Review of the outsourcing policy for registered banks

Rabobank New Zealand Limited submission to the Reserve Bank of New Zealand

December 2015

Introduction

Rabobank New Zealand Limited (Rabobank) is grateful for the opportunity to submit a response on the review of the outsourcing policy for registered banks consultation document (Proposed Outsourcing Policy). Rabobank is a member of the New Zealand Bankers' Association and supports its submission on the Proposed Outsourcing Policy. However, Rabobank believes that if the Reserve Bank of New Zealand's (RBNZ) Outsourcing Policy (Outsourcing Policy) is extended to New Zealand incorporated banks with liabilities of more than $1 billion, Rabobank will potentially be the most significantly adversely affected bank. Hence Rabobank is making this separate submission.

In the appendix to this submission, Rabobank has addressed each of the specific questions on which RBNZ has sought feedback. However, Rabobank also has a number of significant concerns which did not fit neatly as a response to the specific questions asked. These concerns are set out below.

Executive Summary

Rabobank has a number of concerns about the Proposed Outsourcing Policy, based on its experience here in New Zealand and overseas.

(a) ***It could significantly adversely affect the efficiency and resilience of the New Zealand economy.***

An unintended consequence of the Proposed Outsourcing Policy could be that global specialist banks such as Rabobank are not able to compete effectively in the New Zealand market because of the costs imposed on them through the Outsourcing Policy.

(b) ***The transitional and ongoing costs of compliance for Rabobank are significant.***

In Rabobank's case, the impact of the policy is potentially greater than on other banks because it is a global bank and it has infrastructure in a number of jurisdictions but particularly in Australia, Asia and Europe.

(c) ***The proposed policy could be better aligned to other G20 countries*****.**

While Rabobank acknowledges that there is a high level of offshore ownership of New Zealand banks that RBNZ needs to be conscious of, Rabobank submits that a starting point for any proposed policy should be to consider international precedents, with any deviations ideally limited to changes necessary to address any specific risks arising from the concentration of offshore ownership. As a global bank, Rabobank is regulated in a large number of jurisdictions, including 18 of the G20 countries. As such, it supports the initiatives of the Bank of International Settlements (BIS) and Financial Stability Board in trying to create some global consistency in the regulatory environments of banks. The financial services market is a global market and there can be significant compliance and other costs for global banks where one regulator has a materially different approach. This impact is exacerbated by the relatively small scale of Rabobank in New Zealand compared to the global business.

(d) ***Systemically important bank.***

The Proposed Outsourcing Policy proposes a move from the current $10 billion of external liabilities to $1 billion of retail funding. Rabobank does not believe it is a systemically important bank and therefore should not be subject to the Proposed Outsourcing Policy and, in particular, the parental separation part of the policy. Even though Rabobank has [redacted] of the rural banking market, its deposit book (which RBNZ is using as a proxy for systemic importance) is [redacted] of Rabobank's total revolving deposits are unlikely to cause liquidity problems in the New Zealand market in the event of a crisis. Rabobank provides transactional banking products to [redacted] clients.

(e) ***Larger branches of overseas banks are likely to be exempt.***

Rabobank notes the intention to only apply the Proposed Outsourcing Policy to locally incorporated banks while allowing potentially larger branches of overseas banks to be exempt from the Proposed Outsourcing Policy. Rabobank believes all banks over any agreed threshold regardless of organisational form should be covered by the policy.

Rabobank respectfully suggests some modifications to the Proposed Outsourcing Policy in a manner which allows it to be applied in a graduated and proportionate manner depending on the systemic importance of the particular bank.

Rabobank requests that RBNZ consider creating separate policies for:

- outsourcing; and
- recovery and resolution plans (which could include parental separation plans but based on the systemic risk and likelihood of that risk occurring in each bank).

The policies should apply to domestically significant financial institutions with external liabilities of $15 billion (i.e. the threshold RBNZ has set for determining domestically significant banks).

About Rabobank

While all of this information will probably be well known to RBNZ, Rabobank hopes it is helpful in the context of this submission to summarise some of the key information about Rabobank as well as the New Zealand branch of Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Branch).

Place of Incorporation	Netherlands
Primary Regulator	European Central Bank / De Nederlandsche Bank
Credit rating	A+ (Standard & Poor's)
Global Capital	NZ$76.4 billion (HY 2015 June – Euro 46.5 billion)[1]
Global net profit	NZ$2.86 billion (FY 2014 – Euro 1.842 billion)[2]
New Zealand operations	
(a) Branch **(b) Subsidiary**	(a) Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. trading as Rabobank Nederland (b) Rabobank New Zealand Limited
New Zealand balance sheet (total assets)	
(a) Branch **(b) Subsidiary**	[redacted]
New Zealand capital	
(a) Branch **(b) Subsidiary**	(a) N/A [redacted]
New Zealand profit	
(a) Branch **(b) Subsidiary**	[redacted]
Total external liabilities	
(a) Branch **(b) Subsidiary**	[redacted]

