



## **Analysis of the FFIEC source code escrow recommendations.**

A technology escrow guide for leaders and technology decision makers of American financial institutions.

### **PRAXIS Technology Escrow, LLC**

Chris Smith  
Founder & CEO

## White Paper: Analysis of FFIEC Source Code Escrow Recommendations

The Federal Financial Institutions Examination Council (FFIEC) provides uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System. This organization includes a general recommendation on utilizing source code escrow agreements to protect business critical software applications.

Source code escrow agreements are contracts between financial institutions, a professional technology escrow agent and the financial institution's software vendor. These agreements are part of a business continuance plan designed to provide the financial institution with all the documentation, information and materials necessary to support licensed technology in the event of some pre-negotiated default of the software vendor. This practice began in the 1980's and has evolved dramatically in keeping pace with technological change over the years.

Read the FFIEC guidance on Escrowed Documentation here:

<http://ithandbook.ffiec.gov/it-booklets/development-and-acquisition/acquisition/escrowed-documentation.aspx>

**The Problem:** Financial Institutions, like most businesses, must have an actionable continuance plan for business-critical software applications and other technology. While the FFIEC guidance goes a long way in informing financial institutions that they should consider escrowing business-critical software applications and technologies, the proposed standards are too general in nature such that if followed as stated, the resulting source code escrow may not provide the financial institution with appropriate protection for their unique situation. Thus, how does a financial institution comply with FFIEC standards and achieve the protection necessary for their institution?

**The Solution:** This white paper is written to identify opportunities for improvement upon the FFIEC recommendations and serve as a guide for financial institutions when implementing source code escrow protection to help them comply with the FFIEC standards, and to identify and address additional issues related to specific protections needed for any given software application.

**Escrow Agent:** Not all source code escrow providers will offer agreements, protections and services that comply with the FFIEC standards. It is important to ensure that a potential escrow agent adheres to at least these minimum standards and is willing to support a highly customized agreement to address the specifics of your vendor relationship before engaging. The FFIEC standards only assert that the escrow agent be a third party and be able to facilitate the financial institution's annual audit. While both of those factors are important, there are several other important factors to consider when selecting a professional escrow agent.

"Typically, an independent third party retains the documentation in escrow; however, it is each organization's responsibility to periodically (at least annually) ensure the third party holds a current version of the source information. Often, escrow agents provide services for reviewing and confirming source code version numbers and dates. Some agents also perform automated code reviews to ensure the integrity of the escrowed code."<sup>[2]</sup>

Professional, neutral third party technology escrow agents have existed since the early 1980's. Prior to the establishment of the neutral third party escrow agent, attorneys and banks with ties to either the software developer or end user organization often served as the escrow agents until the obvious conflicts

of interest were exposed. Despite the mature technology escrow industry that exists today it is still possible to find the occasional software developer that has an escrow agent that is not a neutral third party, lacks professional experience, facilities, insurance or other protections. As the profession has evolved, the top tier agents have developed very specialized facilities, services, and protections for end users of software. These developments often far exceed the minimum standards specified by the FFIEC and provide the end user with far better protections. Technology escrow deposits are typically stored on some form of magnetic media and thus should be held in professionally built media vault facilities. Or, if the deposit materials are held electronically, the servers must be stored in a secure data center. The escrow deposit materials must be encrypted during transfer via secure FTP services and stored in an encrypted fashion. Further, it is imperative that the escrow agent be provided with complete and functional passwords for all media and files to ensure that the deposit materials are accessible upon testing and / or release. The escrow agent should have significant experience in meeting FFIEC escrow standards as well as a wide variety of experience in other enterprise technology transactions. In addition to adequate facilities and high level experience, the escrow agent should offer comprehensive protections for the escrow deposit materials. These protections include professional Errors and Omissions insurance underwritten specifically for the source code escrow industry. This coverage is difficult to obtain because of the high value of intellectual property and the niche nature of the industry. Being exposed to risks as a result of potential mistakes is well worth guarding against, and the same is true of the benefits offered by audit and verification services.

**Audit and Verification Services** Engaging in a software escrow agreement should provide peace of mind and confidence to both the software developer and the end user financial institution about the availability and accuracy of escrow deposit materials as well as the protection for intellectual property.

Audit and verification services are typically only available from top tier professional technology escrow agents. PRAXIS, for example, offers a Deposit Material Evaluation service that meets or exceeds every FFIEC standard for a relatively small investment. In addition to an audit, a professional technology escrow agent can provide comprehensive software testing services to perform a “simulated escrow release” to ensure that the escrow deposit materials are complete, accurate, and capable of reproducing the software based solely upon the escrow deposit and included instructions. The escrow deposit materials are tested for completeness and accuracy by the escrow agent while the materials remain in the escrow agent’s custody. Thus, the owner of the intellectual property is assured that the deposit materials have not been accessed by the client or other parties and the end user financial institution is assured that the escrow deposit is complete, functional and capable of reproducing the application.

**Negotiations Regarding Escrow** Timing is one of the most often overlooked and arguably one of the most important factors in establishing effective source code escrow protection for licensed software. While the FFIEC addresses timing with respect to updates to the deposit materials, it falls short on the larger priority of recommending at what stage in negotiations the escrow should be established.

