# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Summary</td>
<td>4</td>
</tr>
<tr>
<td>Introduction</td>
<td>5</td>
</tr>
<tr>
<td>Core Processor—A Strategic Partner</td>
<td>7</td>
</tr>
<tr>
<td>The Technology Utilization Gap</td>
<td>8</td>
</tr>
<tr>
<td>Change Core Processor or Stay with Current Processor—First Steps</td>
<td>11</td>
</tr>
<tr>
<td>Assessing Core Processors—Due Diligence</td>
<td>17</td>
</tr>
<tr>
<td>Core Processor and System Selection</td>
<td>19</td>
</tr>
<tr>
<td>Contract Negotiations</td>
<td>24</td>
</tr>
<tr>
<td>Switching Core Processors</td>
<td>26</td>
</tr>
<tr>
<td>Consulting Services</td>
<td>27</td>
</tr>
<tr>
<td>Conclusion</td>
<td>27</td>
</tr>
<tr>
<td>About the Authors</td>
<td>28</td>
</tr>
</tbody>
</table>
A community bank’s core processor should be a strategic partner that supports the bank’s long-term business objectives, but too many banks fail to properly manage this critical relationship. This is most evident when core processor contracts are approaching their expiration or renewal date. In many cases, community banks ask for help finding a new core processor out of frustration, when in reality they simply need additional training or a new module from the existing core processor. Many banks make decisions based on cost without regard to their overall technology strategy or the total value of the solution. This can have negative long-term consequences for institutions that follow this path.

The ICBA Core Processor Resource Guide will help community banks with some of the more important aspects of managing this relationship to maximize the return on their technology investments. Included are some of the steps banks should take to evaluate their core processor, including: assessing the bank’s business needs and utilization of systems; learning the core processor’s philosophies; gauging satisfaction with the current core processor relationship; and evaluating core processor alternatives (including innovation, compliance, and legacy vs. next-generation providers). It also offers insights into negotiating contracts and core conversion project management for banks that decide to switch systems.
INTRODUCTION

Few things are more daunting, and more important, to a community bank than changing core processors. It is one of the most complicated, expensive and time-consuming technology decisions a financial institution can make. It is also the technological cornerstone of the bank, impacting the way the bank interacts with its customers. Perhaps that is why almost half of community banks did not even consider changing core processors the last time their contract expired, according to the 2016 ICBA Core Processor Survey.¹

![Figure 1: Changing Vendors / Platform Contract Expiration](chart)

---

¹ Conducted to better understand community banks’ relationships with their core processors, the 2016 ICBA Community Bank Core Processing Survey was distributed by email to 6,288 community bank CEOs and technology-related titles. The results are based on 630 responses collected between June 28 and July 6, 2016, representing a response rate of 10.0 percent. For questions about the survey or for an executive summary of survey results, please contact Ryan Hadley at ryan.hadley@icba.org.
It is easy to understand why community banks wish to avoid the trouble associated with changing core processors. The core conversion has evolved to directly affect customers, employees, and everyone and everything that interacts with the core system. Every customer touchpoint supported by the bank—including telephone, online and mobile banking, ATMs, and bill pay—is affected. Despite efforts to educate customers in advance, the changes frequently take them by surprise, resulting in a significant number of phone calls from confused, frustrated and upset customers. Add up the staff time, customer impact and the price of the platform, and it is no surprise that ICBA found just 16 percent of community banks change their core processor upon contract expiration.

Despite these hurdles, banks should reassess their core processor and the core processor market well before their contract expiration date. This assessment helps ensure that the bank is using a core processor that best supports its long-term strategic objectives.

There are various reasons why a community bank might need to switch core processors. For example, there are several core systems used by community banks today that are essentially at the end of life, and the core processor may not discuss that fact. In this instance, the core processors are investing very little in research and development and using the revenues to enhance their other systems. Also, a change in the bank’s strategy, such as targeting millennial customers and developing more digitally accessible products and services, might necessitate a more feature-rich platform. Some community banks may wish to be better positioned for future mergers and acquisitions. Many banks may desire an advanced, nimble platform for financial innovation. In these cases, a community bank may need to switch to a different system with the same core processor—something 5 percent of community banks did the last time their contract expired, according to the ICBA study.

Almost by definition, the core processor industry is always evolving. Core processors are constantly investing in different ancillary components, and many are having a difficult time keeping up with the furious pace of change in the financial technology industry. At a minimum, knowing a core processor’s weaknesses can provide negotiating leverage.
A core processor is a strategic partner, one that likely represents a community bank’s largest expense (excluding salaries and benefits) and controls its products and technological capabilities. That is why community banks should know the total value their core processor brings to the table from a strategic sourcing standpoint. A core processor should understand a bank’s strategic objectives and be flexible in adapting to changes in the marketplace to help the bank achieve its goals. In return, the bank should understand its core processor’s strengths, exploiting them to maximize return.

However, not every community bank fully knows or trusts the value its core processor can bring to its operations and profitability. More than 70 percent of community banks stay with the same core processor for more than 10 years, according to the ICBA survey. During this time, a core processor’s offerings are likely to evolve, including software updates and new modules that can streamline processes at the bank and increase efficiencies. Often community banks are so busy with the business of banking that these changes go unnoticed.