[1] NZD/EUR June 2015 0.60905.
[2] NZD/EUR December 2014: 0.6445.
[redacted]

Rabobank's position in the New Zealand banking market

Rabobank believes that it adds significant value to the New Zealand economy and, in particular, the agriculture sector. This value is the increased competition Rabobank brings to the rural banking market and also the increased resilience it provides for the key agriculture sector of the New Zealand economy, particularly in times of financial stress. Rabobank is a specialist in providing financial services to the rural sector and brings its global expertise to the New Zealand market. This is reflected both in the types of products Rabobank is able to offer to New Zealand agricultural businesses and also the quality of service provided. Rabobank, from humble beginnings, has progressively built a meaningful market share and maintained high levels of customer service which are comparable to and/or lead the market. It has achieved this despite intense competition from the incumbent major banks. This is illustrated by the table and graph below, which show that Rabobank has:

- very high overall customer satisfaction with its performance, products and services; and
- consistently high ratings on key attributes relative to other banks operating in the rural sector.

[redacted]

[redacted]

This clearly reflects the quality of service a global specialist banking group, such as the Rabobank group, can provide to the New Zealand economy. Part of this service includes the benefit of Rabobank's global research capability, combined with local expertise to produce, arguably, the best economic research on the agriculture markets in New Zealand. This is because the Rabobank group has people on the ground and operating in both key New Zealand markets and also in countries competing directly with the New Zealand rural sector.

The quality of service and products provided to the agriculture sector is reflected in the asset growth of Rabobank in New Zealand. The table below on market share indicates that Rabobank plays an important role in funding the growth and development of the agriculture sector in New Zealand.

[redacted]

The Rabobank group is also able to bring the benefit of its global balance sheet to New Zealand's wholesale banking markets. Due to the narrow range of banks competing in the agribusiness wholesale banking markets, Rabobank acts as a key competitive constraint on the subsidiaries of the large Australian banks operating in New Zealand.

Rabobank, as a large rural bank, has global diversity in the rural sector which means that it could have capacity to provide liquidity in the rural sector where its competitors may not, especially in times of financial stress. During the global financial crisis, Rabobank remained committed to the New Zealand market even while a couple of significant Australian owned banks stopped lending to the agricultural sector. The graph below highlights the annual net gains and losses of registered mortgages for key lenders between 2005 and 2014. In 2011, Rabobank and (to a lesser degree) Bank of New Zealand were the only banks lending to the rural market. This demonstrates how, even though the sector was experiencing high levels of stress, Rabobank was able to provide liquidity to the system when other banks could not.

[redacted]

As no member of the Rabobank group has shares listed on any stock exchange, the Rabobank group is able to take a longer term view of markets than listed banks, which are under greater pressure to maintain their share price and maximise dividends in the short term. This makes Rabobank more reliable and less prone to short term changes in policy designed to protect share price and maximise dividends.

Financial Impact on Rabobank

The transitional and ongoing costs of compliance for Rabobank are significant and disproportionate. Rabobank believes that the costs for it of complying with the Proposed Outsourcing Policy, based on estimates it has done in conjunction with Deloitte, would be very substantial.

Core Business Area	Estimated Transition Costs	Estimated Infrastructure Costs	Estimated Total Capital Expenditure (NZD)	Estimated Annual OPEX
Retail Banking	[redacted]	[redacted]	[redacted]	[redacted]
Direct Banking	[redacted]	[redacted]	[redacted]	[redacted]
Trading and Treasury	[redacted]	[redacted]	[redacted]	[redacted]
Finance and Regulatory Reporting	[redacted]	[redacted]	[redacted]	[redacted]
Technology	[redacted]	[redacted]	[redacted]	[redacted]
Total Cost	[redacted]	[redacted]	[redacted]	[redacted]

[redacted]

In many cases this will require Rabobank to duplicate infrastructure in New Zealand that it is not required to duplicate anywhere else in the world. These costs will affect Rabobank disproportionately compared to its major competitors (the large Australian banks) as the fixed capital costs of locating infrastructure in New Zealand are not likely to be substantially lower for Rabobank than for those banks – whereas its scale is much smaller. The table below sets out the impact on its capital, profit and key ratios. These show a substantial impact on Rabobank's competitiveness.

Rabobank New Zealand Limited	Now	First 5 years after implementation	5 years+ after implementation
Capital (Tier 1)	[redacted]	[redacted]	[redacted]
Profit	[redacted]	[redacted]	[redacted]
Return on Equity	[redacted]	[redacted]	[redacted]
Cost to Income	[redacted]	[redacted]	[redacted]

[redacted]

The Rabobank group's New Zealand business only represents [redacted] of Rabobank's global on balance sheet assets. If the Outsourcing Policy is applied to Rabobank it will result in infrastructure and operating costs in New Zealand that are significantly disproportionate relative to the size of the New Zealand business compared to that of the global Rabobank group.

