



I've been thinking...

Advice from the Financing Coach www.robseverson.com/blog

BANKING 101 Monday, January 22, 2007

Q. If my payments are current, why am in trouble with my bank?

A. This is a very common question. I've been asked it countless times in my consulting business. The answer is simply "Loss Reserves."

Now I'll bet my last dollar that you'd like to know what loss reserves are. Fair enough! Loss reserves are accrued based on internal guidelines or results of regulatory examinations. The amounts are dependent on the severity of the risk, usually: "doubtful," "substandard," or "loss."

Simply put, **if the total of all of the loss reserves is significantly higher than a bank's equity, the bank is in big trouble.** In the worst case, they could sell their bank if they were unable to come up with enough capital to bring the bank back to solvency.

If you have ever experienced losses in your business, you may have gone into a negative net worth position yourself. You can survive if you are capable of keeping lines of credit and other financing in place until you are able to fix your problem. But in your case, no third party is guaranteeing your trade creditors, so you don't have to worry about them as well.

So, if your payments are current with the bank, what is the problem? **This is the part of banking that business owners seem to despise the most.** What "loss reserves" come down to is the bank's analysis of various financial ratios, which may show that your business's ability to pay debt is deteriorating.

In order to make this assessment, lenders take into consideration: profits, liquidity, and amount of debt you carry compared to your net worth. Argue as we might the fairness of this process, **lenders have used these indicators for many years** and the experience of the banking industry is hard to dispute.

To a certain degree, banks can keep some classified loans in their portfolios. To do this, their decision will usually come down to factors like individual circumstances and the total amount of classified loans in the bank.

The goal for your business—for any business—is to stay ahead of the analysts and foresee any problems with lenders before they become a reality.

If you think you might be heading for a collision with your lender, it is best to **turn your steering wheel before there's a crash.** If you don't know if you are on the "lose-lose" side of an analysis, you might want to call me. I may be able to help you sort out any potential problems before they become an issue with your banker!



Rob Severson, Financing Coach

"A good guy to go to when you need financing."

That's what my friends and clients have told people they have referred to me. My problem solving skills come from the years of experience I've gained in many different business disciplines. Best of all, I have built solid relationships with people from everywhere I've been. I have been fortunate to have spent several years in each of the following areas: accounting, auditing, data processing, commercial banking, sales, management, consulting and venture capital. Each of these arenas provided the opportunity for new relationships, for learning how diverse people "think", and to gain an understanding of what each can do for a business.

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