

Due Diligence and Effective Vendor Management

Corporate America Credit Union

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Your Speaker

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Why Do We Care About Contracts?

- Contract management is a unique convergence of the practical, technical and compliance areas.
- How much of your budget is “contract dependant”?
- You need a process to understand, review, negotiate, execute and monitor all of your Credit Union’s contracts.

Basic Truths About Credit Unions

- Most credit unions have at least one ‘invisible vendor’.
- Most credit unions are better at vendor selection than monitoring.
- Many credit unions don’t consider a CUSO to be a vendor.
- Bad news does not always travel up.
- Some employees get ‘captured’ by a vendor.

Behind the Curtain

- Looking at the PROCESS more than the decision (but both are essential)
- We see the vendors easily. Now the questions are:
 - What do they do?
 - What are the risks?
 - How were they selected?
 - How are they integrated within CU operations?

Benefit of the Bargain

- The credit union needs to be on guard to ensure they are receiving the full value of the products and services for which they have contracted.
- Does the credit union even track this concept?

Typical Vendor Relationships

- CUSO Relationships
- Lending Services
- Payment Systems
- Auditing and Management Consulting Services
- Asset Liability Management
- BSA and OFAC
- Data Processing
- Internet Banking Services

Elements of An Effective Program

- Step 1: Risk Assessment and Planning
- Step 2: Effective Vendor Selections
- Step 3: Contractual Considerations
- Step 4: Measuring, Monitoring and Controlling Risks

Nature of Third Party Risks

- CU is not in direct control of its operations
- They hand over the process, resources and control to a third party
- Critical functions deserve special attention
- What could possibly go wrong?

Vendor Risk Assessment

- A proper vendor risk assessment will list all third party relationships and the exact services each provides; identify the strategic importance of each service; and determine the risk each poses to credit union operations.
- Risk assessments are a dynamic process and should be a regular component of a broader risk management strategy.
- Just an Excel spreadsheet!

Risk Assessment: Specific Inquiries

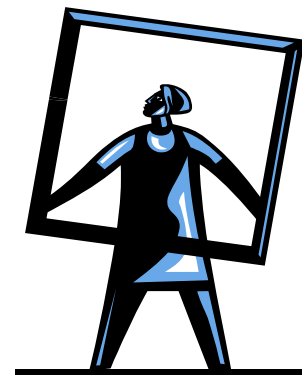
- Expectations for Outsourced Functions
- Criticality of Relationship
- Staff Expertise
- Cost-Benefit Relationship/Risk-Reward
- Insurance Coverage
- Impact on Membership
- Exit Strategy

What is a Contract?

- A contract is an agreement between two or more parties to do, not do, or promise something.
- Contracts can come in many forms — they can be oral or written, implied or express, and legally enforceable or not.
- The strongest contract, in terms of enforceability, has an:
 - offer,
 - acceptance,
 - consideration for the exchange,
 - clearly sets out the terms of the agreement without ambiguity, and
 - is signed by the involved parties with proper capacity to enter into the contract.

Big Picture Issues

- Parties
- What are You Getting
- Term
- Price
- Termination
- Traps – exclusive use?
- Backdoor – can we get out?
- Data Security!



Think About It

- A contract is a vendor's wish list!
- It contains every right they want and limits the credit union's options
- What is the result of not negotiating?

NCUA: Minimum Scope

- Scope of arrangement, services offered, and activities authorized;
- Responsibilities of all parties (including subcontractor oversight);
- Service level agreements addressing performance standards and measures;
- Performance reports and frequency of reporting;
- Penalties for lack of performance;
- Ownership, control, maintenance and access to financial and operating records;
- Ownership of servicing rights;
- Audit rights and requirements (including responsibility for payment);
- Data security and member confidentiality (including testing and audit);
- Business resumption or contingency planning;
- Insurance;
- Member complaints and member service;
- Compliance with regulatory requirements (e.g. GLBA, Privacy, BSA, etc.);
- Dispute resolution; and
- Default, termination, and escape clauses.

Negotiation Is Required!

- Of particular importance, credit unions should exercise their right to **negotiate contract terms with third parties** for mutually beneficial contracts.
- In addition to a legal review of contracts and written agreements relevant to a prospective third party arrangement, it may be prudent for credit unions to obtain a legal opinion about any services provided by the third party under the arrangement.

Housekeeping

- Does Anyone Know How Many Contracts the Credit Union Has?
- Who has the Contracts?
- Is there:
 - a List with Name of Provider;
 - Description of Service;
 - Termination Dates; and,
 - Notice of Non-renewal Date Requirements?
- Can You Find Correspondence with the Vendor and Amendments and Modifications?

