



**RESERVE
BANK**

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GUIDANCE FOR THE PREPARATION OF A SEPARATION PLAN FOR BS11: OUTSOURCING POLICY

Prudential Supervision Department
Guidance Document for BS11

Document version history

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1 Introduction

1.1 Purpose of this document

1. **Introduction:** The purpose of this document is to provide banks with guidance as to how they should prepare their separation plans, which will be required under the revised outsourcing policy. This document has been prepared at the request of the banks and is intended to be indicative of the types of things that banks should include in their separation plan. This guidance is not exhaustive and it is up to bank director to ensure that their separation plan complies with the revised outsourcing policy. Banks are required to have their separation plan non-objected to by the Reserve Bank.
2. Banks are complex and varied institutions, so what is relevant to one bank may not be relevant to another based on their business lines and organisational structure. Therefore, uniform requirements that call for homogenous plans may not be appropriate. However, there are benefits in seeking that banks cover consistent material in their plans wherever possible.
3. This guidance is not an exhaustive list of everything that a bank should cover in its separation plan, and it does not prevent the Reserve Bank from seeking additional information relevant to a particular bank or its group. Nor does it prevent the Reserve Bank from seeking that a bank include additional material in its separation plan if it is considered necessary.
4. As banks have 5 years to transition their current outsourcing arrangements to compliance with the revised outsourcing policy the Reserve Bank expects that the separation plan will evolve with these changes.

2 Focus of a separation plan

1. In preparing its separation plan it is essential that the bank take into account the following policy requirements:
 - that the bank must be open by 9am the business day after a separation. However, these timeframes do not override the other conditions of registration;
 - that the bank must not have any reliance on the parent for the provision of any services or functions that are necessary to meet any of the other outcomes for the outsourcing policy, including the provision of basic banking services to existing customers. This includes any actions, services, or processes required to trigger and carry out the separation plan¹;
 - that the bank needs to ensure that its arrangements for the separation are sustainable; and
 - that the bank needs to ensure that it can meet the outcomes of the policy on an indefinite basis while the New Zealand authorities determine the final resolution. The separation plan should not presume a timeframe for the final resolution.

¹ However, while the parent may choose to continue to provide services to the New Zealand registered bank in the event of a separation, a bank's separation plan must explain how they would be able to meet the outcomes of the policy in the event that the parent cannot for whatever reason provide these services. Banks should review their arrangements with their parent to ensure that they are as robust as possible.

3 Organisational overview

1. The separation plan should set out a high-level description of how the group organises its operations, focusing on the NZ bank and its role within the broader group.
2. This should include:
 - organisational charts, including location;
 - governance arrangements;
 - business lines; and
 - mapping of legal entities.
3. The above information should include the size and volume of banking services and which functions the group performs that are provided by the New Zealand registered bank.

4 Governance arrangements

1. It is essential that separation plans set out an internal operational management framework for separation.
2. Oversight and direction of the separation plan is the responsibility of the board of the bank. Management support and the practical day-to-day response rests with a pre-positioned separation committee which should be established by the bank. This Committee needs to have well defined roles (which include which role within the bank has responsibility for undertaking each required action) and responsibilities to take on in separation which are set out in a formal Terms of Reference (TOR).
3. The Committee's role is to focus on supporting the immediate stabilisation phase following separation, ensuring that alternative arrangements for shared services and processes that underpin the provision of basic banking services and the outcomes of the outsourcing policy or any other relevant policies are up and running promptly after separation has been triggered.
4. Alongside a well-defined TOR, the bank would be expected to have internal documents, such as run sheets, playbooks, and procedures manuals to ensure that the separation can be executed in the timeframes required and this should be managed by the Committee. These documents need to reflect operational ownership, roles and responsibilities, and delegations within the bank's chain of command, together with maximum timeframes within which activities are to be completed.
5. It is essential that the Committee members and any other staff with responsibilities under the separation plan be staff of the bank and not be responsible to the parent or other related party (except where the related party is a wholly-owned subsidiary of the bank located in New Zealand).
6. It is also necessary for the separation plan to recognise that the existing directors and senior management may not be in place post separation, so the plans should avoid too

heavy a reliance on key persons that would concentrate institutional knowledge or skills.

