



HROA Recommended Practice for Service Level Agreements

A collaborative work of the HROA Standards & Practices Committee

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HROA Recommended Practice™ for Service Level Agreement Methodology

Introduction

The HROA Recommended Practice™ for Service Level Agreement (SLA) Methodology is comprised of the most commonly used HR business process outsourcing SLA methods. The SLA Methodology is primarily intended for potential buyers use in establishing, revising and managing SLAs during the negotiation of HR outsourcing contracts. The SLA Methodology was reviewed and approved by the HROA Research and Standards Committee (RSC), with members representing the HRO industry including buyers, service providers, attorneys and advisors. As with all HROA Recommended Practices™, HROA welcomes your feedback and input regarding this documentation.

Why Include SLAs as Part of an Outsourcing Contract?

SLAs are a key factor in understanding the value of outsourcing and may impact pricing and buyer satisfaction.

The key objectives for SLAs are to:

- Establish pre-defined mutual performance expectations
- Provide data and metric reporting to validate service performance and historical trending
- Incent consistently high performance across the entire spectrum of services

The number and types of service levels and performance standards selected by an employer in establishing SLAs vary based on the specific factors comprising that employer's overall outsourcing solution. The service levels are best obtained by aligning the service provider's business model to the buyer's primary business objectives. Selecting too many Critical Service Levels or requiring ultra-high performance targets may drive up buyer comfort, but may also drive up the pricing for the services. Service levels that vary from the service provider's standards warrant negotiation and documentation concerning capability, scalability and pricing. Both the buyer and the service provider are best served by clearly and candidly addressing SLAs early in the sales process and ensuring the final outcome is consistent with the Statements of Work (SOWs) and the overall solution. Keep in mind that there is no "one-size-fits-all" list of service levels and performance standards. For example, the SLAs for a single service are typically quite different from the SLAs for a comprehensive multi-service solution. Global contracts may require a different approach to balance transparency at a country level with meaningful volumes, such as reporting at a country level and having fees at risk for regionally or globally consolidated measures.

When establishing SLAs, consideration needs to be given to:

- Scale, scope, complexity and customization of services included in the SOW
- Geography, regulations and standards that may vary by location/country
- Size of company/volume of activity
- Alignment of buyer and service provider business objectives and business models
- Service level scalability and method of measurement for effectiveness
- Focus on improving performance not obtaining credits
- Focus on key drivers of leading and lagging indicators needed for measurement based on the needs of the buyer

Linkages

HROA Recommended Practices™ provide a basic foundation of single-topic information and tools to use as a common starting point for development, negotiation and management of HR outsourcing relationships. HROA Recommended Practices™ are not intended to cover all aspects nor the spectrum of knowledge related to the topic. Additional education and guidance may be needed to address circumstances specific to a particular buyer and service provider.

The HROA RSC is developing other HRO practices, including Pricing and Statements of Work. Please visit [HROA's Industry Standards & Practices page](#) for more information.

The information in the remainder of this document is to be used in conjunction with the Recommended Practice Service Level Matrix.



General Key Definitions and Terminology

Certain key terms are fundamental to the SLA methodology and are typically used in outsourcing contracts. These terms are defined in a contractual methodology document and are applied in the SLA Matrix. Some of these items are described in further detail in the “Application of the Service Level Methodology” section below.

At Risk Amount – maximum percentage of Base Fee Charges the service provider shall place at risk for missed Critical Service Levels during the Measurement Period. At Risk Amounts typically range from 5% to 13% of the service provider’s Base Charges. The low end of the range is more typical of single function deals (e.g., payroll only), with 10%-13% being more typical of multi-function contracts. The At Risk Amount may also be a consideration in pricing, with higher at risk amounts resulting in higher fees.

At Risk Pool Percentage – sum of all Performance Category Allocation Percentages. This may also be referred to as the “Total Pool Percentage Available for Allocation.” Generally, this ranges from 150% to 275% depending on the number of Critical Service Levels it is spread across. This enables the buyer to spread fees at risk across a number of measures. As it is unlikely the provider will fail at all measures, this allows the buyer to leverage the maximum fees at risk.

Base Charges – monthly recurring charges for the Services provided (does not include one-time transition charges or monthly pass-through expenses).

Burn-In Period – is represented in the column titled SCD+mos (Service Commencement Date + months) on the Service Level Matrix. This is the amount of time after commencement before any Service Level Failure would result in a Performance Credit. The Service Levels should still be measured and reported during this time. Some Service Levels may not have a “burn-in” due to their ultra-critical nature.

Critical Service Levels – Service Levels defined as critical and eligible to be included in the Service Level Credit.

