



Taking It To The Bank

Technology Challenges, Online Prospects

Sizes and locations may differ, but the issues and opportunities for most Indiana banks heading into 2004 are quite similar. The key topics include:

- Keeping up with rapid changes in technology
- Taking advantage of growing online possibilities
- Coping with regulatory concerns
- Expanding services and helping hometown communities grow and prosper

By Tom Schuman

Tackling technology

Jim Cousins, president and CEO of the Indiana Bankers Association (IBA), confirms that considerable time and energy is devoted to technology issues during organization meetings or any gathering of bankers.

"It's a challenge for any size bank. For the big ones, it's integrating the technology into their system. For the smaller banks, it's getting technology they can afford," Cousins explains. "Technology is the tail, not the dog. Customer service is the dog. The challenge is not to let the tail wag the dog."

Mike Cox is president and CEO of First Merchants Corporation in Muncie, a multi-bank financial holding corporation. First Merchants operates 10 banks (in 18 Indiana counties as well as Ohio), two insurance subsidiaries and a trust company. Bank assets total \$3.1 billion with another \$1.4 billion in the trust company.

A week prior to talking to *BizVoice*, he notes that one of the leading questions at a FED meeting in Chicago was, "How do we stay on top of this technology? It's a big challenge for banks like ours, dealing with the information technology side of the business."

It's the same story for Ron Seals, president and CEO of Springs Valley Bank & Trust in Jasper. More than half of the company's \$240 million in assets are in Jasper, with the remainder at the French Lick location.

"With over \$200 million in assets, we can afford all the expense in information technology and electronic information," he asserts. "If you get much smaller than that, it's hard to keep up."

Technology impacts the bottom line in other ways. Fraud concerns, privacy issues and disaster plans all take on heightened awareness in this age of rapidly expanding computer capabilities.

At the same FED meeting, Cox heard an unprecedented statistic as some banks were experiencing higher levels of check fraud losses than bad loan losses. The ability of people to replicate and duplicate checks has never been greater.

Cousins was happy to see Congress make permanent the Fair Credit Reporting Act, which was set to expire on December 31. The legislation contains provisions that assist in combating identify theft.

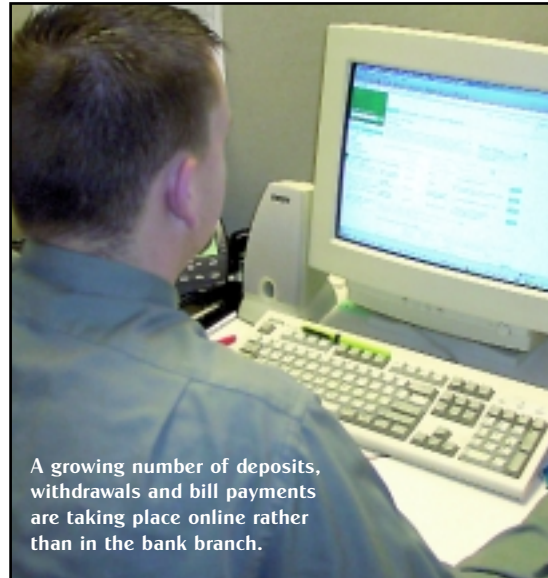
Action online

Do you stand in line at your local bank branch, "waiting here for the next available teller" as instructed? You're still in the majority, but an ever-shrinking one.

"Online banking, online bill pay, that's the future," states Seals, adding that one should expect no different given the levels of computer instruction in schools. "It's going to grow, no question about that."

Springs Valley has had an Internet banking program for a little more than a year. More than 1,200 people, out of a total of 7,000 checking accounts, are enrolled.

Cox says First Merchants was one of the early adopters of a full-service online product. Their banks did not stand alone for long.



A growing number of deposits, withdrawals and bill payments are taking place online rather than in the bank branch.

Customer service remains a critical component for any successful banking operation.

“It’s amazing how quickly it spread throughout the banking industry,” he recalls. “Online started out as a product offering, but quickly evolved to a delivery channel. We have a good system. It makes a lot of sense for our customers.”

It’s not just individuals paying their bills or transferring money between accounts. First Merchants has also seen strong growth in business online banking, with advanced products tailored to business customers.

Cousins says there is no doubt that “online banking services are here to stay. I don’t see it completely substituting (for traditional banks). There are some success stories of online-only banks, but I see it as a supplemental service.

“It’s a work in progress, an evolution not a revolution.” Comparing online growth to the emergence of automatic teller machines, he adds, “It’s going to happen gradually over time. These things don’t change overnight.” One change being implemented today is a result of Check



FDIC-Insured Banking Institutions

	Commercial Banks		Savings Institutions		Total
	National Charter	State Charter	Federal Charter	State Charter	
Indiana institutions	30	121	48	12	211
Indiana branches	934	874	187	38	2,033
*U.S. institutions	2,078	5,792	846	620	9,336
U.S. branches	33,723	31,861	7,764	4,524	77,872

*50 states and the District of Columbia

Source: Federal Deposit Insurance Corporation, as of December 31, 2002

21 federal legislation that has been signed into law. Cousins explains that people won’t necessarily be writing fewer checks, but that those physical documents will not go through the entire routing process. Instead, they will be replaced by truncated, electronic images.

