For nearly five decades, Austin Associates has focused on providing a wide range of consulting services and specialized investment banking expertise to financial institutions.
Many firms do what we do.

But few do all that we do.

- Investment banking
- Strategic consulting
- Financial management
- Risk Management
- Technology Solutions
A Properly Negotiated Contract Should:

- Increase cost effectiveness
- Minimize future expense
- Reduce risk
- Provide accountability
- Increase utilization
- Provide acceptable exit terms
Current Market Conditions

- Tech spending on the increase
  - Banks loosening their purse strings
  - Pent up demand for product/service
- In-house to outsource migrations are escalating
- Revision of bank strategies creating need for core vendor realignment
- Vendors promoting long term contracts
Current Market Conditions

• Contracts becoming increasingly complex and lengthy
• Greater regulatory concern on vendor management
• Additional Regulations on the horizon
  • Consumer Financial Protection Bureau
  • US Bancorp $6.5 million fine
• High degree of concern related to data security
Psychology of Vendor

- Keep profit margins as high as possible
  - Current pricing is higher than market
- If you are a good client with few problems
  - Let the contract auto-renew
- If you are a client that could possibly look at other vendors
  - Lower price (marginally) well in advance of contract expiration
Psychology of Client

- No knowledge of contract expiration date
- Too busy to worry about it now, let it auto-renew
- I will be retiring in the next ___ years; let it renew and the next guy can take care of it
- I don’t want to go through the conversion
- If it’s not broker, don’t fix it
Getting Started

- Holistic Approach
- Form a Review and Decision Committee
  - Include key people that use system
    - Great knowledge base of what works and what does not work
- Do not focus only on price
  - Price usually follows a well developed approach
Identify Needs

Determine direction of bank in 5 years
- Corporate activity planned
  - Acquire/sell
- Customer focus
  - New markets
  - Strategy shift creating need to pursue new clients
Getting Started

• Allow 18-24 months for process
  • If Bank decides to convert
    • Will need at least 6 months for conversion
    • Current vendor may come with renewal contract 24 months in advance of current expiration
Getting Started

Å Review your current contract(s)
    ï Expiration date
    Å Term/renewal
    Å Termination notification requirements
    Å Buyout terms
        ï Early termination
        ï Deconversion costs
    Å Escalation costs
    Å Service Level Agreements
Getting Started

- Audit your most recent invoice(s)
  - Gives complete listing of services/products in use
  - Check pricing to contract
  - Assemble annual/quarterly costs
  - Use invoices as base-line for cost analysis and quotes
Getting Started

- Review and understand the FFIEC IT Examination Handbook: Outsourcing Technology Services
  - Designate a committee member to be in charge of incorporating these guidelines into the process
The financial services industry has changed rapidly and dramatically. Advances in technology enable institutions to provide customers with an array of products, services, and delivery channels. One result of these changes is that financial institutions increasingly rely on external service providers for a variety of technology-related services. Generally, the term "outsourcing" is used to describe these types of arrangements.

http://ithandbook.ffiec.gov/it-booklets/outsourcing-technology-services.aspx
Identify Needs

Determine minimal acceptable requirements

Â Product/service
  ï Current and future needs

Â Contract terms/business issues

Â Performance standards (SLAs)
  ï Minimal acceptable service levels
  ï Remedy if not achieved
Develop Request for Proposal

- Formal statement of needs and requirements
- Common metrics for all vendors
- Proper vendor due diligence as required by regulation
- Assign a point person for vendor communications
Evaluate Responses

- Subjective evaluation
  - Likes/dislikes
- Objective evaluation (financial)
  - Identify all costs
    - Recurring
    - Annual
    - One-time
    - Deconversion
    - Early termination penalties
Pitfalls in Contract Negotiations

- Escalation Provisions
- Term
- SLAs with remedies
  - Service, product performance, security
- Early termination costs
- Deconversion costs
- Merger/acquisition costs
Effects of Escalation

Base Fee - $10,000
Annual Escalation ÷ 3%

The Cumulative Annual Increase line represents the cumulative yearly increase over the base fee amount of $120,000 per year with the selected yearly 3.0% escalation rate.
Effects of Escalation

Base Fee - $10,000
Annual Escalation ÷ 5%

The Cumulative Annual Increase line represents the cumulative yearly increase over the base fee amount of $120,000 per year with the selected yearly 5.0% escalation rate.
Effects of Escalation

Base Fee - $10,000
Annual Escalation 10%

The Cumulative Annual Increase line represents the cumulative yearly increase over the base fee amount of $120,000 per year with the selected yearly 10.0% escalation rate.
Contract Term

• Coterminous Agreements
  ᵗ ALL core and auxiliary products end at the same time
  ᵗ Easier migration to new systems
      ᵗ Better negotiating leverage with new and existing vendors
Contract Term

Å Three year agreements
  ï Does not allow for aggressive pricing
  ï Few, if any incentives
Å Five year Agreements
  ï Allows for aggressive pricing
  ï Allows for incentives and bonuses
  ï Most advantageous term for both bank and vendor
Contract Term

- Seven year agreements
  - Allows for aggressive pricing
  - Allows for incentives and bonuses
  - Be careful of diminishing returns
    - Escalation clauses
    - Market price valuations
    - Technology concerns
    - Early termination fees
    - Flexibility in M&A
Market Price

Beginning Price
Market Price

- End Contract Price
- Renewal Price
- Beginning Price
- New Market Price

20%
Examples of What to Avoid

- Agreements renewed without regards to market price
- Renewal terms
  - Pricing upon renewal at the then current rate
- Future fees undefined
  - Deconversion charges at the then current rate
Examples of What to Avoid

- Loss of discounts upon notification of termination
- First right of refusal
  - Difficult to terminate service
- Conflicting terms and expiration dates
- Inconsistent terms from vendor
Best Practices

- Refer to your contract
- Annual audit of your invoices
- Monitor SLAs continually
- Coterminal agreements
  - Be cautious of term extensions
- Provide notice of non-renewal before beginning renewal process
- Create a competitive environment
- Legal review of all new agreements