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Despite the challenges of an economy in transition, recent years have been relatively kind to the bottom-line aspects of community banking. Psychologically, however, they've certainly been a trial.

The industry's status may have hit a new low a few years back when Bill Gates, the aging Wunderkind of the New Economy, gave an often-quoted speech claiming that bankers were dinosaurs: lumbering relics about to be devoured by more nimble competitors.

Since then, of course, the Dotcom meltdown and a few minor complications involving our antitrust laws have presumably left our friend Mr. Gates sadder but wiser -- and perhaps more humble in recognizing his own analytical limitations.

But Gates has hardly been alone in viewing bankers -- especially community bankers -- as vestiges of the old economy whom time is quickly passing by.

Indeed, even some careful longtime observers of the banking scene have issued dire pronouncements about the future for community banks. Their message can be summed up as follows: "adapt -- change -- or die."

And they're not talking about the kind of gradual, incremental change associated with rolling out a new product or service from time to time. No. What the critics want you to do -- what they're insisting you <u>must</u> do -- is to become a miniature version of Citibank or, better still, Merrill Lynch. That is, be everything to everyone. Except on a smaller scale.

For a community banker, that kind of talk can definitely be demoralizing.

Specifically, we hear that community banks are stuck in a downward spiral of miseries -- miseries that include scarce core deposits, shrinking loan margins, and no-such-thing-as customer loyalty. Meanwhile the costs of doing business never stop rising and they seem to fall hardest on those most lacking in the essential economies of scale.

Let me give you just one example -- an example I can speak to with some authority. In terms of your overall budget and expenses, the cost of regulatory compliance ranks pretty far down on the list. At least I hope it does. But it's a conspicuous cost, because it's a cost whose benefits -- to be frank about it -- aren't always obvious.

Year after year our friends in Congress add new mandates for consumer protection, community service, and more, and order your regulators to carry them out. But the costs -- direct or indirect -- all come back to you, in the form of the people you have to pay to do the extra legwork and paperwork the law requires, and in the form of supervisory assessments you have to pay <u>us</u> so that we can pay examiners to check up on you.

Big banks probably don't like this any better than small ones; they just don't seem to feel it as much.

That's true of many trends in the industry. With costs so high and spreads so thin, it takes size and volume to be viable. At least that's what the so-called experts tell us.

I recently heard a community banker say that if he dwelled on all this and believed everything he was hearing from the analyst crowd, he would have traded it all in for a life of golf and pina coladas a long time ago.

I'm reminded of your Minnesota Twins -- a relatively small market team, with one of the lowest payrolls in major league baseball. It's one of two teams slated for what's euphemistically called "contraction." How demoralizing that must be -- to players and fans alike. Yet, last time I looked, the Twins were at or near the top of their division.

They can't compete with the Yankees for the services of the highest-priced free agents, but they can and have competed in the way that matters most -- on the field. What the Twins may lack in resources they make up for with a strong work ethic and a relentless focus on the intangible elements of success: leadership, teamwork, and personal relationships.

The same thing holds true for community bankers competing with larger banks. On paper, the odds don't look so good.

Yet I know of few bankers who are giving up the franchise. Instead, your numbers are holding strong -- stronger than anyone would expect given today's circumstances.

Despite these challenging economic times, there are still a thousand national banks with less than $100 million in assets. Over the past 18 months, we issued 52 charters for de novo national banks, despite the fact that those 18 months were among the most difficult months for our economy in recent memory.

What's going on here? Is this a case of good old-fashioned American optimism? (Blind optimism, some would say.) Or do community bankers know something that the analyst crowd hasn't quite figured out?

As far as I'm concerned, it's no contest. Community bankers simply know their franchise and its value better than your critics do.

Of course, it's a given that community banks provide personal service. That's your reason for being. A community bank that doesn't provide a high level of service is a community bank that probably disappeared a long time ago -- with the dinosaurs, if you will.

The question is whether personal service means very much anymore -- whether it's enough to sustain several thousand banks more or less like yours. These days, I suspect, most analysts would say no. The very idea of delivering financial services one on one, person to person, across a desk seems so . . . well, so Old Economy.

Moreover, there's a consensus in some quarters that, except for a very few high-strung customers who need a high level of hand holding, most bank customers don't care much about service -- or, if they do, they aren't willing to pay much for it. As for the rest -- those who insist on this higher level of personal attention -- they constitute a relatively small niche market that can easily be satisfied with many, many fewer community banks than presently exist.

This is a hard proposition to refute, partly because service is one of those well-known intangible quantities. We certainly do know that bad service can turn customers into ex-customers in a big hurry -- as demonstrated by the string of multibillion-dollar megamergers that produced disappointing results for management and investors because, at least initially, they produced substandard service for customers. When customers had had enough -- and it didn't take more than a couple of botched transactions and PIN numbers that suddenly stopped working -- these customers took their business elsewhere.

It’s certainly true that competition in financial services has made consumers more price conscious. Who will admit to paying more than you have to? For most people who earn their money lawfully, price is never <u>not</u> an object, regardless of how much money you happen to have.