7. The separation plan needs to be widely useable and transferable for use by subsequent parties exercising control. As such, it should be a practical manual that supports the separation process, and would help a possible statutory manager rapidly come up to speed with the banking group's business lines and operating arrangements.

5 When separation could be invoked

1. It is necessary that the separation plan be robust to enable a separation being invoked any time of the day and on any day of the week (i.e. it needs to be equally workable on the weekend, a public holiday, and on a weekday).

Relationship with the wider group's resolution and recovery plans

2. In addition to the above, the separation plan needs to link in closely with the parent's recovery and resolution planning, leveraging off work done at a Group level around separating the NZ business in crisis (e.g. the living will of the parent bank).

6 Identification of functions and services required to meet the outcomes of the outsourcing policy, including basic banking services

1. A key requirement of the separation plan is that it identifies all the functions and services (whether outsourced or not) currently provided by the bank or by another party (related party or independent third party) on behalf of the bank. The bank should then categorise ones that are relevant for the outcomes of the outsourcing policy (including the provision of basic banking services) and those that they consider are not captured.
2. The separation plans should include a description of all the functions and services that are relevant for the outsourcing policy identified in 6.1. All functions and services that the bank considers not relevant for the policy should be outlined in a separate document or appendix and should be discussed with the Reserve Bank to ensure that the bank's interpretation of the outsourcing policy's requirements are correct.
3. In addition, the separation plan should identify and describe all the operations that underpin each of these services identified as basic banking services or related to the other outcomes of the policy (including operations not outsourced and operations that are outsourced).
4. The separation plan should also cover how all services and functions that do not fall under the definition of basic banking services and are also not relevant to the other policy outcomes will be dealt with post separation (i.e. whether they will be wound down or whether the bank has chosen to continue to provide those services).
5. For services and functions that will not be carried on post separation, the separation plan should explain how affected staff that perform these functions will be managed. This can include redeploying these staff to other areas within the bank that need

additional support following the separation, and also where staff are no longer required as the bank is no longer providing that service or function.

6. Banks should consider the separation plan every time there is a change to any functions or service offerings (i.e. the separation plan is a living document and changes may need to be made to it every time a bank changes its operations or offerings to customers).

7 Identification of all related party dependencies for all functions and services

1. A separation plan should identify which functions are provided by or through other members of the banking group (this includes functions that are and functions that are not relevant to the outsourcing policy). This should include mapping out how and where these functions are provided, including:
 - geographic location; and
 - all parties with any degree of direct or indirect control or ownership over the operations.
2. This process will identify any shared or dependent functions and services that should be available post a separation in order for the bank to meet the outcomes of the outsourcing policy. These processes may relate to (but are not necessarily limited to) infrastructure, IT, Treasury, finance functions, HR and other key systems as agreed with the Reserve Bank.

8 Identification of relevant related party dependencies

1. Following the identification the services and functions that are required to meet the outcomes of the policy (including basic banking services) this should be cross-referenced against the identification of all related party dependencies.
2. Where a related party dependency is identified the bank will need to include that in its separation plan. The separation plan will then need to specify how the function will be separated and how the back-up arrangement will be implemented. This is discussed further in this guidance in sections 9 and 10.

