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Remarks by

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I'm honored to be here tonight to participate in your association's annual scholarship awards banquet. And I congratulate the young men and women who have earned these scholarships and wish all of you good luck in your studies. By its very nature, banking is a business that focuses on the future, and these awards tonight are one more example of how banks in Los Angeles -- and in fact, all across the country -- are finding new ways to invest in that future.

That's what I want to talk about tonight -- the future -- and more specifically, the future of banking. Los Angeles is an especially appropriate place to talk about the future, because California is so often in the vanguard of what happens in the rest of the country. I'll try to keep my comments brief to allow time for any questions you may have.

Many of us came of age in a world where virtually all banking transactions were conducted face-to-face. In California, which led the nation in establishing branch banking, it was a world where banks of all sizes flourished, and big banks prided themselves on the number of branches they had throughout the state.

No more. As all of us in banking know only too well, we are witnessing great change in the banking industry. New technology is altering the fundamental economics of banking and changing the delivery and nature of banking services. In response to increased competition, many banks have expanded beyond their local markets and beyond their traditional products and service offerings.

Moreover, all across the country, market forces and the elimination of legal barriers to interstate banking are producing a slow but steady consolidation within the banking industry. The number of banks is declining while the size of individual institutions is steadily climbing. In Los Angeles County, for example, the number of commercial banks has fallen by 18 percent since 1990, while total assets per bank has risen by nearly 38 percent.

Technological change and industry consolidation are facts of life for all of us. And they have serious implications for the way banks do business and for the customers served by banks -- as well as for those of us involved in bank supervision. The challenge of how to manage these changes is particularly great for urban bankers because of your special commitment to our cities. For all us, the keys to the future are strategy, innovation and adaptability.

Let me take a few moments to focus on some of the factors that are changing the shape of banking today and into the future.

Globalization

The first of these is globalization. Over the last several decades America has seen its markets for goods and services and its capital markets become increasingly international. These trends are especially pronounced here in Southern California, which is home to the two busiest ports in the nation. The global economy is a reality here, from increased trade flows brought on by NAFTA and proximity to the Pacific Rim, to the successful export of southern California products such as aircraft, satellites and movies.

Banks have had to develop an expanding array of products and services to meet the needs of customers in the global marketplace, and bank funding has become much more international. Financial markets are increasingly integrated, with large volumes and ranges of financial instruments being traded across borders. But along with the potential for increased profits, this internationalization of banking carries with it exposure to changes in the currency markets and foreign debt and equity markets, along with foreign credit risks.

Financial product innovation

Just as banks have had to change to meet the needs of a global marketplace, they have also had to develop new financial products to meet the needs of a changing economy and their own operational requirements. There are a dizzying array of financial products out there -- for example, securitization to increase bank liquidity, financial derivatives to hedge against risk, home loans designed to help first time buyers. Banks have adopted better risk analysis techniques and are pursuing new product delivery methods. These innovations have meant lower costs, greater flexibility for users, increased liquidity and better risk allocation. They have also meant greater complexity in managing bank operations.

Technology

To a large extent, globalization and financial product innovation have been driven by perhaps the most significant force of all: technology. As Alvin Toffler called it, "that great growling engine of change" is altering the face of banking and financial services and changing the way consumers purchase goods and services of all types.

Technology has connected global markets, driven down the cost of back room operations and brought us ATMs. And it is helping to fuel consolidation by creating economies of scale. Competition and technological improvements are sparking the discovery of new, more efficient ways to fulfill basic functions such as pooling funds and managing risks. Totally electronic trading, e-money, a paperless payments system, vastly more sophisticated risk pricing and risk control models -- all are either reality or within sight. As with the Internet, we're only just beginning to imagine the possibilities of technology in banking.

A Future for Banks?

But technology also raises serious questions about the future of banking and its role in the economy. For example:

How valuable is a physical bank branch -- in which a bank may have invested millions of dollars -- when customers can do their banking business at a point of sale terminal, or a telephone, or on a computer screen? In a world where each teller transaction costs a bank $4.00, but the same transaction over a telephone or computer line costs a dime, how many banks will choose to maintain large branch networks?

How do we ensure that everyone has fair and equal access to financial services if banks come to rely more and more on technology to deliver financial services?

How do banks build customer relationships when it's possible to surf the Internet to determine the best price on a home mortgage loan, or the best rate for a CD?

What will it take to reap the benefits of what Bill Gates calls "friction-free capitalism," where even the most humble of businesses have the opportunity to reach worldwide markets through electronic commerce?

What does it mean for banking if information and communication technology improve to the point that investors, borrowers and other participants in the financial markets can link up directly with one another much more readily than in the past? What role will banks play in this market?

These are not easy questions to answer, but neither do I think they are insurmountable. I have great confidence in the resilience of banks -- and particularly the adaptability and creativity of community banks. As Bill Randle, Director of Marketing for Huntington Bancshares put it, "Strategy is everything. Technology is nothing more than an enabler." I firmly believe that smaller banks can continue to have an important role in the financial marketplace -- if they can develop an effective strategy to use technology, to carve out a niche, and to serve their customers.

Let me also emphasize that small banks should not consider themselves excluded from the benefits of technological innovation. While it does create challenges, technology also presents opportunities.

