



The Basics of Data Processing (and Other Technology Service) Contracts

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Introduction

Credit unions frequently outsource data processing services to third-party vendors. These third-party relationships are critical for managing and delivering member services. If inadequately managed, these relationships can result in unanticipated costs, legal disputes, financial losses, increased operational risk or a loss in member confidence. One important means of managing risk exposure involving third-party relationships is through well-defined vendor contracts.

Entering into a contract or renewing a contract with a service provider involves more than just signing on the dotted line. Successfully negotiating and establishing a contractual relationship favorable to the credit union requires hard work and thorough preparation.

This paper provides direct, easy to use guidance on safely securing and negotiating data processing service provider contracts. While data processing contracts are the focal point of this paper, the information provided is useful when entering into any type of technology service-provider relationship, including e-commerce services, network administration and security services, and online banking.

Here's a list of information system and technology products and services credit unions typically use and/or offer:¹

- Basic Information Technology:
 - Website
 - Email
 - Internet
- Data Processing
- Home Banking
- Audio Response and Phone-based
- Automatic Teller Machine
- Mobile Banking
- Kiosk
- Services Offered Electronically:
 - Account Aggregation
 - Account Balance Inquiry
 - Bill Payment
 - Download Account History
 - Electronic Cash
 - Electronic Signature Authorization and Certification
 - E-Statements
 - External Account Transfers
 - Internet Access Services
 - Loan Payments
 - Member Application
 - Merchandise Purchase

¹ Based on the list found in Credit Union Profile

- Merchant Processing Services
- New Loan
- New Share Account
- Remote Deposit Capture
- Share Account Transfers
- Share Draft Orders
- View Account History
- Mobile Payments

Part 1 – Generating and Evaluating Bids

Selecting the right service provider is key to a successful data processing contract. References from other users and trusted sources can be helpful. However, regardless of the referral source, always conduct appropriate and thorough due diligence before entering into a business relationship with a vendor.

Preliminary Measurements and Determining Needs

Start by clearly defining your needs and identifying the activities and processes that drive your credit union. Technology should facilitate the way your credit union manages and delivers these activities and processes. Develop a matrix that identifies the critical software features needed to support your work. Take the time to understand the technology services market and how it works, or hire an expert who can assist you in this effort. Identifying the proper technical solution to meet your business needs will ensure the efficient use of your resources.

Request for Proposal

One way to generate bids is through a request for proposal, a formal means of soliciting bids for a service from a group of potential suppliers. The level of detail in the request for proposal can vary depending on the complexity of the service desired, but typically it should describe:

- The credit union's objectives
- The scope and nature of the work to be performed
- Expected production service levels:
 - Delivery timelines
 - Measurement requirements
 - Security control measures
 - Audit reports
- The credit union's security requirements:
 - Incident response
 - Business continuity
 - Change control

Bidders should address these requirements and include estimated costs for the services. A request for proposal should be widely distributed to a pool of potential vendor prospects. Consider consulting with other credit unions for referrals of vendors that you can invite to bid on your project.

Informal Request for Bids

Some credit unions don't use the request-for-proposal process to solicit bids; they simply contact vendors directly. While contacting vendors directly is acceptable, always obtain bids from at least three different vendors and ensure that the bids are for the exact services you desire. Finally, be sure to consider the ongoing costs (annual fees, licensing, and other fees) associated with the project before making a final decision.

Evaluating Bids

Evaluating bids for technology services can be a complex endeavor. Consider engaging a qualified consultant to assist with the evaluation of the bids and with negotiating the terms of the contract. Qualified consultants can help score proposals based on the credit union's business needs and requirements. In addition, consultants with sufficient industry experience may be better positioned to negotiate fair pricing.

Many credit unions do not have the resources needed to understand and evaluate data processing costs and fees. Credit unions choosing to evaluate bids on their own must ensure management understands all the risks and potential costs of doing so. With this understanding, management and staff should evaluate bids and score proposals, based on the credit union's business needs and requirements comparable to how qualified consultants perform such actions. When evaluating bids on your own, consider partnering with other credit unions evaluating bids for similar services to share knowledge and resources and leverage better pricing.

Part 2 – Due Diligence

Once bids have been evaluated and the field of potential vendors narrowed, the next step is to conduct due diligence on each of the potential vendors. Due diligence involves investigating a business before signing a contract. During the due diligence process, gather and evaluate information to the extent necessary to make an informed decision. Properly conducted, due diligence enhances the amount and quality of information available to decision makers and ensures that this information is systematically used to evaluate the proposal and all its costs, benefits and risks.