Consequently, many banks do not invest the time to understand and fully implement these enhancements into their processes and workflows, failing to take advantage of improved efficiencies. When the contract expiration is approaching, many banks assume they need a new core processor, but what they really need is to better utilize their existing system(s). This issue is so common it is known as the technology utilization gap.
While technology partners should take the initiative to help community banks extract the maximum value from their technology investments, community banks often do not fully utilize their core processor’s systems. Many community banks have to determine, based on their own experiences, how to use their systems most effectively. Consequently, they struggle in this effort and few, if any, really succeed in delivering the return on investment typically promised by core processors.

Core processors express concern about ensuring that clients fully deploy software functionality. Core processors report that the longer clients use their systems, the less clients understand about existing and new applications. Newer customers use systems the most effectively due to recent training on features and tools. Staying current is a continuing challenge for banks.

Another ongoing challenge for community banks is balancing the daily demands of servicing existing, potential and new customers while attempting to maximize the utilization of technology to streamline business processes. The typical outcomes of trying to do this with internal resources include:

- bank staff lack the dedicated time,
- users and managers are “too close” to the problem to be objective,
- tenured staff adhere to “the way we have always done it,”
- customers always come first, resulting in project delays,
- re-engineering is generally not a “core competency” within community banks, and
- internal politics easily kill a worthwhile project.

Over time, community banks acquire and implement new systems and technology. Often banks implement new technology to simply automate old processes rather than change workflows. In some cases, community banks shift work from one department to another instead of eliminating it. The result is the dreaded technology utilization gap.

The following chart represents the technology utilization gap found in many banks. There are many reasons for its existence, and most banks can benefit greatly by recognizing that the gap represents significant opportunities, rather than problems for the institution.

![Figure 4: Technology Utilization Gap](source: Vitex, Inc.)

The illustration above shows what typically happens when banks implement a new system or function. Frequently, core processors are not motivated to help the bank obtain maximum utilization because it represents additional cost and risk to them. Their goal is to simply get the new system installed and operational. It then gets worse for the bank because over time the core processor comes out with new enhancements and the bank ends up using even less of the system’s functionality. In most cases, banks can improve customer service and productivity without buying new systems and, instead, focus on reducing the technology utilization gap.
A good first step toward improving technology utilization is the assignment of application owners. An application owner is a staff member from a key business line who has specific roles and responsibilities involving application usage. The five characteristics of effective application owners are:

1. **Subject-matter expertise**: They should be from a major business line, such as new accounts, operations or lending, and not from IT or a technology support function.
2. **Creativity**: They must be creative thinkers who can visualize how improvements in the system can translate into improved efficiency, simplified operations or better customer service.
3. **Peer recognition**: They should be recognized within the bank as an expert with the system and a source for help and advice.
4. **Management support**: They must be highly regarded by senior management and their judgment trusted and valued.
5. **Interpersonal skills**: They must have solid interpersonal skills and the ability to build and foster relationships with the core processor and other departments.

Community banks should begin by designating application owners for major functions, such as operations, lending, finance or new accounts. The number of application owners will vary by the size and complexity of the bank; however, loan and deposit areas are usually the two most important business lines. The key is finding the right person with the right skill set to assume the role. In smaller community banks, it is a part-time role and an extension of the application owner’s current position. In larger banks, it can evolve into a full-time position. In most, it is simply an added responsibility in a job description.

It is important to clearly define the added responsibilities assigned to application owners. These responsibilities typically include:

- Understanding user experiences and concerns and translating them to the core processor.
- Serving as the primary advocate to management for implementing new functionality as it becomes available. This should be a logical outgrowth of the liaison role.
- Driving and implementing new processes and procedures to take advantage of the new system features.
- Developing and nurturing personal relationships with important core processor staff. These relationships are invaluable in “greasing the skids” when the bank needs core processor assistance.
- Developing and cultivating a “peer network” with individuals in similar roles at other banks.
- Serving as a translator for bank management by determining which features merit consideration and how they can enhance the bank’s efficiency and profitability. This role is where the rubber meets the road.
- Seeking user feedback, conveying this information to the core processor and maximizing the peer network to lobby for shaping the core processor’s development list. Numbers make a difference. The more banks pushing for a change, the more likely the core processor will deliver it.

While the application owner concept is only one tool for improving core processor relations and responsiveness, it is an excellent place to start. It can evolve into a committee over time to address which features the bank will implement when system updates are rolled out. Larger banks will have multiple staff members involved in this process, and there may be an organization in the bank dedicated to managing the core processor relationship. Community bank clients ultimately own the relationship with their core processors.
ONLY WHEN A BANK FULLY UNDERSTANDS ITS NEEDS CAN IT EVALUATE A CORE PROCESSOR’S ABILITY TO MEET THEM.
CHANGE CORE PROCESSOR OR STAY WITH CURRENT PROCESSOR—FIRST STEPS

If a bank has done everything it can to get the best utilization and return on its technology investment with its current core processor and any ancillary systems and is still not receiving the capability or service needed to support its long-term strategic goals, then what?

