



9 August 2016

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Dear Ms Learmonth

Re: Reserve Bank of New Zealand (Reserve Bank) Consultation paper: Revised policy proposals for the review of the outsourcing policy for registered banks

Salesforce welcomes the opportunity to comment on the final *Consultation Paper: Revised policy proposals for the review of the outsourcing policy for registered banks* (Consultation Paper).

Salesforce agrees with the Reserve Bank that the focus of the Reserve Bank's outsourcing policy should be to provide a better alignment with the Open Bank Resolution (OBR) policy and that there is a balancing of policy considerations to be made when developing an outsourcing policy.

Salesforce has endeavoured to respond to the questions raised by the Reserve Bank that are of most relevance.

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

Salesforce agrees that the modifications to outcomes (a) to (e) provide clarification for banks as to the Reserve Bank's policy considerations and how banks can satisfy the policy.

Question 3: Are there any other services that should be included in the above lists, but have not yet been captured?



Yes, there are other services which should be considered immaterial and accordingly included in the white list.

The Reserve Bank proposes to keep the definition of outsourcing the same as consulted on last year and proposes a white list of excluded functions.

The proposed definition of outsourcing is:

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 activities on a continuing basis that could be undertaken by the registered bank, now or in the future.

The Consultation Paper rightly focuses upon the clear statement of the objectives of outsourcing policy and the required outcomes. These objectives and outcomes relate to activities of a regulated bank that are relevant to its internal financial monitoring and financial management or provision of basic banking services to existing customers or regulatory oversight and external monitoring of these activities.

The proposed white list (paragraph 72 of the Consultation Paper) appears to reflect these objectives and required outcomes. Similarly, the Monetary Authority of Singapore's revised Guidelines on Outsourcing (issued 27 July 2016) capture as outsourcing activities which have the characteristics that "the institution is dependent on the service on an ongoing basis" and "the service is integral to the provision of a financial service...", as well as using a threshold of materiality.

Salesforce's concern remains that while a white list would be helpful to banks and the Reserve Bank in knowing which activities are definitely out of scope of the outsourcing policy, absence of any clear element within the stated 'activities' or 'functions' within the definition of outsourcing that links back to the stated objectives and required outcomes, the definition over-reaches to capture some activities which should also be excluded.

Banks rightly will wish to be seen to be prudent and conservative in interpreting and applying the Policy, and unless an activity is clearly excluded banks are likely to regard that activity as included. The white list will likely be applied by banks as an exhaustive list: that is, financial institutions will as a matter of prudence assume that any activity which is not expressly whitelisted is a relevantly regulated outsourcing arrangement.

Accordingly Salesforce suggests that the definition could be more appropriately targeted as follows:

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 activities on a continuing basis that could be undertaken by the registered bank, now or in the future, where disruption in the conduct of those activities may reasonably be anticipated to impact provision of basic banking activities to existing customers of that registered bank or other outcomes as referred to in [provision listing final outcomes, as currently stated at para [47] of the Consultation Paper].

Our suggested amendment accommodates the Reserve Bank's view that there is no need to introduce an explicit materiality test. Our suggested amendment keeps the definition of outsourcing intentionally broad but expressly relates it to the Reserve Bank's stated objectives and required outcomes, in order to clearly exclude those arrangements which may otherwise be deemed to be an outsourcing activity by virtue of the proposed definition but which are not intended to be included having regard to the revised objectives and required outcomes of the policy set out in the Consultation Paper.

Salesforce's provision of customer relationship management (CRM) system for use by banks to record and manage details of a bank's third party suppliers (not being a primary record of details about existing customers of the bank's basic banking activities), should not be considered an outsourcing arrangement. Individual banks, and the banking system, are not relevantly dependent upon this service. Accordingly, provision of a CRM system is not integral to the provision of a financial service or a "basic banking service" as defined in the Consultation Paper, other than where a bank is using a CRM system as its primary record of details about existing customers of the bank's basic banking activities).

Should Reserve Bank not adopt a broader category of services in the white list, then we suggest introducing a materiality test to the definition of what constitutes an outsourcing activity.

Salesforce's view is that unless the white list is greatly expanded, the effectiveness of the white list is limited. We therefore suggest that the Reserve Bank reconsider introducing a materiality threshold.

Using a materiality threshold would be consistent with the approach taken by regulators across jurisdictions. For example, in the UK, the Financial Conduct Authority only regulates those outsourcing arrangements which are "critical or important". UK Financial Conduct Authority's SYSC Handbook SYSC 8.1.4 provides that (emphasis underlined)

...an operational function is regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a common platform firm... or its financial performance, or the soundness or continuity of its relevant services and activities.¹

¹ Financial Conduct Authority SYSC Handbook, SYSC 8.1.4.



The Australian Prudential Regulation Authority's (APRA) Prudential Standard 231 only applies to the outsourcing of a 'material business activity' which means an activity:

'that has the potential, if disrupted, to have a significant impact on the regulated financial institution's business operations or its ability to manage risks effectively'.²

Further, APRA's definition of outsourcing (below) is similar to the definition proposed by the Reserve Bank:

"Outsourcing" involves a regulated institution entering into an arrangement with another party (including a related body corporate) to perform, on a continuing basis, a business activity that currently is, or could be, undertaken by the regulated institution itself.³

APRA's definition is broad, but is combined with a materiality threshold which introduces greater certainty than an overly broad definition with a short list of excluded activities.

