolution.** The issue of third party outsourcing has been blurred with both bank parental separation and failure resolution policies. These are all very different issues and international practice suggests that they should be dealt with in separate policies. Furthermore, NZBA and its members submit that outsourcing to a parent should not be treated any differently from outsourcing to an independent third party. The assumption that outsourcing to a parent or related party is inherently risky or relatively riskier than third parties is unfounded. A parent is often better placed to provide a service, and has a shared interest in, and will have strong commercial drivers to protect, the ongoing success of the function, particularly where it is supporting trans-Tasman and global customers that have banking facilities across multiple jurisdictions. A parent also has the benefit of being regulated.
- (b) Does not recognise that banks will always have a greater interest in preventing and effectively managing outsourcing failures than the regulator.** There is an assumption that market failure could arise from a lack of alignment between the interest(s) of individual institutions and the broader public good (for example, because the systemic economic cost may exceed reputational risk or direct cost to a bank). It is hard to see any plausible situation where this could occur for a bank in the New Zealand market (even the larger banks). RBNZ has not provided any evidence or analysis to demonstrate how the system cost of a third party or parent/affiliated entity outsourcer failure could ever be greater than the cost incurred by an individual bank.
- (c) Does not contain a regulatory impact assessment.** A Regulatory Impact Statement should accompany the Consultation Paper, rather than be undertaken after a policy decision has been made. For policies such as the outsourcing policy, which have the potential to impose significant costs on the industry if certain policy positions are taken, it is important that all stakeholders are able to understand, and potentially challenge, the Regulatory Impact Statement.

- (d) Does not effectively analyse the issue of outsourcing supplier monopoly (i.e. where there is only one supplier to choose from).** NZBA and its members submit that reducing the concentration of risk associated with a single supplier (for example SWIFT) is not a matter for an outsourcing policy targeted at individual banks. While a failure of a key supplier to the whole industry could cause significant damage to the financial system, NZBA and its members submit that this should be dealt with by regulation of the supplier, not the banks. Regulating this risk at a bank level has the potential to effectively involve RBNZ "rationing" banks' ability to choose an appropriate supplier – by RBNZ providing a non-objection to the use of a supplier for some banks but not others, simply to mitigate the system risk. This would be a particularly unreasonable outcome for banks which are not allowed to use that supplier, and could significantly affect their competitiveness and the quality of their service offering to customers. NZBA and its members submit that it would be helpful for RBNZ to identify suppliers which are “systemic” across the industry and engage with banks on working with these suppliers.
- (e) Does not include robust definitions to support consistent interpretation.** NZBA and its members understand that the current outsourcing policy has been interpreted and applied inconsistently across the industry. NZBA and its members consider that the new outsourcing policy should contain definitions of certain key terms that are used in the policy to ensure that it is interpreted and applied consistently. NZBA and its members consider that the following key terms and definitions are appropriate for inclusion in the new outsourcing policy:
- *Financial risk positions:* A bank’s financial risk position is the potential for financial loss as a result of the bank’s management of its credit, market and liquidity positions. Includes balance sheet as well as off balance sheet items.
 - *Basic banking service(s):* Access for the majority of customers to most transactions involving domestic New Zealand dollar transactional bank accounts, deposits, basic lines of credit and lending, and the ability of customers to make domestic New Zealand dollar payments.
 - *Clearing and settlement:*

- *Clearing*: the exchange of files, both within a bank or with another bank, containing transactions enabling the recipient bank to post them to customer accounts.
- *Settlement*: the exchange of value in central bank funds between banks.

This approach also aligns with RBNZ's suggestions made in RBNZ's Regulatory Stocktake Consultation Paper dated July 2015, which suggests that a glossary of key terms may be included as part of the revised banking standards (either in individual standards or across the entire set).

Question 2: Without an outsourcing policy how would you propose that a failure is managed?

A failure resolution policy should be separate from an outsourcing policy.

