

# *Technology Outsourcing*

## Tools to Manage Technology Providers' Performance Risk: Service Level Agreements



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# **Tools to Manage Technology Providers' Performance Risk: Service Level Agreements**

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## **Amended as of 02/03/2026**

On 02/03/2026, this bulletin was revised to remove references to reputation risk.

# TOOLS TO MANAGE TECHNOLOGY PROVIDERS' PERFORMANCE RISK: SERVICE LEVEL AGREEMENTS

This document is intended to serve as a resource for banks in addressing specific challenges relating to technology outsourcing. The content was prepared not as examination procedures or official guidance but as an informational tool for community bankers.

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## *Introduction*

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As community banks outsource more of their mission critical applications, properly managing the relationships between financial institutions and technology service providers<sup>1</sup> becomes increasingly important. This brochure discusses the Service Level Agreement (SLA) as an effective tool for managing the risks associated with technology outsourcing and describes practices for measuring and monitoring service providers' performance.

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## *What Are Service Level Agreements?*

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Service Level Agreements (SLAs) are contractually binding clauses documenting the performance standard and service quality agreed to by the bank and service provider. The SLA is a key component in structuring a successful outsourcing contract. The SLA ensures that the institution receives the services it wants at the

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<sup>1</sup> Technology service providers encompass a broad range of entities including but not limited to affiliated entities, nonaffiliated entities, and alliances of companies providing products and services. This may include but is not limited to: core processing; information and transaction processing and settlement activities that support banking functions such as lending, deposit-taking, funds transfer, fiduciary, or trading activities; Internet-related services; security monitoring; systems development and maintenance; aggregation services; digital certification services, and call centers. Other terms used to describe Service Providers include vendors, subcontractors, external service provider (ESPs) and outsourcers.

expected performance standard and price. As such, the SLA is a key component in managing the financial and operational risk involved with outsourcing contracts. It also can be one way to help mitigate risk. By specifying the measurement unit and service range for the selected category, the risk of poor service may be diminished because it becomes an area of focus and is designated as the service provider's responsibility.

The SLA's primary purpose is to specify and clarify performance expectations, as well as establish accountability. Therefore, balancing the need for precise measurement standards with sufficient flexibility is important. A common pitfall is excessive oversight or "micro-management" of the provider responsible for the service, which can also burden the bank employees charged with supervising the service provider relationship and monitoring the SLAs.

A well-designed SLA will recognize and reward, or at least acknowledge, good service. It will also provide the measurement structure — or performance metric — to identify substandard service and trigger correction or cancellation provisions as warranted. In today's outsourcing environment, incentives or penalties in the SLA can be an effective tool for managing service. If services received do not measure up to expectations, direct consequences, such as reduced levels of compensation or a credit on future services, would result.

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### *Structuring and Developing SLAs*

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A typical SLA includes the following components and is tailored to fit the nature of the outsourced service or application:

Service category (e.g., system availability or response time).

Acceptable range of service quality.

Definition of what is being measured.

Formula for calculating the measurement.

Relevant credits/penalties for achieving/failing performance targets.

Frequency and interval of measurement.

Before an SLA is signed, the service provider and the institution should clarify and establish expectations. Unless these expectations are clearly measurable, the service category will be difficult to manage due to the bank's and the vendor's differing goals and perspectives.

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### *Developing a Successful SLA Involves Four Steps*

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**Determining objectives**—Reviewing the strategic business needs of the financial institution includes evaluating its day-to-day operating environment, risk factors, and market conditions. Consideration should be given to how the outsourced service fits into the bank's overall strategic plan.

**Defining requirements**—Identifying the operational objectives (e.g., the need to improve operating efficiency, reduce costs, or enhance security) will help the institution to define performance requirements. It will also help identify the levels of service the bank needs from the service provider to meet its strategic goals and objectives for the outsourced activity.

