The Successful Lawyer-Banker *Relationship*

A LawBiz® Management Special Report

by **Edward Poll**

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Section 1:

Understanding the Lawyer-Banker Relationship

Introduction: The myths

Lawyers and law firms are generally attractive customers for banks. Banks value lawyers as being good financial prospects, with relatively low risk and good potential for providing new business referrals. Given these facts, lawyers should not be deterred from establishing banking relationships because of stereotypical myths. Let's begin our discussion by dispelling the common myths before embarking on discussing the steps involved in a solid lawyer-banker relationship.

Myth #1: Bankers only want to lend you money when you don't need it. The reality is that you first need to establish an ongoing relationship with a bank so that the bank understands your law firm's business dynamics and is comfortable with your ability to share risk in any loan or other transaction. Once an ongoing business relationship exists, you only have to pick up the phone and ask for a transfer of funds. In this scenario, the banker is pleased to do so because you already convinced him or her that you have a sound knowledge of your business

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and profession. The banker understands that you understand what will be needed and when. Equally important, of course, the banker realizes that you understand when and how the loan or line of credit will be repaid.

Myth #2: Bankers hate surprises and will never honor an emergency need. Bankers are people, they want to help, and they will do so if approached in advance of a problem becoming a crisis. A good approach is to suggest alternative ways in which you might handle the particular challenge and ask for the banker's input and advice. A perfect example is disaster recovery. If you have established a good banking relationship, it's much easier to get an emergency loan to cover funds for rent, payroll, new supplies, new office arrangements, and other recovery needs if you review the situation in detail with your banker.

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The reality: Mutual benefit

Banks and law firms are both professional services businesses and can develop mutually beneficial and effective business relationships if they work at them. The purpose of this special report is to provide any lawyer, but particularly those who have solo practices or small firms, with the framework to understand the following:

- How to choose a bank
- How bankers evaluate law firms as clients
- How to secure a loan
- How to use bank services that enhance law firm operations
- How to improve the banking relationship overall

Building a mutually beneficial and effective relationship with a bank is a critical step in making any law firm a more successful business. This LawBiz® Special Report provides the basics that will help you do just that.

> **"Money is like a sixth sense without which you cannot make a complete use of the other five."**
>
> *–W. Somerset Maugham*

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Section 2:

Considering the Different Types of Banks*

Owing to the complexity of the U.S. banking system, choosing a bank requires some detailed thought. Compared to most other countries, the United States has traditionally had many more smaller and localized banks—reflecting such historical events as Andrew Jackson's disbanding of the Bank of the United States in the 1830s, establishment of the regionalized Federal Reserve System in 1913, and the banking laws passed during the 1930s to curb large bank abuses that supposedly contributed to the stock market crash. Until the 1990s, the only large national banks were investment banks like Goldman Sachs and Lehman Brothers (which underwrite securities offerings) and bank holding companies (shell organizations that raise capital in the financial markets to buy shares in existing banks).

* Information in this section was derived from the Web sites of the Federal Reserve Bank of Minneapolis (www.minneapolisfed.org), the Federal Deposit Insurance Corporation (www.fdic.gov), and the State of Connecticut Department of Banking (www.ct.gov/dob).

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But that changed dramatically with the passage of the Gramm-Leach-Bliley Act in 1999, which greatly eased banking restrictions and allowed dramatic nationwide consolidation in banking. A major result is that the number of local financial institutions available for establishing a financial services relationship has shrunk by more than one-third since the mid-1990s.

Still, despite this ongoing change, the basic landscape of financial institutions available to serve law firms and lawyers continues to encompass the following three broad categories: commercial banks, thrifts, and credit unions. Note that generally, however, your choice should largely depend on convenience and personal relationships rather than institution type.

Commercial banks

These are banks in the most traditional sense. Commercial banks receive deposits and hold them in a variety of different accounts, extend credit through loans and other instruments, and facilitate the movement of funds. While commercial banks mostly specialize in short-term business credit, they also make consumer loans and mortgages and have a broad range of financial powers. Nationally chartered banks and community banks are both types of commercial banks.

- *National banks.* Commercial banks can elect to have a national charter, issued at the federal level, which subjects them to supervision by the Office of the Comptroller of the Currency (a division of the U.S. Treasury Department).

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What Are Federal Reserve Banks?