A failure resolution policy might include a requirement to prepare a separation plan to address how inter-bank systems will be managed in a crisis scenario. A failure resolution plan should:

- describe the bank's strategy for orderly resolution in the event of material financial distress or failure of the bank;
- be divided into public and confidential parts;
- include a plan to deal with key suppliers and address 'separation requirements' for banks that outsource to a parent or affiliated entities; and
- be tailored, having regard to the risks and issues associated with the individual bank.

NZBA and its members submit that bank failure is appropriately managed through a failure resolution policy, but that this is theoretically and practically distinct from an outsourcing policy and that the two should be treated as independent concepts/policies.

In essence they are separate disciplines: outsourcing relates to managing material supplier/vendor risk, whereas a failure resolution policy is related to re-capitalising, crisis management/business continuity and the ability to ensure continuity of supply of banking services after re-capitalisation.

Further consultation on the requirements of a failure resolution policy should be undertaken once the updated outsourcing policy has been finalised. This reflects that a failure resolution policy sits naturally as a tool that supports the outsourcing and OBR policies, but is not a part of either.

This approach is particularly important because a separation plan will not be relevant to all NZBA members (as it only applies to those banks who outsource to parent or affiliated entities, and does not apply to outsourcing to independent third parties). However, all banks are able to plan and prepare for failure resolution relevant to their individual circumstances.

Question 3: Do you agree that the current outcomes-focus should be retained?

Partly. While NZBA and its members prefer the greater regulatory certainty of the BIS guidelines and APRA guidelines (for example), they do believe it is important that any model does not force all banks to adopt the same outsourcing strategy. It is important that any policy does not frustrate banks' ability to innovate and take advantage of emerging technologies, and meet changing markets and customer demand for specific products, in circumstances where the bank's governance and risk management enable it to effectively manage the risks.

NZBA's Australian-owned member banks are already subject to a level of regulation by virtue of being subject to group outsourcing policies under APRA's Outsourcing and Offshoring Policy (Prudential Standard CPS 231). Potential differences between the regulatory approaches of APRA and RBNZ to outsourcing could therefore pose significant challenges for these banks. NZBA and its members submit that, where possible, RBNZ should give consideration to aligning its outsourcing policy with APRA's. APRA's

outsourcing policy provides a helpful framework, includes a good level of detail that may be a helpful aid to interpretation, and importantly, includes materiality provisions.

Question 4: Do you agree that changing the objectives to focus more on resolution is right?

While NZBA and its members recognise the relationship between OBR and certain risks arising from outsourcing, as noted above, in accordance with international practice any failure resolution policy (and separation plan requirement) should be separate from an outsourcing policy.

Furthermore, the term “resolution”, and the requirements proposed in paragraph 39 of the Consultation Paper require further clarification (for example, the term “basic business” is broad and open to interpretation).

In particular, in relation to a statutory management event, NZBA and its members submit the proposed outsourcing policy outcomes should focus on a bank’s ability to provide basic banking services to existing customers at the point of bank failure. NZBA and its members support limiting the outcomes to servicing existing customers in respect of their existing products/services, as opposed to writing or obtaining new business or providing new products/services. Even then it is important, and consistent with RBNZ’s statutory obligations, that there is a materiality threshold so that not every minor specialised product and every channel be available, just the most popular of them.

Question 5: Do you agree that the current outcomes are appropriate? Do you agree that the outcomes should also include a resolution-focused requirement? Please explain.

NZBA and its members submit that while the current outcomes are fit for purpose, we are generally comfortable with the proposed new outcomes outlined in paragraph 49(a)–(d). However, NZBA and its members submit that these outcomes should be limited to the extent to which they apply to the provision of basic banking services.

Furthermore, NZBA and its members submit that the reference to "other time-critical settlement obligations" in paragraph 49(a) should be removed, as it is unclear what this encompasses/what it adds.

