4

Bank Fees and Profits

Introduction

4.1 At the hearing with the Reserve Bank in December 1998, the subject of bank fees and charges was raised in the context of 'margin squeeze' and bank balance sheets; there was a perception that banks were trying to raise fees to recoup some of their losses related to the effects of increased competition. [1] The Committee asked the Bank to provide it with a detailed history of changes in bank fees and charges.[2] While the Governor indicated that research on the subject would be difficult to do, he said the Bank would do what it could to provide the information sought by the Committee. [3]

4.2 On 15 June, two days before the Committee's public hearing with the Bank, the RBA released a paper on bank fees in Australia. Just prior to this, in May KPMG released the results of its 17th annual financial institutions performance survey which reported that in the previous twelve months over $10 billion in fees and charges had been collected by Australia's five biggest banks.[4] An addendum issued by KPMG on 25 May 1999 clarified that the $10 billion figure mentioned in their report referred to non-interest income, including overseas fee income, and that estimated revenue from fees and charges on Australian personal transaction accounts would not exceed $1.5 billion.

4.3 Banks had been actively pursuing a strategy of growing non-interest income, KPMG said. Remarking on the success of the major banks in

---

1 Evidence, p. 18.

2 Evidence, p 19.

3 Evidence, p 19.

4 *KPMG 1999 Financial Institutions Performance Survey*. Sydney, KPMG, p 3.

pursuing strategies to grow non-interest income, the report also noted, perhaps prophetically, that:

> While this area of the Majors' income base has proved profitable, any further fee increases will need to be managed carefully in light of public and political criticism.[5]

4.4 Following the release of the initial KPMG report based on the $10 billion figure, there was much public and political criticism of banks in the media. The Victorian Premier promised that his Government would seek an explanation from banks about hikes in bank fees and charges, and the Federal Minister for Financial Services, Mr Joe Hockey, said banks needed to do a better job of explaining to the public why fees and charges were 'necessary'.[6] The Australian Consumers' Association issued a press release arguing that the Government should take action to put a cap on bank fees and charges[7], and the Chief Executive of the Australian Bankers' Association felt obliged to write a letter to the *Australian Financial Review* defending banks and contesting the accuracy of some of the press reporting on the industry.[8]

Margins and fees

4.5 The Reserve Bank's report on bank fees in Australia[9], released two days before the hearing on 17 June 1999, also argued that declining interest spreads resulting from financial market deregulation and increased competition had reduced the scope banks used to have for margins to cross-subsidise banking services.[10] The Bank's study reported that:

> Since the early 1980s, major banks' overall interest spread has narrowed from around 5 percentage points to 3 percentage points.[11]

4.6 The KPMG survey had reported that intense competitive pressures, especially in the home-lending market, resulted in reduced interest margins costing the major banks an estimated $500 million in 1998[12].

---

5 Ibid., p 34.

6 Hockey gives banks some stick. *Australian Financial Review*, 6 May, 1999.

7 Australian Consumers Association. *Media release:Government must take action on bank fees and charges*. 11 May 1999.

8 Banks not fleecing the public. *Australian Financial Review*, 20 May, 1999.

9 'Bank Fees in Australia', *Reserve Bank of Australia Bulletin June 1999*. Sydney, RBA, pp 1-10.

10 *Reserve Bank of Australia Bulletin June 1999*. Sydney, RBA, p 2.

11 Ibid., p 2.

12 *KPMG 1999 Financial Institutions Performance Survey*. Sydney, KPMG, p 32.

Interest margins declined from an average of 3.39 per cent in 1997 to an average of 3.18 per cent in 1998.[13]

4.7 The RBA study reported that bank service charges had risen to reflect their economic costs 'more closely'[14] and, at the public hearing with the Bank in June, the Governor argued that this had to happen when the heavily regulated banking regime, which allowed for cross-subsidisation of banking services, came to an end.[15]

4.8 An increasing proportion of the four major banks' global earnings has come from non-interest income, and this is especially evident in banks' domestic operations.[16] Indeed, KPMG survey results showed that the non-interest income growth strategies of the major banks generated an additional $1,443 million for banks during the 1998 financial year, increasing non-interest income as a percentage of total revenue from 17.8 to 19.2 per cent.[17]

4.9 The RBA report attributed the rise in non-interest income to falling interest earnings as well as to the relatively strong growth in banking services for which fees are charged; the annual growth rates for certain banking activities (eg retail transactions and funds management) involving fees have far exceeded average annual growth rates of bank assets.[18]