**Setting measurements**—Clear and impartial measurements - or metrics - can be developed once the strategic needs and operating objectives have been defined. The metrics are used to measure and confirm that the necessary service levels have been achieved

and the objectives and strategic intent have been met.

Establishing accountability—It is useful to develop and adopt a framework that ensures accountability after the measurement units (i.e., the metrics) have been clearly defined. The service provider rarely owns accountability and responsibility for all tasks. Establishing this accountability usually includes a clear statement of the outcome if the level of service is exceeded or if the expected service fails to meet the stated standard.

*The SLA development process and each of the four steps are discussed in further detail in Appendix 1. A sample SLA is provided in Appendix 2.*

Representatives from the institution (management, legal counsel, and information technology staff) and the service provider typically meet to ensure that performance metrics and targets are properly addressed when developing SLAs. Bank management may also consider interviewing some of the system users to help identify important criteria to incorporate into the SLAs.

Reaching agreement on specific SLAs may involve significant discussion and negotiation between the bank and the service provider. The bank may wish to consult with peer institutions and trade associations about useful benchmarks for performance standards. This information may be helpful in the contract negotiation process and assist the bank in determining if the service levels offered by the provider are reasonable and standard.

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## *Drafting Successful Service Level Agreements*

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Sufficient time and resources should be devoted to preparing SLAs. The agreement will be the primary document governing the procurer and vendor of services that may have a significant impact on the bank's performance. The following items are important reminders for institutions drafting SLAs and selecting the metric(s) to be used to measure vendor performance:

Focus on the most important areas. Financial institutions should identify the performance and risk factors that are most crucial to the success of the outsourced function. The institution should invest its time drafting strong SLAs for these areas. Areas with minimal effect on the process will be of less importance and, accordingly, should have less prominence in the contracting process.

Make sure that performance metrics measure what the bank wants them to measure. Verify that the metrics used to govern the SLA appropriately represent the functions that the bank intends to measure.

The metrics should measure the performance the service provider is giving the bank and not be based on the performance the vendor is delivering in aggregate to all its customers.

Ensure that SLAs are focused on institutional goals. Avoid the trap of creating agreements that are focused on the success of the individual process without regard for the how the process addresses a corporate goal. Each measurement should logically support a requirement that is linked to a strategic goal.

Be specific. Ensure that all parties involved in the SLA understand the terms spelled out in the agreement. Terms should be clearly defined to avoid different

interpretations. Spending extra time defining terms when creating an agreement can prevent misunderstandings and loss of time and money caused by differing interpretations of the intent of the SLA.

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### *Managing SLAs*

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It is worthwhile for the institution to provide for ongoing management of the agreement when a SLA is established. The SLA management process usually goes beyond performance measurement to ensure success. Generally, the measurement process should be kept as simple as possible, emphasizing timely identification of deviations from agreed upon performance metrics. Ongoing communication between the bank and the service provider is also important. The following four-phase methodology is based on observed industry practices that can help banks manage SLAs effectively:

Measure service activity results against defined service levels.

Examine measured results to identify problems and determine causes.

Take appropriate action to correct failed activities, functions, and/or processes.

Continuously guide service providers through feedback sessions based on objectively measured performance metrics.

Before signing an outsourcing contract, the bank may find it beneficial to verify that important performance requirements have been addressed, risks have been identified, and each service level is defined. Each measurement should be defined clearly and concisely. This will provide the foundation for effectively managing service levels throughout the four phases of the SLA management process.

SLA management is an ongoing process, and is viewed as an integral component of the outsourcing relationship. A suggested practice is to include periodic review and change provisions in the SLA to ensure that service level goals and performance measurements can meet the changing business and technology needs of the institution.

