

The Supervisory Committee's Role in Due Diligence Third Party Vendors



Prepared by:
Julie Esser, Director-New Alliances
CUNA Strategic Services
Marcia Barron, CPA, Director-Internal Audit
Credit Union National Association



The process for due diligence that explored in this session is based on the model that has been developed by CUNA Strategic Services for exploring new strategic alliance relationships. Because there are many different situations in which a credit union might hire a third-party vendor, the process described here is very flexible and can be adapted to numerous situations. There is no one set process. These suggestions can be used as a template and can be customized for each project.

Objectives

- Execute a due diligence process
- Identify questions to ask
- Evaluate your results
- Maintain and monitor the relationship

Why Due Diligence?

- To deliver quality products and services to your members
- To protect your credit union's brand, image, and intellectual property
- To manage risks inherent to third-party relationships
- To comply with NCUA's requirements

NCUA's Requirements

The supervisory committee should set policies for management for when a due diligence process should be implemented. The NCUA has published recommended guidelines credit unions should follow when dealing with third-party relationships, NCUA letter number 01CU20. NCUA requires the following items:

- **Planning**—The credit union should evaluate every third-party relationship and determine how it fits into the credit union's business strategy and established risk tolerances.
- **Background Check**—The credit union should conduct background or reference checks to determine that the vendor is reputable and understand how it has performed in other relationships.
- **Legal Review**—The NCUA also requires that you perform a legal review, and have your credit union's attorneys ensure that the credit union is protected contractually in the relationship.
- **Financial Review**—They require a financial review that determines the viability of the company. Will the company be around? Does it have the financial wherewithal to continue operations?
- **Return on Investment**—The NCUA requires that you look at the return on investment to determine the cost of this third-party relationship and whether there is a return on this investment of value to the credit union.

- **Insurance Requirements**—There are insurance requirements. Review your current insurance policies to make sure you have adequate coverage for any increase in liabilities.

The NCUA also recommends that there are controls in place to monitor the relationship to ensure that the expectations established at the beginning of the relationship continue to be met and that the product or services are being provided in a manner that meets the credit union's needs. As a supervisory committee, it is perfectly legitimate to ask for reports on any progress in the relationship, especially if there are any times when the expectations are not being met and you would like to be informed as to what the credit union is doing to take steps to correct any deficiencies.

Due Diligence Stages

- Stage 1 – Problem/Opportunity
- Stage 2 – Evaluation/Feasibility Analysis
- Stage 3 – RFP Development
- Stage 4 – Evaluation of Responses
- Stage 5 – Implementation
- Stage 6 – Ongoing Management

Stage 1 — Problem/Opportunity

Stage One, the problem or opportunity, is made up of two action steps.

1. Define problem/opportunity

The first action is to identify the problem or the opportunity facing the credit union. For example, you might want to provide a better product or service to members or you may be looking to outsource an internal operation. Here is where you determine the real issue that you're trying to resolve.

2. Develop a cross-functional team

The second action is to develop a cross-functional team. This team will be very helpful in the ongoing success of managing the third-party relationship. There are several types of people who should be a part of this group:

- **Business owner**—The person who oversees the project and who may act as the product or the service manager within the credit union. This is the person who will most likely be responsible for the ongoing relationship with the vendor at the end of the due diligence process.
- **Legal person or attorney**—Having legal representation at the beginning of the project can help you achieve a better understanding of your goals and objectives for the relationship and can ensure your needs are articulated in the contract.
- **Financial expert**—A person who can look at and review the financial information and give opinions as to the ongoing viability of the vendor's company.