Step One: Define Strategic and Tactical Business Needs: Before community bankers can begin to ask questions about a core processor, they need to ask questions about their own institutions and understand their own business requirements, strategies and goals. Boards and management should review their strategic plans and discuss markets, customers and prospects to understand the functional requirements of their different business areas. Some of the more significant areas to consider are:

- anti-money laundering,
- business resiliency,
- card services—debit, credit, digital, prepaid and ATM,
- commercial online banking and cash management,
- customer relationship management,
- customer support from any location using phones or tablets,
- customer and product-specific profitability functions,
- cybersecurity—IT, information security and intrusion detection,
- data warehousing and analytics,
- deposit account opening,
- document management,
- finance—general ledger, accounts payable, asset and liability management and credit loss modeling
- fraud detection and mitigation,
- interactive voice response solution,
- integration to non-core products,
- legal and regulatory compliance,
- loan onboarding from application to closing and booking—consumer and commercial,
- networks and communication,
- online and mobile banking,
- online bill payment,
- real-time payments/real-time banking,
- teller system,
- wealth solution, and
- workflow management.

A technology utilization review to understand how current systems are used is always the first step. Frequently, community banks mistakenly bypass this step and immediately focus on the core processor analysis. This review should consider all current products and services with an eye towards future needs and ways they can be improved. The result should be a list of technological requirements. Only when a bank fully understands its needs can it evaluate a core processor’s ability to meet them.
**Step Two: Requirements and Technology Planning:** Many community banks make tactical, reactionary decisions about technology. Often these decisions are driven by core processor interests, a sudden urgent need (equipment reaching capacity limits or contract expiration), or existing technology that has become obsolete. In these cases, executive management views technology as simply another expense.

Some community banks approach technology as a way to gain a competitive edge. For instance, branding a new website under the .BANK web domain can demonstrate to customers that banks take the security of customer information seriously. The .BANK web domain is a more secure, trusted, verified and identifiable location on the internet for the global banking community and the customers it serves. The .BANK domain has security requirements that exceed those of most existing and new web domains. Community banks should consider whether a core processor has the capacity to integrate a new .BANK web domain into the products they offer.

Another key technological advancement is an industry-led initiative, Sheltered Harbor. Sheltered Harbor creates an end-of-day account balance back-up in a secure, encrypted environment. The format to store this data has been established by the financial services industry. The encrypted data will rest in data vaults and require an encryption key to remove the data. In the event of a catastrophic loss to a financial institution, another financial institution may service the failed institution’s customers. Community banks will most likely participate in Sheltered Harbor via their core processor, which will provide a data vault for the secure storage of customer account information.

With a formal technology planning process, however, community banks can begin to think ahead and manage technology strategically. As a result, the balance between the proper selection, implementation and utilization of technology and the ability of banks to accomplish their strategic business objectives becomes crystal clear. In other words, proper technology planning and implementation can clearly help community banks accomplish their strategic business objectives.
Here are some potential objectives and questions to help banks take a more strategic view of their technology needs and develop a formal technology strategy.

To generate deposits:

- Can we attract new commercial accounts using internet-based cash management services?
- Can we measure the return on dollars spent on marketing?
- Do we have a clear strategy to deliver online and digital banking services?
- Can technology help us increase the average number of relationships per customer?
- How do we integrate services such as online account opening into our core system?

To demonstrate a leading technological edge:

- What is the core processor’s strategic plan? Will it be shared?
- Can our core processor help us establish a .BANK website?
- Can our core processor support Sheltered Harbor participation?
- Will there be additional costs for .BANK, Sheltered Harbor or other initiatives?
- Will the core processor be nimble enough to integrate future technological advancements that may provide us a competitive edge over others in the banking sector?

To increase revenue:

- Can we increase fee income without alienating customers?
- What services should we offer that can increase our fee income potential?
- How can we measure customer profitability?
- What are our most profitable products? How do we know?

To control expenses:

- Is the new account process as efficient as it should be?
- Can we justify a document imaging and workflow system? If so, how?
- Do we really need to return checks or check images to all customers?
- Why does it take so many staff members so many hours to prepare board reports?
Step Three: Develop a Short List of Core Processors and Ancillary Systems: Once community banks understand their business and technology requirements and have a technology strategy, they can begin to develop a short list of promising core processors that have a good chance of meeting their needs. Many banks hire a consulting firm to assist with this decision because the core processor landscape continues to change rapidly. Some of the items to take into consideration when developing this list of three or four core processors include:

- **Strategic philosophy**: Once a bank knows what it needs, it must figure out which approach to core processing most aligns with its philosophy, resources and strategy. This involves not just the core processor, but also ancillary services, including online and mobile banking, card services, ATMs and e-billing.

- **Full integration vs. Best of breed**: Community banks have two primary choices when it comes to ancillary products: using the offerings of their core processor, or buying from another vendor. Both approaches have advantages and disadvantages that must be weighed. Core processors have different approaches, costs and philosophies on this topic.

Banks using a full integration strategy purchase all ancillary products from their core processor. The benefit of doing this is that the core processor takes full responsibility for making sure the products are integrated and work smoothly together. If something goes wrong, there is just one vendor to hold accountable. It also makes updates simpler. When customers update their information on the mobile platform, for instance, the core system applies the change across all channels, thereby eliminating multiple manual updates. The downside of full integration is that if a bank is not thrilled with a particular offering, it is stuck with the core processor’s solution.