NZBA and its members also submit that the outcome in paragraph 49(c) should be clarified. It currently links systems and balance sheet data with the availability of a range of options for managing a failed bank. It is not clear from paragraph 49(c) as currently drafted what RBNZ is seeking to achieve in terms of an outcome. It is unclear what may be required of a bank in order for those systems and data to provide "a range of options" for managing the bank, and it is also unclear what the term "at hand" means.

Consistent with the comments above, NZBA and its members consider the introduction of a separation plan will actually confuse the new outsourcing policy (and be out of step with international practice). Accordingly, NZBA and its members submit that a resolution-focused requirement should not be included and therefore paragraph 49(e) should not form part of the outcomes. The policy should instead focus on requiring banks to establish an appropriate framework to manage outsourcing and the actual and inherent risks associated with outsourcing.

To the extent that the outsourcing policy relates to crisis management and the ability to effectively resolve bank failure where outsourcing arrangements are in place, the policy should clarify that the outcomes are relevant to this goal.

Furthermore, requirement 49(e) does not adequately address the reality that in the event of a separation a bank may not trade on indefinitely, and in some circumstances an effectively managed wind-down may be the appropriate response from a statutory manager.

NZBA and its members submit that the key events that could cause failure of an outsourcing arrangement, and that can be managed appropriately by a robust internal outsourcing governance and risk management framework and business continuity planning, are:

- complete (third party or related provider) supplier failure; and
- contained and localised catastrophic loss of one or more outsourcing arrangements stemming from technology failure or natural disaster affecting a third party supplier or related party provider.

Lastly, paragraph 49 contains a number of broad terms which are newly introduced and not defined.

Question 6: Do you agree that the matters identified above are the appropriate matters for inclusion in a separation plan? Are there any matters that have not been identified above, but should be included?

NZBA and its members acknowledge the rationale for RBNZ wanting to introduce the requirement for a separation plan, and considers a separation plan would be a helpful addition (for both banks and RBNZ) to the prudential regulation landscape. However, given the significant upfront and ongoing undertaking required to prepare, manage and maintain such a plan, it is important that any separation plan:

- is suitably structured;
- is appropriately designed and articulated in terms of its scope/content;
- takes into account the potential harm that it seeks to address; and

- is balanced (in terms of its compliance requirements) against the extremely low probability of such harm occurring.

In any event, NZBA and its members submit that any separation plan should be part of a failure resolution policy (which is consistent with international guidelines) and applied in a manner appropriate to the risk involved. Specifically, the proposed requirement to annually test a bank's ability to respond to a parental failure or separation event is unreasonably onerous and high risk given the significant undertaking and high costs involved when balanced against, what is in our members' view, a low probability event – although it may be appropriate if a major bank was to suffer a major credit rating downgrade.

Question 7: Does the proposed definition appropriately define outsourcing? If not, please provide an alternative definition that, in your opinion, better captures what is meant by the term outsourcing.

- (a) **NZBA and its members support the introduction of a definition of outsourcing.** The definition should be clearly articulated and able to be easily understood and consistently interpreted/applied.
- (b) **The Consultation Paper does not elaborate on how the definition of 'outsourcing' has been modified.** Our understanding is that the proposed definition is a shortened version of the definition in the Basel Committee's Report on Outsourcing in Financial Services. NZBA and its members submit that the reasons for the difference(s) should be explained.
- (c) **There is no evidence that other jurisdictions have been considered.** Both the United Kingdom and Canadian definitions of outsourcing include “services, processes and/or functions” as well as “activities”. A wider definition is preferable, and aligns with international practice, to avoid any doubt as to whether some services or processes are “activities”.
- (d) **There is no materiality threshold.** The BIS Outsourcing Report and the APRA Standard include a materiality threshold (e.g. outsourcing principles should only be applied according to the degree of materiality of the outsourced activity to the bank's business). A materiality threshold would address a number of the issues discussed later in this submission around the practical workability of this policy. It would also more accurately reflect the theoretical basis for an outsourcing policy, namely the

potential risk posed by the failure of a material supplier. NZBA and its members submit that immaterial contracts do not pose significant enough risk in the event of failure to warrant pre-emptive regulatory intervention, and do not fall within the ambit of either limb of section 68 of the Reserve Bank of New Zealand Act 1989. Furthermore, a materiality threshold will ensure the policy operates efficiently and will not capture minor outsourcing activities and general procurement that will then need to be included in the compendium and be subject to the RBNZ notification process. NZBA and its members submit that it is imperative that the correct materiality threshold(s) be outlined in the definition of outsourcing.