These increased costs could decrease the likelihood of other banks entering the New Zealand market as locally incorporated entities and, in an extreme case, may encourage existing participants to exit the market. We note that Deutsche Bank is withdrawing from the New Zealand market and understand that its withdrawal was, in part, motivated by the increasing regulatory burden it faced in New Zealand.

Alignment with International Practice

Rabobank is active in over 120 countries and has operations in 42 countries. In particular, it operates in 18 of the G20 countries. Rabobank is therefore subject to regulation in more jurisdictions than any other bank affected by the Proposed Outsourcing Policy.

While Rabobank understands that RBNZ has concerns with the offshore ownership of banks operating in New Zealand, Rabobank does not agree that this should change the focus of an outsourcing policy – although it does accept that it is very relevant to any recovery and resolution planning. Rabobank respectfully submits that RBNZ has not provided persuasive reasons why concentration of offshore ownership is relevant to an outsourcing policy.

Many other countries have large banks, with significant market shares, operating in their jurisdictions with offshore parents (albeit very few, if any, with the same level of offshore ownership of a financial system as New Zealand). For example most of the Global Systematically Important Financial Institutions (**GSIFI's**) operate in a large number of countries often with large market shares in those countries. None of the regulators in other jurisdictions have proposed the same approach as the one contained in the Proposed Outsourcing Policy for large foreign owned banks, and this includes the GSIFI specific recovery regime, which could be regarded as a base model.

To the extent RBNZ is concerned about the concentration risk of large banks owned by Australian parents, then Rabobank believes that the best way to deal with that issue is through cross-jurisdictional cooperation between governments and regulators, rather than a policy which is focused on individual banks. As a starting point to address RBNZ's concerns, RBNZ and the Australian Prudential Regulation Authority (**APRA**) could strengthen coordination oversight of the Australian owned banks operating in New Zealand and, to the extent they have not already been doing so, governments could look at strengthening legislation to deal with a Trans-Tasman bank failure.

Rabobank believes that, for international consistency, RBNZ should consider having, and that it is appropriate for there to be, separate policies relating to:

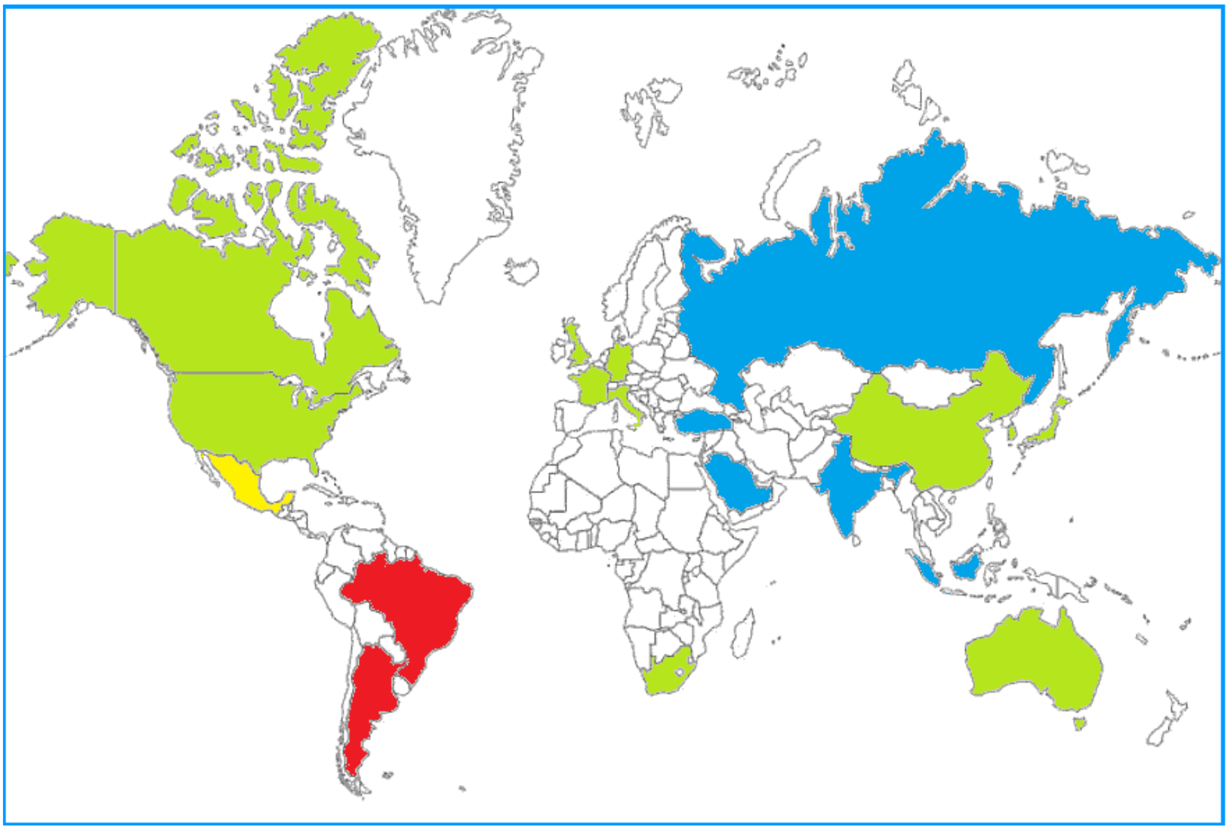
- outsourcing - based on the BIS *Outsourcing in Financial Services* guidelines for outsourcing policies; and
- recovery and resolution - based on the Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions* guidelines (Key Attributes Report).