The Monetary Authority of Singapore gave further consideration as to whether its revised Guidelines on Outsourcing (issued 27 July 2016) should apply to material outsourcing arrangements and elected to continue to apply a materiality threshold and specifically relate information handling to 'customer information':

"material outsourcing arrangement" means an outsourcing arrangement – (a) which, in the event of a service failure or security breach, has the potential to either materially impact an institution's– (i) business operations, reputation or profitability; or (ii) ability to manage risk and comply with applicable laws and regulations, or (b) which involves customer information and, in the event of any unauthorised access or disclosure, loss or theft of customer information, may have a material impact on an institution's customers."⁴

Salesforce suggests that such a definition of outsourcing better reflects the outsourcing policy outcomes of avoiding disruption and damage to the bank's operations, bank's balance sheet and the rest of the financial system.

Activities that are particular, or core to the provision of financial services and "basic banking services" and are inherent to the provision of financial services, should be those outsourcing arrangements that are addressed by the outsourcing policy.

² APRA Prudential Standard CPS 231 – Outsourcing, paragraph 14.

³ APRA Prudential Standard CPS 231 – Outsourcing, paragraph 10.

⁴ Monetary Authority of Singapore, GUIDELINES ON OUTSOURCING 27 July 2016.



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

Q8: Are there any features that are not on the list above that should be added?

Salesforce agrees that having robust back-up arrangements (as opposed to an outright prohibition of certain functions from outsourcing) would be able to meet the objectives of the outsourcing policy.

Salesforce also agrees that the requirements for a robust back-up arrangement should only apply to critical functions, otherwise there would be massive cost implications for both banks and service providers if the requirements cover non-critical functions.

For example, as-a-service offerings such as enterprise resource planning, CRM and other business process services which are designed for global markets and are used across many industry sectors, should not be treated as critical functions.

The requirement listed in paragraph 82 of the Consultation Paper that external audit is conducted at least every two years would be unnecessary for non-critical as-a-service offerings described above.

Another requirement for robust back-up arrangements is for banks to have direct ownership and control over the standby system, meaning that banks have legal and practical ability to control the standby system, whether through owning the system or having a direct relationship with the third party provider. Salesforce agrees that the focus should be on the “control” of a bank’s data. Control of data is a distinct concept from possession of data. It revolves around the ability of a party (the data controller) to exercise stewardship over data, to be confident that the data is up-to-date and to access or recover that data in the event that the primary data repository is not available for any reason. The focus should be on whether the bank has appropriate contractual assurance as to these matters from a suitably reliable counter-party. Many businesses now depend upon third party data warehouses or data custodians to better assure availability of data, noting that tier one data warehouses generally provide a higher level of data security and reliability of infrastructure services than is readily available to even large businesses in respect of their in-house data management functions.

Contractual terms

Salesforce is of the view that the three contractual terms required to be included in all outsourcing arrangements listed in paragraph 112 of the Consultation Paper should only apply to all “material” outsourcing arrangements, applying the definitions of “materiality” and “outsourcing” as suggested above.



As we have stated in our previous submission, Salesforce would consider that it would be reasonable to expect as a condition to the continuing availability of the outsourced services for the benefit of the relevant bank's customers, that the service provider be paid any outstanding amount and also receive assurance for ongoing payments.

Salesforce welcomes the additional words (underlined) to the Reserve Bank's statement that the list of contractual terms in Appendix 1 is a list that the Reserve Bank '*would expect to see included (but not require) in robust outsourcing arrangements*'. We are of the view that expressing the list as an indicative list of matters would avoid the list inevitably becoming a checklist for all outsourcing arrangements. There are certain terms in Appendix 1 which would not be applicable for every outsourcing arrangement. For example, software escrow is not a feature of most as-a-service offerings and generally need not be, if data portability has been appropriately addressed. We also suggest that reporting requirements (including content and frequency of reporting) are not usually featured in as-a-service offerings.

Salesforce welcomes the Reserve Bank extending the transitional path for complying with the new outsourcing policy from two years to five years, including the planning phase.

Conclusion

In conclusion, Salesforce recommends that the Reserve Bank:

- Adds more immaterial services to the white list so it is truly extensive. Our alternative suggestion, if the white list will not be expanded, is for the Reserve Bank to reconsider adding a materiality threshold and further clarifying the definition of "outsourcing", as stated above;
- Further clarify the list of critical functions that require robust back-up arrangements; and
- Clarifies that the three contractual terms in paragraph 112 of the Consultation Paper are required only for material outsourcing arrangements.

Salesforce is of the view that service self-provision (that is, systems deployment in house by a bank) is not necessarily safer than outsourcing to a third party provider. Regulations should therefore set out a clear process of risk evaluation, assessment and mitigation both for outsourcing arrangements and in-house systems. Any outsourcing policy must be clear as to which services it does and does not apply, so that banks that purchase services which are not considered an "outsourcing" activity or outsource "immaterial" services, and the relevant service providers, are not unduly burdened by regulation.

Thank you for the opportunity to respond to the consultation paper. Should you require further information, please do not hesitate to contact me at sgrigorian@salesforce.com.



Yours sincerely

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