- (e) **Proposed definition:** NZBA and its members submit that the proposed definition of outsourcing is too wide, and must be narrowed and linked more directly to the policy's objectives. NZBA and its members propose the following alternative definition:

Outsourcing is defined in this policy as a registered bank's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform, on a continuing basis, activities, services, processes and/or functions that are material to the provision of basic banking services that would normally be undertaken by the registered bank.

Question 8: Are there any other functions that should be excluded from the outsourcing policy, but are not captured in the list above?

- (a) Our understanding is that the functions listed in the Consultation Paper reflect the Canadian guidelines, however this is not acknowledged. NZBA and its members submit that, if it has not already done so, RBNZ should also consider other jurisdictions.
- (b) NZBA and its members submit that certain terms should be clarified, such as:
- "Telecommunication services" – does this include internet services, network services etc.?

- Repairs and maintenance of “fixed assets” – what can be included in the classification of fixed assets?

(c) NZBA and its members submit that the following functions should also be excluded from the outsourcing policy (some of which are excluded under the Canadian guidelines):

- (i) courier services;
- (ii) the purchase of goods, wares, commercially available software and other commodities;
- (iii) credit background and background investigation and information services;
- (iv) correspondent banking services;
- (v) maintenance and support of licensed software (both off-the-shelf and tailored);
- (vi) clearing and settlement arrangements between members or participants of recognised clearing and settlement systems;
- (vii) sales of insurance policies by agents or brokers;
- (viii) ceded insurance and reinsurance ceded;
- (ix) syndication of loans;
- (x) production of plastic credit/debit cards;
- (xi) sales and distribution arrangements such as mortgage brokers, financial planners and other commission-based arrangements;
- (xii) arrangements with licensed and/or regulated exchanges, such as the Australian Securities Exchange and Swap Execution Facilities licensed under Dodd Frank legislation in the USA, including the hosting of trade transaction data;
- (xiii) financial services industry scheme arrangements, such as Visa and MasterCard;

- (xiv) arrangements with trading partners, industry bodies and regulators, including use of internet portals and associated data repositories provided by those third parties or their approved intermediaries (e.g. Global Trade Repository approved under Dodd Frank legislation in the USA) for the submission of instructions and/or information including transaction reporting;
- (xv) Investment Management Agreements (IMAs), which are agency arrangements providing Investment Managers with authority to manage a portfolio of client assets on the bank/Group's behalf (this arrangement is clearly disclosed to the bank/Group's clients under the "Manager of Managers" model client proposition);
- (xvi) cheque printing and statements;
- (xvii) marketing and agency services;
- (xviii) facilities management;
- (xix) document management/archiving/destruction;
- (xx) cleaning contracts;
- (xxi) debt collection;
- (xxii) provision of products by third parties (where the bank distributes a third party product, whether or not white labelled);
- (xxiii) cash transportation services;
- (xxiv) recruitment, contractor and consultancy services; and
- (xxv) immaterial SAAS and cloud services.

Question 9: Do you agree that there are functions that are so integral to carrying on the business of a bank that they should not be outsourced? Do you agree that these examples are appropriate? Are there any other functions or systems that should not be outsourced?

