



Dealing with Banks in 2010 and Beyond

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Currently Banks are reporting considerable profits. Nevertheless the rules of engagement on settling Bank loans have changed.

A plan should always exist to repay all longer-term debt. Furthermore a loan facility should be used solely for the purposes of cash flow fluctuation or expansion and development. However, this is not an easy result to achieve, particularly during a recession when profits decline and cash flow becomes more difficult to manage. The chances are that a business will find it difficult to sell assets to raise funds in order to repay debt or be able to raise money from shareholders in order to achieve this.

Dealing with a Bank is very different if a loan is in arrears or otherwise default on the conditions of the loan agreement. If a loan has already moved to the loan workout team, then a different strategy is required. Following completion of comprehensive review of current facilities and the points of exposure, a work out a strategy can be determined.

What follows is an overview of dealing with a Bank in 2010 and beyond.

Managing the Bank relationship

A Business Principal may need to be pre-emptive and proactive about a Bank relationship. When the Bank credit assessment team reviews loan portfolios and are reviewing cash flow problems a

different bank relationship approach is needed. In order to achieve this, a Business Principal needs to plan to improve the relationship between a business and the Bank.

As with all relationships, this will take time and effort. The chances are that with the high turnover of staff within Banks, and ever changing customers between relationship managers a business may deal with many relationship Bank managers over the years. The initial person who commenced the relationship, may have moved on and the chances are that the current personnel may not know the Business Principal very well.

In many instances the size of the portfolios business Bankers manage have increased, their work pressure and workload have increased and they simply have had less time to go out to visit clients whose loans are performing satisfactorily. As a first step, a business should invite the relationship manager and his assistant to visit the business at their premises. The event needs to be planned carefully. The Banker needs to meet key personnel in the business and ensure that the business is working.

Banking is (or should be) based on relationships, confidence and trust. If a relationship manager knows the Business Principal personally, is on first-name terms with the Business Principal, is confident in the ability of the Business Principal to run the business, forms the opinion



that the business is a good one and feels that he can trust the Business Principal, the Bank may readily agree to work with a business to overcome short term problems.

If facilities are large or if a Business Principal has concerns about the trading conditions ahead, then the Business Principal needs to go a step further. In such an event the Business Principal needs to find out who the relationship manager reports to and ask for a meeting.

This time, a Business Principal should offer to attend the Bank's premises. The Bank relationship manager will never have the power to make decisions about increasing facilities on his own. No one in the Bank would have that power. All applications 'go up the line in the current climate, the credit risk personnel will definitely be involved in every decision. The more that is understood about credit risk and the personalities of the business, the stronger the position will be to negotiate a workout with the Bank.

Amortisation

Currently despite major profits, Banks have become extremely risk averse. This is more than just a case of shutting the door after the horse has bolted. It also has to do with the fact that Bank analysts, stockbrokers and finance writers unduly focus on bad debt provisions made by Banks and this forces Banks to put undue focus on bad debt provisions themselves.

The process is well underway of Banks going through their portfolios, particularly their business-loan portfolios, and picking out loans where their risk element is highest. Loans which are being amortised, in their view, have a lower risk

rating than loans which are not. It provides great comfort to your Bank if they know that your business has the capacity to not only pay the interest, but to also pay back principal.

Bank thinking is that with each incremental reduction in principal, their risk exposure decreases. This may be correct thinking or it may not be. What is relevant is how a Bank reviews a loan. A Business Principal needs to adapt to how a Bank thinks. If a Business Principal is not on an amortisation program or on a program which provides for minimal principal repayments, a Business Principal needs to be pre-emptive, that is to say a Business Principal does not wait for the phone to ring.

A Business Principal prepared for the fact that the Bank will most likely want this to happen, regardless of whether or not a business can afford to do so. The evidence is certainly emerging that where Banks are concerned about the ability of their customer to repay, they are acting quickly and decisively. At this point, the Banks are not concerned about losing a customer. They actually want to lose a customer who is a bad risk or is perceived to be a bad risk.

The chances are that if a Bank does not want a customer any more, then none of the other Big Four will want the Customer. Therefore a survival plan must provide for the Business Principal to be pre-emptive. There will be many thousands of business that may have quite viable business plans which will end up going into liquidation because their Bank wanted their money back and they were unable to procure alternate finance.

In a previous Strategy Update the issue of the directors allowing their corporate entity to continue trading while the



business technically insolvent was discussed. If the Bank requires repayment of its loan and the directors are unable to come up with alternative finance very quickly, then the only prudent step which can be taken by the directors is to appoint a voluntary administrator. Failure to do so is to expose the directors to insolvent trading claims.

A Business survival plan must incorporate steps to be taken in order to pay down debt.

If the assets could potentially be sold, then Business Principals should seriously consider this and earmark the proceeds toward debt reduction. If it is not possible to raise a lump sum, then Business Principals need to rework the cash-flow projections in order to build in meaningful, regular amortisation payments. When a business has a meeting with the Bank, this time with the more senior people they need to present them with the amortisation proposal and seek their assurance that they are happy with it. If they believe that it is inadequate, then go back and re-work it.

The reality is that unless a Business Principal can develop a workable amortisation plan and stick to it, a business is sitting on a knife edge. A plan should also include a review of all equipment lease commitments. A business should be extremely wary of taking on additional debt, except for the purposes of meeting short terms, cash flow or business opportunities, the same applies to taking on further lease commitments.

Building a Bank Relationship

Business Principals should meet the Bank credit personal with the immediate decision makers of the Bank. Furthermore Business Principals should develop an amortisation plan

and confidently present such a plan.

