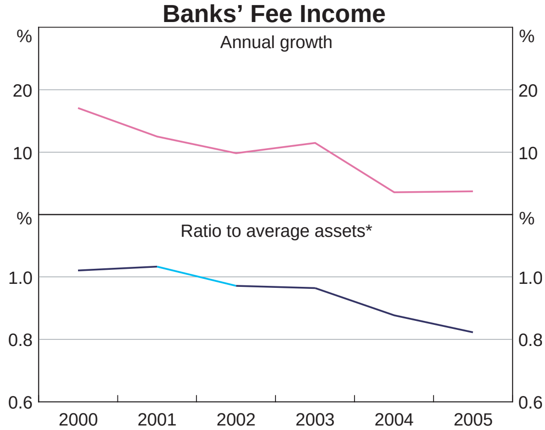
BANKING FEES IN AUSTRALIA

This article summarises the results of the Reserve Bank's annual survey of the fee income commercial banks earn from their domestic banking operations.[1] The latest survey, relating to banks' 2005 financial year, covered 19 banks accounting for more than 90 per cent of the total assets of the banking sector in Australia.

Graph 1

Banks' Fee Income



* Series break in 2002 due to change in banks' reporting of total assets
Sources: APRA; RBA

Fees from Banking Activities

Total domestic fee income of participant banks grew by 4 per cent in 2005, to $9.2 billion (Graph 1 and Table 1). The rate of increase was similar to that in the previous year and well below the longer-run average growth rate. The growth in fee income was also less than the growth in banks' balance-sheet assets by a significant margin, with the result that the ratio of fee income to average assets fell further, to around 0.8 per cent.

Table 1: Banks' Fee Income

	Businesses			Households			Total	
	$ million	Annual change Per cent	Share of total Per cent	$ million	Annual change Per cent	Share of total Per cent	$ million	Annual change Per cent
2000	4 164	15	67	2 083	22	33	6 247	17
2001	4 797	15	68	2 233	7	32	7 029	13
2002	5 099	6	66	2 620	17	34	7 720	10
2003	5 558	9	65	3 049	16	35	8 607	11
2004	5 496	–1	62	3 419	12	38	8 916	4
2005	5 587	2	60	3 660	7	40	9 247	4

Source: RBA

1 *The focus of the survey is fee income earned by banks in the process of taking deposits, making loans and providing payment services. Other forms of non-interest income such as from funds management and insurance operations, are excluded from the survey. The survey relates to fee income earned by each participant bank over the course of their respective financial years. The data from the survey are published in the RBA* Bulletin *Table F.6.*

As in the previous year, banks' merchant service fee income fell due to the effects of payments system reforms introduced in late 2003. Even excluding merchant service fees, however, banks' fee income grew by only 5 per cent in 2005. This growth appears to have been mostly due to increases in the volume of banking services rather than increases in unit fees.

Businesses

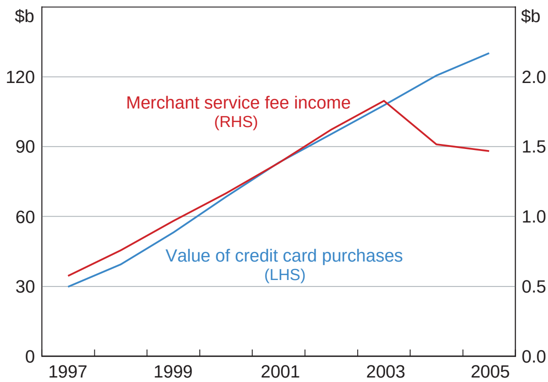
Banks earned $5.6 billion in fees from businesses in 2005, much the same as two years earlier (Table 2). The steady level of overall business fee income reflects mainly a rise in loan fees offset by a fall in merchant service fees. Notwithstanding an 8 per cent rise in the value of credit card purchases made in 2005, merchant service fee income fell by 3 per cent in 2005, after falling by 17 per cent in the previous year. As noted above, this is due to the effect of the credit card reforms introduced in October 2003 (Graph 2).[2]

Even excluding merchant service fees, growth in banks' business fee income was relatively low in 2005, at 3 per cent. All of the components showed below-average growth in the year.

The fastest growing component, and the biggest contributor to overall growth, was income from business loan fees, which rose by 5 per cent. Even here, growth was well below average, despite growth in business credit in the year being at its highest for nearly a decade. This suggests that competition between lenders, particularly from regional and foreign-

Graph 2

Merchant Service Fee Income and the Value of Credit Card Purchases



Source: RBA

Table 2: Banks' Fee Income from Businesses
$ million

	2002	2003	2004	2005	Growth 2005 Per cent	Average growth 1999–2004 Per cent
Deposit accounts	681	710	737	754	2	9
Loans	1 197	1 351	1 485	1 563	5	9
Merchant service fees	1 622	1 826	1 516	1 468	–3	9
Bills	1 074	1 077	1 120	1 151	3	5
Other fees	525	594	639	651	2	16
Total	**5 099**	**5 558**	**5 496**	**5 587**	**2**	**9**

Source: RBA

2 *One of the outcomes of these reforms was a reduction in the interchange fee that a merchant's bank pays to a cardholder's bank whenever a credit card purchase is made. Competition between banks has since seen this reduction in interchange fees flow through to a reduction in the merchant service fees that banks charge merchants for providing credit card facilities.*

owned banks wanting to expand their market share, has contained growth in business lending fees. This is consistent with surveys conducted by JPMorgan and East & Partners in 2005, which found that the number of businesses experiencing reductions in their loan fees exceeded the number reporting increases.