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### *Summary*

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Service Level Agreements are tools to measure, monitor, and control the operational and financial risks associated with outsourcing technology services. Essential to this process is establishing realistic performance metrics and continuous problem tracking and resolution. The bank should consider working closely with service providers to identify, verify, and correct problems; perform root-cause analysis; and make process modifications to prevent problems from recurring. As the outsourcing relationship progresses, SLAs should reflect the evolution of services provided. Accordingly, they should be updated to facilitate continued service improvement. Well-constructed SLAs are an effective tool for managing service provider performance and ensuring that the bank receives the quality of service that it needs and expects.

## APPENDIX 1 – DEVELOPING SLAS

### *Four-Step Process*

While many factors determine how the bank and its service provider will agree to manage the quality of service, the four-step process<sup>2</sup> outlined below may be helpful in developing successful SLAs. This process facilitates identifying essential requirements for the outsourced service and translating the requirements into measurable and accountable performance standards.

- Determining objectives.
- Defining requirements.
- Setting measurements.
- Establishing accountability.

### *Determining Objectives*

The first step in creating an SLA is determining the standards the outsourced activity needs to meet in order to assist the bank in attaining its strategic goals. The bank should consider the criticality of the activity to the bank’s mission and weigh the impact success or failure will have on the bank’s operations. The institution also needs to consider the relationship of the outsourced activity to other systems, applications, and functions in the bank and take into account any critical interdependencies. Based on this analysis, the bank can identify the objectives that are critical in ensuring the success of the function. For each activity, function, and process, a clear objective is needed to understand what constitutes success.

### *Defining Requirements*

In order to attain strategic goals, it is important to identify how the institution is going to achieve the objectives that have been set. To establish these requirements, the institution can break the objectives down into specific activities that must be undertaken to achieve the goal. While the objectives refer to broad statements geared toward attaining success, the performance requirements are targeted at the specific activities that the bank can require from the service provider to ensure the strategic objective is met.

### *Setting Measurements*

In formulating an agreement, the bank can identify specific measurements that indicate if the prescribed requirements are being met. The measurements - or metrics - that correspond to the performance requirements represent tangible or quantifiable deliverables that bank management can monitor and discuss with the service provider, as appropriate. Target metrics should be objective and clearly linked to the bank’s business needs and risk management requirements. Metrics should be established based on specific tolerance levels and the minimum acceptable levels of service. A minimum acceptable level of service also should be set to define the point of significant failure.

The following table provides two examples of strategic objectives and related performance requirements, along with target metrics. The first objective pertains to system security and may be appropriate for an outsourced activity involving sensitive data or applications. The second objective addresses certain reliability and availability needs that may be associated with an outsourced system that processes or stores information essential for bank employees or customers. The corresponding performance

<sup>2</sup> The “Four Steps” for developing SLAs are based, in part, on research from the Gartner Group entitled “Key Factors in SLA Development.”



requirements and measurements provide the means to quantify and document service provider performance.

*Establishing Accountability*

Clear definitions of accountability are important to ensure that both the bank and the service provider understand their roles and responsibilities for each service level requirement. However, beyond simply designating a role or activity, accountability should also be established by specifying the consequences if a given service level is not met. Incentives and penalties can play a key role in establishing accountability. Incentives can be used to motivate a service provider to meet or exceed specified service levels by offering a reward. Rewards should generally be attractive enough to motivate the provider, but less than the actual financial value provided by the service. Penalty clauses also should be considered and bank management should have the right to exercise these penalties for any defined service delivery failures.

When negotiating incentives and penalties into an SLA, it is helpful to consider:

The importance of the performance measure to the bank—This will help the bank determine how to weight the associated incentives/penalties as well as the frequency for monitoring performance.

Each party’s expectations for quality and consistency—These factors, coupled with prior experiences, may help the bank determine the best method for motivating the provider toward desired performance.

