



FINANCIAL SERVICE CENTERS OF AMERICA, INC.
A NATIONAL TRADE ASSOCIATION

A GUIDE TO MANAGING YOUR BANK RELATIONSHIP

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This guide will: (i) summarize the issues faced by banks in servicing Financial Service Centers (“FSCs”); (ii) offer suggestions on things that an FSC can do to help its bank address those issues; (iii) provide tips on how to develop, maintain and nurture a banking relationship; and (iv) describe some standard underwriting criteria used by banks that specialize in lending to FSCs.

1. Heartaches faced by banks servicing FSCs

- **Bank Secrecy Act (“BSA”)** – The BSA requires banks to know their customers, measure the risks of each customer, understand the business needs, anticipate activity levels, and monitor actual activity to determine if it is consistent with the business and with expectations. Implementing monitoring systems is difficult, and the penalty for failure is steep. Rewards to the bank must justify the effort needed to comply and the risk of not catching deliberate illegal activity.
- **Backroom Operating Headaches** – High volumes of transactions, deposit processing deadlines, return item requirements, forgery claims, and cash vault requirements are all issues that many banks are ill-equipped to handle, especially if they only have a few such accounts. Bank “operations” people are often at odds with “account reps”.
- **Deposit Processing Liability** – Processing checks poses liability to banks. A high volume of checks creates the potential for high liability, and makes it more difficult to identify high-risk transactions. Banks are liable for forged items that are processed through its accounts, even if the account holder is defunct. Forgery claims can be presented back to a bank months or even years after they were negotiated. The most common forgeries are U.S. Treasury items (Social Security and SSI checks), but they can also include “commercial” checks cashed for contractors or other third parties. Banks

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also are at risk for check kiting schemes, and some have suffered substantial losses at the hands of unscrupulous (or desperate) FSCs.

- **Credit Risk** – Formal credit underwriting is discussed below, but outside of formal credit facilities, banks servicing FSCs are often asked to provide “uncollected” facilities to support cash draws that are subsequently covered by check deposits.
- **Scale** – Unless a bank has a sufficient scale of customers, it becomes cost-prohibitive to properly service the accounts.

2. Overcoming the heartaches

- **BSA** – Don’t fight the bank; it’s not their fault! They don’t want to be a policeman, but the role has been thrust upon them. Bite your tongue when they ask for stupid things ... over and over again. Take BSA seriously. You have to help the bank with this, or you will die.
- **Operations** – Where possible, seek-out banks that specialize in servicing the industry. In any case, build relationships with the “back-room” people as well as with the “account reps”. Understand their problems, and help them solve those problems. Keep complaints at a high, professional, level. When looking for a new bank, let the bank know who and what you are, rather than “sneaking” into a branch office.
- **Liability** – Provide copies of bank statements from previous banks that reflect activity levels, return item volume, account balances, and uncollected levels. Provide policies and procedures on commercial check cashing activity to help alleviate concerns on future claims. You may have to offer a CD as collateral that would survive account closing. Have a strong financial condition.

3. Tips on creating and maintaining banking relationships (and starting over if they disappear anyway)

- **Teach, nurture, support and promote your banker** - Your banker represents you to the bank, so the more he/she knows about you, your business, and your industry, the better able he/she is to respond to questions and concerns from others in the bank. If your banker is knowledgeable and confident, he/she will be more respected within the bank, and better able to serve you. Helping your banker succeed in his/her job helps you. Unfortunately, with turnover, transfers, mergers and acquisitions, etc. being what they are, you need back-up. Make sure that you get to meet and interact with your banker’s superiors, and senior officers of the bank. Clearly, the size of the bank will dictate what level of access you can achieve, but you should always try to be acquainted with officers at levels above your normal contact point. It is perfectly normal for you to request an annual meeting or lunch with your banker and his/her bosses. It gives you an opportunity to pat your own guy on the back, raise issues with senior management that you deem appropriate, get to know who the big shots are and what they consider important, and best of all, gives you a chance to show them what a great guy you are. Meanwhile, if your representative leaves, you still have a relationship with the bank. If you feel that your banker may be somewhat inexperienced, or over his/her head, and not able to properly handle a particularly important issue on your behalf, offer to meet with him/her and his/her bosses so that you can help with the presentation. Yes, you sometimes have to be a

babysitter, and yes, you may have to retrain new bankers over and over, but, unfortunately, such is life. You do it because it is in your own best interests.

- **Be proactive** - Send financial information without being asked. Better yet, send a letter indicating your analysis of those results, good or bad. Tell your banker of your plans and potential future needs ahead of time. If you discover an errant credit to your account, report it as soon as you discover it. The larger the credit, the sooner should be the report; it builds credibility, which can be useful in arguing against occasional errant debits, which are likely to be more common.
- **Be ready to start over** - Yes, doing this is a significant investment in time and energy, but in the long run, it can pay very nice dividends. If that day comes when “Corporate” has decided to kick out all of the FSCs, you may have a chance to be the exception. If not, you will be well-prepared to start over again.

4. Lending criteria

- **Specialized lenders** – Unless you are dealing with a bank that specializes in servicing FSCs, borrowing will likely be limited to loans based on “outside” collateral or financial strength. The criteria below apply to those lenders who understand and service the industry, and lend against the value of the underlying business. These banks are sometimes referred to as cash flow lenders, because they consider the value of an entity is a function of that entity’s ability to generate cash flow to its owner. Such a bank also has to believe that there is a reasonable market for such entities, and that the marketplace has established values for such entities based on prior sales. Finally, such a bank also has to be confident in its ability to find ready buyers for such entities, in the event that it winds up foreclosing on a loan. Clearly, any such bank has to have an intimate knowledge of the industry, its major players, and its risks. Assuming that you are of good character, have a clean personal credit history, and have a solid reputation within the industry and with other banks and creditors, there are three primary factors that determine whether and how much you can borrow: collateral, cash flow and capital.
- **Collateral** – Specialized lenders typically value a business in terms of a multiple of its cash flow or gross revenues. A common valuation is one time gross revenues. They then advance a percentage of that value, often 50%. Thus, if you have a business that grosses \$1,000,000, the lender might assign a collateral value of \$1,000,000 and be willing to provide credit facilities totaling \$500,000.
- **Cash Flow** - The second parameter used by banks is called the “Coverage Ratio.” This is a measurement of how much available cash flow (Earnings Before Interest, Taxes Depreciation and Amortization – EBITDA) there is from the business to pay debt service requirements. A typical Coverage Ratio is 1.25 times. This means that cash flow available for debt service (after reasonable allowance for owners’ draws) must exceed debt service requirements by 1.25 times. If your business is operating at low margins, perhaps due to recent openings of new stores, low volume stores, or any

other reason, it may limit your ability to borrow, even if collateral values would otherwise support higher debt.

- **Capital** - The third underwriting parameter used by banks is called the Debt to Net Worth Ratio, which basically measures how much equity the principals have in the business. The bank does not want this to be too high, because then the bank has too much at stake relative to the principals of the business. In measuring equity, the bank would typically consider loans to the company from the principals as equity, provided that the principals subordinate that debt to the bank, but would subtract from equity any loans to the principals from the company. A Debt to Net Worth Ratio limit of no more than 3.0 times is typical.