Fee income from business deposit accounts increased by 2 per cent in 2005, also low by historical standards. As with loan fees, the growth in deposit fee income appears to have been mainly due to growth in the number of accounts and transactions as, for small businesses at least, the unit costs of operating transaction accounts were generally steady in 2005.

Households

Banks' fee income from households was $3.7 billion in 2005, an increase of 7 per cent in the year, compared with average annual growth of 15 per cent in the preceding five years (Table 3). With growth in household fee income having exceeded growth in business fee income for most of the survey's nine-year history, the share of banks' total fee income attributable to households has increased from around 30 per cent to 40 per cent since the survey's inception.

Table 3: Banks' Fee Income from Households
$ million

	2002	2003	2004	2005	Growth 2005 Per cent	Average growth 1999–2004 Per cent
Loans:						
– Housing	625	723	785	772	–2	14
– Personal	366	357	393	425	8	22
Credit cards	425	589	761	899	18	29
Deposit accounts	1 115	1 309	1 413	1 483	5	13
Other fees	90	71	68	81	19	–17
Total	**2 620**	**3 049**	**3 419**	**3 660**	**7**	**15**

Source: RBA

Total fees paid by households on credit cards rose by 18 per cent in 2005, to just under $900 million. Though still strong, this represents a significant moderation in growth from earlier years when there were widespread increases in unit fees on credit cards, including annual membership fees and charges for cash advances, overdrawn accounts and late payments (Table 4). Though there were fewer instances of unit fees being increased in 2005, some earlier increases contributed to the growth in credit card fee income in the year because they were in effect for only part of the previous year.[3] Increases in the number and usage of credit cards and, perhaps, the incurrence of penalty fees also supported growth in credit card fee income in 2005. The relatively slow growth in 2005 may also reflect the increase in the market share of 'no-

3 *There was a notable increase in the average fee banks charge for foreign currency conversions in 2005 associated with a change in the way in which they pass on the fees they are charged by the credit card schemes for processing these transactions. In the past, these fees were embedded in the exchange rate at which the currency conversion took place but they are now mostly included within the separate foreign currency conversion fee charged by the card issuer.*

Table 4: Fees on Credit Cards[(a)]

	2000	2001	2002	2003	2004	2005
Annual fees ($)[(b)]						
– No-frills cards	..	..	..	..	..	38
– Standard cards	23	23	25	27	28	28
– Standard rewards-based cards	38	48	61	76	85	85
– Gold rewards-based cards	84	87	98	128	128	134
Cash advance fees[(c)]						
Own bank's ATM ($)	0.4	0.6	1.0	1.4	1.4	1.4
– Per cent of value	..	0.4	0.8	0.8	1.1	1.1
Other bank's ATM ($)	1.3	1.3	1.6	1.6	1.6	1.6
– Per cent of value	..	0.4	0.8	1.1	1.4	1.4
Overseas ATM ($)	2.9	3.9	3.9	3.6	3.6	3.6
– Per cent of value	..	0.4	0.8	1.1	1.4	1.4
Foreign currency conversion fee (per cent of value)	0.8	1.0	1.0	1.3	1.5	2.4
Late payment fee ($)	20	20	21	23	29	29
Over-limit fee ($)	0	6	13	25	28	29

(a) Average fees for credit cards with interest-free periods issued by major banks, other than the annual fee on no-frills cards, which is based on a wider sample of lenders. As at end June each year. RBA calculations based on Cannex data.
(b) Includes fees for membership in reward program where separately charged.
(c) For credit card cash advances, banks tend to charge the higher of either a flat dollar fee or a percentage of the advance.
Sources: Cannex; RBA

frills' credit cards, which have lower annual fees (and interest rates) than traditional rewards-based cards.

After growing at an average annual rate of 17 per cent over the previous three years, banks' housing loan fee income fell by 2 per cent in 2005. Part of this decline is attributable to a fall in the demand for housing loans, with the total number of housing loan approvals estimated to have declined in 2005. Banks have also been competing more aggressively for new lending by discounting or waiving loan establishment fees.

In contrast to housing loans, growth in fee income from personal loans was relatively strong in 2005, at 8 per cent, though this contributed little to overall growth in banks' fee income from households given its relatively small share. The stronger growth in this segment is consistent with the higher rate of growth of personal credit in the year.

The largest component of banks' fee income from households is fees on deposit accounts, which account for 40 per cent of the total. This segment grew by 5 per cent in 2005, again lower than the average for recent years. The slower growth may partly be due to the trend towards banks offering all-in-one transaction accounts, which charge a flat monthly account-servicing fee in return for unlimited free electronic transactions.[4] The increasing popularity of low or nil-fee online savings accounts is another factor that has contributed to the slower growth in banks' deposit account fee income in recent years.

4 *Some types of transactions, such as over-the-counter withdrawals, cheques and use of ATMs not belonging to the customer's bank, can still incur charges for each transaction.*

Conclusion

The rate of growth in banks' domestic fee income in 2005 was around its lowest level in the survey's nine-year history. Part of this outcome reflected the full-year effect of the decline in merchant service fee income following the reforms to credit card interchange fees that took effect in October 2003. Mostly, however, it reflected increased competition between banks limiting the fees they charge. The growth in fee income that has occurred appears to have been due more to increases in the use of banking services than increased charges.