BANKING FEES IN AUSTRALIA

Since 1997 the Reserve Bank has undertaken an annual survey of the fees that commercial banks earn from their Australian banking operations.[1] This article summarises the results of the latest survey, relating to banks' 2004 financial year. The survey covered 19 institutions that account for over 90 per cent of the total assets of the Australian banking sector.

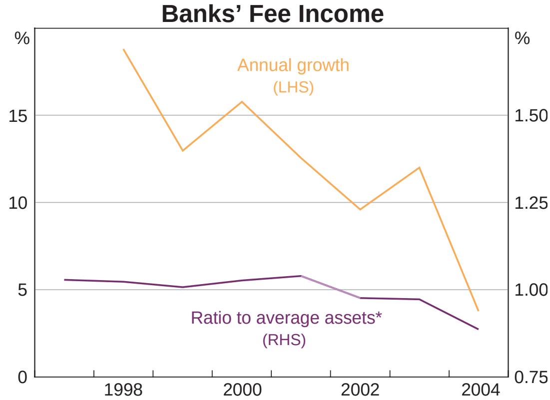
Fees from Banking Activities

Total domestic fee income of participant banks grew by 4 per cent in 2004, one-third the rate of increase in the previous year and the lowest in the survey's history (Graph 1 and Table 1). Growth in fee income was significantly slower than that in banks' balance sheet assets, with the result that the ratio of fee income to average assets fell to 0.9 per cent, well below the level of recent years.

The slower growth in fee income in 2004 was primarily due to a sharp fall in banks' merchant service fee income due to the credit card reforms introduced by the Reserve Bank in late 2003. Excluding merchant service fees, banks' fee income grew by around 9 per cent, closer to the average rate of growth seen in recent years but still below growth in assets.

Graph 1

Banks' Fee Income



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

Businesses

The decline in merchant service fees was reflected in total fee income from businesses, which fell by 1 per cent in 2004, despite growth in fee income from business loan and deposit facilities (Table 2).

Merchant service fees are the fees that banks charge merchants for providing credit and debit card facilities. In the case of credit cards, banks charge these fees partly to cover the 'interchange' fee that they pay to a cardholder's bank whenever a credit card purchase is made. On 31 October 2003, the Reserve Bank introduced reforms to credit card interchange fees, with

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 income from funds management and insurance operations, are excluded from the survey. The survey relates to fees 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.*

Table 1: Banks' Fee Income

	Households			Businesses			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
1997	1 162	na	29	2 880	na	71	4 042	na
1998	1 524	31	32	3 277	14	68	4 802	19
1999	1 724	13	32	3 701	13	68	5 425	13
2000	2 095	22	33	4 186	13	67	6 281	16
2001	2 240	7	32	4 829	15	68	7 070	13
2002	2 638	18	34	5 110	6	66	7 748	10
2003	3 066	16	35	5 612	10	65	8 678	12
2004	3 443	12	38	5 562	–1	62	9 005	4

Source: RBA

the effect that they were substantially reduced. Competition between banks has since seen this reduction in interchange fees flow through fairly quickly to a fall in credit card merchant service fees, resulting in a reduction in the average merchant service fee of around 25 per cent.[2]

Reflecting this, the total merchant service fee income earned by banks last financial year declined sharply. Even after allowing for the increase in the value of credit card purchases (Graph 2), and the fact that this year's fee survey does not yet reflect a full-year effect of the reforms, banks' total merchant service fee income fell by 17 per cent in the 2004 financial year. Two-thirds of the total decline in merchant service fee income in 2004 was from small businesses.[3]

Excluding merchant service fees, banks' fee income from businesses rose by 7 per cent in 2004, more in line with the historical average growth rate of 8 per cent. The biggest contributor

Table 2: Banks' Fee Income from Businesses
$ million

	2001	2002	2003	2004	Growth 2004 Per cent	Average growth 1998–2003 Per cent
Deposits	421	435	462	499	8	12
Loans	1 323	1 289	1 437	1 574	10	8
Merchant service fees	1 441	1 633	1 837	1 522	–17	19
Bills	1 010	1 045	1 047	1 090	4	5
Other	634	709	830	877	6	12
Total	**4 829**	**5 110**	**5 612**	**5 562**	**–1**	**11**

Source: RBA

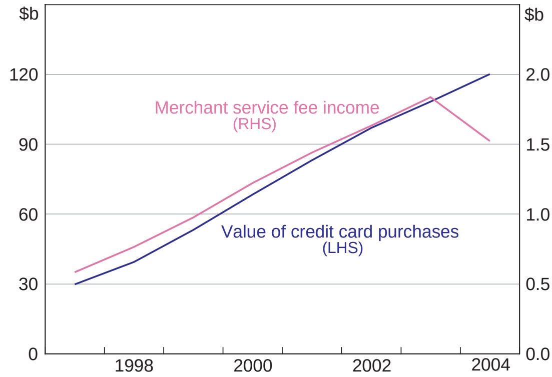
2 *See 'Merchant Service Fees for Credit Cards', RBA* Bulletin, *July 2004, pp 10–13, and Payments System Board* Annual Report 2004.

3 *Note that comparison of the small and large business results may be affected by differences in the definition of business sizes used by the participant banks.*

to this was fee income from business loans, which increased by 10 per cent, mainly due to a rise in fee income from large business loans. Total fee income from the provision of bank bill facilities grew by 4 per cent, which was in line with average growth over the previous six years, following a flat outcome in the previous year. As a ratio to the total amount of credit extended to the business sector, loan and bill fees together remained broadly stable at around 1 per cent.