Contract Basics

- Are All the Pieces of the Puzzle There?
 - Reed & Jolly: Forget what the Sales Rep said – all that web-site stuff, visits to the home office, other credit union users and pamphlets and promotional material ARE NOT PART of the contract unless incorporated by reference. Keep copies anyway.
- Key Contract Provisions – Examples
 - Price, Term, Termination, Warranties, Liability, Boilerplate, Exhibits & Attachments
 - Special Attention: Privacy, Indemnification, Early Termination, Deconversion –and - Breach

Basic Contract Negotiation Tips

- Remember who created the contract form and who it will benefit (Rule of Construction)
 - Get a copy of their contract as early as possible
 - If the language works, keep using it
 - If changes are agreed to, put them in the contract!
 - Nothing sacred about “boiler plate” language
 - Where did that term come from anyway?
- ❑ Reed & Jolly: Contract renewal means vendor re-selection.

Negotiating the Deal

- Who is on the Team?
 - Usually – User, Finance, Compliance
 - Importance to CU Operations? – Timing? – Price?
- Lead Person – Must read every word, Make sure files are complete, Everyone with a need to know buys in, Keeps things moving
- Use of outside Consultant/Counsel – Set minimum threshold for outside review (dollar, mission), document decision not to send outside. Remember - reasonable expectation – they don't know your operations the way you do!

Negotiating the Deal

- All Contracts involve Compromise – Your vendor due diligence will give you an understanding of what is available for the service being purchased, the price and whether the vendor you select is reliable
- Identify Vendor Contacts as Negotiations begin
 - With authority to make changes, respond to questions

Negotiating the Deal

- Understand Your Bargaining Position
 - Changes often require “legal” review by Vendor
 - Adds Cost, Delay
 - You will often hear – “legal won’t let us change it.”
- Your Attorney/Consultant – must know credit union *operations* (not necessarily a collection attorney), should identify “show stoppers”, suggest language

Negotiating the Deal

- Set Realistic Expectations
 - Price & Term are usually negotiable
 - You deserve a clear statement in the Contract of what the Product/Service is and is expected to do
 - Privacy and Data Security Must Meet *Minimum* Compliance Standards – aim high.
- Reed & Jolly: Always be prepared to walk away.

Reed & Jolly's First Rule of Contract Evaluation

- If You Can't Tell What You Are Getting for Your Money in the First Part of the Agreement, You have a Problem



Start at the End

My Job	Done
1. I have read the contract, including all attachments and exhibits.	
2. All terms and conditions of the contract conform with the final negotiations / agreements of the parties.	
3. No supplementary verbal or written agreements were made.	
4. All documents incorporated by reference in the contract, including exhibits and appendices, are attached.	
5. The contract adequately describes all that the other party must do to make the project work.	
6. Those carrying out the contract can meet the terms of the contract (e.g., the work can be completed, and it can be completed according to any time limits provided in the contract; we will be able to hire the personnel specified in the contract, etc.).	
7. Everyone necessary at the Credit Union has signed off on the project, i.e., budget, senior management, project responsible parties/users.	
8. This contract does not conflict with any other contracts, promises or obligations of the Credit Union, e.g., exclusive use.	

Document Everything!

- It is not going to be enough to have gone through this process.
- You must document your efforts and findings, and keep this information in a readily accessible (and readable) format!

Effective Problem Identification

- Every contract should have a responsible party assigned to it
- Understand what the relationship is suppose to provide – Be realistic!
- Conduct regular performance assessments
- Keep a log of all problems – date, nature of problem, key parties, and resolution
- Remember: Lots of “small” problems could be a BIG problem

What Happens if Something Goes Wrong?

- Basic contract breach scenarios
 - Minor default
 - Material default
- What is the vendor's right to cure?
- Always look at the “end game”
- You have already determined alternative vendors and exit strategies in your Risk Assessment

Communicating Problems

- Be clear
- Give specific examples
- Dates and Times Are Important
- Offer your desired resolution
- Give a timeline for an expected resolution
- Remember with whom you spoke
 - Name and title are important
- Keep notes, document everything!

Creating a Paper Trail

- Use e-mails or letters
- Remember the “evidence” rule
- Keep correspondence short, clear, and concise
- Stay away from accusations and emotions
- Save them in a file!

Benefits of a Paper Trail

- Memorializes the issues
 - Creates an easy to follow timeline
 - Lets a third party easily review the nature and history of the issues
 - Hard to refute correspondence
 - Admissible in court
- Reed & Jolly: It is much easier to rely on a document than on the recollection of a telephone call.

A Final Look

- Do Your Vendor Due Diligence
- Keep a Complete File of Everything the Sales Rep said and You Received from the Company
- Negotiate Hard but Realistically
- Put Details in the Proposal
- Get the Contract ASAP to Begin the Review

A Final Look

- Focus on Term, Price, Security and Contract Clarity – can you put the pieces together
- Lock Down Internal Accountability Issues
- Monitor Performance Like a Hawk – Pounce on Nonperformance and Document It
- Check the Invoices – No Surprises
- Remember Contract Renewal Means Renegotiation

Regulatory Guidance

- NCUA Letter to CU 01-CU-20
- NCUA Letter to CU 04-CU-13
- NCUA Letter to CU 07-CU-13 & Supervisory Letter 07-01
- NCUA Letter to CU 08-CU-19
- Part 748 NCUA Rules and Regulations
- Part 701 & 741 NCUA Rules and Regulations (Indirect Auto Lending)
- AIREX Exam Questionnaires

Questions?