“The federal government,” Seals believes, “is trying to get to a checkless society.”

Regulatory pressures

The aforementioned Fair Credit Reporting Act contributes to a healthy credit environment, according to Cousins, a Washington lobbyist and congressional staff member for 22 years before coming to Indiana in 1993. A key component for the entire lending industry is continuation of a national credit reporting and evaluation standard.

Seals, who is also chairman of the IBA this year, doesn’t dispute the benefits of the fair credit legislation or other regulations that aid in privacy protections or shelter against money laundering. Add in the Sarbanes-Oxley corporate governance provisions enacted in 2002, though, and the price tag adds up.

“Sarbanes-Oxley is very expensive. It puts a lot of pressure on every institution, particularly smaller ones,” Seals contends. “Some of the rules that come out of these laws need to be tweaked periodically to be less burdensome.”

Cox would like to see increased consistency

among regulators. Policies or procedures that work in one instance may be found to be lacking the next time around.

“Interpretations differ from one regulator to another. It’s very much a moving target,” Cox states. “What internal controls are working or are likely to work are open to that interpretation.”

Serving the community

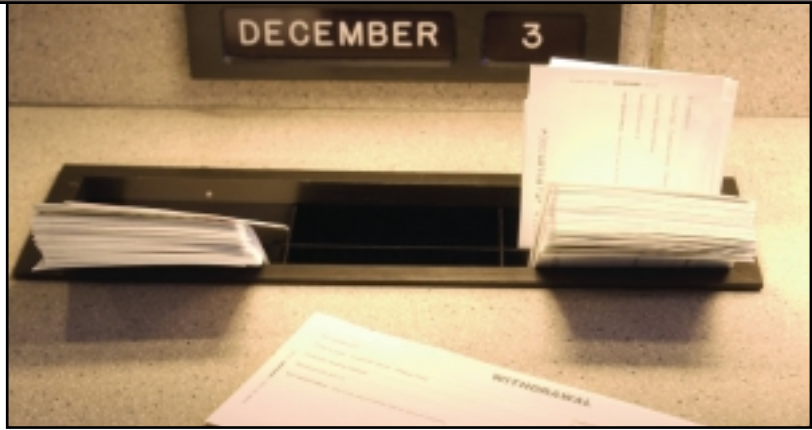
The Graham-Leach-Bliley Act passed by Congress in 1999 opened the doors for banks to expand their service offerings. Many, like First Merchants and Springs Valley, are involved in some aspect of the insurance business. The battle continues in Congress between larger banks seeking real estate brokerage powers, with strong opposition from the real estate industry.

The changes, though, were not as dramatic in Indiana, Cousins points out, as state law allowed banking/insurance combinations prior to the federal legislation. He says there has been little movement in the state or nationally for banks and insurance companies to be co-owned.

Insurance, investment and brokerage businesses are ancillary to banks’ primary mission – one that no doubt has been impacted by the economic slowdown of the last few years.

“Lending to local businesses is the bread and butter of the bank,” Cousins extols. “In the last two or three years, the thing that has provided a good alternative has been mortgage refinancing. It appears loan demand, though, is starting to pick up.”

Despite some struggles for the wood products and furniture industries, Seals says the economic problems have not been as severe in Jasper as many other places. The second Springs Valley location (French Lick), however, operates in a lower spot on the economic scale.



Some banking forms will never disappear.

INFORMATION LINK

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Mortgage lending has been a strong suit. Springs Valley sold \$35 million in business to the Federal Home Loan Bank of Indianapolis in 2002. The bank competes against three other primary entities in Jasper. Each has developed its own customer base, with the available options keeping prices in line for consumers.

Although not the outlet for venture capital or higher-risk financing, banks play a critical role in economic development.

“Looking at helping a good business or industry establish itself in the community” is how Seals, a veteran of 47 years in the banking business, describes the mission. “Banking is a risky business. How you control that risk determines whether you are successful.”

As an association leader, Cousins says he welcomes the addition of “de novo” or community banks to the industry. Competition is an asset when considering the big picture, but certainly a concern for the banker looking out for his company and its shareholders.

“What we focus on is not the amount of competition but the kind of competition, making sure there is a level playing field. The two or three (community banks) started a year means that overall Indiana is viewed as a positive area for business investment,” he reports. “Where we get concerned is when people provide the same services without the same tax and regulatory burdens (referring to credit unions).”

Cox says First Merchants banks are typically the largest locally headquartered operation in the markets it serves. Those markets – including Muncie, Lafayette, Anderson and Hamilton County – have strong university and/or health care presences that have “cushioned the economic sluggishness” of the manufacturing sector in the early 2000s.

Banks do deal primarily with companies that have a demonstrated track record. As leaders in the community, however, there is a larger economic development role.

“We give strong local support to the initiatives that are under way in business incubation, angel investing,” Cox details. “We’re supporters, can help with the organizational structure, introduce investors into the network and be in an advisory role.”