9 Operational processes to effect separation

1. **Operational processes to effect separation:** Describe how these functions and services that are required to meet the outcomes of the outsourcing policy and that are dependent on related parties will be transitioned to alternative service providers in the event of a separation from the parent, whilst maintaining operational continuity. This should include the runsheets, playbooks, and instruction manuals for the planned separation of each business unit and should be stored in a central data repository, and be subject to regular review and (where necessary) revision. The separation plan should detail:

- a) **Operational governance arrangements:** For each business unit, detail the governance, control, and risk management arrangements that will support the planned separation approach; map all identified related-entity dependencies to owners/executors of the separation (and where necessary, set out post separation arrangements where these differ from pre-separation arrangements). The bank should assess whether these arrangements are consistent with the planned separation approach. This should include consideration of whether adequate delegation and escalation arrangements are in place ex ante, for example a pre-positioned crisis management team with well-defined TORs.
- b) **Operational arrangements to support on-going functionality:** The separation plan should identify all actions that need to take place on the day of the separation event which will enable the use of the back-up or the pre-arranged and contracted alternative arrangements. The separation plan will also need to identify any on-going actions necessary to maintain on-going use of back-up or pre-arranged and contracted alternative facilities.

The plan should highlight where manual intervention is required to support on-going access arrangements, including the level of manual intervention (e.g. how many identified personnel are required to undertake this function and whether the nature of the manual intervention is on-going). This should include details of the BAU responsibilities of all relevant staff, and should clearly demonstrate the bank's ability to deliver all necessary on-going actions under a separation event.

The bank should also provide business line mapping of how key functions and supporting services will be arranged post separation.

- c) **Run-plan:** how long it will take to implement full separation (when all identified functions have been separated and being sourced from the either the back-up capability or the pre-arranged and contracted alternative providers).
- d) **Funding and liquidity during and post separation:** Separation plans only require that the bank continue to operate and provide services necessary to achieve the outsourcing outcomes post separation; there is no requirement around post separation business plans and strategy (and indeed this may be the responsibility of the statutory manager rather than the bank's (existing) directors) and no need to show on-going financial viability of the separated entity. If a bank is subject to Open Bank Resolution all liabilities incurred whilst the bank is under statutory management will be guaranteed by the government.

The separation plan should consider whether or how the separated bank will have access to collateral allowing them to access the RBNZ's (regular) liquidity facilities as well as the systems for this access. This might include information on the amount and location of assets which would qualify for central bank facilities.

10 Other factors to consider for separation

1. This section sets out the other factors that the bank should consider for its separation plan. The intention of this section is to assist the bank in determining how aspects of the requirements should be interpreted, including the length of time that the arrangements may need to be in place to ensure that the bank can continue to operate, as well as other factors such as funding and staffing requirements.

- a) **Duration of separation:** When the bank is placed into statutory management or is otherwise separated, there will be an immediate stabilisation phase (in which the separation plan is enacted). To the extent that the bank has been separated as part of a resolution process, this may be followed by a longer restructuring phase during which a more permanent solution is decided - whether that be winding down the business, selling or transferring it in part or whole to a private sector purchaser, or re-organising it to restore it to viability as a standalone entity under new owners.

The separation plan needs to ensure operational continuity can be maintained throughout this restructuring phase: keeping the bank as a 'going concern' will minimise creditor losses, as well as customer and financial system disruption. The Reserve Bank has made it clear to banks this could take a matter of months, rather than days: indeed, the current guidelines indicate this may be for an 'indefinite' period.

That said, the separation plan does not need to consider what the final state of the bank may be (i.e. is the bank ultimately wound-down, sold off to new owners, resolved as a viable and sustainable standalone entity going forward) . However, the separation plan should ensure the outcomes of the outsourcing policy including, on-going provision of basic banking services to existing customers can continue until such a point is reached and the plan should not presume a timeline for when this may be.

- b) **Post separation staffing arrangements:** The plan should also consider how non-financial resource requirements will be met post separation, with a particular focus on staffing requirements. This should cover the redeployment and possible relocation of staff to manage the post separation systems.
- c) **Funding:** The plan should detail how the bank will manage its funding post separation.

In order to demonstrate this, the plan will need to outline which systems and controls the bank will use in order to manage its funding, operational costs, and liquidity risks. This includes the issuance of new funding arrangements and managing the bank's financial position. The bank must be able to do this without any reliance on its parent.