Rabobank believes that adopting the above approach will be clearer for regulated banks and make it easier for those banks to understand and hence improve compliance (noting that inconsistent compliance with the existing Outsourcing Policy because of differing interpretations appears to be an important reason for the Proposed Outsourcing Policy).

Rabobank believes that the parental separation requirement of the Proposed Outsourcing Policy is likely to best sit as a component of a recovery and resolution plan that is consistent with the Financial Stability Board guidelines.

There are also international templates which Rabobank believes RBNZ could have regard to in the development of recovery and resolution plans. Rabobank has, for example, filed a recovery and resolution plan with the US regulators. Splitting the Proposed Outsourcing Policy in this manner would enable RBNZ to adopt an approach to outsourcing more closely aligned to BIS guidelines – which it could apply to all registered banks but with a differentiated or graduated approach in relation to recovery and resolution plans (which is the Financial Stability Board practice).

The graphic below shows the G20 countries that had implemented recovery and/or resolution plan requirements and outsourcing requirements in separate policies as at December 2014.



= has separate recovery and/or resolution and outsourcing policies.
= does not have recovery and/or resolution or outsourcing policies.
= has a recovery and/or resolution policy but not an outsourcing policy.
= does not have a recovery and/or resolution policy but has an outsourcing policy.

Suggested Modifications

As indicated, Rabobank has a preference for the RBNZ to consider separate policies for:

(a) outsourcing; and

(b) recovery and resolution.

Rabobank submits that the Proposed Outsourcing Policy could appropriately be based on the BIS *Outsourcing in Financial Services* guidelines. Examples of policy guidelines which could be relevant for the New Zealand market include those adopted by the APRA, the Canadian Office of the Superintendent of Financial Institutions and the Monetary Authority of Singapore.

Rabobank submits that recovery and resolution planning should be limited to domestically significant financial institutions – which would not include Rabobank. In effect, such planning would be required for locally incorporated banks with more than $15 billion of external liabilities (i.e. the threshold set by RBNZ for banks of domestic systemic importance and the threshold at which branches must incorporate).

If, however, RBNZ determines that its preference is to have a recovery and resolution policy that applies to all banks with more than $1 billion of retail deposits, then Rabobank believes that the Outsourcing Policy should be applied in a proportionate and graduated manner.

If RBNZ determines it should adopt a lower threshold for a parental separation plan/recovery and resolution plan, then Rabobank respectfully submits that RBNZ should look to the following factors when deciding whether to require a resolution plan from a bank and how detailed that plan must be:

(a) the market share of the bank;

(b) the scope of operations of the bank;

(c) the potential scale of disruption which would be caused by the bank failure;

(d) the economic benefits provided by having that bank as a participant and, in particular, any improvements in the efficiency in the New Zealand economy inherent in its operating model;

(e) the credit rating of the relevant bank (i.e. the greater the probability of default, the more detailed the plan would need to be);

(f) the amount of local capital held by the bank (e.g. rather than insourcing an operation, the bank may be required to hold additional capital instead);

(g) the substitutability of the bank's operations by others in the market place;

(h) the range of jurisdictions in which the bank operates and the places in which its infrastructure is held (and relationships with these regulators in these jurisdictions); and

(i) the economic incentives to keep operating a failed bank (including the benefits of integrated infrastructure e.g. because of the difficulties and lack of incentive to turn it off for one jurisdiction).

Conclusion

While Rabobank in New Zealand represents [redacted] of the total banking market in New Zealand,[8] Rabobank believes it is the [redacted] lender in the rural market, with approximately [redacted] market share. Rabobank believes its presence in the New Zealand market provides significant competition for the Australian owned banks and improves the resilience of the rural banking sector in New Zealand. Given the importance of the rural sector to New Zealand, Rabobank believes there are significant economic advantages, not just to the financial markets, but also to the New Zealand economy as a whole, from having Rabobank operate in New Zealand. However, Rabobank is only able to be competitive because it is able to leverage its global infrastructure when operating in the comparatively small New Zealand market.

Adding significant costs to Rabobank's infrastructure by requiring it to duplicate resources in New Zealand could materially affect its competitiveness. Rabobank believes that the lost economic benefit for New Zealand from making Rabobank (and other potential entrants) uncompetitive is likely to outweigh any benefits to the soundness of the New Zealand economy created by applying the Proposed Outsourcing Policy in its full rigour to Rabobank.

