FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

FIL-50-2001
June 4, 2001

TO:
CHIEF EXECUTIVE OFFICER
SUBJECT:
Bank Technology Bulletin

The attached FDIC Bank Technology Bulletin introduces three short documents containing practical ideas for banks to consider when they engage in technology outsourcing. They are for informational purposes only and should not be considered examination procedures or official guidance.

For further information, please contact DOS E-Banking Branch by e-mail at e-banking@fdic.gov.

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Director, Bank Technology Group

Attachment: Bank Technology Bulletin

Distribution: FDIC-Supervised Banks (Commercial and Savings)

NOTE: Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 801 17th Street, NW, Room 100, Washington, DC 20434 (800-276-6003 or 202-416-6940).

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June 4, 2001

Federal Deposit Insurance Corporation

Bank Technology Bulletin

TO: Chief Executive Officers of All FDIC-Supervised Banks

SUBJECT: Technology Outsourcing Information Documents

On November 29, 2000, the FDIC, along with the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration, issued guidance on risk management of technology outsourcing (Financial Institution Letter 81-2000, Risk Management of Technology Outsourcing). The guidance focused on four key areas: risk assessment, service provider selection, contract terms, and oversight of outsourcing arrangements. Because community banks may face particular challenges in engaging and supervising their technology providers, the FDIC has talked with bankers and other experts to identify areas where assistance might be useful. Three informational documents were produced as a result of those discussions:

- Effective Practices for Selecting a Service Provider
- Tools to Manage Technology Providers' Performance Risk: Service Level Agreements
- Techniques for Managing Multiple Service Providers

The documents are being offered as a resource of practical information to community banks on how to select service providers, draft contract terms, and oversee multiple service providers when outsourcing for technology products and services. They have been prepared not as examination procedures or official guidance but as informational tools for community bankers. The documents help answer questions bankers might have about identifying and selecting the best service provider for a task, ensuring that the bank receives the desired level of service, and overseeing outsourced operations that are distributed among multiple service providers.

An additional Bank Technology Bulletin--*Protecting Internet Domain Names*--is posted on the FDIC's Web site at http://www.fdic.gov/news/news/financial/2000/fil0077a.html

Printed copies of the documents, which are in the form of brochures, can also be obtained after June 11, 2001, by contacting the FDIC's Public Information Center. Faxed requests are preferred.

Write to:
FDIC Public Information Center 801 17th Street, NW, Room 100, Washington, DC 20434
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For further information, please contact DOS E-Banking Branch by e-mail at e-banking@fdic.gov.

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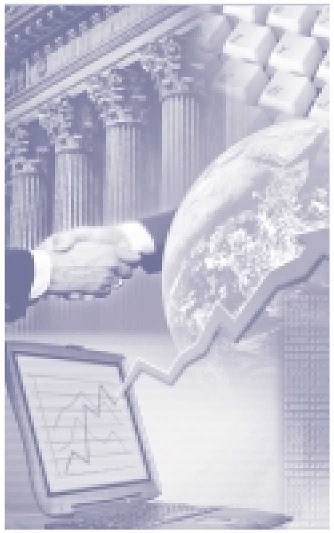
Director, Bank Technology Group
Distribution: FDIC-Supervised Banks (Commercial and Savings)

Effective Practices for Selecting a Service Provider



FDIC

Technology Outsourcing

Effective Practices for Selecting a Service Provider

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
www.fdic.gov

EFFECTIVE PRACTICES FOR SELECTING A SERVICE PROVIDER

This document is intended to serve as a resource for banks in addressing specific challenges relating to technology outsourcing. The content was prepared not as examination procedures or official guidance but as an informational tool for community bankers.

Introduction

As community banks become more involved in technology outsourcing, they face significant challenges in managing the risks associated with reliance on third party technology service providers[1]. Outsourcing has become more complex with many banks using vendors for key business functions and relying on multiple providers. This brochure suggests techniques that can facilitate the process by which financial institutions conduct due diligence and select the best service provider.

Objectives of the Selection Process

The objective of the selection process is simple: identify the best-qualified service provider and negotiate a contract that meets the needs of the financial institution. The selection process also should be cost effective, efficient, and appropriate for the nature of activities that the bank is seeking to outsource. Of course, the process

[1] Technology service providers encompass a broad range of entities including but not limited to affiliated entities, nonaffiliated entities, and alliances of companies providing products and services. This may include but is not limited to: core processing; information and transaction processing and settlement activities that support banking functions such as lending, deposit-taking, funds transfer, fiduciary, or trading activities; Internet-related services; security monitoring; systems development and maintenance; aggregation services; digital certification services, and call centers. Other terms used to describe Service Providers include vendors, subcontractors, external service provider (ESPs) and outsourcers.

that the bank uses to select a provider or team of providers will depend on the criticality and complexity of the service to be outsourced. In addition, the degree of process formality may depend on the nature of the outsourced service and the bank's familiarity with the prospective providers. Also, banks may wish to consider using consultants to provide expertise and assistance throughout the selection process.

Identification of Qualified Providers

Prior to identifying prospective service providers, it is essential that bank management have a clear understanding of the requirements and expectations that they are seeking to meet. As discussed in the FFIEC Guidance, "Risk Management of Outsourced Technology Services," a comprehensive risk assessment should consider how the outsourcing arrangement will support the institution's objectives and strategic plans and how the relationship with the service provider will be managed. The next step in the process involves conducting due diligence to evaluate service providers and determine their ability, both operationally and financially, to meet the institution's needs.

In some situations, the bank will either already know or quickly be able to determine a "short list" of provider candidates. This may occur when a specialized service is offered by a small number of providers, when size or geographic location is important, or when existing relationships with other providers (e.g., the bank's core data processor) are critical factors. If the bank has already identified possible providers and does not seek to expand the pool of candidates, management can proceed to evaluation and contract negotiation.