I recently read about a community banker who started offering his customers free checking, only to find the name of one of the bank’s major shareholders on his new account list. That's right: it had taken the lure of free checking to convert a longtime major shareholder -- who I daresay wouldn’t have missed that extra ten or fifteen dollars a month -- into a customer.

But I think that’s an extreme case. I’m reminded of an <u>American Banker</u> headline, talking about the preference for smaller financial providers, that read, “Small Is Better, Say the Very Rich.” I cannot imagine that the merely rich, the near rich, and the hope-one-day-to-become rich wouldn't agree with that assessment.

Coincidentally, I also see a report by an independent financial consultant who argues that banks have the edge over traditional investment advisory firms in competing for the business of high net worth individuals. So if small is better than large, and banks are better than the rest, small banks must enjoy the best of all worlds.

The fact is that personal service is something that people increasingly see as a symbol of their station in life. It used to be that a chrome-wheeled, big-finned Cadillac in the driveway told your neighbors you had arrived. Today the badge of status may be more subtle -- and less garish. Today, status is more likely to be associated with personal services, in the form of a gardener or a masseuse -- or a personal banker.

It’s human nature -- and it’s the nature of our economy. When people can afford a high level of service, it's something they’re almost invariably willing to pay for. And that’s good for you as community bankers.

It’s good for you because the demographics are all on your side. The aging of the baby boom generation is about to produce a bumper crop of affluent retirees who’ll be reaping the harvest of their inheritances, the appreciation in their homes, and the build-up in their retirement savings. These are people who’ll be ready and able to pay for high quality financial services, obtained from people they trust. That’s where you come in.

So it’s clear that, in important respects, small <u>is</u> better. But, as the analysts are quick to point out, it’s hard for a community bank to stay afloat without the aforementioned economies of scale. So how <u>do</u> you compensate for the razor-thin margins, heavy fixed costs, lack of asset diversification, and a narrow transaction base -- all the factors that complicate the life of the community banker?

I have two suggestions.

The first is to aggressively seek out new markets. And you might say, "But Mark, the well is dry. There aren't any new markets out there." But I'm not talking about traditional bank customers. I'm talking about the people we used to call the unbanked -- the millions of Americans who use financial services -- and pay for financial services -- but not generally at a bank.

There are lots of these people out there, and it may be that you've seen them -- lined up on payday at the check-cashing shops, or at the title loan outlets, or at the payday lenders. They're paying for financial services, all right -- and paying and paying. We estimate that the fees they pay to check-cashers and payday lenders alone add up to nearly $4 billion a year. You can make a lot of that business yours -- but only if you spend some time learning about the people who patronize the nonbank providers and start catering to their needs.

Making these folks your customers would also render a great service to your community, because you know that they are often gouged by the nonbank providers and buried under a mountain of high-priced debt whose only out -- a ruinous one -- is often bankruptcy.

Comptroller Hawke has made the point that the key to serving the unbanked is for bankers is to make effective use of technology. You can cut costs -- and offer bank services at prices everyone can easily afford -- by reducing paper transactions and providing electronic access to funds and other bank products.

The key is payroll direct deposit. The United States lags well behind most European countries and Japan in the percentage of private employees who use direct deposit, largely because of the prevalence of small employers here who rarely see direct deposit as worth the trouble.

Here again is where you come in. These small businesspeople are already your customers, and it's your job to convince them that direct deposit <u>is</u> worth the trouble. Some community banks are offering various incentives -- such as free or low-cost payroll processing -- to businesses that are willing to adopt direct deposit for their employees, who in turn sign up for ATM-based accounts. Those are the bankers who are poised to take advantage of expanded customer relationships in the future.

But technology has even wider application for community banks. Now don’t get me wrong; I'm not saying that technology is any banker's panacea. But for many community bankers, technology can be liberating -- and profit producing. Technology is what the military refers to as a “force multiplier” -- something that adds value to your existing assets but may have little value in and of itself.

More and more community bankers have put that value to use. For many, technology has provided a more comfortable margin of success.

Technology is being mobilized in various ways, both routine and strategic. Some institutions have automated the loan application process through technologies such as laptop origination and automated underwriting. More than half of all community banks today use profitability analysis software to aid in their corporate decision making. Others have invested heavily in advanced systems to help manage the paper flood. Document imaging and image check processing are helping community banks get by with fewer people -- without impairing their ability to deliver high quality service.

The Internet is obviously another big part of the industry’s future. But perhaps better than your large-bank brethren, community bankers have recognized an essential truth about technology generally and the Internet particularly: it’s no end in itself.

Many of you were initially skeptical -- and properly so -- about the value that the Internet added to the health and profitability of your institution. The well-publicized troubles of the Internet-only start-up banks illustrate the wisdom of such skepticism.

But after spending a decent interval on the sidelines, more and more community bankers have decided to join the game, having concluded that online delivery is not only compatible with good customer service, but also, increasingly, a vital adjunct to it.

Many of your customers are demanding it -- and the customers who demand it most are the very customers whom community bankers can least afford to lose -- those relatively high net-worth older folks and retirees I was referring to a moment ago: your bread and butter.