The flip side is a best-of-breed strategy, in which a community bank individually chooses each of its ancillary systems. It might use a new account system it really likes from one vendor and mobile banking from another. The advantage of this approach is that the bank can select the best vendor in each category. The downside is that the bank serves as the interface between ancillary services and core processors and is responsible for making sure they work together. While ideally the two vendors will work together and share information, there is always a challenge as to whom is responsible if there is a problem. For example, if a new update causes the interface to break, there are now three parties involved: the bank, the core processor and the ancillary system. Banks need to go into a best-of-breed environment understanding this commitment. Neither vendor will test its systems on the other’s when producing an update, increasing the likelihood of at least temporary problems when new versions are released.

Community banks taking a best-of-breed strategy need to account for the extra time necessary to manage multiple vendors when considering pricing. **As a rule of thumb, community banks that select a product from someone other than the core processor should add a 25 to 50 percent premium on top of the ancillary system’s one-time cost and a 25 percent premium on ongoing costs to account for managing the core processor relationship.** These numbers are never included in core processor business proposals, yet provide a more accurate picture of the total costs.
FIGURE 5: INTEGRATING PRODUCTS OUTSOURCED TO CORE PROVIDER

Perform function using this model.

Source: 2016 ICBA Core Processor Survey
FIGURE 6: INTEGRATING PRODUCTS AND SERVICES OUTSOURCED TO THIRD-PARTY PROVIDER

Web hosting
- Somewhat difficult: 3%
- Very difficult: 13%
- Somewhat easy: 36%
- Extremely easy: 12%
- Total: 55%

Card processing-credit
- Somewhat difficult: 7%
- Very difficult: 15%
- Somewhat easy: 29%
- Extremely easy: 11%
- Total: 54%

Card processing-debit
- Somewhat difficult: 6%
- Very difficult: 20%
- Somewhat easy: 35%
- Extremely easy: 12%
- Total: 44%

ATM processing
- Somewhat difficult: 4%
- Very difficult: 16%
- Somewhat easy: 40%
- Extremely easy: 12%
- Total: 41%

Mobile banking
- Somewhat difficult: 3%
- Very difficult: 18%
- Somewhat easy: 44%
- Extremely easy: 17%
- Total: 36%

Compliance management
- Somewhat difficult: 2%
- Very difficult: 15%
- Somewhat easy: 26%
- Extremely easy: 4%
- Total: 30%

Credit analysis/behavior scoring
- Somewhat difficult: 7%
- Very difficult: 11%
- Somewhat easy: 26%
- Extremely easy: 7%
- Total: 27%

Online banking
- Somewhat difficult: 3%
- Very difficult: 17%
- Somewhat easy: 46%
- Extremely easy: 11%
- Total: 26%

Remote deposit capture
- Somewhat difficult: 4%
- Very difficult: 13%
- Somewhat easy: 37%
- Extremely easy: 12%
- Total: 24%

Apps technology
- Somewhat difficult: 3%
- Very difficult: 13%
- Somewhat easy: 35%
- Extremely easy: 15%
- Total: 22%

ePayments
- Somewhat difficult: --
- Very difficult: 8%
- Somewhat easy: 38%
- Extremely easy: 10%
- Total: 22%

Peer-to-peer payment
- Somewhat difficult: 2%
- Very difficult: 11%
- Somewhat easy: 44%
- Extremely easy: 8%
- Total: 18%

Financial accounting
- Somewhat difficult: 5%
- Very difficult: 9%
- Somewhat easy: 18%
- Extremely easy: 12%
- Total: 15%

Fraud detection
- Somewhat difficult: 3%
- Very difficult: 15%
- Somewhat easy: 34%
- Extremely easy: 14%
- Total: 13%

Cash management
- Somewhat difficult: 2%
- Very difficult: 16%
- Somewhat easy: 30%
- Extremely easy: 7%
- Total: 12%

eBilling
- Somewhat difficult: --
- Very difficult: 13%
- Somewhat easy: 27%
- Extremely easy: 19%
- Total: 11%

Customer relationship management
- Somewhat difficult: 17%
- Very difficult: 21%
- Somewhat easy: 33%
- Extremely easy: 4%
- Total: 5%

Source: 2016 ICBA Core Processor Survey
ASSESSING CORE PROCESSORS—DUE DILIGENCE

Once functional and technological requirements are narrowed down, community banks need to decide the most appropriate core processor and comply with the applicable regulatory requirements for conducting initial and ongoing due diligence.2

In addition to agency-specific guidance on managing or outsourcing technology core processors, community banks should also review the Federal Financial Institutions Examination Council’s IT Handbooks on “Outsourcing Technology Services,” “Supervision of Technology Service Providers,” and, if applicable, the “Retail Payment Systems” booklet for relevant information on outsourcing retail payment systems and related functions.3

Initial and ongoing due diligence is a critical function of the core processor relationship. The Bank Service Company Act (12 USC 1861-1867(c)) provides that any service contracted by a bank to a third-party shall be examined as if the bank was providing the service directly. Therefore, ensuring the core processor adheres to the regulatory requirements, and the bank has documentation of its due diligence process, is critical throughout the contractual term of the core processor relationship.