When performing due diligence, confirm and assess key information about the potential service provider such as:

- Existence and corporate history;
- Qualifications, background and reputation of company principals, including criminal background checks when appropriate;
- Other credit union clients using similar services that may be contacted for reference;
- Financial status, including audited financial statements reviews;
- Strategy and reputation;
- Service delivery framework, capability, status and effectiveness;
- Technology and systems architecture;
- Conversion and de-conversion abilities, including track record;

While credit unions frequently outsource data processing services to third-party vendors and hire experts to assist with conducting due diligence, management cannot outsource its responsibility.

Credit union management is responsible for evaluating and performing thorough due diligence before entering into any relationship, particularly a contractual relationship.

- Internal control environment, security history and audit coverage;
- Legal and regulatory compliance; including complaints, litigation or regulatory actions;
- Reliance on and success in dealing with third-party service providers, including subcontractors;
- Insurance coverage; and
- The ability to meet disaster recovery and business continuity requirements.

If the proposed vendor will host or access member information, closely evaluate the vendor’s information security program. This includes evaluating all aspects of their data management and security controls, including:

- Risk-management processes;
- Data-encryption methods;
- Network security monitoring and testing;
- Incident response plans; and
- Requirement for employees and contractors with access to client member personal information to pass pre-employment criminal background checks.

For critical services, ensure the vendor’s business continuity planning program aligns with the credit union’s own program. Evaluate the service provider’s business continuity plan, testing strategy and testing results to ensure they meet the credit union’s requirements and promote resilience.

For additional business continuity planning guidance, refer to Federal Financial Institutions Examination Council Business Continuity Planning IT Examination Handbook, Appendix J, “Strengthening the Resilience of Outsourced Technology Services.”

For additional guidance on the due diligence process, refer to the [Supervisory Letter](#) enclosed with Letter to Credit Unions, 07-CU-13, “Evaluating Third-Party Relationships.”

Complete due diligence includes probing for information about intangibles, such as the third party’s service philosophies, quality initiatives, and business and management styles. These should fit the credit union. If considering a foreign-based service provider, the evaluation should also assess the [additional elements](#) discussed below.

Part 3A - Negotiating the Terms of the Contract: Overview

After selecting a vendor and conducting proper due diligence, it’s time to negotiate the contract. Negotiating the contract requires diligent discussions and sometimes compromise to reach a final agreement all parties accept. Careful preparation is important to determine which contract terms and provisions to negotiate. Especially avoid pressure to sign immediately—make sure management understands everything in the contract BEFORE approving the contract.

Begin with the premise that pretty much everything in the contract is negotiable!

Begin with the premise that pretty much everything in the contract is negotiable. This principle applies to new contracts and renewals of existing contracts. To more effectively negotiate contract terms, research and get a

clear understanding of the credit union’s needs and the vendor’s proposed services. Negotiate the terms of the contract, then conduct a final legal review before signing it.

The Contract

The contract is the legally binding document that defines all aspects of the relationship between a credit union and a vendor. A contract should be obtained for all data processing servicing relationships. It is the single most important control a credit union has in the outsourcing process and, as such, always:

- Negotiate the terms of the contract;
- Actively participate in drafting the contract;
- Verify the contract accurately describes the desired and agreed upon servicing relationship;
- Ensure the contract is clearly written and contains sufficient detail to comprehensively define the rights and responsibilities of each party; and
- Engage legal counsel early in the process to help prepare and review the contract.

The prevalence of automatic renewal or “evergreen” clauses in data processing contracts brings to light the importance of appropriate contract oversight and monitoring procedures. Ensure you understand contract notice requirements, including when and how notice must be given and have a mechanism in place to ensure timely notices are provided to vendors. Otherwise, the credit union will be bound by increased terms and fees included in the contract’s automatic renewal language. And remember, everything’s negotiable, including evergreen clauses.