However, when the bank seeks to create or expand a list of possible service providers, it may be helpful to use tools and techniques such as Requests for Proposal (RFP), Requests for Information (RFI), and Requests for Quote (RFQ). These are ways to obtain specific information about a service provider's ability to meet the bank's requirements and the fees that they charge for the service. In an RFP, the bank outlines its business objectives and technical requirements and solicits responses from service providers that describe their ability to meet these needs and related prices. A more detailed discussion of the RFP process is provided in the Appendix. The RFI and RFQ are respectively targeted at obtaining specific information about the technical solutions that are available and prices charged for a particular service.

In initial communications with service provider candidates, the bank should want to make clear that: (1) the service provider cannot disclose any information about the bank's systems or its business plans to others outside the candidate's team; (2) the service provider expects that commitments made during the selection process will be binding in any final agreement; and (3) the service provider identify all subcontractors, consultants, or third parties on which it is relying to provide services to the bank.

Evaluation and Selection

Once the bank has identified a prospective provider or list of candidates, the evaluation and selection process can commence. Even in situations where only one provider is identified, it is important that the institution still evaluate their technical expertise, operating controls, financial condition, and management. When a larger group of candidates is being considered, the evaluations can be quantified and ranked to facilitate selection of a small number of the best-qualified providers.

The evaluation criteria are essential to the selection process and allow the financial institution to methodically review the candidates' proposals. The overriding objective is to select the most qualified provider. Utilizing standard evaluation criteria assists in this selection effort. Some suggested evaluation criteria are:

- Compatibility of the service provider's vision/value proposition with that of the bank.
- Ability to execute the vision/value proposition.
- Functionality of the service or system proposed. (Do the functional features meet the stated requirements?)
- Technology in terms of type, power, modularity, and ability to upgrade/refresh or scale.
- Service and support in terms of maintenance hours, response time, resolution time, security, disaster planning, and other service levels.
- Cost/Price.
- Financial stability of the vendor.

Depending on the situation and the outsourced activity, each of the above criteria may be given greater or less weight in the overall evaluation. Other criteria may be considered, as appropriate. In addition, bank management may consider on-site visits, reference checks, and inquiries with industry groups and peer institutions.

The following represent suggested practices that can facilitate the evaluation process:

- Be specific in all requests for information from candidates. Prioritize the requested information and indicate minimums and maximums for the length of response. A useful rule of thumb is that, "You get what you ask for."
- Consider using numerical scores based on quality ranking factors. By using consistent scoring systems or metrics, objective evaluation standards can be applied. Make sure the quality ranking factors are aimed at achieving the bank's goal.
- Determine minimum acceptable scores for the criteria used before rating the bids. Narrow the list of proposals by eliminating bids that do not meet the required minimums.
- Document the evaluation process and methodology used to score the respective proposals. It is generally a good practice to document requirements and priorities before starting the evaluation stage of a project.
- Consider conducting meetings and/or oral presentations where service providers can respond to questions and provide additional information.
- Consider ways to keep the process manageable. Depending on the complexity of the outsourced activity, the evaluation process can be time consuming and resource intensive.
- When working with a larger list of prospective candidates, narrow the group to a small number (e.g., two or three) to solicit "best and final" offers.

Negotiating the Contract

Communication with prospective providers can commence at various points in the evaluation and selection processes. For example, clarifications or requests for additional information may be needed to fully evaluate a proposal. Meetings and oral presentations may be used to engage the provider in more detailed discussions. Informational meetings may also be useful to determine a provider's willingness to depart from their original proposal in terms of price or services offered. Banks may also choose to engage multiple candidates in discussions concurrently to compare their responses.

After the selection process has narrowed the choice to one or a small number of strong candidates, negotiations with the provider(s) can help the bank finalize the terms of the contract. The negotiation process can help the bank establish terms that are agreeable to all parties and confirm that there is common understanding of the roles and responsibilities. Direct communication with the provider may help to determine whether organizational cultures are compatible and may provide an opportunity to interact with personnel who will play a key role in the future relationship.

Negotiating a contract is the final step in the procurement process. If a Request for Proposal was used or a Statement of Work was provided to the candidates to solicit their proposals, these documents can be directly incorporated into the contract. Key terms and conditions, as well as technical solutions and pricing, are generally established based on the proposal responses and final offers. A few points that might be useful in the contract negotiation and approval phases follow:

- As a general industry practice, information technology contracts are commonly set for a three- to five-year term. The shorter term enables the institution to reflect the pace of change in the technology industry.
- Prices indicated in the contract and service provider's proposal can be more effectively considered when they are broken down by each category of service (workspace, network services, etc.) and for the technology services by platform group.
- It is useful to explicitly state all charges as part of the invoicing procedures, occupancy policy, communication protocols, additional test time, and annual increases. Specifying each additional increment of cost is important in order to minimize the financial risk of increased prices for additional or reduced workload.
- Many contracts contain exit clauses that allow the institution to cancel the contract for reasons such as a failure to perform.
- Service level agreements should be stated in the contract. (Further information on service level agreements is provided in a separate FDIC document on technology outsourcing.)
- Having a clear understanding of the current and anticipated future requirements of the outsourced service can allow the bank to obtain a long-term solution rather than a quick fix.
- Set a realistic time line for completing the contract negotiation process.
- Obtain a list of all key personnel and a list of any subcontractors, consultants, or third parties on which service delivery depends.

Summary

Selection of a competent and qualified service provider is perhaps the most critical part of the outsourcing process. The process of selecting a vendor and determining their qualifications may vary in its formality and requirements for time and resources. Key determinants of the process will be the bank's foreknowledge of qualified providers and the number of candidates under consideration. Criteria for selection should be determined in advance to facilitate the evaluation process. Once a single or handful of qualified providers has been identified, further negotiations can help to finalize an agreement that is mutually beneficial.