Earnback – opportunities available to the service provider to earn back Performance Credits.

Expected Service Level – target level of performance for a Critical Service Level or Key Measure; the goal is performance that averages the Expected Service Level.

Key Measures – Service Levels that are not defined as critical and do not have fees at risk, but are measured and reported on a scheduled basis. Note: Key Measures may also be called key performance indicators (KPIs).

Measurement Period – timeframe for calculating Service Level performance, which is typically one month. To allow for an adequate sample size, a quarterly or other frequency may be used.

Minimum Service Level – minimum level of acceptable performance for a Critical Service Level or Key Measure.

Performance Category – grouping of related Service Levels.

Performance Category Allocation Percentage – portion of the At Risk Pool Percentage allocated to a Performance Category expressed as a percentage.

Performance / Payable Credits – monetary amounts the service provider will pay to buyer in the event of a Service Level Failure.

Service Commencement Date – date the service provider begins administering the contracted services.

Service Levels (SL) – performance standards for the covered services, including Critical Service Levels (CSL) and Key Measures (KM).

Service Level Matrix – The document which sets forth the Service Levels, associated credit calculations, and other details of the measures as agreed between buyer and service provider.

Service Level Allocation Percentage (SL Allocation Percentage) – the portion of the Performance Category Allocation Percentage allocated to a Critical Service Level expressed as a percentage.

Service Level Failure – occurs when (1) a Minimum Service Level is not met during the Measurement Period, or (2) an Expected Service Level for the same Service Level is not met more than (typically) 3 to 4 times during a 12 consecutive month period. This applies to both Critical Service Levels and Key Measures.

Window – Measurement Period for a given Critical Service Level or Key Measurement.

Example: How the At-Risk Amount is Allocated Across Individual Service Levels

In the example below, the At-Risk Amount = 10% and the At Risk Pool Percentage = 150%. By allocating this first by performance category and then amongst the Service Levels within that Performance Category and multiplying by the At-Risk Amount, you can determine the calculated percentage of fees at risk for each Service Level.

Table 1 **HR Critical Service Levels**

Performance Category	Performance Category Allocation Percentage	Service Level	Service Level Allocation Percentage	Calculated Percentage of Fees at Risk (Illustrative)
Payroll Administration	60%	Payroll Accuracy	50%	3%
		Payroll Timeliness	50%	3%
Employee Service Center	50%	Average Speed to Answer	50%	2.5%
		Employee Satisfaction	20%	1%
		Case Management Timeliness	30%	1.5%
Information Technology	40%	Payroll System Availability	100%	4%
Total At-Risk Amount = 10%	150%			15%

For example, the Performance Category of Payroll Administration is assigned 60% of the At Risk Pool Percentage. The Payroll Accuracy Service Level is assigned 50% of the Payroll Performance Category. So, the fees at risk for Payroll Accuracy is calculated as (60% * 50% * 10% = 3% of the monthly fees).

SLA Establishment: Considerations of Buyers and Service Providers

The establishment of SLAs is negotiated during the contract process. Buyers must understand the risk associated with having services provided by a service provider and mitigate such risk. Service providers are accountable for the services and associated performance; therefore, the service provider must ensure the SLAs reflect the risk associated with performing the services. When daily call or processing volumes exceed ten percent of the forecast due to something outside the service provider’s control, the service provider shall be exempt from fees at risk resulting from any missed metric.

Negotiations

As part of such negotiations, both parties should address and understand the following:

- At Risk Amount
- At Risk Pool Percentages
- Service Level definitions, minimums and targets – especially for non-standard Service Levels requested by the buyer
- Number of Transactions included in the population
- Critical Service Level assignment
- Earnback methodology
- Service Level Failure definition
- Associated impact on At Risk Amounts during commencement period

Methodology

SLA methodology should balance the interests of the buyer and the service provider.

BUYER – the goals for SLAs are to:

- Establish pre-defined performance expectations that align to the buyer's business objectives and goals
- Establish a barometer for trending
- Establish benchmarks and a method for measuring improvement
- Provide data and metrics to validate perceived service performance, quality, issues, and Voice of the Associate (VOA)
- Provide the service provider insight into the buyer's control plan and service priorities

SERVICE PROVIDER – the goals for SLAs are to:

- Establish pre-defined performance expectations based on measurable items
- Establish a barometer for trending
- Establish benchmarks and a method for measuring improvement.
- Provide data and metrics to validate perceived service performance, quality, and/or issues
- Focus on providing the same level of service for all buyers through a consistent approach

Application of Service Level Methodology

Service Level Classes

Service Levels describe the contracted performance standards and should be specifically related to the services described in the Statements of Work. There are usually two classes of Service Level performance metrics used: (1) Critical Service Levels, and (2) Key Measurements.