These individuals, many of whom migrate with the seasons, place great stock in personal banking relationships. But they cannot be without access to their accounts year-round, even if their bank lacks a brick-and-mortar presence everywhere they nest. These folks -- these prime customers -- are among the most computer-literate segments of the population, and for increasing numbers of them, online account access is a must.

Judging by the rate at which community national banks have embraced the Internet -- with nearly three times as many having web sites today compared to only two years ago -- it's clear that you're giving those customers what they're asking for.

Here in the OCC's Midwestern District, for example, the share of national banks offering transactional Internet banking rose from 29 percent at start of 2001 to 44 percent at the start of this year. Fifty-nine percent of national banks supervised by our Minneapolis field office enable their customers to conduct transactions over the Internet.

So much for Mr. Microsoft's dinosaur characterization!

The Internet can also be a vital tool in helping community banks get -- and stay -- profitable. I'm thinking now of the myriad ways in which doing business online can lower the cost of doing business. When customers fill out an application, check account balances, make fund transfers and loan payments, and do these things electronically, without having to tie up one of your employees, you not only save money; you also free up that employee to do things that add real value to your bottom line. That's a win-win for you <u>and</u> for your customer.

All of this promise and potential, of course, comes with a caveat. Internet banking may not be for everyone. It poses distinct risk management challenges that must be understood and addressed.

Some of these risks, such as those related to web site security, apply to banks of all sizes. But community banks are most apt to rely on third party providers for advanced technology, and so it's particularly important that you establish effective procedures to monitor vendor performance. If you rely on a single vendor for Internet services, the risk management challenges are even greater.

It's crucial that you develop appropriate contingency plans on the off chance that your vendor will become unable to deliver on his or her commitments. For if not appropriately controlled and provided for, such a failure could prove highly damaging to a bank's ability to function -- and to its long-term reputation.

At the OCC, we're working hard to identify and analyze the risks associated with Internet banking, and training our examiners to help you manage these risks. If Internet banking is a delivery method you decide makes strategic sense for your institution, we'll be there to help.

That brings me back to a point I made at the outset, when I cited the burden of regulatory compliance as another area in which community banks may perceive themselves as being disadvantaged as compared to their larger counterparts. Whether this perception is valid or not, I cannot honestly say. But you should know how sensitive we are to the burdens that regulation imposes on all banks, especially during these challenging times. And you should know what we're doing at the OCC to help lighten the load.

In one respect, the disadvantage facing community banks that are also national banks is all too real. Although the OCC assessment schedule is progressive -- that is, large national banks pay more than their pro rata share of the costs of their supervision -- the assessments you pay as national banks are still considerably higher than you'd be paying under a state charter. You know this, and so do we.

This fee disparity is the result of a system under which the Federal Reserve and the FDIC provide the federal supervision of state-chartered banks but don't charge those banks for their services. Indeed, the resources used by the Fed and the FDIC for this purpose are provided in large part by national banks, which means that you are effectively subsidizing the supervision of your competitors.

And because the states themselves actually provide only a small part of the total supervision their banks require, the states can afford to charge less -- much less -- than a comparable national bank pays to the OCC, which provides all of its supervision.

We believe that this arrangement is unfair and harmful to you and to the dual banking system, and Comptroller Hawke has taken the lead in urging Congress to address this issue in the context of deposit insurance reform. Everyone agrees that banks should contribute to the insurance funds based on the risks they present, and that healthy banks should not be required to bear the costs and risks of providing deposit insurance to poorly managed institutions. We strongly believe that the same principle of equity should apply to supervisory assessments as well, and that the fee disparity between national and state banks should be eliminated.

In the meantime, we are doing everything possible to control our costs so as to minimize the burden of supervision on you. And, like you, we too have embraced technology as a part of the answer.

National banks caught a glimpse of the future in this regard when we introduced National BankNet a year and a half ago. Since then, we have added a variety of enhancements to this extranet service, to which almost 1500 national banks have already subscribed. If you haven't, I would urge you to do so. It's one of the many benefits of being a national bank.

But the best is still to come. The day is not far off when most supervisory communications will be taking place through BankNet. You'll be able to comment on proposed regulations, pay your assessment bill, and file corporate applications, all online. And we're working to further automate the examination process itself. We call that "Supervision of the Future" -- and it looks to the day when examiners will be able to perform even more of their routine supervision remotely.

That will mean fewer burdens on you -- less staff time preparing for exams, less time producing paperwork, and a less intrusive examiner presence. But let me assure you that your examiner will be there when you need her. The time spent at your institution will be quality time, more productive time, and time that produces greater value to you. We're working very closely with the industry to ensure that our supervision is responsive to your needs.

So let me leave you with these thoughts. Continue to base your franchise on the delivery of high quality personal service to your customers. Make prudent use of the advantages of technology. Seek out new markets -- especially among underserved elements of your service population. And hang in there -- because your hard work, perseverance, and creativity will pay off. Keep it up for the sake of your communities -- and for dinosaurs everywhere. Thank you.