



12 August 2016

For the attention of:
Victoria Learmonth
Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

By email

Dear Sirs

**Consultation submission:
Revised proposals for the outsourcing policy for registered banks**

We welcome the opportunity to submit on the Consultation paper on the above, dated 23 May 2016.

We have seen the submission being made collectively by ANZ Bank New Zealand Limited, ASB Bank Limited, Bank of New Zealand and Westpac New Zealand Limited (the Other Banks). We agree with their position on matters relevant to us and our response references their response where appropriate.

In our view, the key areas for further development or clarification of the proposed policy are:

- A need for further explanation of what might be regarded as an 'integral function' and confirmation that this will apply only to outsourcing to a related party. A bank will need to be able to confirm with the RBNZ at an early stage whether a contemplated outsourcing is regarded as 'integral', so that the additional requirements can be factored into the decision as to whether to proceed with the outsourcing proposal. An agreed RBNZ response time should be set.
- Additional material added to the White List (or similar guidance) to captures functions which are not considered outsourcing within the scope of the policy and those that are not related to the outcomes of the BS11 policy. In particular, the White List should address the treatment of software in order to prevent the non-objection process becoming unnecessarily burdensome.
- A pragmatic approach to the point at which a bank should engage with the RBNZ regarding the non-objection process, with guidance on this point. This should be before the contract is signed.
- A realistic approach to implementation of the policy including response timescales, so that banks remain able to move with market developments.
- A revision of the proposed conditions to adopt a proportionate approach to the outsourcing covered by the compendium, the timetable for updating the compendium and the need for internal audit involvement.

If you have any further questions regarding the above, please feel free to contact me or Julie Bottomley.

Yours faithfully

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Liz Knight

GM Operational Risk and Compliance

Cc Julie Bottomley, Senior Manager, Compliance

Appendix

Objectives and outcomes

Q1: Do you agree that the modifications to outcomes (a) to (e) provide clarification?

We support the outcomes focused approach and the Other Banks' suggested amendments to Outcomes a) and d).

Definition of basic banking services

Q2: Have we included the right services and scope? Are there any other services that should be included in the proposed list of basic banking services, such as trade finance and letters of credit? If appropriate, please provide the value/volume information on these services that are currently outstanding for your bank.

Trade Finance and Letters of Credit

We agree with the Other Banks' submission.

Cash in the definition of basic banking service

We agree with the Other Banks' submission.

Functions generally not captured by the outsourcing policy ("White List")

Q3: Are there any other services that should be included in the above lists, but have not yet been captured?

Materiality

We understand that the RBNZ does not wish to allow banks to apply a materiality threshold to determine whether the policy applies to an outsourcing proposal, but will use the White List to tailor the application of the policy requirements.

1. Functions which are not outsourcing

We agree with the Other Banks that the inclusion in the White List of items which would not appear to fall within the definition of outsourcing is likely to cause confusion regarding the interpretation of the definition. We support their suggested amendment to the definition of outsourcing.

We suggest that these items are retained in the policy in a separate list, since they appear to have caused confusion in the past.

Given that payment switches have been provided by external specialist providers for some time, and that RBNZ regulates New Zealand payments and settlements systems, we also agree with the Other Banks that payment switches should be outside the scope of the outsourcing policy.

2. Outsourced functions which are not relevant for BS11 purposes

It is important that the White List acts as an effective gate to prevent an inefficient non-objection process. We support the amendments to the White List proposed in the submission by the Other Banks.

Funds Management and Insurance Functions and Discretionary Investment Management Services

We note that an amendment to the definition of outsourcing, as proposed above, would make it clear that the above services are not covered by the Policy.

3. Outsourced functions that require a short form application for BS11 purposes

We agree with the Other Banks that a flexible way of updating the White List should be established at the next stage, before final publication of the Policy. We understand that the RBNZ may publish the White List as a separate appendix to the Policy.

Prohibited functions and the appropriateness and robustness of back-up capability

Q4: Do you agree that having robust back-up arrangements would be able to meet the objectives of the outsourcing policy?