1. **Critical Service Levels** are performance metrics defined for the most important Performance Category. Critical Service Levels have associated fees, called Performance Credits, payable by the service provider to the buyer for missed Critical Service Levels in accordance with the terms of the contract.

The buyer and service provider need to mutually agree on the areas of service which are most critical to the buyer's business objectives based on the services included in the SOW. Typically, the focus is on service deliverables that:

- Most directly reflect the value and purpose of the service,
- Impact user satisfaction,
- User / Buyer business operations,
- Key business and technology integration points, and
- Increase legal, regulatory or fiduciary risk.

The number of Critical Service Levels defined should be manageable and in direct correlation to the complexity of the deal, so that the impact of missing a service level is not diluted and/or does not adversely affect either party.

Critical Service Levels represent protection for the buyer and risk for the service provider and require significant investment by the service provider in areas such as controls, staffing, operations and service recovery to ensure performance capability.

2. **Key Measures** are performance metrics with target measurements for non-critical service areas. Key Measures are not eligible for Performance Credits, but certain approaches allow "promotion" of Key Measures to Critical Service Levels over time. Key Measures cover less critical service deliverables, sub-processes or interim activities that are related to Critical Service Level performance, and are reflective of overall effective and efficient service performance management. Based on periodic contractual SLA reviews, adjustments are negotiable and Key Measures may be promoted to Critical Service Levels.

Service Level metric reporting normally begins immediately following the Service Commencement Date. However, to allow for stabilization where appropriate, application of Performance Credits may be reduced or waived for some period of time (usually two to six months) following the Service Commencement Date.



Service providers usually provide the procedures, measurement methods and monitoring tools necessary to report performance of the metrics against the Service Levels on a monthly or quarterly basis for both Critical Service Levels and Key Measures. The volume and timing of the service activities impact setting the measurement period for each Service Level metric to ensure adequate sample sizes. Most Service Levels are measured monthly; some quarterly and a few may only be measured annually.

Service Level Failure

Performance that falls below the Service Level target(s) is called a Service Level Failure and is generally reported to the buyer in the next scheduled performance report. Note that in cases of sustained outages or service failures in Critical Service Levels areas such as Payroll or IT, there are often specific, more stringent notification procedures.

Many contracts require the service provider to provide a root cause analysis report and remediation plan to the buyer in order to resolve the issue and prevent the same failure from recurring.

At Risk Amounts and Performance Credits

The primary function of SLAs is to confirm the service provider's delivery of the Services within the contractual standards to ensure the buyer is receiving the quality of services promised, supporting buyer satisfaction and the service provider's reputation. Another function of SLAs is to incent service provider compliance with the performance targets.

The At Risk Amount is the value or percentage of fees the service provider is contractually obligated to place at risk for missed Critical Service Levels during the pre-defined measurement period.

A Performance Credit represents a specified financial amount payable to the buyer by the service provider based on a contractual obligation in the event of a Service Level Failure of a Critical Service Level. To provide a pool of funds to cover Performance Credits, an At Risk Amount is determined.

Usually, few Service Level Failures occur within a given Measurement Period. Therefore, the totals of the Performance Category Allocations normally add up to more than 100% (to increase the probability of the At Risk Amount being reached). The At Risk Pool Percentage available for allocation is commonly capped at 150% to 300% of the total At Risk Amount.

In the event of a Service Level Failure, Performance Credits are calculated as follows:

$$\text{Performance Credit} = A * B * C$$

- A. At Risk Amount for the Services
- B. Performance Category Allocation Percentage for the Performance Category in which the Service Level Failure occurred
- C. Service Level Allocation Percentage for the Critical Service Level in which the Service Level Failure occurred

Using the example set forth in Table 1, assume the service provider fails to meet the Critical Service Level for Average Speed to Answer. The At Risk Amount is 10% of the Base Fee Charges. Assume that the Base Fee Charges for the month are \$2,000,000. The Performance Category Allocation is 20% (2% of the total of 10%) of the At Risk Amount and the Service Level Allocation Percentage for the defaulted Critical Service Level is 25%. The Performance Credit is calculated as:

- A. 10% of \$2,000,000 = \$200,000
- B. 20% of \$200,000 = \$40,000
- C. 25% of \$40,000 = \$10,000

$$\text{Performance Credit} = \$200,000 \times 20\% \times 25\% = \$10,000$$

If more than one Service Level Failure is accrued in a reporting period, the sum of the Performance Credits is credited to the buyer, but may not exceed, in total, the At Risk Amount.