The final outcome of the process should be the selection of a viable service provider that meets the procurement needs and objectives of the bank. Undertaking this commitment can provide significant benefits for complex information technology services or projects. Benefits include, but are not limited to, focusing the bank on the objective and strategic fit of the procurement, as well as facilitating due diligence in the selection of a service provider.

APPENDIX

Requests for Proposal (RFP) - Definition and Overview

A Request for Proposal is a tool that can be used to facilitate the selection of a qualified service provider and assist with the contracting process. The RFP can help a financial institution identify the best service provider(s) for their specific requirements by inviting competition, as service providers respond with a solution or combination of solutions, and the institution selects the most viable provider. The RFP can be particularly useful when bank management is seeking to create or expand a list of potential service providers or when projects are complex and represent a strategic or long-term enterprise investment.

The Process

The RFP process consists of a set of tasks that can be grouped into three major categories: development of a baseline, proposal preparation, and selection activities. The following are some of the many tasks that are generally part of the RFP and vendor selection process. The list is not intended to be all-inclusive, and the steps may either be expanded or contracted to meet the needs of any particular situation.

Development of a Baseline:

- Determine the purpose and goal of the procurement.
- Assign a proposal project team and an evaluation team.
- Plan the outsourcing project in terms of cost schedule, functional requirements, and resource requirements.

- Develop a “baseline” that represents a current “as is” description of the affected environment in terms of current cost, inventory of systems, and services.
- Develop a “needs assessment” which describes management’s assumptions on how to more effectively serve its customers.
- Determine the future requirements by analyzing anticipated needs and project objectives.
- Determine the disparity between the current environment and the future requirements in order to identify the gaps that need to be filled to get from the current environment to the desired environment.

The various tasks that comprise the baseline activity are designed to establish a clear picture of the goal and objective of the procurement. In addition, a detailed understanding of the current environment is typically established in order to determine if there is a gap between the current environment and future needs. Finally, this baseline understanding of cost and service levels is useful in conducting a cost/benefit or return on investment analysis.

Proposal Preparation:

- Develop the Statement of Work, a technical document that outlines basic requirements.
- Draft the RFP based on the contents of the Statement of Work.

Proposal preparation tasks are focused on defining the requirements, which are then presented in the form of a Statement of Work or similar document. The Statement of Work indicates desired services, the roles and responsibilities of each party, and the required service levels or performance standards.

A Typical RFP Format Includes the Following:

- Executive summary.
- Introduction:
  - Background on the financial institution and/or business division.
  - Scope of services being requested. (e.g., Web hosting, infrastructure outsourcing, disaster recovery, etc.)
  - Background on the business process, including current status, existing roles, and responsibilities of the people who will be working with the vendor.
  - Statement on the confidentiality of information.
- Overview:
  - Statement of mission/vision of the financial institution.
  - Statement of business objectives the institution wants to achieve.
  - Statement of scope in terms of which business functions, business units, applications, packages, geographies, and technology platforms are being covered by the RFP.
  - Role of the service provider.
- Project schedule:
  - Service provider RFP question deadline.
  - Service provider analysis meeting (optional).
  - Proposal due date. (Generally, according to industry practices, service providers

need four weeks to respond comprehensively to anything other than simple undertakings. Less time may result in poorer, less innovative and probably costlier solutions.)

  - Service provider demonstration day.
  - Contract negotiation.
  - Final decision.
  - Proposed implementation start date.

- Statement of Work:
  - Detailed technical requirements, describing the required business applications and their functionality, as well as the hardware and infrastructure platform and communications requirements for each outsourced area and operational configuration.
  - Transition, implementation, training, start-up, maintenance, and security requirements.
  - Performance criteria for success of the solution.
  - Project management and service level reporting requirements.
  - Indication of performance/service level incentives and penalties.

Tools to Manage Technology Providers' Performance Risk: Service Level Agreements

This document is intended to serve as a resource for banks in addressing specific challenges relating to technology outsourcing. The content was prepared not as examination procedures or official guidance but as an informational tool for community bankers.

Introduction

As community banks outsource more of their mission critical applications, properly managing the relationships between financial institutions and technology service providers[1] becomes increasingly important. This brochure discusses the Service Level Agreement (SLA) as an effective tool for managing the risks associated with technology outsourcing and describes practices for measuring and monitoring service providers' performance.

What Are Service Level Agreements?

Service Level Agreements (SLAs) are contractually binding clauses documenting the performance standard and service quality agreed to by the bank and service provider. The SLA is a key component in structuring a successful outsourcing contract. The SLA ensures that the institution receives the services it wants at the expected performance standard and price. As such, the SLA is a key component in managing the financial and operational risk involved with outsourcing contracts. It also can be one way to help mitigate risk. By specifying the measurement unit and service range for the selected category, the risk of poor service may be diminished because it becomes an area of focus and is designated as the service provider's responsibility.

The SLA's primary purpose is to specify and clarify performance expectations, as well as establish accountability. Therefore, balancing the need for precise measurement standards with sufficient flexibility is important. A common pitfall is excessive oversight or "micro-management" of the provider responsible for the service, which can also burden the bank employees charged with supervising the service provider relationship and monitoring the SLAs.

A well-designed SLA will recognize and reward, or at least acknowledge, good service. It will also provide the measurement structure -- or performance metric -- to identify substandard service and trigger correction or cancellation provisions as warranted. In today's outsourcing environment, incentives or penalties in the SLA can be an effective tool for managing service. If services received do not measure up to expectations, direct consequences, such as reduced levels of compensation or a credit on future services, would result.