End users of software greatly benefit from negotiating the source code escrow while negotiating the software license agreement or software as a service (SaaS) subscription agreement. During these negotiations, the financial institution will have maximum leverage and generally be able to negotiate far more lenient escrow release conditions, timeframes for release and other key terms. The escrow requirement should be clearly stated as in the license agreement and the escrow agreement should be an exhibit to the license agreement. It is not uncommon for end users to make escrow compliance a condition of performance under the license agreement and make penalties for nonperformance such as the ability to withhold license and / or maintenance payments until escrow compliance is documented. This type of “performance driving” language can be extremely effective in reaching escrow compliance

with reluctant software vendors. The general rule is that the escrow agreement should be negotiated and executed along with the license agreement to ensure software vendor compliance prior to commencement of material license or subscription payments.

**Release Conditions and Right to Use Language** The crux of the escrow agreement is the terms under which the escrow deposit materials are to be released and what rights the end user beneficiary would have to use the materials following a release of the escrow deposit materials. The FFIEC recommendations mention addressing these issues but provide little depth. A professional technology escrow agent will not provide legal advice but can typically provide numerous examples of release conditions and other sample provisions. It is important to consider a wide array of possible scenarios and consider the practical and legal implications. Deciding upon the proper language for each escrow scenario can often require a discussion among the technology escrow agent, an experienced technology transaction attorney and stakeholders at the financial institution.

**Governing Law** Governing law is another important component of these agreements not addressed by FFIEC standards. Historically there has been very little litigation involving technology escrow agreements, however, it makes sense to have the governing law of the escrow agreement match with the venue specified in the software license if possible so that any disputes are simplified. While this concept may seem obvious, most escrow agents will not allow a change of venue in their escrow agreements. This level of flexibility in the escrow agreement will prove to be invaluable should a dispute arise, and it's a big reason to partner with a professional technology escrow agent who completely understands your needs and offers a wide range of flexibility to change key escrow terms including governing law.

**Dispute Resolution** Another critical issue not mentioned in the recommendations is how the parties would solve any dispute regarding the escrow deposit materials. Because time is of the essence when a financial institution is experiencing system downtime any dispute resolution process should be clearly specified including the process, time frames, venue and etc. to avoid delays. Further, it is often advisable that the financial institution have access to and use of the escrow deposit materials during any dispute resolution process. This requires an "immediate release" provision which is not standard in most escrow agreement templates but can be critical to the success of the business continuance plan.

**Potential Escrow Deposit Materials** FFIEC standards loosely address what should be included in the escrow deposit:

"Definitions of minimum programming and system documentation;<sup>[3]</sup>

Definitions of software maintenance procedures;

Descriptions of the source information media (for example, magnetic tape, disc, or hard copy) and assurances that the media is operable and compatible with an organization's existing technology systems;

Assurances that source programs will generate executable code."

A professional technology escrow agent can typically provide a list of potential materials, information and best practices on what could be included in the escrow deposit and assist with contract language detailing the proper requirements to be placed upon any given software vendor. The necessary escrow deposit materials will vary greatly from one situation from the next. This is especially true as more software applications move to the internet as software as a service (SaaS). Thus, top tier escrow agents typically provide some examples that may be helpful to you in determining what types of materials, information, documentation and the like to include. For example, PRAXIS maintains an updated list of "potential

deposit materials” in their resource center which can be downloaded here:

<http://praxisescrow.com/resource-center/>

The FFIEC recommendations are an excellent reminder that an escrow agreement tailored to the specifics of each business critical software vendor relationship can provide financial institutions with a business continuance plan for their licensed technology. The effectiveness of any escrow agreement will lie in the customizations of the agreement to address specific needs as well as the software vendors’ performance under the escrow agreement. Some top tier technology escrow agents provide a comprehensive suite of services to address these concerns.

PRAXIS was founded to provide the most flexible and customizable escrow agreements and solutions available. In addition to providing standard escrow agreement templates, PRAXIS has created an escrow agreement template that incorporates the FFIEC standards, provides a much higher level of protection and still provides financial institutions with the flexibility to further customize the agreement to meet the specific needs of any financial institution.

Download the PRAXIS FFIEC compliant source code escrow agreement here:

<http://praxisescrow.com/resource-center/>

**In summary**, the technology escrow industry is a niche of the broader technology industry. As such, it would be difficult for any governing body to advise detailed recommendations unless they had the specific experience on staff or consulted with industry experts on a periodic basis. The FFIEC recommendations are very basic and set a low standard. It is important to engage with a professional, neutral third party escrow agent that meets these minimal standards but also provides a much more robust offering and a willingness and the expertise to help customize a solution that will protect your licensed business technology.

## **About the Author**

Chris Smith is Founder and CEO of PRAXIS Technology Escrow, LLC and a veteran of the technology escrow industry since the late 1990’s. Throughout much of the past three decades Chris has helped financial intuitions, Fortune 500 companies and countless software and technology companies implement customized technology escrow solutions. Chris has held executive level positions with Iron Mountain and the NCC Group and was Co-Founder and President of Escrow Associates, LLC which was acquired by NCC Group in 2011. Throughout his career Chris has been an educator and is certified to deliver continuing legal education (CLE) courses in several states.

## **About PRAXIS Technology Escrow, LLC**

This white paper was written for technology leaders and decision makers of American financial institutions that are subject to FFIEC oversight as guide for ensuring that basic recommendations are met but with further guidance on how to implement customized protections over and above the stated minimums. PRAXIS is a worldwide provider of highly customized software and technology escrow services based in Atlanta, Georgia.

PRAXIS Technology Escrow, LLC

(800) 213 9802 / (770) 459 1202

[www.praxisescrow.com](http://www.praxisescrow.com) or [info@praxisescrow.com](mailto:info@praxisescrow.com)