The credit personnel will stand up for a business unless they have great confidence in the business.

The best way to build confidence levels is to pre-empt what a manager would require in order to have a decent understanding of the business and to provide them with a comprehensive monthly report.

A Business Principal should prepare a simple one-page document outlining the nature of the business, stressing its strengths, its capacity to withstand a downturn, and detailing the lengthy relationship it has had with the Bank.

The monthly report that is provided to the Bank should contain all the key information which will assist. The data will be easily accessible because it will simply be extracted from the reports which are provided by a Bank managing a business carefully.

Apart from a monthly profit and loss statement, the report should contain the following information:

- summary of debtors' based on 30, 60, 90-day and over 90-day categories,
- summary of outstanding creditors, broken down into aged categories,
- Monthly full-time-equivalent staff numbers, on a month-by-month basis,
- Bankers in a workout will be happy if they see reductions in numbers,
- Monthly figure for the total labour costs incorporating total gross wages, payroll tax, superannuation contributions and WorkCover premiums. (They will like to



see this monthly figure reducing rather than increasing),

- confirmation that all statutory obligations have been paid and details of any outstanding statutory obligations,
- comment on forward orders, and
- General comment on achievements made by the business over the last month.

If a loan is performing satisfactorily, the chances are that the Bank personnel will not even read the report noted above.

Credit Accounts

If a Business Principal has any concerns at all about the Business situation, transfer all credit accounts to another Bank. This will preclude a Bank from grabbing the money and help you to build goodwill with another Bank.

Individual guarantors to the Bank facility should also close their accounts with that Bank and open new accounts elsewhere.

Dealing with the Bank Default Team

If a Bank's facility is referred to a Bank default team severe difficulties could occur. Nevertheless, if the underlying business is sound and profitable, all is certainly not lost. By the time a loan facility has been referred to a Bank workout team, the Bank will have already made a provision to cover anticipated losses.

The provisions made will err on the side of caution, which means that the Bank will have provided the maximum amount it expects to lose, then there is definitely a way to possibly circumnavigate the dangerous waters that lie ahead. The task

of the Bank workout team is to clear up the Bank facility as quickly as possible. While it is still on the Bank's books it is an 'impaired asset' so that even the remaining unwritten-down component has a negative impact on the Bank's credit rating score.

The Bank workout team will be looking for a prompt solution to their problems. Taking an aggressive or high-handed attitude with a Bank workout team could simply be disastrous. It will merely antagonise them and harden their attitude against the borrower. In addition the borrower, may send the message that the Bank cannot work constructively with the borrower in order to solve the problem. The borrower needs to be able to convince the Bank that the business can offer a solution to their problems, which will offer a result better than the alternatives. The bottom line alternative is for the Bank to appoint a Receiver pursuant to their debenture or otherwise appoint a liquidator.

Banks are aware that either course of action will result in a serious reduction in the value of the assets held by the business; including its business goodwill and that substantial costs will be incurred.

In order to conduct meaningful and constructive negotiations, a borrower needs to do the following:

- Involve an accountant or solicitor who has acted on behalf of Banks and preferably the particular Bank in question, in doing 'work-out' arrangements. This needs to be someone who the Bank respects and who has proven track record in doing what they say they will do.



- Deal with the decision-makers. It is essential that a Business Principal negotiate at the right level. Reporting lines within the default team are short and they are granted extensive powers by the Bank in order to 'do deals.

To ensure that an agreement can be reached decisively and quickly the Business Principal should make sure the Bank decision makers are present at the meeting in respect to workout arrangements. The only way to ensure that the decision-makers are present is to ask who they are and to ask that they be present at the meeting.

If a plan can be structured which will produce a result for the Bank leading to a return in excess of the amount written down, the chances are that the Bank will accept the proposed workout plan. However, the Bank must have confidence that the borrower can fulfil the proposed arrangements and has the resolve and fortitude to do so. The plan must be workable and the plan must involve an element of pain for the business and, if there are guarantors of the facilities, by those guarantors. The Bank will not want to wear all of the write-off and see the business obtaining a windfall gain.

It is important to understand exactly what the Bank is looking for and its expectations. A Bank in a workout situation does not think like a natural person. If a natural person makes a loan to someone, the person expects to get it all back. In the mind of the Bank, if a provision has been made, then the amount of the provision has already been lost. It has already gone as far as the Bank is concerned. The Bank wants to improve its

bad debt losses in the short term because this a major element on which the Bank will be judged by the stock market. Any recovery exceeding the written-off level represents a bonus to the Bank because it goes straight to the bottom line.

As such any work out plan must show that a Business Principal can provide a return to the Bank, in the short term, significantly greater than would be obtained through receivership or liquidation. This could vary in many situations. Understanding how a Bank works can offer a lifeline to a business when a business most needs it and, ultimately, a longer-term windfall gain. However, timing is critical and the Business' ability to perform is also critical.

The workout proposal will probably need to incorporate plans for the disposal of real estate and perhaps components of the business which have a marketable value and which can be sold off so that they are left with a slimmed-down business that has a much-reduced debt burden. To be successful, the plan will probably involve ultimately terminating the relationship with the Bank and taking the reduced funding requirements and on-going operational Banking needs elsewhere, if the plan is to incorporate the Bank accepting a write-off they will want you off their books when the arrangements are completed.

If a Business Principal is concerned about their level of underlying Bank debt at this stage, even when a business is going well, it is suggested they consult a work-out specialist in order to go through the likely scenario which may need to be enacted in perhaps 12 months time, in any unforeseen circumstance.



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Melinda Wood - ili Enquiries (02) 9251 3611 enquiries@ili.com.au**