Structuring and Developing SLAs

A typical SLA includes the following components and is tailored to fit the nature of the outsourced service or application:

- Service category (e.g., system availability or response time).
- Acceptable range of service quality.
- Definition of what is being measured.
- Formula for calculating the measurement.
- Relevant credits/penalties for achieving/failing performance targets.
- Frequency and interval of measurement.

Before an SLA is signed, the service provider and the institution should clarify and establish expectations. Unless these expectations are clearly measurable, the service category will be difficult to manage due to the bank's and the vendor's differing goals and perspectives.

Developing a Successful SLA Involves Four Steps

- Determining objectives - Reviewing the strategic business needs of the financial institution includes evaluating its day-to-day operating environment, risk factors, and market conditions. Consideration should be given to how the outsourced service fits into the bank's overall strategic plan.
- Defining requirements - Identifying the operational objectives (e.g., the need to improve operating efficiency, reduce costs, or enhance security) will help the institution to define performance requirements. It will also help identify the levels of service the bank needs from the service provider to meet its strategic goals and objectives for the outsourced activity.
- Setting measurements - Clear and impartial measurements – or metrics - can be developed once the strategic needs and operating objectives have been defined. The metrics are used to measure and confirm that the necessary service levels have been achieved and the objectives and strategic intent have been met.
- Establishing accountability - It is useful to develop and adopt a framework that ensures accountability after the measurement units (i.e., the metrics) have been clearly defined. The service provider rarely owns accountability and responsibility for all tasks. Establishing this accountability usually includes a clear statement of the outcome if the level of service is exceeded or if the expected service fails to meet the stated standard.

The SLA development process and each of the four steps are discussed in further detail in Appendix 1. A sample SLA is provided in Appendix 2.

Representatives from the institution (management, legal counsel, and information technology staff) and the service provider typically meet to ensure that performance metrics and targets are properly addressed when developing SLAs. Bank management may also consider interviewing some of the system users to help identify important criteria to incorporate into the SLAs.

Reaching agreement on specific SLAs may involve significant discussion and negotiation between the bank and the service provider. The bank may wish to consult with peer institutions and trade associations about useful benchmarks for performance standards. This information may be helpful in the contract negotiation process and assist the bank in determining if the service levels offered by the provider are reasonable and standard.

Drafting Successful Service Level Agreements

Sufficient time and resources should be devoted to preparing SLAs. The agreement will be the primary document governing the procurer and vendor of services that may have a significant impact on the bank's performance. The following items are important reminders for institutions drafting SLAs and selecting the metric(s) to be used to measure vendor performance:

- Focus on the most important areas. Financial institutions should identify the performance and risk factors that are most crucial to the success of the outsourced function. The institution should invest its time drafting strong SLAs for these areas. Areas with minimal effect on the process will be of less importance and, accordingly, should have less prominence in the contracting process.
- Make sure that performance metrics measure what the bank wants them to measure. Verify that the metrics used to govern the SLA appropriately represent the functions that the bank intends to measure.
- The metrics should measure the performance the service provider is giving the bank, and not be based on the performance the vendor is delivering in aggregate to all its customers.
- Ensure that SLAs are focused on institutional goals. Avoid the trap of creating agreements that are focused on the success of the individual process without regard for the how the process addresses a corporate goal. Each measurement should logically support a requirement that is linked to a strategic goal.
- Be specific. Ensure that all parties involved in the SLA understand the terms spelled out in the agreement. Terms should be clearly defined to avoid different interpretations. Spending extra time defining terms when creating an agreement can prevent misunderstandings and loss of time and money caused by differing interpretations of the intent of the SLA.

Managing SLAs

It is worthwhile for the institution to provide for ongoing management of the agreement when a SLA is established. The SLA management process usually goes beyond performance measurement to ensure success. Generally, the measurement process should be kept as simple as possible, emphasizing timely identification of deviations from agreed upon performance metrics. Ongoing communication between the bank and the service provider is also important. The following four-phase methodology is based on observed industry practices that can help banks manage SLAs effectively:

- Measure service activity results against defined service levels.
- Examine measured results to identify problems and determine causes.
- Take appropriate action to correct failed activities, functions, and/or processes.
- Continuously guide service providers through feedback sessions based on objectively measured performance metrics.

Before signing an outsourcing contract, the bank may find it beneficial to verify that important performance requirements have been addressed, risks have been identified, and each service level is defined. Each measurement should be defined clearly and concisely. This will provide the foundation for effectively managing service levels throughout the four phases of the SLA management process.
SLA management is an ongoing process, and is viewed as an integral component of the outsourcing relationship. A suggested practice is to include periodic review and change provisions in the SLA to ensure that service level goals and performance measurements can meet the changing business and technology needs of the institution.

Summary

Service Level Agreements are tools to measure, monitor, and control the operational and financial risks associated with outsourcing technology services. Essential to this process is establishing realistic performance metrics and continuous problem tracking and resolution. The bank should consider working closely with service providers to identify, verify, and correct problems; perform root-cause analysis; and make process modifications to prevent problems from recurring. As the outsourcing relationship progresses, SLAs should reflect the evolution of services provided. Accordingly, they should be updated to facilitate continued service improvement. Well-constructed SLAs are an effective tool for managing service provider performance and ensuring that the bank receives the quality of service that it needs and expects.

APPENDIX 1 – Developing SLAs

Four-Step Process

While many factors determine how the bank and its service provider will agree to manage the quality of service, the four-step process[2] outlined below may be helpful in developing successful SLAs. This process facilitates identifying essential requirements for the outsourced service and translating the requirements into measurable and accountable performance standards.

- Determining objectives.
- Defining requirements.
- Setting measurements.
- Establishing accountability.