Federal Reserve banks are the fiscal agents for the U.S. Treasury, which means that they are the federal government's bank. The Reserve banks offer many services to financial institutions, which makes them bankers' banks as well.

Reserve banks

- Hold the cash reserves of depository institutions and make loans to them
- Move currency and coin into and out of circulation, and collect and process millions of checks each day
- Provide checking accounts for the Treasury, issue and redeem government securities, and act in other ways as fiscal agent for the U.S. government
- Participate in the activity that is the primary responsibility of the Federal Reserve System, the setting of monetary policy
- **Supervise and examine commercial banks that are members of the Federal Reserve System for safety and soundness**

Source: Board of Governors of the Federal Reserve System

Or they can choose a state charter, which brings both federal and state supervision and regulation.

- *Community banks.* The community bank is a special category of the nationally chartered bank. They are small local banks that focus on

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small business loans and household deposits and loans. State-chartered banks that elect to join the Federal Reserve System are supervised by the Fed's Board of Governors (a responsibility delegated to the Federal Reserve district banks). The remaining state-chartered banks are supervised by both the state agency and the Federal Deposit Insurance Corporation (FDIC).

From a practical standpoint, most of these regulatory and organizational distinctions should not have any effect on the type of commercial bank you choose. The only exception is that state-chartered banks can choose not to join the Federal Reserve System. If it does choose to become a member of the Federal Reserve System, the state bank must obtain federal deposit insurance, which has for some years remained at $100,000 per depository account. The corollary is that deposits at some state banks may not be covered by FDIC insurance. The FDIC's Web site (www.fdic.gov) has a locator feature that lets you enter a bank's name and confirm whether or not deposits there are insured.

Thrifts

Thrifts, often still known by the term "savings and loan associations," are federally chartered to accept savings and small deposits and make loans primarily for real estate and construction purposes. Most of these institutions are technically owned by the depositors, who receive shares in the association in exchange for their deposits (which are insured by the FDIC in the same manner as deposits at commercial banks). Thrifts and their holding companies are

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http://www2.fdic.gov/idasp/main_bankfind.asp

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Questions, Suggestions & Requests

supervised at the federal level by the Office of Thrift Supervision, a division of the Treasury Department.

Mutual savings banks, a close relative of thrifts, are state-chartered savings institutions that were originally designed to accept deposits from individuals and make residential mortgage loans. Over time, they have broadened the type of services offered and now are considered to be the functional equivalent of a commercial bank. Deposits at mutual savings banks are also insured by the FDIC, which acts as a supervisor along with state banking agencies.

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The number of thrifts declined dramatically in the late 1980s and early 1990s. The savings and loan crisis of the 1980s forced many institutions to close or merge with others, at an extraordinary cost to the federal government. However, there has been a resurgence of interest in thrift ownership, which, thanks to the Gramm-Leach-Bliley Act, can now be an investment strategy for insurance companies and securities firms. To the average law firm, given the broadening of thrift services and the presence of FDIC insurance, the nature of thrift ownership should not be an issue.

Credit unions

Credit unions are not-for-profit financial cooperatives that initially required individuals to share a "common bond" for membership (such as employment at the same firm) in order to receive personal loans and other consumer banking services. Deregulation in the 1970s and 1980s gradually relaxed restrictions on both membership and the types of products and services offered by these financial institutions. Today, credit unions are largely indistinguishable from commercial banks, although they are exempt from federal and state taxes due to their not-for-profit status. Deposits at credit unions are termed "shares" and are insured by the federal government through a fund operated by the National Credit Union Administration, the federal agency also responsible for supervising national credit unions.

Credit unions accept deposits in a variety of accounts. All credit unions offer savings accounts, or time deposits. The larger institutions also offer checking

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and money market accounts. Credit unions' financial powers have expanded to include almost anything a bank or savings association can do, including making home loans, issuing credit cards, and even making some commercial loans. (Many lawyers use credit cards to finance growth. It may be expensive, but sometimes it is the only avenue open for the short term.)

Some commercial banks claim that the tax-exempt status of credit unions gives them a competitive advantage as far as the rates they can afford to pay on deposits and charge for loans. Credit unions are also localized and generally have a reputation of being very service-oriented institutions. However, they typically may not have the sophistication to accommodate such law firm needs as trust accounts and cash collection lockboxes.

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