[8] Based on RBNZ's figures of registered banks' assets.

SUBMISSION TABLE

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?
With respect, Rabobank does not agree with the analysis of the problem or that the potential problems with outsourcing are appropriately identified. Rabobank considers that the analysis is suboptimal because the Proposed Outsourcing Policy: (a) does not sufficiently distinguish between third party outsourcing and failure resolution (which should ideally be separate); (b) could better balance the efficiency and soundness of outsourcing against the systemic risks; and (c) does not adequately address branches of overseas banks. ***The analysis in the Proposed Outsourcing Policy does not sufficiently distinguish between third party outsourcing and failure resolution*** The proposals in paragraphs 51 – 57 of the Proposed Outsourcing Policy would require banks to prepare separation plans to describe the processes that would be undertaken if an event of separation occurred with a bank's parent. Rabobank does not believe that the Outsourcing Policy is the appropriate policy to contain such a requirement. Including outsourcing requirements in the same policy as bank separation requirements is not aligned with international practice. While there are international policies that deal with outsourcing to parent companies, they do not require parental separation plans. Rabobank submits that a separation plan is more appropriately part of a recovery and resolution plan. This is consistent with Rabobank's experience in other jurisdictions. ***The Proposed Outsourcing Policy does not adequately take into account the economic benefits of outsourcing as well as the soundness benefits of outsourcing*** Section 68 of the Reserve Bank of New Zealand Act requires RBNZ to exercise its banking supervision and registration powers for the purposes of promoting the maintenance of a sound ***and*** efficient financial system. In order to comply with its statutory objectives, RBNZ must consider both of these purposes. Rabobank believes that the Proposed Outsourcing Policy focuses too heavily on soundness at the expense of efficiency. Global banks offer specialised products, services and expertise that would not otherwise be available in the New Zealand market. For example,

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Rabobank specialises in providing rural banking services and has [redacted] rural specialist bankers across the country. The kind of rural specialisation Rabobank offers may be lost if Rabobank is required to make material changes to its operating model and, in particular, lose the capability to leverage its global infrastructure to compete in New Zealand.

If the projected initial and ongoing costs of complying with the Outsourcing Policy became too great, the parent companies of global banks may decide to exit (or not enter) the New Zealand market.

The Proposed Outsourcing Policy does not cover branches of overseas banks

It is not clear to Rabobank why New Zealand is contemplating not requiring compliance by branches of overseas incorporated banks over the Outsourcing Policy threshold. Rabobank believes this is an important issue, even though it was not included as a question in the Proposed Outsourcing Policy. Not having the Outsourcing Policy apply to branches effectively creates a competitive advantage for any bank operating as a branch in New Zealand over those that are locally incorporated.

As RBNZ is aware, Rabobank operates both as a branch and as a subsidiary in New Zealand. If Rabobank had merged the operations of Wrightson Farmers Finance Limited (Rabobank's former name) into its Branch when it entered the New Zealand market (as was an option at the time) it would not be subject to the Proposed Outsourcing Policy under the proposals. The fact that Rabobank chose, instead, to retain a New Zealand subsidiary and register it as a bank should not, it believes, be the determining factor as to whether or not the Rabobank group's New Zealand businesses are covered by the Outsourcing Policy. RBNZ has recently advised Rabobank informally that it would not be prepared to allow the Rabobank business to be transferred to the Branch – because the outcome would be that it was not subject to a range of policies only applying to locally incorporated banks.

While Rabobank accepts that in the event of an insolvency of a branch, New Zealand creditors (potentially) have access to the global assets of the relevant bank, cross border insolvencies are inherently complex, with sometimes unexpected results.

The disruption to the economy of a significant branch being unable to provide services is no different to the disruption which would occur in a subsidiary bank. For example, if all of the Rabobank group's New Zealand assets were held in the Branch and Rabobank failed globally, the disruption in terms of loss of service, contagion and immediate economic impact for customers would be the same. While technically customers could make claims against the global bank and potentially get a greater recovery, this could be outweighed by the time, cost and complexity of pursuing a claim. We understand most

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recovery and resolution policies around the world apply equally to branches and subsidiaries. In contrast, the lowering of the Outsourcing Policy threshold to $1 billion would create distortions in compliance costs amongst direct competitors. For example, Rabobank has retail deposits of [redacted] and would be captured by the Proposed Outsourcing Policy. The Hongkong and Shanghai Banking Corporation Limited (HSBC) and Citibank N.A both have New Zealand retail deposits over $1 billion [redacted] but would not be captured by the Proposed Outsourcing Policy. Although the Rabobank parent company also operates as a Branch in New Zealand, the intertwined nature of some of the Branch's functions with Rabobank's (for example, data storage) would probably mean that the Outsourcing Policy would also apply de facto to the Branch. International practice is for outsourcing requirements to apply to local and foreign financial institutions. The APRA's *CPS 231: Outsourcing* (CPS 231) applies to local and foreign authorised deposit-taking institutions (although it does not apply in respect of arrangements between the branch and its head office). The Canadian Office of the Superintendent of Financial Institutions (OSFI) *Guideline on Outsourcing of Business Activities, Functions and Processes* (OSFI Guidelines) applies to the Canadian branch of a foreign owned bank. The failure resolution plans required to be submitted to the Federal Reserve by certain banks in the United States must contain a number of different matters similar to those in the Proposed Outsourcing Policy (for example, the proposed requirements at paragraph 39 of the Proposed Outsourcing Policy). The Federal Reserve requires both United States incorporated banks and overseas incorporated banks to comply with these requirements (including a number of Australian banks with operations in the United States).