Determining Objectives

The first step in creating an SLA is determining the standards the outsourced activity needs to meet in order to assist the bank in attaining its strategic goals. The bank should consider the criticality of the activity to the bank's mission and weigh the impact success or failure will have on the bank's operations or reputation. The institution also needs to consider the relationship of the outsourced activity to other systems, applications, and functions in the bank and take into account any critical interdependencies. Based on this analysis, the bank can identify the objectives that are critical in ensuring the success of the function. For each activity, function, and process, a clear objective is needed to understand what constitutes success.

Defining Requirements

In order to attain strategic goals, it is important to identify how the institution is going to achieve the objectives that have been set. To establish these requirements, the institution can break the objectives down into specific activities that must be undertaken to achieve the goal. While the objectives refer to broad statements geared toward attaining success, the performance requirements are targeted at the specific activities that the bank can require from the service provider to ensure the strategic objective is met.

Setting Measurements

In formulating an agreement, the bank can identify specific measurements that indicate if the prescribed requirements are being met. The measurements – or metrics - that correspond to the performance requirements represent tangible or quantifiable deliverables that bank management can monitor and discuss with the service provider, as appropriate. Target metrics should be objective and clearly linked to the bank's business needs and risk management requirements. Metrics should be established based on specific tolerance levels and the minimum acceptable levels of service. A minimum acceptable level of service also should be set to define the point of significant failure.

The following table provides two examples of strategic objectives and related performance requirements, along with target metrics. The first objective pertains to system security and may be appropriate for an outsourced activity involving sensitive data or applications. The second objective addresses certain reliability and availability needs that may be associated with an outsourced system that processes or stores information essential for bank employees or customers. The corresponding performance requirements and measurements provide the means to quantify and document service provider performance.

Table 1 - Examples of Objectives, Requirements, and Measurements

Strategic Objective	Performance Requirement	Measurement
Sensitive system and bank/customer data must be protected with strong security.	Regular checks for intrusions or other security breaches.	Copies of intrusion scan reports to be sent at pre-determined frequency.
	Periodic security assessments, tests, or reviews.	Copies of independent security assessment reports to be provided at pre-determined frequency.
	Timely reporting of incidents and follow up to bank management.	Regular incident reports (frequency will depend upon system criticality).
Mission critical systems must be reliable and available.	System downtime must be minimal.	Specified requirement for system uptime (e.g., 99.9%).
	The system must be able to support certain volumes of activity at a given time.	Specified requirement or parameters for capacity (e.g., 1,000 transactions processed per minute).

Establishing Accountability

Clear definitions of accountability are important to ensure that both the bank and the service provider understand their roles and responsibilities for each service level requirement. However, beyond simply designating a role or activity, accountability should also be established by specifying the consequences if a given service level is not met. Incentives and penalties can play a key role in establishing accountability. Incentives can be used to motivate a service provider to meet or exceed specified service levels by offering a reward. Rewards should generally be attractive enough to motivate the provider, but less than the actual financial value provided by the service. Penalty clauses also should be considered and bank management should have the right to exercise these penalties for any defined service delivery failures.

When negotiating incentives and penalties into an SLA, it is helpful to consider:

- The importance of the performance measure to the bank¾ This will help the bank determine how to weight the associated incentives/penalties as well as the frequency for monitoring performance.
- Each party’s expectations for quality and consistency¾ These factors, coupled with prior experiences, may help the bank determine the best method for motivating the provider toward desired performance.
- The severity of the consequences to the bank if key performance measures are not met¾ The effect on the institution should be a motivating factor for the institution when determining whether compensation clauses or other remedies should be provided.

APPENDIX 2 – Sample Service Level Agreements

(Note: This SLA is for illustration purposes only, and not to be relied upon as a model contract for any specific service agreement. Actual SLAs will vary widely depending on the services contracted. Additional provisions or an increase in the scope of this SLA will be necessary to govern other aspects of the relationship, such as security. Consult with bank legal counsel for specifics of contract clauses and formation advice.)

Purpose

This agreement is between Buyer and Vendor. This document outlines the service level roles, responsibilities, and objectives of Buyer and Vendor in support of the given functional area.

Scope of Services

Vendor will house, manage, and operate all hardware and software necessary to provide Internet banking applications to Buyer.

Service Category

This SLA addresses application availability.

Acceptable Range of Service Quality

The Internet banking application shall be available at least 99.5% of each week.

Definition of What is Being Measured

"Availability" will be measured as the percentage of minutes each day that the Internet banking application will be able to receive and respond to messages from the Internet. The server's ability to receive messages will be ascertained using time-check availability software.

Formula for Calculating the Measurement

System availability shall be measured as the number of minutes per day that the Buyer's Internet banking application is capable of receiving and responding to messages from the Internet divided by 1,440 (the total number of minutes in a day). A 30-minute period from 2:00 AM to 2:30 AM shall be excluded from the calculation because Vendor will be performing system maintenance at this time each day.

Relevant Credits/Penalties for Achieving/Failing Performance Targets

If Vendor is unable to provide this service level to Buyer, Vendor will provide priority support to Buyer until performance levels are met. Service below the prescribed level will result in a rebate of 50% of the monthly fee for the month in which the exception takes place.

If Vendor fails to provide the agreed upon service level for more than two consecutive months, Buyer shall have the right to renegotiate the contract and/or terminate this agreement.

Frequency and Interval of Measurement

The system's availability shall be measured daily by Vendor using time-check availability software. Vendor shall submit monitoring reports generated by this program to Buyer on a weekly basis.

Buyer's Responsibilities

Buyer shall review all monitoring reports and advise Vendor of any deviations from this agreement in a timely manner.

(Include any other items that Buyer will need to do so that Vendor may perform its tasks.)

Vendor’s Responsibilities

Vendor shall assume responsibility for customer communications at the point that customer messages leave the Internet service provider.