The common due diligence steps include:

- **Request for proposal:** The process begins with a request for proposal (RFP). For banks that are unfamiliar with a core processor’s capabilities, the RFP is an in-depth request list that should include the current configuration for the core system and network, current and future interfaces, and new product initiatives. Interview staff to obtain information about all products and what is working well and what needs improvement. The due diligence results will show which features each core processor offers. Additionally, the due diligence process should include a request for a core processor’s financials to help banks assess the overall financial condition of the core processor.

- **Demonstrations:** Not all features work well for all banks. Extensive demonstrations allow the core processor to show how the feature specifically works and gives the community bank the opportunity to compare it with existing processes to gauge whether it is indeed an improvement or a potential challenge. These demonstrations are critical. Plan on two days per core processor. Core processors should demonstrate a live system, not a PowerPoint presentation.

- **Focus groups:** Community banks can obtain the most value out of demonstrations by creating a focus group of application users. These are the people who use the system every day and know the pain points and efficiencies of the existing system. They should ask about processes they use today as well as any new features the bank is likely to use in the future. The focus group should score each system and weigh the importance of the area to determine a usability score to help make the decision.

---


- **Site visits**: Core processor demonstrations can be complimented by site visits, which help banks understand the core processor’s operations and ability to meet contractual obligations. The key to core processor demonstrations and site visits is asking the right questions so core processors tell the bank what it needs to know rather than what the salesperson wants it to convey. Site visits should include demonstrations of the onboarding and account-opening processes and a discussion of integrating with ancillary systems from other vendors.

- **Reference calls**: Seek out references from peer banks. Be sure to have prepared questions related to product integrations, financial condition and stability of the core processor, information security, data ownership and other issues important to the bank.

- **Financial analysis**: As with any significant investment, community banks can use the due diligence process to review the overall financial condition of the core processor. For example, the Office of the Comptroller of the Currency issued guidance that suggests banks evaluate growth, earnings and pending litigation. The guidance also states that the bank’s analysis may be as in-depth as if the bank was extending credit to the core processor. This is particularly true for a core processor because the bank’s entire business rests in the financial security of the core processor.

- **Cost calculation**: This analysis should incorporate more than just direct costs and cover a period of at least five years. Factor in all costs, people, facilities, interfaces and support. As a community bank becomes more familiar with the core processor’s offerings, it can more easily compare pricing—adding and subtracting products and services as needed. It is also helpful to look ahead and factor in potential pricing changes if the bank grows, acquires another institution or expands business lines. These apples-to-apples comparisons are rarely easy to make due to core processors using different terminology.
CORE PROCESSOR AND SYSTEM SELECTION

There are many features and functions for banks to consider when deciding on a core processor. Banks should analyze their functional needs and consider other high-level items discussed below.

1. **Legacy vs. next-generation systems**: One of the most significant decisions a community bank must make is whether to select a legacy or next-generation core processor. Legacy core processors primarily comprise of the “big three”—Fiserv, Jack Henry and Associates and FIS. Together, they hold 70 percent of the community bank core processing market share, according to ICBA’s survey.

Core processing has become a basic commodity. Every system can handle checking and savings accounts, IRAs, CDs, and personal, auto, mortgage, agriculture and commercial loans. What sets next-generation core processors apart, they assert, is how easily the core system interacts and integrates with other systems, enabling innovation in the products around them. Some legacy core systems are known for being inflexible and posing difficulties for banks looking to tie into ancillary or next-generation core processors.

While the legacy core processors share many similarities, not all companies calling themselves next-generation core processors are the same. A few companies genuinely offer brand new systems. Others offer what is essentially the same old system but with a new coat of paint. Some systems with module-based cores designed for banks with more than $100 billion in assets are now sold downstream to community banks.

The flexibility of next-generation systems may come with risk, especially if the core processor is a startup with few, if any, customers. New systems create additional risk for banks relying on unknown and untested entities for critical services. Banks enamored with startups should have a large programming staff ready to take on the huge technical burden of getting the system operative and keeping it running smoothly.

2. **Ability to innovate**: Regardless of whether a bank selects a legacy or next-generation system, one of the most important features of any core processor is its ability to innovate. This includes the research and development dollars it invests into its core and ancillary products as well as its ability to play nice or interface with other systems. Core processors should offer innovative solutions and provide access that helps community banks create a competitive advantage in today’s disruptive and increasingly competitive marketplace.

In the past, some legacy core processors made it extremely difficult to tie third-party vendors into the core system, but core processors are increasingly realizing that this may not be a sustainable business practice going forward. Today, one-third of community banks cite limitations with the core processor as the primary barrier to adding new products and services, according to ICBA’s survey, with 77 percent reporting cost as the primary barrier.

Other core processors have open application interface systems (APIs) that make it easier to tie in new products and services. This is critically important in an evolving payments ecosystem where prompt adoption of innovations such as faster consumer and business payments are increasingly expected by customers. If a bank’s core processor has a closed system that prevents it from taking advantage of new developments, it will be difficult for both the core processor and the bank to compete.

