

Your Bank Relationship and The Credit Crisis

124 banks have failed so far in 2009. Hundreds more are in danger of joining the list. Financial markets, although strengthening due to significant government steps, are still in disarray. Lenders relied on their ability to securitize debt. This activity underpinned a significant portion of all consumer, and more recently, commercial lending. These markets have not recovered and the market for securities backed by home mortgages has improved only due to Federal Reserve purchases. During 2009, the FED bought the overwhelming majority of the home mortgage backed securities issued in 2009 and will complete a planned \$1.25 trillion in purchases of these by March, 2010. In addition to tighter scrutiny by regulators and the promise of new regulations to come, the federal government has taken direct positions in a number of banks and other financial institutions through the TARP program.

The financial crisis has had a profound effect on banks and their customers. Easy money is a thing of the past. We are in the transition to a more rational approach to lending and more fees for bank services as many big banks struggle to return to profitability. In anticipation of interest rates moving higher as the economy recovers and the inflationary effects of stimulus related government spending, banks are raising interest rates on loans now.

Banking relationships are a casualty of this transition. Where you may have had what you thought was a real relationship, you may suddenly find that relationship is either much more tenuous than you ever expected, or worse.

Companies are finding that, even though they have performed well through the crisis, they are subject to higher interest rates or floors, requirements for credit enhancements, more intense reporting requirements, covenants suddenly being enforced or tightened, or in the worst case, their loans are being called rather than being renewed.

So now what? How do you manage your bank relationship under these circumstances?

Your Bank

The first thing to do is to have a clear picture of what is going on at your bank. Find out if it qualified for TARP funds? If it did qualify, did it choose to accept these funds or not? Is it subject to an order or memorandum of understanding with its primary regulator? Was it absorbed by another bank, either as a result of failure or a deal otherwise engineered by the FDIC? Does it have significant exposure in riskier types of loans such as for undeveloped land or speculative residential or commercial construction? Has its level of non-performing assets relative to its loss reserves and its capital base forced it to realign its resources and abandon certain markets? Has the bank's circumstances impaired its ability to serve your needs?

Or, is your bank one of the few who demonstrated proper financial discipline during the go - go times of the past decade? Has it avoided the financial pitfalls that damaged so many other institutions? Has your bank remained profitable during the current economic downturn and is it in a strong capital position? Has it historically focused on serving businesses such as yours or has it recently changed course due to financial problems with its original business model?

Study your bank's balance sheet and its profit and loss statement along with the management report provided quarterly for publicly traded institutions. Read analysts' reports, if available, to obtain an independent view of your bank's financial performance. While some financial institutions are indeed taking steps to better health, assuming your bank is fine is dangerous. Significant risk remains with aligning your company's future with a bank that does not control its own destiny.

Your Bank Relationship

Do you have relationships at all levels of your bank? Knowing the people at your branch is not enough. You should not only know your relationship manager, but should make a point of meeting a few others up the food chain. There is value in having multiple people within the bank know about your business. At local and regional banks you should expect to have the opportunity to be introduced to the president and other members of the senior leadership team.

Have you been repeatedly reassigned to different relationship managers? Are you finding you are dialing an "800" number instead of working with an actual human? Have you been in the situation where you call your relationship manager only to find out that she or he is no longer there? Stability is important in any relationship, particularly in a banking relationship. You don't want to have to "retrain" a new relationship manager every few months.

Your relationship manager should show a sincere interest in knowing you and your business and should be your "go to" person as issues arise. She or he should understand what you do, how you do it, and why this distinguishes you from the competition. She or he should know why you perform the way that you do. If you are facing adversity your relationship manager should be the person at the bank, who, because of that specific knowledge, can be an advocate for your business within the bank. If you have no such relationship, or your relationship was with someone no longer there, then you may be at risk and face some unpleasant surprises.

Banks have certain rules your business needs to play by when you borrow. These are usually detailed in your loan agreement. If you are renegotiating your loan or operating line, you are probably finding new reporting or performance requirements. Talk to your relationship manager about these changes to ensure that you understand exactly what the bank expects.

Understanding financial covenants is critical. Whether you are subject to debt service coverage, leverage, cash or capital requirements, make sure you understand them. Don't rely on your bank to calculate these. The best borrowers calculate covenant results and key financial ratios that are contained in the period financials provided to their relationship manager. The best borrowers take an active interest in and control of the process.

Providing accurate, timely financial information to your bank is critical. If you don't, you are sending up a red flag. Delayed financial reporting is usually the first warning sign that a company is having trouble. If you are required to report quarterly, within 30 days, deliver the reports within that time period. If you are required to update projections, invest the time necessary to deliver accurate and usable information. Make sure all the financial information you submit makes sense and revenues and expenses are properly allocated. Banks pay particular attention to balance sheets. It is amazing how little sense some balance sheets make.

If an issue is brewing, bring it to your relationship manager's attention earlier rather than allowing it to become a surprise. If you see a miss coming, you can do some damage control. Banks like clients who are proactive. Provide explanations of the causes of any unexpected problems along with the steps that have been or will be taken to address them. Proactive disclosure is critical to a healthy relationship. If your company is facing challenges, you may want to assemble an outside board to help you navigate. The bottom line is to let your bank know you are taking positive steps to mitigate the negatives. And, make sure you are talking about the positives.

Choosing a New Bank

If you have experienced a discontinuity with your bank or with your relationship manager, you may want to explore a new relationship.

Choosing a new bank is really about choosing the right bank. It is not so much about size, but about focus. Banks specialize. Some banks may be focused on consumer deposits and large companies. Some banks have excessive exposures in certain areas of their loan portfolios and may not really be able to offer you what your company needs. They may have too many loans to one type of business, or too many loans secured by certain kinds of assets.

You may want to consider a bank with a clear and consistent focus on serving the business community and a demonstrated expertise in serving businesses like yours. You need a bank big enough to support the resource requirements of your business but also may find great benefit in working with a smaller bank that will value your business more than a larger bank.

How responsive is the bank? Are credit decisions made locally or are they made in another state? Does your prospective bank have a one size fits all approach? Do they have a box you need to fit neatly into, or is there a commitment to understand the nuances of what you are doing? The more complex or unique your business is, the more likely you need to find a bank that will truly take the time to understand all the moving parts.

Banks want to know the same things about you that you should want to know about them. Does your company have adequate capital? Are your assets properly valued? Do you have the liquidity necessary to operate or grow? What is the probability of continuing cash flows? Has growth slowed or stopped, or do you have a problem funding growth internally? Can you service your debt? Remember, above all, a bank wants to know how it will be paid back. Collateral, while important, is less so than cash flows.

Do you know the rules? Do you understand FDIC insurance and its limitations? Do you understand how the bank applies holds to checks or other deposits? Have you explored the bank's electronic banking systems? Is it capable of performing the kinds of cash management tasks you require? What other important services can the bank offer? Payroll? Private Banking and Wealth Management? SBA loans?

A real bank relationship goes both ways. It is about you investing the time to understand your bank, how it fits your needs, and developing a clear understanding about what the bank expects from your business. It is a commitment from the bank to know and understand your business, and then acting to support it by providing financing alternatives, cash management services and trusted advice.