Vendor shall ensure that all messages are processed in a timely fashion. (Be sure to define the specifics of "timely" standards.)

Vendor shall ensure that the system shall be able to accept and respond to 1,200 inquiries per minute.

(Include any other items that Vendor will need to do to provide the prescribed level of service to Buyer.)

Escalation Guidelines

In the event that Vendor is unable to meet the terms of this agreement, the CIO of Buyer and IT Manager of Vendor shall discuss resolution of the situation. If Vendor will be unable to provide service for more than two hours, Vendor’s contingency operating plan shall be invoked.

Renegotiations

Authorized representatives of Buyer and Vendor must mutually agree upon changes to this SLA.

All changes must be made and agreed to in writing.

Either party may request review of this SLA at any time. Each party will review the SLA annually and advise the other party of any desired changes.

[1] Technology service providers encompass a broad range of entities including but not limited to affiliated entities, nonaffiliated entities, and alliances of companies providing products and services. This may include but is not limited to: core processing; information and transaction processing and settlement activities that support banking functions such as lending, deposit-taking, funds transfer, fiduciary, or trading activities; Internet-related services; security monitoring; systems development and maintenance; aggregation services; digital certification services, and call centers. Other terms used to describe Service Providers include vendors, subcontractors, external service provider (ESPs) and outsourcers.

[2] The "Four Steps" for developing SLAs are based, in part, on research from the Gartner Group entitled "Key Factors in SLA Development."

Technology Outsourcing

Techniques for Managing Multiple Service Providers

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TECHNIQUES FOR MANAGING MULTIPLE SERVICE PROVIDERS

This document is intended to serve as a resource for banks in addressing specific challenges relating to technology outsourcing. The content was prepared not as examination procedures or official guidance but as an informational tool for community bankers.

Introduction

Financial institutions increasingly rely on a wide variety of service providers[1] to support an array of technology-related functions. Outsourcing information technology to multiple service providers may provide banks with a variety of benefits including access to expert technology skills, lower costs, and increased productivity. However, these arrangements also may alter the risk profile of the institution. Specifically, risk management processes involving outsourced activities are often distributed among several companies and may necessitate a coordinated contract oversight approach by bank management.

This brochure discusses two techniques to manage risks inherent in multiple service provider relationships. The first technique involves the use of a lead contractor to manage the bank's various technology providers. The second technique, which may present its own set of implementation challenges, involves the use of operational agreements between each of the service providers.

[1] Technology service providers encompass a broad range of entities including but not limited to affiliated entities, nonaffiliated entities, and alliances of companies providing products and services. This may include but is not limited to: core processing; information and transaction processing and settlement activities that support banking functions such as lending, deposit-taking, funds transfer, fiduciary, or trading activities; Internet-related services; security monitoring; systems development and maintenance; aggregation services; digital certification services, and call centers. Other terms used to describe Service Providers include vendors, subcontractors, external service provider (ESPs) and outsourcers.

Multiple Service Provider Relationships

A multiple service provider relationship typically involves an environment where two or more service providers collaborate to deliver an end-to-end solution to the financial institution. Each one of the service providers has their own core competence and focus area. Together, these providers strive to deliver an integrated service and solutions package to the bank. The nature of the contractual relationship between the service providers and the bank often varies from institution to institution. In many cases, institutions use a lead provider who, in turn, subcontracts with other service providers. Direct "stand-alone" contracts between the bank and each of its service providers represent another common approach.

Multiple service provider arrangements are often used in the deployment of an electronic commerce solution. For example, a web-hosting firm may work with a communications carrier and one or more application service providers[2]. The financial institution may have separate contracts with each provider (carrier, web host, application service provider) or may have one lead entity (such as the application service provider) that then subcontracts with the carrier, web host, and other providers.

Stand-alone contracts with each service provider usually call for increased day-to-day management of each provider. Additionally, if coordination among each provider is not a requirement of the individual agreements, the opportunities for schedule and performance problems and complexities are likely to arise. Contracting for a technology solution by utilizing one lead provider may diminish the need for the bank to become directly involved if subcontractors fail to perform and/or miss their agreed-to schedule. The lead provider will be solely responsible for meeting the contractual obligations of the subcontractors to other service providers and the bank.

Each financial institution will want to consider the most appropriate risk management strategy when contracting for technology services. Assigning a lead contractor and utilizing inter-provider service level agreements are two techniques that, if deployed correctly, can assist the institution in managing risks related to complex technology outsourcing arrangements.

Using a Lead Contractor

Bank management may select to structure a multiple provider outsourcing arrangement by designating a lead contractor who is responsible for establishing subcontracts with the other providers and managing their performance. This structure may result from a bank's existing relationship with a service provider who subsequently subcontracts with other firms to provide additional applications and features. A lead contractor structure can also result when a group of providers bid on a contract as a team with pre-established roles and relationships.

Regardless of whether the relationship between the lead contractor and the subcontractors was pre-existing, there are techniques that bank management can employ to manage risks associated with dependence on the lead provider. These techniques, which include provisions in the Statement of Work for defining roles and responsibilities of the contracting parties, are detailed further in the Appendix.

An effectively implemented lead contractor relationship ultimately increases the performance risk for the lead provider, even though it

[2] Application Service Providers (ASPs) specialize in providing business applications and processing power to banks.

simplifies the boundaries of the relationship. This is due to the fact that the lead provider assumes responsibility for all aspects of the contract, and therefore for the performance of all subcontractors. This structure allows the bank to establish a single point of responsibility for the entire relationship. A contract that clearly defines the roles of the lead provider and subcontractors may streamline the negotiations of legal issues such as the limitations of liability, indemnity, and warranty since responsibility need not be divided among multiple parties. It may also enhance the efficiency of the general contracting process.