There is also the question of real-time versus batch-oriented transactions and consistency across all delivery channels—ATMs, branches, telephone, online, point of sale and mobile. Customers, particularly millennials, expect real-time interactions, and core processors are working to respond to these needs.
3. **In-house vs. outsourced processing**: There are many factors to consider when deciding between in-house and outsourced core systems, including strategy and resources. Banks that keep core processing in-house have the flexibility to design their own systems for their specific needs, including hardware, software and ancillary services. They also must deal much more directly with third-party vendors. In-house core systems present a large upfront cost, but may result in a lower monthly cost—though some of the savings may be negated by employing a larger, technically advanced IT staff and maintaining the proper physical environment. These banks also are more directly responsible for disaster recovery, updates, regulatory requirements, procurement and maintenance. Outsourcing relieves banks of the challenges of developing and maintaining core processor system updates as well as the direct responsibility of providing disaster recovery—though regulators have made it clear that banks are still responsible for the actions, compliance and preparedness of their core processors. Budgeting is simpler with core processor outsourcing, and it is often easier to accommodate unplanned growth or a merger or acquisition. Additionally, less in-house staff is needed to maintain systems.

ICBA’s survey shows that community banks are steadily moving away from in-house core processing. Today, **63 percent of community banks outsource core processing**, compared to 50 percent in 2010. Community banks also outsource most ancillary products, including online and mobile banking, payments card processing and web hosting. The systems most likely kept in-house include compliance management, credit analysis, behavioral scoring, financial accounting, and customer relationship management, though most outsource these as well.
4. **Gauging satisfaction**: Once a community bank evaluates its needs and selects a philosophy, the next step is to assess how well its core system measures up throughout the organization. While executives lead the charge on a potential conversion, some of the most valuable insight comes from the staff using the system every day. Banks should gather a team of employees from across the bank to gauge their satisfaction with the existing systems. Potential questions for each participant include:

- **Are you getting the service and information needed to perform your job?**
  - Why or why not?
  - What are some examples?
  - What is the impact on the bank’s customers?

- **Are there system functionalities that would make your job easier?**

- **Are there manual workarounds you perform because the system lacks the functionality?**
  - What are some examples?
  - What is the impact on the bank’s customers?
  - What is the impact on your productivity?
  - Would workflow changes lessen or eliminate workarounds?

- **Are we experiencing a significant number of system defects or downtime?**

- **Are we satisfied with the core processor’s customer service?**
  - Are you getting the service needed? Why or why not?
  - Is the response time reasonable?
  - Is the response accurate and germane to the situation?

Staff responses will help management ascertain whether the core system is meeting the expectations of staff and customers. This information, coupled with other potential productivity efforts, helps management determine whether these challenges can be remedied without the hassle of a core conversion.

Many community banks do not need to switch core systems. Existing systems likely have the tools to meet bank strategies. Many banks may have fallen into the technology utilization gap and need better core processor management to ensure their procedures and workflows keep pace with core developments. The solution may be as simple as asking for a new account representative who is more responsive or proactive. In some cases, however, the core system is too outdated, so a conversion is the best alternative.
5. **Compliance**: As mentioned earlier, regulators are clear that while community banks may outsource core processing and other activities, they may not outsource responsibility for those activities. Congress established this requirement in the Bank Service Company Act, and the FFIEC and prudential regulators have established the guidelines and requirements for examining this crucial responsibility. The key takeaway for community banks is that if a bank contracts or outsources a service, the bank will be examined as if it is providing the service itself. Therefore, community banks should proceed carefully with initial due diligence and establish a process for ongoing due diligence and risk assessment of the core processor throughout the contract term.

The issue extends past compliance and into risk management. It is essential for community banks to assess the potential risks of outsourcing to a particular core processor. The end goal is to understand the impact a core processor’s actions could have on the bank and what steps are necessary to mitigate those risks. The six main risks to consider are:

- **Strategic risk**: This results from a poor business decision or a decision that does not support the community bank’s long-term objectives. For example, a long-term contract may limit a bank’s growth opportunities if the core processor cannot keep up.

- **Reputation risk**: This is the potential fallout from negative public opinion. For example, the bank’s reputation may suffer if a core processor prevents it from providing vital services to customers.

- **Compliance risk**: This is the risk of violating laws, rules or regulations, or failing to comply with internal policies, procedures or business standards. For example, failing to keep confidential personal data secure.

- **Transactional risk**: Improper monitoring of core processors may result in the poor execution of a product or service, opening the bank to transactional risk. Additionally, the core processor may fail to live up to the terms of the contract, resulting in missed transactions and disaster management failure.

- **Operational risk**: This results from failed internal processes, people, and systems or from external events. Third-party relationships often integrate the internal processes of other organizations with the bank’s processes and can increase the overall operational complexity.

- **Credit risk**: If the core processor does not meet the obligations of the contract, the bank is exposed to credit risk.

Data and cybersecurity also fall under this umbrella, posing risks in each of the six categories. Community banks may want to consider reviewing the FFIEC Cybersecurity Assessment Tool for sections relevant to core processor management to ensure the proposed core processor relationship matches the cybersecurity risk and maturity levels of the institution or whether any adjustments will need to be made resulting from the selection of a particular core processor.

When selecting a core processor, it is essential to understand whether a core processor under consideration has the tools, policies and procedures to help the bank continually assess, monitor and mitigate these risks. If a core processor cannot demonstrate that it takes risk management and compliance seriously by following new developments, delivering reports and respecting the bank’s regulatory requirements, it is not a good choice.

