

4 December 2015

Victoria Learmonth
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
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By email: Victoria.Learmonth@rbnz.govt.nz

Dear Victoria

Consultation Paper: Review of Outsourcing Policy for Registered Banks

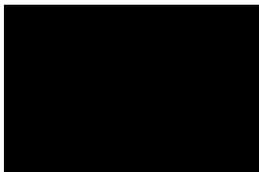
Thank you for the opportunity to submit on the Reserve Bank's proposed revision to the outsourcing policy covering registered banks.

Our comments are outlined below for your consideration. We would be happy to expand on these and respond to any questions or points of clarification.

We note that an industry submission has been prepared by the New Zealand Bankers' Association, which we support. The NZBA submission does not address one of the core policy changes that would impact us; the lowering of the threshold for the application of the Outsourcing Policy. Our submission focusses on that aspect and on the general problem analysis.

Once again thank you for the opportunity to provide feedback on this matter.

Yours sincerely



Jeremy Valentine
General Manager – Risk, Legal & Governance
The Co-operative Bank Limited

CC – Bruce McLachlan; Gareth Fleming; Andy Wood; Scott McKinnon; Grace Xu

Q1

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?

The Co-operative Bank (Co-op) appreciates The Reserve Bank's ("RBNZ") desire to periodically review its policy suite and engage with the industry in consultation on this.

However, Co-op submits that in setting the problem definition the RBNZ has:

- (a) given insufficient weight to one of its primary duties;
- (b) has not identified a key consequence of its threshold change proposal; and
- (c) overstated the need for a link between two separate policy objectives.

Co-op notes that in exercising its supervisory powers the RBNZ must do this for the purpose of "*promoting the maintenance of a sound and efficient financial system*". Co-op submits that a focus on lowering the threshold to banks with assets over \$1bn is inconsistent with that policy objective through it imposing unnecessary obligations on smaller banks without a demonstrated need or benefit. A very likely outcome of such a change would be to reduce efficiency through the imposition of costs without commensurate benefit or need.

In Co-op's submission the consultation paper overstates the link between Open Bank Resolution and Outsourcing and consequently proposes a threshold alignment that is unnecessary to achieve policy objectives and meet the efficiency obligation that forms part of RBNZ's regulatory role.

Co-op notes that the NZBA has compiled an industry submission on the overall consultation paper and is accepting of that submission. Co-op's primary submission is that the lowering of the threshold for compliance with the Outsourcing Policy is unnecessary and would cause significant and disproportionate costs for those additional banks that would be subject to the Policy as a result. Other than a general comment Co-op does not propose to specifically address other questions in the consultation paper.

Q2	
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Q18	<p><i>DO YOU THINK 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 BE IMPACTED BY AN ALIGNMENT? IF SO, PROVIDE DETAILED COMMENTS.</i></p> <p>Coop submits that an alignment between the threshold for the Open Bank Resolution and Outsourcing policies is unnecessary and unjustified. Co-op therefore strongly favours "Option 1 – Status Quo".</p> <p>Co-op considers that those two policies serve different purposes and should accordingly be treated differently.</p> <p>Open Bank Resolution operates as a resolution tool in the event of a bank failure event, whereas the Outsourcing Policy focusses on broader</p>

	<p>risk management. Under the former there is a case for a lower threshold given the consequences and the need for immediate action in such an event. Under the latter the application threshold should rightly take account of bank size to have proper regard to the overall supervision responsibilities of the RBNZ as regulator.</p> <p>Co-op submits that the consultation paper does not provide a compelling rationale for alignment of the policy thresholds and in fact raises issues that support separate treatment. Co-op understands that international practice is to maintain separation between function outsourcing and failure resolution.</p> <p>If the threshold for compliance with the Outsourcing Policy was lowered as proposed in the consultation document, Co-op would be significantly affected, particularly given the proposed breadth of the Outsourcing definition and the more limited optionality and bargaining power Co-op would have.</p> <p>For smaller domestic banks like Co-op the imposition of an obligation to effectively provide a back-up option for key functions would pose a significant cost burden. Given the uncertainty around changes to the scope of Outsourcing Co-op has not attempted to estimate the cost or effort to implement such arrangements but has no doubt they would be significant and would be absolutely disproportionate to the risks they seek to manage (given size and scale).</p> <p>Co-op does note that as an agency bank one of its key functions, the settlement and clearing of transactions, is facilitated by banks that are covered by the Outsourcing Policy and over which RBNZ has clear oversight. Co-op submits that as a practical matter this provides a fundamental protection.</p> <p>The implications of Co-op’s agency banking arrangements and related functions being caught under the proposed outsourcing arrangements are potentially sufficient to force the Bank to reconsider its business model. The complexity and scale of matters that may be covered by an outsourcing policy would certainly question the existing model.</p>
Q19	
Q20	
Q21	