Many lead contractors may already have existing arrangements with potential subcontractors for the provision of various ancillary services. As a result, there may be a preference for selecting one of the subcontractors with which the contractor already does business. Financial institutions may wish to carefully examine all contractual provisions in their agreements with the lead contractor to determine the level of responsibility the lead contractor is willing to accept for the actions of the subcontractors that the lead contractor selects.

In some cases, the lead contractor may include contract language that attempts to eliminate all responsibility for losses caused by the subcontractors or sets a fixed dollar limit on the lead contractor's maximum liability for any claims regarding the work of the subcontractors. Financial institutions may wish to consult their legal counsel in order to determine potential exposure to losses for which there may be no ready recovery. It is also important to note that, when using a lead contractor, the financial institution lacks direct privity[3] of contract with the subcontractors and will have less influence over the specific activities of each subcontractor.

Using Inter-Provider Operating Agreements

Financial institutions that prefer to maintain a direct contractual relationship with a variety of technology service providers can choose to integrate their efforts by negotiating for operational agreements directly with each of their service providers. This operational agreement can take the form of inter-provider Service Level Agreements (SLAs). This type of SLA is a separate contract requiring each of the providers to meet the other providers' service or performance requirements. Examples of such requirements include on-time delivery of a critical application or platform, network or platform availability specifications, and security requirements. This type of agreement requires the individual providers to communicate and work together.

Implementing operating agreements between various service providers can be challenging because the bank may lack significant negotiating leverage. Although some additional leverage may be gained by negotiating through user groups, challenges remain in attempting to deviate from the standard forms, contract structure, and delivery approach of established providers. Notwithstanding this, it is important to stress that the intent of the inter-provider agreements is to encourage co-operation and communication between technology providers implementing integrated systems and services.

Communication and co-operation begin with the financial institution developing well thought-out contract goals and objectives that have been agreed to by the senior executives, business managers, and information technology managers and clearly articulating these to the service providers. Contract terms and conditions can be established based on these goals. When determining how goals and objectives will be

[3] Privity is a legal term defined as "A relation between parties held to be sufficiently close and direct to uphold a legal claim on behalf of or against another party with whom this relation exists." (Webster's II New Riverside University Dictionary)

met, it is helpful to clearly define handoff points between the various service providers.

In addition, bank management and legal counsel may consider establishing the minimum acceptable levels of service that are expected of participating providers as their respective contribution to the team. The minimum service levels provide the performance floor for the inter-provider agreements. Any provider that does not meet these minimum performance standards should be held responsible. Therefore, it may be useful to ask that all service providers participate in developing the inter-provider agreements and accept and agree to the specific terms, minimum performance standards, and the corresponding metrics that will be used to measure their individual and collective performance.

Considerations for Financial Institutions

The following points represent suggested practices that can be helpful to banks in administering outsourced arrangements involving multiple service providers.

- Be explicit about where the ultimate responsibilities lie. If there is a lead contractor, try to make that organization responsible for as much of the overall activity as possible. Be certain everyone knows who is responsible for what, even if some of that responsibility ultimately rests with the institution itself.
- Incorporate protection, in the form of contract provisions for renegotiation, re-evaluation, exit strategies, and other similar activities, into the agreement.
- Include contract provisions that spell out the conditions for subcontractor relationships that are beyond the initial participants. Institutions might define the circumstances for which they have explicit approval and who can be selected to fulfill what function.
- Specify the circumstances when new service providers may be brought into the relationship. This can help minimize the tendency of service providers to resist bringing in new parties and avoid situations where such resistance hinders productive working relationships.
- Retain within the organization the capability to monitor and manage the entire relationship effectively, even if the bank relies heavily on the lead provider or a third party vendor for relationship management.
- Ensure that the lead provider and all subcontractors agree to share and make available all contractor-specific and proprietary technology needed for the services provided. If any sub-contractors or even the lead provider are replaced, all proprietary technology and critical applications should be made available to the replacement provider/subcontractor.

Summary

To manage multiple service provider outsourcing relationships successfully, institutions may find it helpful to focus on three issues:

- Adopt an appropriate outsourcing strategy given the particular objectives sought by the bank (e.g., lead-subcontract approach or multiple single contract relationships).
- Use a contract that comprehensively addresses and outlines the roles and responsibilities of all parties involved. The contract should include provisions for approving subcontractors as well as defining the expected levels of service to be provided to the bank.
- Ensure that effective communication channels are maintained between all relevant parties.

Ultimately, the key to successful management of a multiple service provider environment is contract oversight. Regularly scheduled reviews can help point out problems early enough to effect resolution before matters get out of control. Institutions may wish to develop guidelines in the contract that define regular interaction between the service provider(s) and bank managers.

APPENDIX

Tips for Managing Lead Contractor Relationships – Terms and Conditions

Techniques for effectively managing lead contractor relationships may include the following contractual terms and conditions, which can be included in the binding agreement with the lead provider. Institutions may choose to use some or all of these techniques to accommodate individual circumstances:

- Approve all major subcontractors—Requires the institution's review and approval for any subcontractor and the associated subcontract management team.
- Change of control provisions—Enables the institution to terminate part or all of the agreement if another firm acquires the lead provider or a major subcontractor.
- Service Level Agreement—Indicates the lead contractor's specific performance requirements in discrete metrics (i.e., availability of 99.95%, or response time of two hours). The lead contractor is then responsible for achieving these requirements throughout the subcontractor structure.
- Termination for convenience—Allows the institution to terminate the agreement for their convenience. In some cases, the institution may be responsible for an early termination charge to the contractor.
- Termination for cause—Enables the institution to terminate the lead contractor due to the material failure of either the lead or subcontractor to perform the contracted service.
- Transition assistance—Requires the lead provider to transition the contract to a new provider over a period of time in the event of termination.