2. WITHOUT AN OUTSOURCING POLICY HOW WOULD YOU PROPOSE THAT A FAILURE IS MANAGED?
Rabobank submits that a separate failure resolution plan is the most appropriate method for managing bank failure and would be consistent with international bank failure management practice and Financial Stability Board guidelines. Rabobank is not opposed to the failure resolution objectives proposed at paragraph 39 of the Proposed Outsourcing Policy. However, it does not believe that the Outsourcing Policy is the appropriate policy through which these objectives should be achieved. The proposed failure resolution objectives at

2. WITHOUT AN OUTSOURCING POLICY HOW WOULD YOU PROPOSE THAT A FAILURE IS MANAGED?
paragraph 39 only apply to failure resolution to the extent the matters apply to a bank's outsourcing arrangements. The objectives therefore do not contemplate a comprehensive overview of a bank's failure resolution procedures. Addressing failure resolution matters through a variety of different policy documents and requirements could create inconsistency and uncertainty if a bank failure occurred. In order to minimise the possibility of confusion and conflicting procedures if a bank failure event does occur, Rabobank supports the approach of requiring domestically systemically important registered banks to submit failure resolution plans to RBNZ that deal with failure resolution on a holistic basis. Rabobank respectfully submits that a failure resolution plan could: (a) describe on a holistic basis the bank's strategy for orderly resolution in the event of material financial distress or failure of the bank; (b) be divided into public and confidential parts. Banks required to submit failure resolution plans in the United States are permitted to include sensitive information in a confidential section of a failure resolution plan, with the public section being made available online through the regulator's website; (c) include a plan to deal with key suppliers (which would include requirements related to the objectives raised at paragraph 39 of the Proposed Outsourcing Policy); and (d) be tailored having regard to the risks and issues associated with the bank in question. The plan should take account of the specific circumstances of the bank and reflect the nature, complexity, interconnectedness, level of substitutability and size of the bank. For example the failure resolution plan of a highly rated bank of low systemic importance would not need to be as comprehensive as the failure resolution plan of the bank of the greatest systemic importance. The European Union Bank Recovery and Resolution Directive 2014/59/EU (BRRD) stresses the importance of proportionality and requires that the content of plans should take into account the nature of the institution's sources of funding, including mutually guaranteed funding or liabilities, and the degree to which group support would be credibly available. International best practice is to require financial institutions that could be systemically significant to produce failure resolution plans. The G20 countries adopted the Financial Stability Board's Key Attributes Report in November 2011. The Key Attributes Report sets out twelve essential features that should be a part of the resolution regimes in all jurisdictions. One of these features is a resolvability assessment which should detail the extent to which key operational functions are outsourced to other group entities or third party service providers. Due to the adoption of the Key Attributes Report by the G20, certain banks in jurisdictions such as the United States, Canada and the United Kingdom

2. WITHOUT AN OUTSOURCING POLICY HOW WOULD YOU PROPOSE THAT A FAILURE IS MANAGED?
are required to submit failure resolutions to their respective regulators. In the United States, banks with total consolidated assets of $50 billion or more are required to periodically submit failure resolution plans to the Federal Reserve under the Dodd-Frank Act. In Canada, the six largest banks which have been deemed to be domestically systemically important must submit resolution plans to the OSFI. Likewise, UK banks are required to submit recovery and resolution plans to the Prudential Regulation Authority.

3. DO YOU AGREE THAT THE CURRENT OUTCOMES-FOCUS SHOULD BE RETAINED?
With respect, Rabobank does not agree that the current outcomes focus should be retained because it: (a) has not worked to date; and (b) is inconsistent with international practice. Paragraph 35 of the Proposed Outsourcing Policy highlights that the current Outsourcing Policy requirements do not require banks to engage with RBNZ but instead require banks to 'satisfy' RBNZ that arrangements are adequate. Rabobank agrees that this is an unsatisfactory position and believes that the lack of engagement is probably due to the outcomes-focused nature of the Outsourcing Policy. The international approach for the objectives of outsourcing policies is to place ultimate responsibility for the outsourcing policy of an institution in the hands of the relevant financial institution. Rabobank supports this approach. Rabobank supports a policy which is clear and not open to a divergence of interpretations. Rabobank believes Canada, Australia and the United Kingdom all have policies that could provide a good starting template for New Zealand. Rabobank also believes that comprehensive resolution plans (which could include some or all elements of a parental separation plan) should only be required from banks that meet the systemically important threshold currently set by RBNZ (i.e. banks with NZ$15 billion in liabilities net of amounts due to related parties).

