TECH REVELATIONS
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Protecting Yourself In Times of Consolidation

How do you protect yourself from something you never could imagine would happen? The answer is...you can't. You can, however, play and adjust. Over the last eight years we have seen massive consolidation in the banking industry. **Banks are acquiring to survive as are the vendors**. This has created an unforeseen dynamic related to the operating agreements that govern the relationship between these two entities.

At some point in time in the past (I cannot quite pinpoint when) the vendors recognized that there is no real language governing the cost to terminate their agreements. Some major vendors in the banking technology industry have spent the last four years ratcheting up termination related fees to the point where it is absolutely absurd, opportunistic and predatory. In this month's edition of Tech Revelations we will review the types of termination fees and how to protect yourself during your next contract negotiation.

So let's talk about termination fees. I am going to keep this simple and split them into three categories.

1. Liquidated Damages
2. Deconversion Fees
3. Legacy Data Conversion (Export/Import) Fees

Before we get into the weeds on protecting your bank, lets talk about each of these fees in a little more detail.

Liquidated Damages
Liquidated Damages or better known as "LD's" are the fees you pay to terminate a contract early. Typically these fees are based on the following formula…

(Average Monthly Fees) x (Remaining Months in Contract Term) = LD's

For example, your monthly cost of services for a specific vendor may be $34,000 per month. Let's say your bank is acquired with 34 months left in your contract. Here are your total liquidated damages…

$34,000 x 34 = $1,156,000 total LD's

Liquidated damages are standard practice in the industry and your vendor needs this to protect their revenue stream and their overall value as an organization. You can never completely eliminate LD's but you can negotiate them and carve out some language specifically for merger and acquisition.

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We will discuss this in just a bit.

Deconversion Fees

Deconversion fees are the fees associated with deconverting (moving) from an existing system or service. These fees typically involve shutting a system down and your data being transferred to a file format that can be used to convert to a new system. Other fees include special project management, running a system parallel for a period of time and additional/custom file cuts. The problem with deconversion fees is they are rarely specifically quoted in your contract. The typical bank's contract will simply say that deconversion services *"will be provided at published rates at the time of deconversion"*. This is not good. *This is a major loophole and blind spot in your contract. Several years ago we witnessed these fees more than doubling overnight.* Ever since then we have been scrambling to protect our customers against deconversion fees that are all over the board. To further complicate matters, some systems need several file cuts throughout the conversion process while others simply need to be shut down. There is a way to make sure you understand all the moving parts before you sign your next contract but before we go into that let's not forget your Legacy Data.

Legacy Data Conversion Fees

Legacy Data can be summed up as all of your check images, document images, COLD/Optical archival report data, signature cards and driver's license images. Your vendor for any of the systems that warehouse this data will need to export all of *your* data onto a USB drive so it can be imported into the new system you are converting to. In the past, the fees to export and import this data were relatively reasonable but we are now seeing these fees skyrocket for no apparent reason. To make matters worse, some vendors are encrypting this data so third party conversion service providers cannot help with the data conversion at more reasonable rates. Remember, as it relates to your Legacy Data, there are two sides to this coin. You have to export the data from your current system and then you have to import it into the new system. Some banks choose to obtain viewing licenses of their current systems and maintain them until they no longer need the images. I am a proponent of the fully-integrated system and just think it is cleaner to have it all in one place. Since there are two sides to this fee (export and import) you will need to negotiate predetermined rates with the vendor you are moving from and the vendor you are moving to.

How to Protect Yourself

First let me say that your vendors will push back when you discuss these fees in your next contract negotiation. Do NOT give in as they are masters at diverting your attention or refusing to tie down all angles of the various forms of termination fees. Stay the course and dig in your heels until you feel you have covered all services/products governed by the specific agreement you are negotiating. So here we go…

1. **Negotiate Liquidated Damages for Merger/Acquisition:** The likelihood of you terminating your agreement early for any other reason than a merger or acquisition is very slim. As I mentioned above, you are not going to totally eliminate LD's but you can minimize them. Essentially you will run into two scenarios in a merger or acquisition. The first is a merger of two banks on different systems owned by different vendors. The second would be where two banks merge who are on the same system or systems owned by the same vendor. Let's discuss how you approach each scenario:

Figure 1: Liquidated Damages Negotiation Dashboard

	Merger with Same Vendor	**Merger with Different Vendor**
Basis for Negotiation	Compression in Revenue	Revise Formula
Priority 1	Negotiate ability to waive LD's and only pay the compression in revenue which the vendor will recognize with the merger of two customers.	Formula Baseline: (Average Monthly Fees (less pass thrus) x 50%) x months remaining in term = Total LD's
Priority 2	Negotiate discounted conversion fees or the cost to convert one institution onto the "go forward" platform or service	Negotiate discounted conversion fees based on new business the vendor will obtain organically through your merger or acquisition.