Contracts are often complex, yet despite their inherent complexity, credit union management must ensure it has a thorough understanding of everything in the contract. Generally contracts should:

- Be clearly written and sufficiently detailed to provide assurances for performance, reliability, security, privacy and reporting;
- Address business requirements and key risk factors;
- Be flexible enough to allow for changes in technology, strategic initiatives and credit union operations;
- Quote actual prices, not estimates. With the exception of volume estimates, all price quotes should be actual prices;
- Clearly specify de-conversion fees and renewal prices, not refer to a “list” of other prices that may be changed by the vendor;
- Permit the credit union to terminate the agreement if the vendor persistently does not comply with [service-level agreements](#);
- Require the vendor warranty its product or service;

And contracts should not:

- Allow the vendor to change the fee schedule during the term of the agreement, unless there are reasonable limits or restrictions specified in the contract, about such changes; and
- Permit the vendor to determine what constitutes a “defect.”

Contracts must be clear and contain certain key elements. Credit union management must integrate all the key elements along with any other necessary contract provisions into the contract to make sure it meets the credit union's needs.

Service-Level Agreements

Service-level agreements are formal documents that outline the credit union's predetermined requirements for service and establish incentives to meet these requirements and provide penalties for failures to meet them. In order to protect themselves against service provider performance failures, credit unions should link service-level agreements to contract provisions regarding incentives, penalties and contract cancellation.

Credit union management should develop service-level agreements by first identifying the significant elements of the service. The elements can be related to tasks, such as processing error rates, system uptime and others, or they can be organizational, like employee turnover. Once management identifies the elements, it should devise ways to objectively measure performance. Determine the frequency of the measurements and an acceptable range of results to define when a service provider misses service-level agreement benchmarks. Finally, ensure the contract contains remedies, such as a fee or reimbursement, for failure to meet service-level agreements.

Although the specific performance standards may vary with the nature of the service delivered, management should consider service-level agreements to address the following issues:

- Availability and timeliness of services;
- Confidentiality and integrity of data;
- Change control;
- Security standards compliance, including vulnerability and penetration management;
- Business continuity compliance; and
- Help desk support.

Service-level agreements addressing business continuity should measure the service provider's contractual responsibility for backup, record retention, data protection, and maintenance of disaster recovery and contingency plans. The service-level agreements can also test the contingency plan's provisions for business recovery timeframes or identify periodic plan tests. Contracts and service-level agreements should not contain extraordinary provisions that would excuse the vendor or service provider from implementing its contingency plans. However, outsourcing contracts should include clauses that cover unforeseen events, such as those the credit union would not be adequately prepared to meet such as fires or floods.

Pricing Methods

Credit unions will often have several choices when it comes to pricing. Management should consider all available pricing options and choose the most appropriate for the specific contract. Examples of different pricing methods include:

- **Cost Plus:** The service provider receives payment for its actual costs, plus a predetermined profit margin or markup, usually a percentage of actual costs. For example, the service provider provides a server at a cost of \$5,000, plus a 10 percent markup—the credit union pays \$5,500.

- **Fixed Price:** The price is the same for each billing cycle for the entire contract period. The advantage of this approach is you know exactly what the cost will be each month. Problems may arise if you do not adequately define the scope or the process. Often, with the fixed-price method, the service provider labels services beyond the defined scope as additional or premium services. For example, if a service provider bills a credit union \$500 per month for maintaining a website, and the institution decides it wants to add another link, the service provider may charge more for that service if it is not clearly defined in the original contract.
- **Unit pricing:** The rate is set for a particular level of service, and the credit union pays based on usage. For example, if a credit union pays \$0.10 per page view on a website, and the site has 5,000 page views for the month, the cost is \$500 for the month.
- **Variable pricing:** The price is based on a variable such as system availability. For example, the provider bills the credit union \$500, \$600, or \$800 per month for service levels of 99.00, 99.50, or 99.75 percent system availability, respectively. If a website was available 99.80 percent of the time in a billing period, the credit union would pay \$800.
- **Incentive-based pricing:** Incentives encourage the service provider to perform at peak level by offering a bonus if the provider performs well. This plan can also require the provider to pay a penalty for not performing at an acceptable level. For example, the credit union contracts to build a website, and the service provider agrees to do so within 90 days for \$5,000. The credit union offers the provider \$6,500 if the website is ready within 45 days, but will only pay \$3,500 if the provider fails to meet its 90-day deadline.
- **Future price changes:** Service providers typically include a provision that will increase costs in the future either by a specified percentage or per unit. Some credit unions may also identify circumstances under which price reductions may be warranted, such as a reduction in equipment costs.