- (a) **NZBA and its members submit that there should not be any blanket restrictions on the outsourcing of a function.** The key issues should be the level of control over the potential risks of the proposed outsourced activity, and access to outsourced functions, and we consider that the risks posed by any proposed outsourcing should be assessed having regard to the specific circumstances of that function in the context of the particular bank at the relevant point in time .
- (b) Instead, the outcomes focus and concept of 'legal and practical control' should be retained across all functions. NZBA and its members respectfully submit that RBNZ should look at outsourcing arrangements in the whole with all risks and mitigating factors considered. RBNZ, for example, outsources ESAS, which is the critical payment function, to Datacom. If the proposed new outsourcing policy were applied to RBNZ it would likely be required to insource ESAS. However, RBNZ has clearly determined that it is comfortable with the risks and mitigating factors surrounding this outsourcing arrangement.
- (c) From a practical perspective, prohibiting 'named' functions, such as SWIFT Gateway, could quickly become outdated or encourage deliberate avoidance behaviours.
- (d) Technological developments will change the risk profiles of particular functions over time. That is another reason why blanket prohibitions are inappropriate. Further, the policy needs to take into account the potential for significant technology shifts and innovation, and be flexible and neutral/agnostic to technology so as to allow banks to adapt to these changes.
- (e) The rationale for the different treatment of outsourcing to parent entities when compared to third party suppliers is unsubstantiated and in our members' view unfounded (see our response to question one above). Services are outsourced to parent entities under arms' length contractual arrangements which would usually include the payment of recharge fees. In certain situations, when compared to outsourcing to a third party or keeping the function in-house, outsourcing functions to a

parent, in our members' view, reduces rather than increases any risk of failure and brings with it increased benefits (for example, a common interest in the function's ongoing success).

(f) Notwithstanding the above, the proposed list of prohibited functions as currently drafted is confusing, and its scope is unclear. For example:

- Does it relate to the function and/or the data? Legally these are two distinct concepts.
- What does ownership and control mean?
- What is captured by regulatory reporting? We assume it refers only to RBNZ prudential reporting? If so, the scope is unclear.

(g) It is unclear from paragraph 63 of the Consultation Paper whether the three functions identified would be, if the policy proposal was retained, the only functions intended to be prohibited. This is because paragraph 63 identifies these as “examples of functions that may be appropriate to prohibit banks from outsourcing”. NZBA and its members would be interested to know whether there are other functions intended to be prohibited and whether RBNZ intends to consult on these.

(h) **NZBA and its members submit that the examples are not appropriate:**

Calculation of financial position and regulatory reporting: It is common practice in the New Zealand market for registered banks to outsource data processing and storage functions and therefore these examples are likely to have a wide impact. A blanket restriction will prevent a proportional application of the policy based on the issues and risks associated with the registered bank. In the case of smaller registered banks, a blanket restriction on outsourcing data processing and storage relating to the calculation of a bank's financial position and regulatory reporting will have significant economic and service level quality implications, when balanced against the very minor risk of such outsourcing to the wider financial system.

SWIFT Gateways: The blanket restriction in the second example would cause significant economic costs for smaller banks, particularly given that the Consultation Paper does not specify whether smaller banks would also be required to join the New Zealand payments system. Is the implication that all banks over the \$1 billion threshold must join the system? Furthermore,

smaller banks use third parties for their SWIFT Gateways, namely other registered banks. If those other registered banks are subject to the outsourcing policy (which, given their size, they will be), RBNZ should be satisfied with those arrangements because if that other registered bank (SWIFT Gateway provider) were to fail, RBNZ would be able to appoint a statutory manager in respect of that bank, negating the need to also appoint one for the smaller bank. Smaller banks should be reasonably able to use the service of an RBNZ regulated institution.

Question 10: Do you think an outsourcing arrangement compendium would be useful as a reference record between the Reserve Bank and a bank?

Yes - but the compendium should not form part of a bank's conditions of registration or be included as a board compliance requirement because it would be too detailed. Rather it should be an operational requirement of the policy. This is especially significant in respect of outsourcing to a parent bank.