2. **Negotiate a Cap on Total Deconversion Fees:** You have to look at your relationship with each vendor holistically. Let's use your core processing vendor as an example. In addition to core, your core vendor likely provides item processing, ATM/Debit Card Processing, Platform (Teller, Deposit, Loans), Online/Mobile Banking, Bill Payment, Telephone Banking, Document Imaging, CRM, Cold/Optical Storage and various other systems. The best way to start negotiating is to get a sample deconversion estimate from your vendor. Make sure you ask them to include estimates on all the optional services. In our experience, the optional services are not really optional. Also, and this is very important, make sure you understand how many file cuts are included in the estimate. Let me explain, during a conversion to a new system your new vendor will likely need two test cuts and a live cut just before conversion. Your current vendors estimate may only include one test and one live file cut. Make sure you negotiate that extra file into the deconversion language of your contract. Once you have the entire scope of your relationship (all services), all of the optional services identified and the number of file cuts you should have the total cost of your deconversion fees. After you pick yourself up off the floor you can negotiate a cap on those fees. At Genesys, we believe a reasonable place to start is 30% of the total fees. That is how utterly stupid these fees have been inflated.

   > ***Disclaimer:*** *I feel it is important to note that these fees will vary from vendor to vendor. Not all vendors are hiking their deconversion rates. Jack Henry & Associates is an example of one vendor who has demonstrated a tremendous amount of integrity in this area.*

   I cannot stress the importance of obtaining these estimates from ALL of your vendors and negotiating reasonable deconversion rates while you are purchasing a new system/service or during renewal negotiations. You will not have much luck negotiating the fees after the ink is on the paper and you will not get your files until all the fees are paid.

3. **Negotiate a Cap on the Cost to Export Your Legacy Data:** In the past, the cost to export your check images, COLD/Optical archive, document images, etc. - onto a portable drive was anywhere from $7,500 to $15,000. This is no longer the case. We recently had a $300 million bank hire us to help them with navigating the decision to change item processing providers. Their current provider's first quote to put their check archive in an X9 formatted file on a USB portable drive was more than $240,000. I could not believe it...I was in shock. I literally said a prayer and thanked Jesus that we did not negotiate their original agreement. Even if we did, there is no way of knowing when decisions like this will be made by your vendor. So, as it relates to your Legacy Data, here are some guidelines...
   a. Understand what you have on file today in your 7 year archive of check images.
   b. Understand the amount of data (in gigabytes) that you have on file today for all other Legacy Data.
   c. Obtain an estimate on **exporting** the data into a standard (unencrypted) format. This applies to your existing vendor in a renewal situation and covering your rear-end on the front end if it is a new vendor relationship.
   d. If you are moving to a new vendor get a quote on the cost to **convert** and **import** the Legacy Data. Most vendors will not bring this up until you are in the midst of conversion. Not good.
   e. Negotiate a cap on the import and export fees in advance of signing any new agreements. The cap will be relative to the amount of data you have on hand but I would use the 30% rule here as well.
   f. Just for review I have provided a table below that spells things out a little better.

Figure 2: Legacy Data Negotiation Dashboard

	Current Vendor	New Vendor or Service
Conversion Related	Estimate to Export to Unencrypted File	Estimate to import Legacy Data
Contract Negotiations	Renewal: Cap export for all current systems governed under contract.	New Contract: Cap export for all systems governed under contract.

Getting it Into the Light

Light cleanses everything. This just needed to be brought out into the light. The costs associated with terminating an agreement and getting your bank's data moved to another system has remained in the dark long enough. If you are a vendor and you are offended or upset by this article you might want to take a long hard look at whether what you are charging is appropriate. If you are not offended, then you are saying “AMEN brother...preach it!”. Because your fees are reasonable and you are happy to tie this stuff down for your customer and would love to see your competition held accountable. Am I right? I think I am.

My hope is that by shedding light on these fees, those vendors who have jacked up their termination fees will come back down to the pre-consolidation rates of the past. If not, my hope is for all banks to stop accepting this as the norm and take the steps necessary to protect themselves by spelling it out in their contract. Take the time to do your research, get your ducks in a row and negotiate effectively to make sure termination fees do not eat your lunch down the road. Your vendors may push back or become unresponsive or slow to respond. Worst case, they just say no. *By the way, from a partnership perspective, this is a huge red flag. It speaks to their integrity. Their ability to do what is right in lieu of making a quick buck. Most importantly, it speaks to the unknown, the unforeseeable future I mentioned earlier. It speaks to their ability to sit in a room and find other areas where they can charge you outrageous fees...just because they can.* My advice there is simple...DO NOT sign that contract and go somewhere else where they will carve out the language you need.

At Genesys, we value the relationship we have with all the vendors in the banking technology space. We are not on a witch hunt here. We simply cannot let another bank get burned just because they were not our client. ***So pass this article along to your banking buddies and make sure they are protected***. The only way to fight this dynamic in the market, which I am convinced presented itself due to the consolidation in the industry, is to understand that it exists and do everything you can to prevent it...one bank at a time.

If you have a major technology contract coming up for renewal or you are evaluating your options on a key system within your bank - we can help. Hundreds of banks nationwide have trusted Genesys to help them through that process. Reach out to us and we can schedule some time to take a look at what you have in front of you.