Earnback

Buyers want performance, not Performance Credits. In many contracts the service provider may Earnback Performance Credits by providing consistently high performance. This is generally defined as average performance



at or above the Expected Service Level over the Contract Year or other 12-month period. This provision provides incentive to the service provider to put extra effort into recovering from a Service Level Failure and maintaining high average performance, rather than “giving up” on that measure.

The exact process for applying Performance Credits and recovering Earnbacks varies by service provider and buyer. However, following is an example of how the Earnback process may be applied:

Within 30 days after each contract year, the service provider delivers a report to the buyer covering each Critical Service Level which had a Service Level Failure during the preceding 12 months, including calculations for the yearly performance average and total amount of Performance Credits imposed. If the service provider achieved a yearly performance average for the Critical Service Level that was greater than, or equal to, the Expected Service Level for a particular Critical Service Level, the service provider may be relieved from the Performance Credits assessed during the preceding contract year for that Critical Service Level.

Modifying Service Level Agreement

According to the terms for SLA review set out in the contract (typically annually or semi-annually), the Buyer may review performance against the Service Levels and add, change or delete Service Levels and/or reallocate the fees at risk amongst the measurements.

There are many reasons for modifying the SLAs during the term of the contract. For example, some Service Levels may be preplanned to be adjusted upon completion of improvement projects; buyer business needs may change and the importance of a particular service areas may increase or decrease accordingly, and/or the services provided may be modified requiring changes to remain in alignment with the SOW.

In addition, Service Levels may change in order to focus service provider attention on particular areas of performance concern. For example, if multiple misses of a Key Measurement are causing buyer dissatisfaction, that Key Measurement may become a Critical Service Level assuming it can be measured.

The following types of changes may occur:

- Additions or deletions to Performance Categories
- Additions or deletions to Service Levels (Critical Service Levels and Key Measurements)
- Modifications to Performance Category Allocation Percentages
- Modifications to Service Level Allocation Percentages
- Pre-planned changes in Service Levels as described in the contract
- Movement of Critical Service Levels to Key Measures and/or vice versa

Modifications to Service Levels are bound by related terms in the contract. There may be a period of time allowed to transition to the new performance standard and before Performance Credits are instituted. For totally new Performance Categories or Service Level measures, a baseline may need to be established before performance targets can be determined, especially for Critical Service Levels.

Minimum and Expected Service Levels

More than one accepted process is used to set performance targets. This HROA Recommended Practice™ describes one of the most common methods used – Minimum and Expected Service Levels.

With this method, Service Levels include both a minimum and an expected attainment level and the goal is performance that averages the expected level. By setting both Minimum and Expected Service Levels, a certain amount of fluctuation in performance is acknowledged which protects the service provider from Service Level Failures triggered by minor temporary variations in performance.

A Service Level Failure is triggered by either a single miss of the Minimum Service Level or multiple misses of the Expected Service Level (typically defined as more than 3 or 4 misses in a 12-month period) for a Critical Service Level or a Key Measure.

If there both a Minimum Service Level Failure and an Expected Service Level Failure occur for the same Critical Service Level in a given Measurement Period, Performance Credits typically accrue only for the Minimum Service Level Failure.



If Earnback applies and the service provider achieves a Yearly Performance Average (i.e, performance that is greater than or equal to the Expected Service Level) the service provider may be relieved from paying any Performance Credits assessed during the preceding contract year for that Critical Service Level.

Introduction to Critical Service Levels and Key Measurements

The following two documents provide HROA's Recommended Practice for Critical Service Levels and Key Measurements. The documents are designed to provide a full set of measurements with recommended definitions, common "burn-in" periods, expected and minimum performance levels and credit allocations. The HROA Standards & Practices Committee believes these are an illustrative framework for negotiation between the parties; however, modification is required to reflect the realities of each specific relationship.

These measures will need to be carefully reviewed to:

- Remove any measurements that don't correspond to the scope of services for the agreement;
- Move measurements from Critical Service Levels to Key Measurements or vice versa, as appropriate to the client's priorities;
- Consider size or geographic impacts on the definitions or performance levels;
- Evaluate the cost/value trade-offs inherent in increasing or decreasing performance targets;
- Ensure that both parties understand what is being measured and how it is being measured.

The measures appropriate in your relationship may be higher or lower or defined differently than what we provide in the framework due to differences in volumes, complexity and cost/value decisions.

Throughout the documents, we have included notes in [blue text](#) to provide additional guidance and clarity to the parties as they evaluate this framework. Most of these notes can be eliminated from the contractual documents that ultimately result from the negotiations.