

## **2013 OCC Guidance on Third Party Service Providers**

**By Joan Warrington and Judy Mok, Morrison Foerster LLP**

Third party service providers are an integral part of the financial services industry, providing critical functionalities (*e.g.*, credit decisioning support, payment processing services, records retention, documents destruction) to financial institutions and other participants in the payment process. Given the complexity of services provided, financial institutions may face significant operational difficulties in transferring the services of such third party service providers that fail to meet appropriate service levels. Given the sensitive nature of information to which these third party service providers may have access, including personally identifiable information belonging to customers of financial institutions, regulators expect financial institutions to be accountable for the actions of the companies with which they contract. Financial institutions are expected to be prudent in choosing appropriate third party service providers and monitoring the performance of these providers, beginning with contract negotiations with these companies.

On October 30, 2013, the Office of the Comptroller of the Currency (“OCC”) issued a Risk Management Guidance on Third-Party Relationships<sup>1</sup> (“2013 OCC Guidance”) which sets forth detailed expectations for national banks and federal savings associations with respect to assessing and managing risks associated with their relationships with third party service providers. The 2013 OCC Guidance calls for more comprehensive and rigorous oversight and management of third party relationships that involve “critical activities.” The 2013 OCC Guidance defines “critical activities” as significant bank functions (*e.g.*, payments, clearing, settlements, custody) or significant shared services (*e.g.*, information technology), or other activities that: (i) could cause a bank to face significant risk if the third party fails to meet expectations; (ii) could have significant customer impacts; (iii) require significant investment in resources to implement the third-party relationship and manage the risk; and (iv) could have a

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<sup>1</sup> See <http://occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html>. The 2013 OCC Guidance rescinds OCC Bulletin 2001-47 “Third-Party Relationships: Risk Management Principles,” and OCC Advisory Letter 2000-9, “Third-Party Risk.”

major impact on bank operations if the bank has to find an alternate third party or if the outsourced activity has to be brought in-house. Most notably, the 2013 OCC Guidance includes the types of contractual provisions the OCC expects to see in banks' agreements with their service providers. According to the 2013 OCC Guidance, "developing a contract that clearly defines expectations and responsibilities of the third party helps to ensure the contract's enforceability, limit the bank's liability, and mitigate disputes about performance." Specifically, the 2013 OCC Guidance provides that banks' contracts with third party service providers should address the following topics:

1. Nature and Scope of Arrangement
2. Performance Measures or Benchmarks
3. Responsibilities for Providing, Receiving, and Retaining Information
4. The Right to Audit and Require Remediation
5. Responsibility for Compliance with Applicable Laws and Regulations
6. Cost and Compensation
7. Ownership and License
8. Confidentiality and Integrity
9. Business Resumption and Contingency Plans
10. Indemnification
11. Insurance
12. Dispute Resolution
13. Limits on Liability
14. Default and Termination
15. Customer Complaints
16. Subcontracting
17. Foreign-Based Third Parties
18. OCC Supervision

The 2013 OCC Guidance provides detailed descriptions of the issues that need to be addressed with respect to each of the foregoing topics in the contracts between banks and their third party service providers. For example, the 2013 OCC Guidance states that a contract should include "a provision that enables the bank to terminate the contract, upon reasonable notice and without penalty, in the event that the OCC formally directs the bank to terminate the relationship" and also addresses limitation of liability, asking "whether the contract limits the third party's liability and whether the proposed limit is in proportion to the amount of loss the bank might experience because of the third party's failure to perform or to comply with applicable laws." It also "prohibits the third party and its subcontractors from using or disclosing the bank's information, except as necessary to provide the contracted activities or comply with

legal requirement.” Not surprisingly, many banks and other financial institutions use the 2013 OCC Guidance as leverage to negotiate more bank favorable provisions in their contracts with their service providers, in particular with respect to bank approval rights and oversight and control of their service providers. While some companies may feel that this gives banks unfair negotiating leverage, the key takeaway from the 2013 OCC Guidance and other regulatory guidance on this issue (as noted below) is that service providers will be held to the same standards to which the regulated entity is subject. Therefore, these standards provide flexibility depending on the risks the particular services pose to the financial institutions, their customers and operations. Even entities that are not under OCC supervision, but involved in third party service provider relationships, should consider using the 2013 OCC Guidance as a “best practices” guide. For banks and federal savings associations that are under the supervision of the OCC, it is crucial to review the 2013 OCC Guidance and make sure they manage their third party service provider relationships accordingly and meet the expectations of the 2013 OCC Guidance when negotiating contracts with their service providers.

As conveyed in the 2013 OCC Guidance, the OCC expects banks to practice effective risk management regardless of whether such banks perform the activity internally or through a third party. Similarly, other regulators have issued bulletins and guidance on their expectations with respect to how banks and other financial institutions should manage their relationships with third party service providers. For example, in April 2012, the Consumer Financial Protection Bureau (“CFPB”) issued a bulletin about third party vendors<sup>2</sup>. In October 2012, the Federal Financial Institutions Examination Council (“FFIEC”) issued a guidance on IT service providers<sup>3</sup>. The Federal Deposit Insurance Corporation (“FDIC”) joined the regulatory bandwagon with its September 2013 Financial Institution Letter regarding payment processing relationships with high risk merchants<sup>4</sup>. The Board of Governors of the Federal Reserve System (“Federal Reserve Board”) followed shortly thereafter with a Guidance on Managing Outsourcing Risks<sup>5</sup> in December 2013.

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<sup>2</sup> See [http://files.consumerfinance.gov/f/201204\\_cfpb\\_bulletin\\_service-providers.pdf](http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf).

<sup>3</sup> See [http://ithandbook.ffiec.gov/media/153533/10-10-12\\_-\\_administrative\\_guidelines\\_sup\\_of\\_tsp.pdf](http://ithandbook.ffiec.gov/media/153533/10-10-12_-_administrative_guidelines_sup_of_tsp.pdf).

<sup>4</sup> See <https://www.fdic.gov/news/news/financial/2013/fil13043.html>.

<sup>5</sup> See <http://www.federalreserve.gov/bankinforeg/srletters/sr1319.htm>.

Financial institutions may not always be able to seek indemnification for non-compliance with regulatory requirements by their service providers. Recent CFPB actions raise the possibility that financial institutions could be barred from receiving indemnification under certain circumstances.<sup>6</sup> In another example, both a bank and service provider were sued in 2008 when the FDIC and the Federal Trade Commission (“FTC”) joined forces against CompuCredit Corp. and Synovus Financial Corp. for deceptive credit card marketing practices in an unprecedented act of regulatory cooperation. So, it’s clear that stakes are going up not only for financial institutions but also service providers.

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<sup>6</sup> See [http://files.consumerfinance.gov/f/201312\\_cfpb\\_consent-order\\_0010.pdf](http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0010.pdf).