Graph 2

Merchant Service Fee Income and the Value of Credit Card Purchases



Source: RBA

Fee income from business deposit accounts increased by 8 per cent in 2004, a little above growth in the previous year. Within the total, income from transaction fees increased by 15 per cent, significantly outpacing growth in account-servicing fees of 4 per cent. The increase in business deposit fee income appears to reflect growth in the number of accounts and transactions, as the unit costs of operating business deposit accounts were generally either steady, or in some cases lower. Some banks, for example, offered fee discounts or temporary fee waivers on business deposit accounts as part of their efforts to attract small business customers.

Households

Banks' fee income from households was $3.4 billion in 2004, an increase of 12 per cent in the year, compared with average growth of 17 per cent in each of the preceding two years. Strong growth in fee income from credit cards contributed most to the growth in 2004 (Table 3).

In 2004, fees paid by households on credit cards grew by 30 per cent to almost $800 million, in line with average annual growth since 1998 of 29 per cent. For the first time, banks in aggregate earned more from households in credit card fees than they did from fees on housing loans. Growth in the number of credit card accounts and spending per credit card contributed to the rise, though some of it was also due to a rise in unit fees. Annual membership fees on some credit cards were increased in 2004, following increases in the previous few years. There were also some further increases in charges for cash advances, overdrawn accounts and late payments, which are likely to have contributed to the growth in total credit card fee income (Table 4).

Banks' fee income from loans to households grew at a slower pace in 2004. Housing loan fees rose by 10 per cent, which was a slower pace than in the preceding two years, consistent with the moderation in the growth of housing loans in 2004. Fee income from personal loans rose by 9 per cent, well below the average historical growth rate of 25 per cent. Growth in fees from housing and personal loans may also have been held down in 2004 by fee discounts or waivers as banks reacted to the slowing in the housing loan market.

Table 3: Banks' Fee Income from Households
$ million

	2001	2002	2003	2004	Growth 2004 Per cent	Average growth 1998–2003 Per cent
Loans:						
– Housing	486	601	679	746	10	9
– Personal	298	431	448	488	9	25
Credit cards	345	438	607	787	30	29
Deposits	868	943	1 084	1 164	7	16
Other fees	242	225	248	259	4	0
Total	**2 240**	**2 638**	**3 066**	**3 443**	**12**	**15**

Source: RBA

Table 4: Fees on Credit Cards Issued by Major Banks[(a)]

	2000	2001	2002	2003	2004
Annual fee – standard cards ($)[(b)]	38	48	61	76	85
Annual fee – gold cards ($)[(b)]	84	87	98	128	128
Own bank's ATM					
cash advance fee ($)[(c)]	0.4	0.6	1.0	1.4	1.4
– Per cent of value	–	0.4	0.8	0.8	1.1
Other bank's ATM					
cash advance fee ($)[(c)]	1.3	1.3	1.6	1.6	1.6
– Per cent of value	–	0.4	0.8	1.1	1.4
Foreign ATM					
cash advance fee ($)[(c)]	2.9	3.9	3.9	3.6	3.6
– Per cent of value	–	0.4	0.8	1.1	1.4
Foreign currency conversion fee (per cent of value)	0.8	1.0	1.0	1.3	1.5
Late payment fee ($)	20	20	21	23	29
Over-limit fee ($)	0	6	13	25	29

(a) Average fees for credit cards with interest-free periods and rewards programs issued by major banks. As at end June each year. RBA calculations based on Cannex data.
(b) Includes fees for membership in reward program where separately charged.
(c) Most banks have changed the fee structure on credit card cash advances from a flat dollar fee to a percentage of the advance (above a flat minimum fee).
Sources: Cannex; RBA

Fee income from household deposit accounts grew by 7 per cent in 2004, to $1.2 billion. This was well below average growth since 1998 of 16 per cent. The slowing in growth may reflect the recent moves by banks to offer household deposit accounts with more simplified fee structures. For example, most of the major banks now offer accounts with unlimited free electronic transactions and fixed monthly account-servicing charges of around $5, with non-electronic transactions, such as over-the-counter withdrawals and cheques, as well as withdrawals from ATMs not belonging to the customer's bank, continuing to incur additional fees per transaction.

Despite this change in fee structure, growth in transaction fees on household deposit accounts was well in excess of the growth of account-servicing fees in 2004, consistent with evidence that the number of deposit account transactions grew more quickly than the number of accounts. The emergence and rapid uptake of low or nil-fee online savings accounts in recent years may have also contributed to the weaker growth in household deposit fee income in 2004. Overall, the rise in household deposit fee income in 2004 seems to be due more to growth in the number of accounts and transactions than increases in the cost of these banking services.

Conclusion

In 2004, growth in banks' domestic fee income was the lowest it has been in the survey's eight-year history. In large part, this was due to a sharp fall in merchant service fees for credit cards, with other sources of fee income growing more in line with the pace of recent years. But whereas growth in banks' fee income in earlier years was partly attributable to increased charges for banking services, recent growth would appear to be due more to increases in the use of banking services, evident in the higher number of customer accounts and transactions. One exception to this is credit cards where, in addition to increased use, there have been increases in unit fees over the past few years.

In previous years' analysis of the bank fees survey, it was shown that, in aggregate, the increase in bank fees since the mid 1990s had not offset the benefit that banks' customers had received from the reduction in banks' interest margins. It was also noted that not all customers have necessarily benefited from declines in interest margins on loans. For example, customers with only deposit accounts have faced a significant rise in fees over this period without any offsetting benefits in the form of lower interest margins. The results from the 2004 survey do not change these conclusions.