

LOUISIANA CREDIT UNION LEAGUE 2009 ANNUAL MEETING & CONVENTION

EVALUATING VENDOR RELATIONSHIPS

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OVERVIEW

- BACKGROUND
- REASONS FOR DUE DILIGENCE
- NCUA REQUIREMENTS
- VENDOR SELECTION
- CONTRACT NEGOTIATING/DRAFTING
- FREQUENTLY ASKED QUESTIONS

BACKGROUND

- November 2001 (NCUA Letter No. 01-CU-20) all credit unions should conduct a due diligence review prior to entering into a vendor relationship
- October 2007 (NCUA issues Supervisory Letter No. 07-01) NCUA Field Staff given guidance regarding evaluation of vendors
- April 2008 (NCUA issues Letter No. 08-CU-09) NCUA examination questionnaire published

NCUA DEFINITION OF DUE DILIGENCE

THE SYSTEMATIC, ON-GOING PROCESS OF ANALYZING AND EVALUATING NEW STRATEGIES, PROGRAMS, PRODUCTS, OR OPERATIONS TO PREPARE FOR AND MITIGATE UNNECESSARY RISKS

WHY CONDUCT DUE DILIGENCE?

- NCUA REQUIREMENT
- CONFIRM ASSUMPTIONS
- IDENTIFY ISSUES EARLY IN THE PROCESS
- GAIN ADDITIONAL INFORMATION
- VERIFICATION OF BUSINESS PLAN

3 KEY AREAS FOR EVALUATING VENDOR ARRANGEMENTS

- Risk Assessment
- Due Diligence
- Performance Measuring/Monitoring

RISK ASSESSMENT

- Business Plan – develop a strategic plan for the product under consideration
- Purpose of Vendor Relationship - demonstrate how the vendor relationship relates to the Credit Union's strategic plan
- Functional Risk Assessment - determine risk related to vendor function, taking into account credit union risk tolerance, financial impact, and criticality of the function or relationship
- Risk of Outsourcing - weigh the risks and benefits of outsourcing versus maintaining those functions in-house
- Exit Strategy – develop a plan to disengage with vendor with minimal disruption

DUE DILIGENCE

- Know your vendor – review vendor’s background, business model, experience, and financial strength
- Assess Vendor’s Role - understand vendor’s responsibilities and all of the processes involved
- Negotiating/Contracting - negotiate a relationship and agreement based upon needs and residual risks associated with the vendor

PERFORMANCE MEASURING/MONITORING

- Expectations - develop detailed policy guidance to outline expectations and limit risks originating from vendor arrangements
- Administration and Monitoring – implement and monitor vendor performance
- Staffing – develop the necessary staff to monitor vendor performance

NCUA EXAMINATION FOCUS

- Critical Vendors - Focus on vendors which provide important services such as IT and loan underwriting services, not the landscaper (examiners will review decisions based on a “reasonableness” standard)
- Review of Alternatives - Consider alternatives in the vendor selection process and develop contingency plans in the event of poor or lack of service by the vendor

- SAS 70 - Tool to be used in developing an analysis of the vendor, but credit unions still need to develop their own control processes
- Strategic Planning - A good due diligence review is not a substitute for a strategic planning error, i.e., should the credit union have engaged the vendor in the first place
- Product Offerings - Credit unions should only develop and offer products and services that they understand
- Monitoring of Vendor - Credit unions must be able to run and monitor any outsourced service
- CUSOs - Both vendors and CUSOs will be treated the same for due diligence purposes

- New Vendor - comprehensive due diligence and risk-assessment review
- Existing Vendors – compressive due diligence if the vendor is a “critical service provider,” there are changes in the vendor’s policies, there are problems with the vendor, or if the credit union significantly changes its process with the vendor
- Use of Consultants – Consultants may be used, but credit unions must establish their own controls and do their own monitoring of a vendor relationship

VENDOR SELECTION

- Develop a Request for Proposal (“RFP”)
 - Builds internal alignment
 - Builds alignment with vendor
 - Builds standard process, enabling credit union to compare several vendors against same set of requirements

- **Essential Elements of a RFP**
 - Description of Credit Union
 - Project Description and Goals
 - Design Requirements
 - Technical Requirements
 - Functional Requirements
 - Project Duration and Timeline
 - Basis for awarding a contract
 - Selection Schedule

CONTRACT NEGOTIATING / DRAFTING

- Confidentiality Agreement
 - Protection in case there is no agreement
- Letter of Intent
 - Address critical issues early
 - Memorialize agreed upon terms
 - Momentum builder
- Contract
 - Do not “award” the business until the contract is signed
 - Contracts only read when there is a dispute – cover all contingencies

• Essential Elements of a Contract

- Contract drafting is the beginning of the process, not the end
- Duties of the parties
- Term of the contract
- Payment and Price
- Liabilities, Responsibilities, and Warranties
- Penalties for non-performance
- Confidentiality
- Dispute Resolution

OFFICIAL SOURCES OF GUIDANCE ATTACHED

- NCUA “Due Diligence Over Third Party Services Providers,” Letter to Credit Unions No. 01-CU-20 (2001)
- NCUA “Evaluating Third Party Relationships,” Supervisory Letter No. 07-01 (2007)
- NCUA, “Evaluating Third Party Relationships,” Letter to Credit Unions No. 07-CU-13 (2007)
- NCUA, “Third Party Relationships Questionnaire,” Letter to Credit Unions No. 08-CU-09 (2008)