In the end, no core processing system will fully meet a bank’s expectations. Every system involves compromises. The key is to find the system with the least compromises—and then negotiate for the best pricing, terms and performance standards.

---


CONTRACT NEGOTIATIONS

One of the final steps of the process is negotiating the contract(s). Most community banks are vulnerable to the core processors who do this every day.

One of the biggest mistakes community banks make with their core processor selection is failing to properly manage the timeline, allowing a contract to automatically renew without renegotiating pricing or terms. Expiration dates should be closely monitored so that there is ample time to evaluate the options, conduct due diligence and implement the system, if necessary.

The ideal time to begin reviewing core processor options is 18 to 24 months before the existing contract expires. This provides six to eight months for due diligence and another six to 12 months for implementation. Institutions that wait any longer to begin the process may run out of time to make a move, severely limiting their options and diminishing their pricing negotiation leverage if they do not have enough time to perform a core conversion.

Negotiating a fair contract that delivers the most value for the bank is a discussion that goes far beyond pricing and enhancing the bank’s business proposition with strategic sourcing. It is also about managing risk by securing terms and performance standards that benefit the bank.

Contracts are far-reaching and detailed documents that ensure a bank is creating a core processor relationship that supports the bank’s long-term strategic objectives. It provides tools to help identify, measure and mitigate risk.

It ensures that the core processor will deliver services in the manner the bank expects. Some critical areas to address in a contract are:

- **Data ownership and access.** Community banks need access to data generated by their customers both for analytical and deconversion purposes. Community banks should always discuss data ownership and access with a core processor. Depending on the contract terms, bank and customer data may be the property of the core processor or the bank. Paying a core processor a fee each time a report is requested can be costly over the long term. However, acquiring the data from a core processor at the end of a contract, when the core processor owns the data, can be a costly one-time transaction and play an outsized role in influencing a community bank’s core processor decision.

- **Performance standards.** Located in the service-level agreement (SLA), these are measurable benchmarks community banks can monitor to ensure adequate performance standards are met. The SLA should also have penalties if the service levels are not met. Without penalties, the bank has no leverage and there are no consequences for the core processor in the case of non-performance. Both performance standards and penalties are negotiable.

![Figure 8: Additional Charges Imposed by Core Processor](image-url)
• **Termination of contracts.** These key provisions should address deconversion, early termination fees, exit fees and length of notification so there are no surprises later.

• **Duration of contracts.** Community banks should think about contract length from a pricing and strategic standpoint and take into consideration the likelihood of a future merger or acquisition. Most community banks (63 percent) renew their core processor contract at least once every five years, according to the ICBA survey. Be wary of auto-renewal contracts, however. Banks with auto-renewals should, at a minimum, have a reminder system in place so that the contract can be evaluated 18 to 24 months before the auto-renewal date.

• **Alignment of contract terms.** Community banks should implement an internal process to centrally manage and align core processor and ancillary contract expiration dates so that all contracts are coterminous. This is crucial for several reasons. First, it is common for the execution of an ancillary contract to extend the life of the entire core processor relationship (the core as well as other ancillary services). Second, if a bank ultimately decides to end a relationship with a core processor, coterminous agreements can help reduce early-termination penalties and deconversion fees. Third, this provides banks with more negotiation leverage because it is much easier to move to a new core processor.

Other areas to consider include:

• **Scope of product and service:** Are all the services clearly defined? Does the bank understand what is included in the agreement and what is not? Although this might seem intuitive, many banks are surprised when they learn during implementation that all of the features and functionalities in the demo are not included in the agreement.

• **Security and confidentiality:** Does the agreement have language covering the core processor’s responsibility to comply with current legal and regulatory requirements? What about future regulatory requirements? Is the core processor required to comply in a timely manner? At what cost?

• **Audits:** Does the agreement give the bank or its proxy the right to audit the core processor’s operations? What about access to audit results performed by the core processor’s auditor?

• **Reporting:** Is robust reporting capability included in the system? Are there additional costs?

• **Business resumption and contingency planning:** Is it included in the contract? What are the core processor’s business continuity plans should it become inoperable due to a natural disaster or cyberattack? What is the timeline for resuming the bank’s services?

• **Subcontracting (including off-shore outsourcing):** Can and does the core processor do it? Do you care or want to restrict it? Be mindful of regulatory guidance on this activity.

• **Costs:** Is pricing transparent? Are all costs clearly identified and defined? Are cost of living increases reflected? Are termination fees and deconversion fees included and defined? Are there hidden charges?

• **Software ownership and licensing:** Who owns the software? How long is the term of the license? What happens at the end of the term if the bank still wants to use the license? Do you need to rebuy it? What happens if the core processor is sold?

• **Dispute resolution:** If the core processor is not meeting the agreed upon service levels, what happens? Are there penalties for non-performance? Can the bank withhold an invoice payment without penalties if it is disputed?

• **Assignment:** If the bank has a change of control, can the license be transferred to the acquiring bank?

• **Data ownership and analytics:** Does the bank or the core processor own the customer data? Are there additional costs for data requests? Is data access easy for the bank? Are there any restrictions on the bank’s access to customer data?