NZBA and its members submit that an appropriate materiality threshold should be put in place, and that RBNZ should publish appropriate guidance around the expected operation of the compendium. If no materiality threshold is included, the compendium would become too detailed and onerous for both the banks and RBNZ to maintain. As discussed in our response to question seven above, many of these issues could be resolved by an appropriate materiality threshold included in the definition of outsourcing.

Question 11: Are there any other matters not addressed above that should be included in the compendium?

As noted in our response to question 10 above, NZBA and its members submit that an appropriate materiality threshold should be included to ensure the document remains practical and not overly detailed/onerous.

Question 12: What are the costs to you of establishing and maintaining an outsourcing arrangement compendium that forms part of your conditions of registration?

No view.

Question 13: Do you agree that all contracts for outsourcing arrangements should be required to include the terms outlined in paragraph 81?

- (a) **The required terms should be consistent with international requirements.**
- (b) **Needs to be applied flexibly** (i.e. not imposed on all arrangements if not possible or reasonable). In practice RBNZ should use its discretion when the contract is minor/immaterial or is with a global supplier that will only contract with a bank on standard terms (in particular, some global suppliers may not agree to the statutory management provisions in contractual arrangements).
- (c) **Some terms will not apply.** NZBA and its members question the blanket applicability of a number of the items included in Appendix One (which paragraph 82 of the Consultation Paper states RBNZ would “expect to see included in robust outsourcing arrangements”). Some of the terms in this comprehensive list will not be relevant to every outsourcing contract, and some will be overly onerous even in a standard procurement contract. On this basis NZBA and its members submit that Paragraph 1 of Appendix One should be amended to state that the contractual terms are those which RBNZ “would expect to see included in robust outsourcing arrangements, to the extent that they are relevant to the subject matter and context of that particular contract:”, leaving the banks with discretion to determine whether they are relevant and necessary.

**Question 14: Do you agree that option two is the most appropriate option for the assessment of outsourcing arrangements?
Please explain.**

NZBA and its members support option two over option one.

However, NZBA and its members have a number of issues with option two.

NZBA and its members submit that the scope and breadth of option two is too wide in its current form and will result in practical difficulties and potential backlogs, creating significant costs and operational and administrative inefficiencies for both banks and RBNZ.

NZBA and its members submit that RBNZ must respond proportionally to the risk posed by an outsourcing arrangement, and that RBNZ should be required to provide reasons for making a determination that a contract requires non-objection before it is entered into. For clarity, per the definition suggested in our response to question seven above, NZBA and its members submit that the non-objection requirement should only apply to material outsourcing arrangements.

NZBA and its members submit that there also needs to be transparency around the process (i.e. how will the decisions be made, will there be a formal charter, will there be any opportunity to appeal etc.). NZBA and its members submit that option two should be accompanied by an adequate appeals process.

NZBA and its members also seek greater clarity around what RBNZ will be looking at. For example, if RBNZ wishes to review the legal terms of a contract, it could accept an opinion from the relevant bank's lawyers.

NZBA and its members also have concerns about the proposed timing of RBNZ's engagement under option two. It appears that RBNZ will be engaged at the end of the process after a bank may have spent months and significant amounts of money (including on external legal fees) negotiating large contracts. Any intervention by RBNZ should occur at a much earlier stage to prevent the expenditure of time and money on contracts which could ultimately be objected to by RBNZ.

NZBA and its members also have a very high level of concern about RBNZ adequately resourcing the consideration of proposed outsourcing arrangements and the time that might be taken for consideration. Many outsourcing proposals will require a knowledge of the technology involved.

NZBA and its members are also concerned that the moral hazard risk RBNZ will be incurring in assessing outsourcing proposals may result in an overcautious approach being taken by RBNZ to the issue of non-objection advice.

Question 15: Do you agree that the approach outlined above is an appropriate way to manage the assessment of outsourcing proposals? If not, please explain.

No, because there are no set timeframes within which RBNZ must consider/respond to an application.