Bundling

The provider may entice the credit union to purchase more than one system, process, or service for a single price. This is referred to as “bundling.” While this can have benefits—it allows a credit union to streamline operations by using a single service provider—there can be pitfalls with a bundling arrangement.

- Bundling may result in a single consolidated bill that does not provide details on the pricing for each specific system, process or service. Although the bundled services may appear cheaper, it’s more difficult to determine the true cost of each individualized service.
- Bundles may also include processes and services that the credit union does not want or need. Additionally, it may not allow the credit union to discontinue a specific system, process, or service without renegotiating the contract for all remaining services.

To address these potential issues, ensure the contract itemizes the price for each system, process, or service. Also, consider contracting for ancillary services separately, even if they are with the same provider.

Contract Inducement Concerns

Do not sign servicing contracts that contain provisions or inducements that may adversely affect the credit union. Such provisions may include extended terms (up to 10 years), significant increases in costs after the first few years, or substantial cancellation penalties.

Inducements can take several forms, including:

- Offering a cash bonus upon completion of the conversion.
- Offering up-front cash. The provider states that the credit union acquires the right to future cost savings or profit enhancements that will accrue to the institution because of greater operational efficiencies. These improvements are usually without measurable benchmarks.
- The credit union defers expenses for conversion costs or processing fees under the terms of the contract.
- Low installation and conversion costs in exchange for higher future systems support and maintenance costs.

These inducements may offer a short-term benefit to the credit union, but the service provider usually recoups the costs by charging a premium for the processing services. These excessive fees may adversely affect a credit union's financial condition over the long-term. Accordingly, it is always wise to evaluate the effects of costs over the life of the contract. Credit unions must also ensure they account for contract inducements in accordance with generally accepted accounting principles.

Consider your system conversion schedule very carefully. Performing a system conversion during a required regulatory reporting period may fit within your vendor's schedule, but it could cause you problems if the system conversion doesn't go well. Bad timing where a system is not fully functional has negatively affected financial reporting, testing, audits, examinations, and member services.

Contract Length

Consider coordinating expiration dates of contracts for interrelated services, such as website, telecommunications, programming, network support, so they coincide, where practical. Doing so can minimize the risk of incurring penalties and expenses for redundant services.

Before agreeing to long-term contracts, consider your strategic goals and whether the provider or service will continue to meet the needs of the institution over the entire contract term. Satisfaction levels, technology changes, and other considerations, such as growth and mergers, could lead the credit union to seek alternative services during the life of a long-term contract. However, such long-term contracts can present significant difficulties and high costs if the credit union needs to seek alternative services.

Consider the type of technology and current state of the industry when negotiating the length of the contract and its renewal periods. While there can be benefits to long-term technology contracts, such as stable or predictable pricing, certain

Imagine a credit union just six months into a long-term contract for data processing services when the board decides to merge with another credit union. Such a situation presents difficulties for the acquiring credit union and makes the merging credit union less attractive as a merger candidate. Have an "exit plan" and negotiate a contract term that makes sense for your credit union.

technologies can have a short service life or could be rendered obsolete very quickly. In these cases, a shorter-term contract may prove beneficial.

Similarly, before expiration consider the appropriate length of time required to notify the service provider of your intent not to renew the contract. Factor this consideration into your evaluation of contract proposals and negotiate an appropriate term.

Part 3B - Negotiating the Terms of the Contract: Performance Parameters and Financial Details

Scope of Service

The contract should clearly describe the rights and responsibilities of all parties, including:

- Description of required activities, implementation timeframes and assignment of responsibilities. Implementation provisions should include an impact analysis or integration plan identifying existing systems or planned interrelated systems, such as an internet banking system being integrated with existing core applications or systems customization;
- Obligations of, and services to be performed by the service provider including software support and maintenance, training and member service;
- The credit union's obligations, including timely notice requirements and payment of service and other fees;
- Modification rights of each party to change existing services performed under the contract;
- Renegotiation guidelines for adding new or different services; and
- Service-level agreement failure fees or reimbursement schedule.

Ownership and Licensing

The contract should address the ownership of, rights to and allowable use of the credit union's data, equipment and hardware, system documentation, system and application software and other intellectual property rights. Ownership rights of the credit union's data must remain solely within the credit union's purview. Other intellectual property rights include: the credit union's name and logo, its trademarked or copyrighted material, domain names, web sites designs and other work products developed by the service provider for the credit union.