It should be confirmed that the proposals only apply to matters outsourced to a related party.

Further clarity on what constitutes an ‘integral function’ is necessary. Banks will need to be able to engage with RBNZ to confirm whether a function is regarded as ‘integral’, at an early stage in the process, as the application of the requirements is likely to affect the desirability of outsourcing the function.

We understand that the RBNZ intends to agree a list of functions with each bank separately, taking into account RBNZ’s view of materiality. The approach will also need to consider how these lists are updated as banking markets and methodologies change.

Whilst recognising that these requirements are intended to apply only rarely, we support the response of the Other Banks re:

- Clarifying that loss of transactions relates to permanent loss, or loss preventing the delivery of the outcomes
- Aligning the switch over timing with the delivery of the outcomes
- Giving more flexibility on the frequency of testing of the back up arrangement and on the nature of the testing – which might be agreed with the RBNZ on a case by case basis.
- Allowing the outsourcing to certain related parties.

Engagement process

Q9: How many outsourcing proposals do you anticipate filing annually? Please note that this engagement process would not capture existing outsourcing arrangements that are covered by the transitional path to compliance, it would only cover new outsourcing proposals.

We recognise that banks need to take accountability for ensuring that outsourcing arrangements are robustly set up in accordance with the Policy – that it is not appropriate for banks to appear to rely on the RBNZ to provide assurance on their outsourcing arrangements through the vetting process. However, we agree with the Other Banks that banks should be able to submit a short form for review before a contract is completed and approved. This would allow for any differences between the bank and the RBNZ in the interpretation of practical control to be discussed and the contract adjusted accordingly, within the negotiation process. Revisiting a contract after the conclusion of the process is likely to cause costs and cast the banking industry in a poor light.

We would welcome some guidance on this point, and would expect to be able to discuss the appropriate point for submission of the short form with the RBNZ supervision team on a case by case basis.

We agree with the Other Banks concerns that appropriate resource may not be available within the RBNZ to provide feedback within suitable timescales. Given the size and nature of the short-form, we would expect that engagement with the submitting bank would come well within the 20 working day timeframe.

Compendium

Q10: Please provide comment on whether the draft condition of registration would work as envisaged?

If the condition of registration proposed is retained, we note that it requires a bank to keep a 'compendium of its outsourcing arrangements'. Given the penalties attaching to a breach of the condition, the wording should be clarified so that it refers only to those matters within the scope of the policy and those matters which the RBNZ has considered material to the outcomes ie those which have been the subject of 'long form' consideration. A condition requiring inclusion of matters outside the policy, or which the RBNZ considers by short-form to determine materiality to the outcomes does not appear proportionate.

We agree with the Other Banks that the requirement for a quarterly review by the internal audit function is disproportionate. The net effect will be to redirect internal audit resource from other risks which have been prioritised on the basis of risk in the three year internal audit plan approved by the Finance, Audit and Disclosure Committee of the Kiwibank Board.

We also agree that the requirement to update the compendium within 5 working days is a disproportionate inclusion in the condition.

Transitional path

Q12: Do you agree with the new proposed transitional period?

We agree that the proposed five year transitional period is helpful, but would welcome more clarity about how the policy implementation timetable will work. We understand from general discussion that the transition will be agreed with each bank individually, but with the engagement requirement will apply to new outsourcing immediately. We are unclear how the policy will be applied to existing outsourced arrangements from the date of the new policy or date of renewal of the arrangement.

In the context of potential competition between banks for scarce IT resources, IT contract specialists, and finance, risk and payment specialists required to execute these sorts of arrangements it may be that more time is required for certain functions or by particular banks. Despite best endeavours to become compliant, some circumstances (such as a delay in a large technology build) may require flexibility in terms of the transitional compliance timeframes.

Other comments

We understand that, subject to consideration of the consultation responses, the RBNZ currently intends to issue a draft of the policy in early 2017 with a short period to comment on any minor textual amendments. We are keen to see a draft policy document to ensure that our understanding of the revised document is correct. We believe that the draft policy would benefit from a flowchart to assist with common understanding of navigation between the decision points and actions.