This could add significant cost and/or delay to contractual arrangements for little value/benefit. The logistics regarding the length of time between engaging with a vendor and RBNZ approval would impact on banks' speed to market and the efficiency gains banks may potentially achieve through outsourcing.

Whilst 20 working days is a reasonable timeframe, the qualifier in the Consultation Paper that this is an expectation only is not acceptable, and NZBA and its members submit that a stronger commitment to responding to outsourcing proposals within an appropriate timeframe is required to better reflect the commercial and practical realities which drive the operation of banks. As part of this stronger commitment NZBA and its members would also like to see confirmation from RBNZ that it will not use queries/questions of the bank to in effect "re-start the clock" with respect to the response timeframe.

NZBA and its members submit that a process which allows for default acceptance of a contract if RBNZ has not provided the bank with an answer within 20 working days would be preferable.

Question 16: Do you agree that having standardised applications would assist in reducing the time taken to assess outsourcing proposals?

Yes, NZBA and its members support a standardised approach provided the criteria are reasonable.

Question 17: How many requests per annum do you expect to file in a business-as-usual state? How many requests do you expect to file at the outset of the policy?

Any response to this question would necessarily depend on the definition of outsourcing decided on for the updated outsourcing policy (discussed in our response to question seven above). If it is only necessary to notify outsourcing proposals in respect of activities that are material, NZBA estimates that its members would each notify approximately 5-10 proposals per year. If however it is necessary to notify all outsourcing arrangements according to the definition in the Consultation Paper, the number for each member could be in excess of 100 per year and is likely to increase.

Question 18: Do you think that that the threshold for the outsourcing policy should be aligned with the threshold for OBR pre-positioning, given the inter-linkages of the two policies? Would your bank impacted by an alignment? If so, provide detailed comments.

NZBA members will address this question in their own individual submissions.

Question 19: Do you agree that 6 months is an appropriate amount of time for banks to provide the Reserve Bank with a plan for how it will come to compliance with the revised outsourcing policy, noting that its form has not yet been finalised?

Until the outsourcing policy is finalised and its collective impacts understood, this question is difficult to answer. However, given the significant amount of activity and co-ordination that the policy will require (for example, members' parents and vendors will need to be engaged to understand the impact of the updated policy and then develop plans to implement it), initial indications from our members suggest that the six month timeframe is too aggressive and that some banks will require at least a two year planning timeframe.

To achieve this, NZBA and its members strongly submit that another round of consultation is needed, with bilateral engagement and industry workshops to fine tune the detail of the policy.

Question 20: Do you agree that 2 years would provide a sufficient timeframe to reach compliance with the policy?

No. For example, if an updated outsourcing policy were to impact more banks than are currently affected, newly affected banks would have a significant amount of contract renegotiation to undertake before becoming compliant. Furthermore, many vendors simply have no incentive to change. Two years will not be sufficient time for this process for some banks.

Initial indications from our members suggest that a five year timeframe to reach full compliance is more realistic. Some members consider that the most efficient and practical approach would be to implement compliant solutions as part of the normal system refresh lifecycle – this would take them 10 – 20 years to become fully compliant.

Grandfathering provisions and appropriate flexibility to allow contracts to be amended as they come up for renewal/roll-over will also assist the transition, both operationally and administratively. We note that some contracts (particularly the more material/important ones) are for terms of more than two years, with many outsourcing contracts running for an average of 3-5 years. There is also a risk

of opening banks up to penalties under existing contracts if these must be prematurely renegotiated to ensure compliance with the new outsourcing policy. These are potentially significant costs which could be easily avoided under a reasonable transition plan.

NZBA and its members also note that when the current outsourcing policy was introduced in 2006 it took some banks up to two years to negotiate their path to compliance with RBNZ.

Question 21: How much do you think transitioning to compliance will cost and how could those costs be reduced by an appropriate transitional path?

NZBA members will address the cost of compliance in their own individual submissions. Costs could be reduced by allowing compliance to be achieved over the normal refresh cycle for impacted systems.