THE BETTENFIELD GROUP

FIELDREPORT

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Vendor Management: **Watching Out for Pitfalls**

In this shifting economic environment, banks are increasingly looking to third-party relationships to extend their capabilities and compete in the marketplace. The trade-off for these added efficiencies is the added complexity of adequately overseeing these vendors. Bank boards and regulators expect the risk associated with the vendors and the outsourced function to be managed as though the vendor were an internal bank department. One of the greatest concerns for smaller banks in establishing a vendor management program is ensuring compliance to regulations designed to govern larger institutions.

Managing Your Vendors

The FFIEC and the OCC provide guidance for banks as they manage these third-party relationships. The framework of this risk management process consists of four components: risk assessments targeted to the bank's business needs, due diligence prior to the selection of the vendor, detailed contracts with terms addressing the role and responsibilities of both parties, and ongoing monitoring of the vendor and its risk.

What Banks Do Well

In the BettenField Group's work with banks, we have observed that they have addressed the early stages of vendor risk governance and vendor procurement. That is, banks recognize the need for a Board-approved vendor management policy, and banks are capably assessing their own business needs, identifying vendors, and assessing the vendors ability to provide services.

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Addressing the Gaps in Vendor Management

On other hand, we have found that there are some principle areas of vendor management that small to mid-sized banks struggle with:

- **Lack of Procedures**—Vendor management should be governed by strong procedures that ensure that each business owner conducts the vendor procurement, oversight, and reporting processes in accordance with regulatory expectations. Even those banks with sufficient procedures often falter in making sure that their employees are properly executing them.

- **Contract Controls**—Often, executed contracts do not provide sufficient controls for the bank to monitor the performance of the vendor nor do they have a mechanism to redress any gaps in performance.

- **Insufficient Due Diligence**—While banks are assessing vendors based on their own business needs, they are frequently not performing sufficient due diligence based on the identified risks of a vendor. In cases where due diligence has been performed, it has been done without formal protocols and with insufficient documentation.

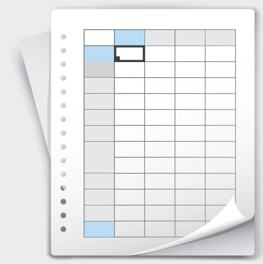
- **Ongoing Monitoring and Reporting**— Where banks most frequently stumble, though, is in failing to monitor their vendors on an ongoing basis. Performance reviews, when they happen, go undocumented, and annual risk assessments are neglected. These controls, and others, are essential because they form the body of regular reports that go to management committees and the board.

Moving Forward

This regulatory guidance is not only required; it is also prudent for the bank. Although implementing this oversight may sound daunting initially, banks can take steps toward a more secure future by instilling a sense of accountability within the business owners overseeing the critical vendors.

The First Step

To understand the scope of the challenge, gather existing vendor contracts and information to build a spreadsheet outlining the material data for each vendor.



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