4.	**DO YOU AGREE THAT CHANGING THE OBJECTIVES TO FOCUS MORE ON RESOLUTION IS RIGHT?**
Rabobank does not agree. Rabobank submits that there should be an outsourcing policy, but it must be clearer on requirements.	

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.**
Rabobank does not agree because such an approach is misaligned with international practice (refer to question 3). Rabobank submits that there should be a separate failure resolution policy.	

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?**
Rabobank does not agree because, in line with current international practice, a separation plan should not be included in a bank's outsourcing arrangements and should be developed as part of a recovery and resolution plan.	

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.**
No because the Proposed Outsourcing Policy does not:	

(a) elaborate on why the proposed definition of 'outsourcing' was modified from the Basel Committee's Report on Outsourcing in Financial Services definition;

(b) set a materiality threshold for outsourcing arrangements captured by the Proposed Outsourcing Policy requirements; and

(c) provide any evidence that definitions from other jurisdictions have been considered (in particular, the definitions from the United Kingdom and Canadian policies).

8. ARE THERE ANY OTHER FUNCTIONS THAT SHOULD BE EXCLUDED FROM THE OUTSOURCING POLICY, BUT ARE NOT CAPTURED IN THE LIST ABOVE?

Rabobank has reviewed the list of activities excluded from the outsourcing policies of other jurisdictions and notes that the list of exclusions in the Proposed Outsourcing Policy largely replicates the list from the OSFI Guidelines. The Proposed Outsourcing Policy omits some exclusions that are included in the OSFI Guidelines but does not outline why these activities are not on the exclusion list. Rabobank believes they should be included.

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?

Restrictions on outsourcing certain functions

Rabobank does not agree that there should be a blanket restriction on the outsourcing of a function. The only issue should be the level of control and access for both the bank and the supplier upon a failure.

Rabobank understands it is inconsistent with international practice to impose a blanket restriction on the outsourcing of a certain function. CPS 231 does not impose any such restrictions on banks in Australia outsourcing a certain function. Likewise, the OSFI Guidelines do not impose any restrictions on Canadian banks outsourcing certain functions. Rabobank has not seen any evidence from these jurisdictions that the lack of a blanket restriction on the

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outsourcing of certain functions has created problems.

Appropriateness of the examples

Rabobank does not agree with the examples in the Proposed Outsourcing Policy of functions that should be restricted from being outsourced:

Data storage: Rabobank understands that China is the only other jurisdiction in which the Rabobank group operates that requires banks to maintain data separately in that jurisdiction (although Indonesia does require Rabobank's core systems to be located within the jurisdiction). In general, outsourcing policies only require that there are appropriate protections over the security and privacy of data in the place it is stored and contracted rights to it. While there may be reasons to require data to be available in New Zealand for systemically important banks, requiring it for smaller banks will entail a major capital and operational cost that is significantly disproportionate to any benefit to the soundness of the financial system it could bring. A blanket restriction on outsourcing data storage could have significant economic and service level quality implications while addressing only a very minor risk to the wider financial system, especially relative to larger registered banks.

SWIFT Gateways: Rabobank [redacted] SWIFT gateway to process files. The blanket restriction in example two would cause significant economic costs for Rabobank, particularly given it would likely mean Rabobank would also be required to directly join the New Zealand payments system. Rabobank believes as long as a regulated institution is providing the SWIFT gateway and payment services in New Zealand this should be sufficient.

10.	**DO YOU THINK AN OUTSOURCING ARRANGEMENT COMPENDIUM WOULD BE USEFUL AS A REFERENCE RECORD BETWEEN THE RESERVE BANK AND A BANK?**

Yes a compendium would be useful but it should not form part of a bank's conditions of registration.

11. ARE THERE ANY OTHER MATTERS NOT ADDRESSED ABOVE THAT SHOULD BE INCLUDED IN THE COMPENDIUM?
No.

12. WHAT ARE THE COSTS TO YOU OF ESTABLISHING AND MAINTAINING AN OUTSOURCING ARRANGEMENT COMPENDIUM THAT FORMS PART OF YOUR CONDITIONS OF REGISTRATION?
Rabobank estimates that the cost of maintaining such a compendium would be approximately [redacted]

13. DO YOU AGREE THAT ALL CONTRACTS FOR OUTSOURCING ARRANGEMENTS SHOULD BE REQUIRED TO INCLUDE THE TERMS OUTLINED IN PARAGRAPH 81?
Rabobank agrees with the provisions which have been suggested. The proposed provisions are largely aligned with CPS 231 and the OSFI Guidelines, although Rabobank notes that the provision at paragraph 81(b) in respect of parallel rights for arrangements made through a parent or related party has not been included in Australia's or Canada's policies. For Rabobank, this could be particularly intrusive given the global nature of much of its infrastructure. It may be particularly problematic to obtain direct contractual rights against group wide suppliers when New Zealand only accounts for less than 1% of total group operations.