A recent article in the Harvard Business Review discussed the transformation of banking and made this observation: "The winners of the future will be those who best... meet customers' needs, not those who cling to old institutional arrangements." Companies may choose to continue purchasing financial products and services from banks because the quality is high or the costs are low, not because the provider is a bank.

In addition, banks may find new roles to fill. For example, if the volume of small business loan securitization increases, banks could play an important risk management role in evaluating and monitoring locally-based credits.

As for branches, I believe that they will play a role in the delivery of financial products for some time to come. However, we are likely to redefine the concept of a branch. The full service branch is already giving way to the supermarket kiosk. But there is also the potential for in-store Internet terminals or teleconferencing technology to link customers with centralized service agents.

And there is still room for current or new financial institutions to create new products by packaging traditional functions in new ways. For example, banks can target baby boomers who are approaching retirement age with a full-service package of retirement products, including asset management and insurance.

Any discussion of the future of banking would be incomplete without spending a moment to talk about the impact of all this change on one particular group -- bank customers -- and in particular, bank customers in low- and moderate-income areas who may have been underserved by banks in the past.

Community efforts

We at the OCC recognize the challenges for low-to-moderate income communities in the changing banking landscape. Increasing consolidation in the banking industry, greater reliance on technology to deliver banking services -- both have the potential to create further barriers to financial services for some segments of our society. But, perhaps perversely, advances in technology also bring with them the potential to bring more people into the financial system. All of us -- bankers, regulators and community groups -- must strive to make sure that technology acts as an enabler and not a stumbling block in our efforts to ensure fair and equal access to banking services for all Americans.

With that goal in mind, efforts are under way to draw on the resources and ingenuity of low-to-moderate income areas, community groups and banks. In June, the OCC will host a pilot day-long program, in Oakland, that will bring together banks and community groups to discuss electronic banking. The purpose is to create a greater understanding among the parties involved -- to get to a mutual understanding of the impact of technology on banking and how the banking needs of low- and moderate-income communities can best be met.

Making sure that low-to-moderate income consumers can use technology to access bank services will require innovative and creative public-private partnerships and industry-consumer cooperation. For example, libraries across the country have become resource centers that provide access to computer equipment and the technical assistance to use it. Banks have partnered in such projects by providing necessary financial and technical support. Citibank, for example, is a supporter of the Mar Vista Library project in Los Angeles. This busy branch, serving predominantly low- and moderate-income neighborhoods, has become the first virtual electronic library in the Los Angeles Public Library System.

Helping low-income communities gain access to financial services in the age of technology will also require partnerships that span industries. In Compton, a unique project is coming together that capitalizes on the fiber optic path built as part of the "Blue Line" light rail transit system. The Blue Line TeleVillage, scheduled to open in mid-May, will provide the community with low-cost access to the Internet, video conference facilities for distance classes and computer classes on banking and ATM access. Many corporations and government agencies are involved in this effort. For example, Wells Fargo Bank will provide workshops on money management skills at the center and will install an ATM on the site. The TeleVillage serves as a model for the kind of public-private partnerships that will build access to the future.

The past few years have shown a noticeable shift in bank support of economic development -- as a necessary complement to affordable housing efforts and an important component of truly sustainable community development. These new economic development efforts include micro-finance and other small business lending, business training and technical assistance, job training, and business incubators.

Last year alone, national banks made more than $400 million in CDC investments, which will leverage over $1 billion in additional resources.

Clearly banks have made a commitment to economic development and the revitalization of our communities. I'm proud of the banking system for living up to this commitment and working to establish efforts such as the California Economic Development Lending Initiative (CEDLI).

The OCC has a role to play in this process by helping to create community development partnerships that build on the bedrock of safety and soundness. To accomplish this, the OCC has hired community development specialists in all of our districts. We have begun a best practices program to identify common characteristics of quality community development lending and share these insight with the banks we supervise.

The Regulator's Role

Before I conclude my remarks, let me say a few words about how the OCC views its role in this changing banking landscape. It is a role that is made all the more difficult because we must operate within a framework of laws that has not changed substantially in the last 50 years.

The OCC is committed to adhering to free market principles in helping create the kind of financial services industry the country and the economy needs in the next century. The changes we've seen to date -- and the innovations I am certain we will see in the future -- hold enormous potential for consumers and the economy. Our goal is to work with market forces, not against them, so that consumers as well as the banking industry will see lower prices and enjoy a greater array of financial services to help them in their professional and personal lives.

At the same time, we must also recognize that, in fact, government regulation plays a critical and necessary role in helping the market work efficiently. At the OCC, we have set ourselves four primary goals: ensuring the safety and soundness of the national banking system, including limiting systemic risk; enhancing banks' ability to compete in the financial services marketplace; increasing the efficiency of our own operations in carrying out our mission; and ensuring fair and equal access to financial services for all Americans, including providing appropriate consumer protections. In other words, we must let the market evolve but in a way that meets these goals.

Banking today faces more and different changes than at any time in recent memory -- globalization of markets, increased competition, pressure for consolidation, and technological advances. But I believe banks are up to the challenge. I believe that the successful banks of the future will be an integral part of an innovative financial services industry, capable of fostering growth and opportunity for businesses, individuals and communities. And I believe that smaller, community banks will be among those successful banks.

I appreciate the opportunity to talk with you, and I will be happy to answer any questions.

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