Cost

The contract should fully describe the fee calculation for base services, including development, conversion and recurring services, as well as charges based on the volume of activity or for special requests. Contracts should also address the responsibility and additional cost for purchasing and maintaining hardware and software. Any conditions under which the cost structure may change should be addressed in detail, including limits on cost increases. Also see [Pricing Methods](#) and [Bundling](#) sections.

Performance Standards

The contract should include performance standards that define minimum service-level requirements and remedies for failure to meet standards identified or outlined in the contract. For example, common service-level metrics include system uptime percentages, deadlines for completing batch processing, or processing error limits. Industry standards for service levels may provide a reference point. A credit union should review performance standards to ensure consistency with its goals and objectives. For more information, see the [Service-Level Agreements](#) section.

Source Code Escrow

When a computer program is in its original programming language, such as FORTRAN or C, before translation into object code (usually by a compiler program), it's called "source code." If the vendor were to go out of business, file bankruptcy, or simply stop providing support, the credit union could be left stranded with unsupported software. To support the business continuity of critical services, consider requiring the data processor to escrow the source code for their software.

Include in the contract provisions for an escrow agreement with a reputable third-party escrow agent to hold the source code in trust until a release condition occurs. If such a release condition occurs, then the escrow agent is contractually bound to provide a copy of the source code to the credit union or an alternate servicer. The contract should require the service provider to update the source code provided to the escrow agent at least quarterly.

Limitation of Liability

Standard contracts may contain clauses limiting the amount of liability that can be incurred by the service provider. If the credit union is considering such a contract, management should assess whether damage limitations are adequate to the amount of losses the credit union may reasonably experience as a result of the service provider's failure to perform its obligations.

Indemnification

This process protects and binds the parties by creating a promise to pay for the cost of possible damage, loss or injury. Legal counsel should review indemnification provisions to ensure the credit union will not be held liable for claims arising as a result of service provider negligence. Reciprocal hold harmless agreements for the other party's negligence are common in these types of contracts.

Termination

Assess the timeliness and expense of the contract's termination provisions. The extent and flexibility of termination rights can vary depending on the service. Consider including termination rights for a variety of conditions or situations, including the following:

- Change in control in situations like acquisitions and mergers;
- Convenience;
- Substantial increase in cost;

- Repeated failure to meet service levels;
- Failure to provide critical services; and
- Bankruptcy, company closure or insolvency.

The contract should establish notification and timeframe requirements and provide for timely return of the credit union's data and resources in a machine-readable format upon the contract's termination. Any costs associated with de-conversion assistance (translating computer data from one format to another) should also be clearly stated.

Part 3C – Negotiating the Terms of the Contract: Subcontracting and Provider Concerns

Subcontracting and Multiple Service Provider Relationships

Some service providers contract with other third parties to deliver services. Credit unions should be aware of and approve all subcontractors. Consider contract provisions that prohibit assignment of the contract to a third party without the credit union's consent. Assignment provisions should also reflect notification requirements for changes to material subcontractors. To provide accountability, designate the primary contracting service provider in the contract.

The contract should also specify that the primary contracting service provider is responsible for the services outlined in the contract, regardless of which entity actually provides them. Also, consider including in the contract, notification and approval requirements for changes to the service provider's significant subcontractors.

Foreign-based Service Providers

Contracts with foreign-based service providers should include additional provisions to protect member privacy and confidentiality of credit union records in conformance with U.S. laws and regulations.

Before entering into a contract with a foreign-based vendor, carefully consider which country's law will control the relationship. Based on that review, include choice-of-law and jurisdictional covenants that provide for resolution of disputes between the parties under the laws of a specific jurisdiction. These provisions are necessary to maintain continuity of service, access to data and protect member information.

The laws of the foreign country may not recognize choice of law provisions and may differ from U.S. law about what they require of organizations or how they protect credit union members and their sensitive private information. Thus, a credit union's due diligence should include an analysis of a country's local laws by legal counsel competent in assessing the enforceability of all aspects of a contract.

Part 3D- Negotiating the Terms of the Contract: Management Concerns and Compliance

Controls

Consider implementing contract provisions addressing the following controls:

- Internal controls of the service provider;
- Compliance with applicable regulatory requirements;
- Record maintenance requirements for the service provider;
- Access to the service provider's records by the credit union;
- Notification requirements and approval rights for material changes to services, systems, controls, key project personnel and service locations;
- Setting and monitoring parameters for financial functions, including payment processing or extension of credit on behalf of the credit union; and
- Insurance coverage maintained by the service provider.