14.	**DO YOU AGREE THAT OPTION TWO IS THE MOST APPROPRIATE OPTION FOR THE ASSESSMENT OF OUTSOURCING ARRANGEMENTS? PLEASE EXPLAIN.**
Option 2 is acceptable.	

15.	**DO YOU AGREE THAT THE APPROACH OUTLINED ABOVE IS AN APPROPRIATE WAY TO MANAGE THE ASSESSMENT OF OUTSOURCING PROPOSALS? IF NOT, PLEASE EXPLAIN.**
Rabobank does not agree because there are no strict timeframes for RBNZ to respond to an application. This could add significant cost or delay to contractual arrangements. A process which allowed for a default acceptance of a contract if RBNZ has not given the bank an answer within 20 working days would be preferable from Rabobank's perspective. Even then Rabobank would prefer and approach consistent with that adopted by APRA. In Australia, under CPS 231, a bank is required to give notice to APRA at least 20 working days **after** the outsourcing arrangement has been entered into. This notification must be accompanied by a statement outlining the key risks involved in the outsourcing arrangement and the risk mitigation strategies put in place to address these risks. APRA may request additional material where it considers it necessary in order to assess the impact of the outsourcing arrangement on the bank's risk profile. The Australian approach reduces the risk of significant costs to banks caused by a delay in regulatory approval of an outsourcing arrangement.	

16.	**DO YOU AGREE THAT HAVING STANDARDISED APPLICATIONS WOULD ASSIST IN REDUCING THE TIME TAKEN TO ASSESS OUTSOURCING PROPOSALS?**
Yes.	

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?**

If Rabobank must notify RBNZ of *material* outsourcing arrangements only, Rabobank estimates it would notify RBNZ of 5 to 10 proposals per year.

If Rabobank must notify RBNZ of all outsourcing arrangements, Rabobank estimates it would notify RBNZ of between 30 to 50 proposals per year.

18.	**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.**

Rabobank does not believe there is a sufficient linkage between OBR and outsourcing to justify aligning the thresholds.

OBR is part of a failure management plan whereas an outsourcing policy is about ensuring banks appropriately manage risk when contracting key services from third party suppliers.

International practice is to have separate policies regulating outsourcing and recovery/resolution issues and Rabobank prefers this approach. Even if there are aspects of the New Zealand banking industry which are unique, such as the concentration of Australian owned banks, the base position should be international practice, amended as necessary to take into account such unique aspects of the New Zealand market. OBR is relevant to recovery and resolution planning only and the OBR threshold is only relevant in that context (and even then, Rabobank believes it should be $15 billion and only apply to systemically important banks).

Rabobank does not think the Proposed Outsourcing Policy provides adequate evidence justifying the increase in the threshold. Rabobank does not see any reason for a change in assessing the systemic importance for smaller banks (i.e. those under the $10 billion threshold which has been in place over the past nine years), particularly given paragraph 103 suggests that the threshold was set correctly in 2006. Rabobank believes that any evidence of a change in the systemic importance of smaller banks should be disclosed if it is to be the basis for lowering the Outsourcing Policy threshold. In effect, Rabobank would be grateful to receive any analysis done by RBNZ of how the systemic importance threshold has lowered in dollar terms when the

market size has increased, meaning banks with only small market shares ought to now be regarded as systemically important (the threshold was around 7.5% of the market when the local incorporation policy was set around 15 years ago and is now be less than 1%). If RBNZ pursues the proposal in the Proposed Outsourcing Policy to align the outsourcing threshold with the OBR threshold, Rabobank submits that the alignment should also be extended to branches of overseas incorporated banks for the following reasons: (a) the different treatment of branches will give them a competitive advantage (as outlined above); and (b) cross-border insolvency issues can still arise in the case of an insolvent subsidiary. Rabobank would be materially impacted by the alignment of these policies.

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?
Yes.

20. DO YOU AGREE THAT 2 YEARS WOULD PROVIDE A SUFFICIENT TIMEFRAME TO REACH COMPLIANCE WITH THE POLICY?
Possibly not. As Rabobank would be coming under the Outsourcing Policy for the first time and it would have a significant amount of contract renegotiation to undertake before becoming compliant. Many large global vendors simply have no incentive to change. Two years may not be sufficient time for this process.

21. HOW MUCH DO YOU THINK TRANSITIONING TO COMPLIANCE WILL COST AND HOW COULD THOSE COSTS BE REDUCED BY AN APPROPRIATE TRANSITIONAL PATH?
Rabobank estimates that the initial capital costs for transitioning to compliance will be [redacted] Once Rabobank has fully transitioned, it expects to incur annual operating expenditure costs of [redacted] Rabobank does not believe these costs will be materially reduced by a transitional timetable.