• **Patent infringement:** If the bank receives a patent infringement demand letter based on its use of the core processor’s product or service, does the core processor accept legal liability for resolving infringement allegation?
SWITCHING CORE PROCESSORS

A core conversion is far more than an IT project. It is a complex and time-consuming strategic project that touches every department and business line at the bank and has the potential to seriously disrupt bank and customer activities if not handled carefully. No wonder so many community banks make it all the way through the core processor selection process only to get cold feet at the last minute. A core conversion typically takes anywhere from six to 18 months of planning and implementation. That makes conversion project management a critical activity.

Senior bank management must be involved from the onset. It begins with senior management designating and empowering a conversion project manager and developing a detailed conversion project plan. The bank’s project manager should be able to bring together stakeholders from across the bank while working with the core processor’s project manager to keep the project seamless and on time.

The plan should be high-level enough that team members do not become bogged down with small details, but specific enough that it provides a clear path and identifies all “critical path” items. Additionally, the plan should include routine meetings to provide progress updates, address challenges and make appropriate decisions. Basic elements of a successful conversion project include:

• Conversion team: An interdisciplinary team made up of individuals from across the bank who can be assigned various tasks is crucial to success.
• Hardware changes: Complete any required hardware changes or network upgrades before the core conversion, if possible.
• New procedures and workflows: A new system can mean a new and more efficient way of doing business, but only if the bank has a team in place to implement new procedures and workflows to take advantage of the system's capabilities.
• Testing: Establish a testing plan to ensure the system is operating consistent with expectations and requirements and to identify any problems. You cannot test too much.
• Training: Do not skimp on training, especially for customer-facing employees who will be inundated with questions after the conversion. Have a schedule for training staff, picking up the pace as the conversion date approaches. Everyone should know what the new system does and how to do it.

• Communications: Typically, customers do not pay attention to core conversion communications until the conversion is complete. Banks need a communications plan covering all of their channels to repeatedly and consistently deliver the messages. Be sure to have a plan for responding to the increased volume of customer inquiries after the conversion is complete. Mirror the same strategy for staff communications.
• Implementation: Community banks and core processors should be in sync regarding all conversion and implementation schedules and activities. The responsibilities of all parties should be clearly defined, including guidelines for additions, deletions or changes. While the goal is to meet all deadlines, there should be a plan for renegotiation or extension guidelines if needed. Someone should be responsible for ensuring the core processor is delivering everything that is needed.
• Post-conversion: Consider contracting with the core processor to have onsite support for frontline staff, because the core conversion team on site will be working with the core implementation team.

Community banks also need to be aware of common pitfalls, especially when it comes to compliance. Areas of concern include deposit and loan documents. Be sure to double-check to make sure the forms comply with the Truth in Savings Act (Reg DD) and the Truth in Lending Act (Reg Z). The Bank Secrecy Act/anti-money-laundering systems may also change with the core processor and require special attention.
CONSULTING SERVICES

Selecting a core system is one of the most complex and expensive decisions a community bank makes. However, it is also one of the most strategic and can bring immense value and vision to all aspects of the bank. The length of a contract combined with the challenge of switching to a new core processor makes it essential for community banks to make a well-thought-out decision that will best support their long-term strategic and financial issues.

Many community banks engage a professional services firm to assist and guide them through the process of selecting the proper core processor system. The role of professionals should be to determine, with an experienced and unbiased eye, which processors and systems offer capabilities best suited to meet the business needs of the bank. These include:

- the long-term strategic objectives of the bank,
- the bank’s current market environment,
- the ability of the bank’s staff to adapt to the new environment,
- the history of the core processor(s) and their ability to provide long-term strategic and operational support, and
- the long-term effort and expense required of the bank to maintain or develop interfaces, products, services and information.

Consultants can also aid in contract negotiations, using their market knowledge to help banks secure contracts with the most beneficial pricing and terms.

CONCLUSION

A community bank’s core processor is a strategic partner that can help a bank achieve its long-term business objectives—but only when it is carefully selected and implemented with an eye toward streamlining processes and boosting efficiencies. Making the most of this critical relationship involves going beyond the status quo to fully explore all the options when a core processor contract approaches its expiration date. Community banks need to take the time to assess their own business needs and their satisfaction with current core processors. Then they must consider other marketplace options. Only then can they fully understand if they are deriving enough value from their current arrangements. While most community banks may ultimately choose to stay with their current core processor, this exercise helps ensure that a bank is using the core system that best supports its strategic objectives and provides the most advantageous terms and pricing possible.

Ultimately, no core system will fully meet a bank’s expectations. Every system involves compromises. The key is to find the system with the least compromises and then negotiate for the best pricing, terms and performance standards.
ABOUT THE AUTHORS

ICBA

The Independent Community Bankers of America®, the nation’s voice for more than 5,700 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high quality products and services. ICBA’s mission is to create and promote an environment where community banks flourish. With 52,000 locations nationwide, community banks employ 765,000 Americans, hold $4.9 trillion in assets, $3.9 trillion in deposits, and $3.3 trillion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA’s website at www.icba.org.

RANDY ROTH

Randy Roth is president, CEO and founder of Vitex Inc., a consulting organization dedicated to assisting bank CEOs and executives with complex core system decisions, technology contract negotiations and core conversion project management. For more information, visit Vitex’s website at www.vitex.com.