The severity of the consequences to the bank if key performance measures are not met—  
The effect on the institution should be a

TABLE 1 – EXAMPLES OF OBJECTIVES, REQUIREMENTS, AND MEASUREMENTS

Strategic Objective	Performance Requirement	Measurement
Sensitive system and bank/customer data must be protected with strong security.	Regular checks for intrusions or other security breaches.	Copies of intrusion scan reports to be sent at pre-determined frequency.
	Periodic security assessments, tests, or reviews.	Copies of independent security assessment reports to be provided at pre-determined frequency.
	Timely reporting of incidents and follow up to bank management.	Regular incident reports (frequency will depend upon system criticality).
Mission critical systems must be reliable and accessible.	System downtime must be minimal.	Specified requirement for system uptime (e.g., 99.9%).
	The system must be able to support certain volumes of activity at a given time.	Specified requirement or parameters for capacity (e.g., 1,000 transactions processed per minute).



motivating factor for the institution when determining whether compensation clauses or other remedies should be provided.

## APPENDIX 2 – SAMPLE SERVICE LEVEL AGREEMENT

*(Note: This SLA is for illustration purposes only, and not to be relied upon as a model contract for any specific service agreement. Actual SLAs will vary widely depending on the services contracted. Additional provisions or an increase in the scope of this SLA will be necessary to govern other aspects of the relationship, such as security. Consult with bank legal counsel for specifics of contract clauses and formation advice.)*

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### Purpose:

This agreement is between Buyer and Vendor. This document outlines the service level roles, responsibilities, and objectives of Buyer and Vendor in support of the given functional area.

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### Scope of Services:

Vendor will house, manage, and operate all hardware and software necessary to provide Internet banking applications to Buyer.

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### Service Category:

This SLA addresses application availability.

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### Acceptable Range of Service Quality:

The Internet banking application shall be available at least 99.5% of each week.

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### Definition of What is Being Measured:

“Availability” will be measured as the percentage of minutes each day that the Internet banking application will be able to receive and respond to messages from the Internet. The server’s ability to receive messages will be ascertained using time-check availability software.

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### Formula for Calculating the Measurement:

System availability shall be measured as the number of minutes per day that the Buyer's Internet banking application is capable of receiving and responding to messages from the Internet divided by 1,440 (the total number of minutes in a day).

A 30-minute period from 2:00 AM to 2:30 AM shall be excluded from the calculation because Vendor will be performing system maintenance at this time each day.

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### Relevant Credits/Penalties for Achieving/Failing Performance Targets:

If Vendor is unable to provide this service level to Buyer, Vendor will provide priority support to Buyer until performance levels are met. Service below the prescribed level will result in a rebate of 50% of the monthly fee for the month in which the exception takes place.

If Vendor fails to provide the agreed upon service level for more than two consecutive months, Buyer shall have the right to renegotiate the contract and/or terminate this agreement.

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### Frequency and Interval of Measurement:

The system's availability shall be measured daily by Vendor using the time-check availability software. Vendor shall submit monitoring reports generated by this program to Buyer on a weekly basis.

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### Buyer's Responsibilities:

Buyer shall review all monitoring reports and advise Vendor of any deviations from this agreement in a timely manner.

(Include any other items that Buyer will need to do so that Vendor may perform its tasks.)

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### Vendor's Responsibilities:

Vendor shall assume responsibility for customer communications at the point that customer messages leave the Internet service provider.

Vendor shall ensure that all messages are processed in a timely fashion. (Be sure to define the specifics of "timely" standards.)

Vendor shall ensure that the system shall be able to accept and respond to 1,200 inquiries per minute.

(Include any other items that Vendor will need to do to provide the prescribed level of service to Buyer.)

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### Escalation Guidelines:

In the event that Vendor is unable to meet the terms of this agreement, the CIO of Buyer and IT Manager of Vendor shall discuss resolution of the situation. If Vendor will be unable to provide service for more than two hours, Vendor's contingency operating plan shall be invoked.

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### Renegotiations:

Authorized representatives of Buyer and Vendor must mutually agree upon changes to this SLA.

All changes must be made and agreed to in writing.

Either party may request review of this SLA at any time. Each party will review the SLA annually and advise the other party of any desired changes.