- d) **Derivatives:** As large proportion of a bank's derivatives will be with the parent who has failed and other derivatives may have to be voided due to the separation/failure event, the bank will be required to "close-out" these positions. The bank will need to demonstrate that they have the ability to close-out these positions without support or systems from their parent bank. The plan should detail how the bank will be able to calculate its financial position without these derivatives and that any losses or gains as a consequence of early termination of derivative contracts are correctly recorded in the bank's financial position.

The bank will also be required to demonstrate that it has systems and controls to manage existing derivative contracts that haven't been closed out.

11 Communications with critical stakeholder groups

1. The separation plan should include how communications with staff, customers, counterparties, and regulators will be managed during the separation process. How existing customers will be informed (in particular those who have products and services suspended) is important to maintaining confidence in the banking sector.

There should be a pre-determined communication strategy with the bank's staff and customers to ensure that the separation process is orderly and doesn't undermine broader confidence in the wider banking sector. How the separation event is communicated to the bank's staff and customers will be a key influence on its ability to retain them post separation.

There also needs to be well defined processes in place to govern any interaction between the bank's internal separation committees and external stakeholders. For example, there should be communication and coordination protocols in place between the bank's internal separation committees, prudential and financial regulators and the Statutory Manager (as appropriate). However, there should also be recognition that once the Statutory Manager is in control of the bank the communication protocols and processes with external stakeholders will be under their control.

12 Assessment of separation

1. **Assessment of separation:** The separation plan should be tested by the bank on at least an annual basis. Annual is defined consistently with the revised outsourcing policy, meaning it is a period of 12 months, commencing on the day after the day on which the relevant obligation was last performed). However, testing should be conducted on a or more frequent basis if changes in the business environment or the wider group's operating structure are made and that this may affect the ability to operate on an independent basis. This will highlight implementation barriers (including issues that might arise from the way the bank currently organises its operations) and form the basis for iterative remediation work to refine the separation plan or the bank's operations. This might include measures to realign legal entities, business units and functions, or the location of shared services, to improve separability. Alternatively, the assessment process may conclude that an alternative strategy is more appropriate. The separability assessment should consider the credibility and feasibility of the strategy:
 - **Feasibility:** Banks should consider factors such as how likely it is that key processes and systems will be able to be accessed once the bank has been separated from the parent and where alternative service providers are used, and whether there will be sufficient capacity.
 - **Credibility:** This should at a minimum consider the impact of the preferred separation approach on market functioning, other financial institutions, market infrastructures, and customers.

13 Storage of information

1. **Information storage:** Arrangements should be in place to ensure the relevant staff, the Statutory Manager (for scenarios where separation coincides with appointment of a Statutory Manager) and where necessary, regulators, have access to sufficient information to execute an orderly separation as well as undertaking any preparatory steps. For example, information on the separation approach should be stored in a central data repository that can be easily accessed by relevant staff and external stakeholders. Further, the plan should outline what historical information the bank stores in order to facilitate potential forensic analysis.

14 On-going compliance with conditions of registration

1. In the event the bank undergoes a separation but no Statutory Manager has been appointed, the bank will need to remain registered if it is going to continue to provide basic banking services during and post separation. As a 'standalone entity' it will need to continue to meet all of its conditions of registration – in particular its minimum capital adequacy and liquidity requirements. The plan should demonstrate how this will be achieved, with this assessment incorporated into the funding and liquidity assessment mentioned above.
2. In the event the bank undergoes a separation and Statutory Manager has been appointed, not all conditions of registration will be relevant and others may have been breached (leading to appointment of the statutory manager in the first place). While the statutory manager will be responsible for ensuring the bank acts prudently as directed by the Reserve Bank through a possible new set of conditions of registration or section 120 of the Reserve Bank of New Zealand Act 1989, the separation plan should consider how the bank during and post separation can meet the spirit of all conditions of registration imposed before appointment of the statutory manager.²

² Some conditions of registration, such as those pertaining to governance of a bank, may not be relevant.