The collective effect of these terms and conditions is to enable the institution to negotiate and discuss the lead service provider's delivery and organizational model, service levels, and form of contract. These terms and conditions may then "flow down" to each of the subcontractors.

Tips for Managing Lead Contractor Relationships – Statement of Work

The Statement of Work, which is contained in the body of the contract, clearly describes the roles, rights, and responsibilities of all parties to the contract. Considerations for the Statement of Work may include, but are not limited to, the following:

- Timeframes and activities for implementation and assignment of responsibility.
- Implementation provisions that take into consideration other systems or inter-related systems to be developed by different service providers (e.g., an Internet banking system being integrated with existing core applications or systems customization).
- Services to be performed by each service provider including duties such as software support and maintenance, training of employees, or customer service.
- Obligations of the financial institution.
- The contracting parties' rights in modifying existing services performed under the contract.
- Guidelines for adding new or different services and for contract re-negotiation.
- Use of proprietary processes, technologies, or software by all pertinent service providers and provision of these proprietary assets to necessary third parties.

FDIC

Federal Deposit Insurance Corporation

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Bank Technology Bulletin

TO: Chief Executive Officers of All FDIC-Supervised Banks

SUBJECT: *Protecting Internet Domain Names*

As the number of banks with Web sites continues to grow steadily, the number of incidents involving disputes, confusion and fraud related to their Internet domain names also has increased. To protect their online identities, banks can employ internal controls that ensure timely registration and renewal of relevant domain names, periodically review the status of similar domain names, and be familiar with the formal and informal dispute resolution processes.

This bulletin alerts senior bank management to potential domain name-related problems, and highlights actions that may help to avoid or resolve such problems.

DEFINITIONS

Internet Domain Name: A unique identifier for an Internet site that can be compared to a mailing address for a physical location. A domain name often includes two or more parts separated by periods. Common suffixes (called "top-level domains") include .com, .net and .org, in addition to country-related domains such as .us for the United States. Separate registration is required for ownership of each variation of a domain name (e.g., bankname.com, bankname.net and bankname.org).

Cybersquatting (Cyberpiracy): The act of registering a particular Internet address - usually a well-known company name - with the intent of holding it until it can be sold for profit.

Nature of the Problem

Internet domain names have been used to perpetrate fraud and have led to both public confusion and legal disputes. For example, fraudulent operators have created Web sites that attempt to mislead customers into disclosing their passwords or other sensitive information. They do this by acquiring domain names that may be similar in spelling to those of legitimate Web sites. Some Web sites also have been created to publish harmful information about an organization, using a domain name that is similar to the "target." Another problem involves "cybersquatters" who have attempted to sell desirable domain names to companies at exorbitant prices. These situations could result in considerable reputational harm and financial cost.

DOMAIN NAME REGISTRATION

The process for registering a domain name is relatively fast and simple. Applicants submit a request to one of several registrars indicating the desired domain name, the name of the owner, contact information, and details about the computers that will support the domain name service. The registration and payment process can be completed online. Any domain name can be registered, provided that it not currently registered to someone else. This process does not preclude the granting of similar names to separate parties.

Risk Management Techniques

To prevent customer confusion, reputational harm, fraud and legal disputes, bank management can employ a number of practices and techniques. Timely registration and renewal of a bank's domain name(s) are important to assure that the bank acquires and retains ownership of the Internet addresses that it desires. Any lapses in registration could result in the loss of a domain name to another party.

Bank management may choose to consider acquiring more than one domain name to retain control over the use of all similar names. However, this strategy may entail financial and administrative costs. Either way, institutions may benefit from conducting periodic Internet searches to determine whether there are names being used that are similar to their domain name, legal name or other trade/product names. In addition to similar domain names that have different suffixes (e.g., *bankname.com and bankname.net*), management also may want to look for variations in spelling and punctuation (e.g., *bankname.com and bank-name.com*).

Possible Resolutions

Depending on the nature of the problem involving a bank's domain name, management may pursue various courses of action. Legal recourse may be available under the Anti-Cybersquatting Consumer Protection Act, 15 U.S.C. §1125(d), which prohibits registering or using a domain name that is confusingly similar to another name, with the intent to profit. Other situations involving Web sites that are used to promote fraud or illegal activity can be addressed under existing laws that address financial fraud and computer crime (e.g., 18 U.S.C. §1101 - Fraud and False Statements, 18 U.S.C. §1030 - Fraud in Connection with Computers, 18 U.S.C. §1343 - Wire Fraud). Banks also are reminded that suspicious activity involving domain names should be reported according to existing instructions for filing Suspicious Activity Reports with their primary federal regulator and law enforcement agencies.

Disputes over domain names also can be handled by private arbitrators. A dispute resolution process, outlined in the Uniform Domain-Name Dispute-Resolution Policy, has been established by the Internet Corporation for Assigned Names and Numbers (ICANN) to deal with conflicts arising over domain name ownership. All registrars in the .com, .net, and .org domains are subject to this policy, the text of which can be accessed at ICANN's Web site at www.icann.org.

Security Considerations

It is important that bank management be alert to security considerations regarding domain name servers, which are computers that allow Internet users to locate information and resources on the Internet by domain name. These servers maintain a database of domain names and their corresponding network locations. Unauthorized changes to the server could result in misdirected Internet traffic or obstructed access to a bank's Internet site. While many banks outsource this function to third-party service providers, bank management can ensure that security features are in place and assessed periodically.

Management also can consider security in its communications with the bank's domain name registrar. For example, to prevent unauthorized changes to a bank's domain name information, management can ensure that proper controls are in place for authenticating and authorizing all requests for modifications to its registration.

For More Information

Questions and requests for additional information can be directed to DOS E-Banking Branch by e-mail at e-banking@fdic.gov.

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