Reports

Contractual terms should include the frequency and type of reports the credit union will receive, including performance reports, control audits, financial statements, security, and business resumption testing reports. The contract should also outline the guidelines and fees for obtaining custom reports. Generally, consider requiring reporting related to:

- Service-level metric;
- Service provider financial statements;
- Service provider insurance policies;
- Incident response program and test results;
- Business contingency plans and test results; and
- Audit and consulting reports and corrective action related to:
 - Internal audits;
 - [Control reviews](#) like Statement on Standards for Attestation Engagements 16 Service Organization Control reports (SOC 1, SOC 2, and SOC 3); and
 - Security assessments.

Audit

Specify in the contract the types of audit reports the credit union is entitled to receive like financial, internal control, and security of the service provider audits. The contract should specify the:

- Frequency of audits;
- Charges for obtaining the audits; and
- Rights of the credit union and its regulatory agencies to obtain audit results in a timely manner.

The contract should also require the service provider to provide sufficiently detailed reports covering findings of these audits to adequately assess—without compromising—the service provider's security.

The contract may also specify rights to obtain documentation about resolution of deficiencies and to inspect the service provider's processing facilities and operating practices. Management should consider, as part of its risk assessment, if it can rely on internal audits or if there is a need for external audits and reviews.

For services involving access to open networks, like internet-related services, pay special attention to security issues. Consider including contract terms requiring periodic control reviews performed by an independent

party with sufficient expertise. These reviews may include penetration testing, intrusion detection, firewall configuration reviews and other independent control reviews.

Dispute Resolution

Take the time to know and understand your options for dispute resolution before you need them. This may require you to consult with legal counsel.

Dispute resolution options typically include negotiation, mediation, arbitration, and litigation. Vendor contracts oftentimes include mediation or arbitration terms. Credit unions may choose to negotiate inclusion of such terms in vendor contracts without such clauses.

Consider including a provision for a dispute resolution process that attempts to resolve problems in an expeditious manner and provides for continuation of service during the dispute resolution period. But, in all cases, know what you're agreeing to before you enter into the contract.

The default method of legal dispute resolution is litigation, which is usually time consuming, stressful and costly. Sometimes litigation is unavoidable, but it shouldn't be the first option. Including dispute resolution terms in the contract may help solve the issue before jumping to litigation.

Generally, arbitration and litigation are legally binding and final dispute resolution mechanisms. Mediation is generally not binding as mediators do not make decisions for the parties. However, it can still be time-consuming and costly. In addition, there are multi-tiered dispute-resolution clauses that may require negotiation and mediation occur before any formal proceedings are undertaken.

Business Resumption and Contingency Plans

The contract should address the service provider's responsibility for backup and record protection of:

- Equipment and hardware;
- Program and data files; and
- Disaster recovery and contingency plans.

Additionally, contracts should address business resumption and contingency plans by:

- Outlining the service provider's responsibility to test the plans regularly and provide the results to the credit union;
- Addressing interdependencies among service providers when determining business-resumption-testing requirements;
- Requiring the service provider to provide the credit union a copy of their contingency plan outlining the required operating procedures in the event of a business disruption; and
- Including specific provisions for business-recovery timeframes that meet the credit union's business requirements.

Security and Confidentiality

The contract should address the service provider's responsibility for security and confidentiality of the credit union's resources, like its information and hardware, and should:

- Prohibit the service provider and its agents from using or disclosing the credit union's information, except as necessary or consistent with providing the contracted services;
- Protect against unauthorized use, such as disclosing information to the credit union's competitors;
- If the service provider hosts or accesses nonpublic personal information of the credit union's members, verify the service provider complies with all applicable requirements of the privacy regulations;
- Require the service provider to disclose breaches in security that may materially affect the credit union or its members; and
- Require the service provider report to the credit union when intrusions occur, the effect on the intrusion and corrective action taken to respond to it.

Regulatory Compliance

Ensure contracts with service providers include an agreement that the service provider and its services will comply with applicable regulatory guidance and requirements. In accordance with the [Gramm-Leach-Bliley Act](#), the contract must contain compliant provisions for privacy and security.

- **Privacy:** As required by [Part 716 of NCUA's Rules and Regulations](#) (cross-referenced to [Consumer Financial Protection Bureau's Part 1016, Regulation P](#)), the contract must contain compliant provisions for the privacy of consumer financial information and disclosure of nonpublic personal information. The contract should prohibit the service provider from using or disclosing consumer financial information or nonpublic personal information without the credit union's express written consent, unless specifically authorized by law.
- **Security:** As required by [Part 748 of NCUA's Rules and Regulations](#), the contract must contain compliant provisions for securing and safeguarding information. The contract must require the service provider to:
 - Implement appropriate measures designed to protect against unauthorized access to or use of member information;
 - Properly dispose of member information; and
 - Take appropriate action to address incidents of unauthorized access to member information, including notifying the credit union as soon as possible following any such incident.

The contract should also indicate the service provider agrees to provide accurate information and timely access to the appropriate regulatory agencies, based on the type and level of service it provides the credit union.

Part 4 - Legal Review

Make sure management understands everything in the contract BEFORE signing on the dotted line!

Once you've successfully negotiated the terms of the deal, and before you sign the contract, carefully review it and all relevant legal issues. It is prudent to engage

qualified external legal counsel to review the contract. Legal counsel should be independent and have the experience necessary to properly review the contract.

However, it is not enough for legal counsel to review and understand the contract, credit union management must also independently review, evaluate and fully understand all of the business terms and conditions contained in the contract.

If a contract clause is unclear, does not appear to add value, or is not reciprocal when appropriate, request the clause be removed or adjusted. When the credit union does not agree with a clause, management or their legal counsel should suggest more appropriate language. Extra care must be taken for contracts involving [foreign-based vendors](#).

Conclusion

Credit unions need to take the right steps to negotiate the best data processing contracts and remember, early termination penalties, fees, escape clauses, default terms and almost every other contract term is negotiable. Before signing a contract:

- Shop around and understand what each vendor's offer means to the credit union;
- Conduct thorough due diligence on potential vendors;
- Negotiate contract terms and provisions;
- Carefully review the contract and make sure management understands it;
- Ensure the contract:
 - Clearly defines the rights and responsibilities of all parties;
 - Requires adequate and measurable service levels;
 - Does not contain provisions or inducements that could have a significant adverse impact on the credit union; and
- Engage legal counsel to review the contract before you sign it.

Don't just sign a data processing or other technology service contract on the dotted line. Review it and make sure it is a good fit for your credit union. Remember everything in the contract is negotiable. So, negotiate, negotiate, and negotiate! And get the best terms for the credit union.

References

[Federal Financial Institutions Examination Council, "Outsourcing Technology Services" IT Examination Handbook](#)

[Federal Financial Institutions Examination Council "Business Continuity Planning" IT Examination Handbook, Appendix J: "Strengthening the Resilience of Outsourced Technology Services"](#)

[Supervisory Letter](#) enclosed with [NCUA Letter to Credit Unions, 07-CU-13, "Evaluating Third-Party Relationships"](#)

[NCUA Letter to Credit Unions, 02-CU-17, "e-Commerce Guide for Credit Unions"](#)

Appendix – Contract Review Checklist

Does the contract:

- Provide a complete and detailed description of the product or service provided by the service provider?
- Clearly define the cost of the products and services for the duration of the contract?
- Term align with the credit union's other services, future business needs or both?
- Outline the responsibilities of the credit union and service provider, and address subcontracted services and oversight?
- Contain service-level agreements, including measurable service standards, performance reporting, and remedies for failure to meet the defined standards?
- Address the ownership, rights to, and allowable use of the credit union's data, equipment or hardware, system documentation, system and application software, and other intellectual property rights?
- Specify the type and frequency of audits the service provider will undergo, reporting of audit results, and associated fees?
- Describe the service provider's responsibility for the security and confidentiality of the credit union's information and hardware?
- Address the service provider's responsibilities for backup and record protection, including equipment, program and data files, and maintenance of disaster recovery and contingency plans?
- Specify the types of insurance coverage the service provider will maintain?
- Describe all member support services and how the service provider will handle member complaints?
- Require the service provider to comply with applicable regulatory requirements and include Gramm-Leach-Bliley compliant provisions for privacy and security?
- Indemnify the credit union from liability arising from the service provider's negligence?
- Contain reasonable or proportional limits on the liability that can be incurred by the service provider?
- Provide a fair and timely dispute resolution process and require the service provider to continue providing services during the dispute resolution period?
- Contain termination rights for various conditions, notice and timeframe requirements, and related fees?



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