4.10 While for most of the 1990s fee income growth rates did not exceed average annual growth rates in bank assets and the ratio of non-interest income to assets actually fell, in 1998 the trend was partly reversed when fee income growth rates more than doubled their previous averages. The RBA reported that fee income grew by 21 per cent in 1998, and was derived from housing loan revenue (which increased by 56 per cent), household transactions (where fee revenue increased by 80 per cent), and merchant-service fees (where revenue increased by 28 per cent).[19]

4.11 KPMG reported that income from fees and commissions for the major banks increased by 22 per cent from 1997-98[20], principally through

---

13 Ibid., p 52.

14 Ibid., p 2.

15 Evidence, p 75.

16 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 6.

17 *KPMG 1999 Financial Institutions Performance Survey*. Sydney, KPMG, p 33.

18 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 7.

19 Ibid., p 7.

20 *KPMG 1999 Financial Institutions Performance Survey*. Sydney, KPMG, p 33. The percentage increase in fees and charges income was 36 per cent for other retail banks(p38).

increases in transaction and card fees[21], raising this income as a proportion of total assets from 1.04 to 1.11 per cent[22].

4.12 According to the Reserve Bank, fees from the household sector earned the banks $1.4 billion in 1998, fees from business around $3.1 billion, while other domestic non-interest income (including fees from providing other services such as funds management, insurance and advisory services) earned the banks an additional $7.2 billion.[23]

4.13 Bank fees from the household sector include monies earned from fees on deposit and loan accounts as well as from charges on retail transactions. Nearly half the fee income in the household sector was earned from loans, including housing loan account servicing fees comprising one-fifth of total fee income in this sector.[24] Approximately one-fifth of fee income in the sector, amounting to $270 million, was earned from fees on retail transactions.[25]

4.14 The Bank's study shows that account-servicing fees charged by the major banks have, indeed, increased since the early 1990s, while the average number of free account transactions has decreased. For customers who exceed the threshold of fee-free transactions, transaction fees have increased dramatically. Own-bank ATM transaction fees have doubled since 1991, other-bank ATM transaction fees have more than quadrupled, EFTPOS charges have nearly doubled, and cheque costs have increased by 25%. Meanwhile, the cost of a counter withdrawal has increased more than four times from an average of 0.50 cents in 1991 to $2.15 in 1999.[26]

4.15 As the RBA study on bank fees points out, though, the majority of banks' domestic fee income is derived from businesses.[27] In 1998, banks earned about $3.1 billion from businesses, one-third of which came from small business.[28] More than half the total income from this sector was earned from fees on loans and bill lines, and about a quarter (24%) has been earned from merchant-service fees which banks typically earn from card transactions.[29] The six banks in the RBA study earned $750 million in 1998 from merchant-service fees, which represents an increase of 28 per cent from 1997 earnings of $585 million.

---

21 Ibid., p 33.

22 Ibid., p 53.

23 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, pp 4 – 6.

24 Ibid., p 4.

25 Ibid., p 5.

26 Ibid., p 3.

27 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 5.

28 Ibid., p 5.

29 Ibid., p 5.

4.16 The Committee was interested to learn that fee costs for businesses are greater than they are for households, and fees have not been offset by margin reductions on business lending rates. [30] Fees now cost businesses an additional 1 per cent which is 'comparable' to the reduction in margins on lending rates over the past few years.[31] At the hearing in June the Governor admitted that businesses '…pay a lot more in fees and charges than households'[32] but that, basically, '…business fees have not changed that much'.[33] The Bank intends to do more research on the subject of business fees[34], and the Committee looks forward to the Bank reporting direct to the Committee on this before its next meeting with the Bank in November 1999.

4.17 At the June hearing, the Bank was asked to comment on the reasonableness of increases in household fees. In response, the Governor claimed that the purpose of introducing competition into the financial market was not to drive down fees, but to drive down margins.[35] In fact, the result of competition would be that fees which had not formerly been charged would be charged.[36] The Governor said:

> The nature of competition is that it drives down those things where very high profits are being earned, as with mortgages, but as it does so it prevents companies…from subsidising those areas where they are actually losing money. So the main effect of competition is to squeeze margins, and that means that you can get a better deal on your borrowing or lending but it raises the costs for running accounts and having transactions. It seems to me that that is absolutely inevitable.[37]

4.18 According to the Bank's estimates, account servicing, loan and retail transaction fees have added an estimated 0.4 per cent to the cost of loans to households, but the rise in fee levels is well short of the decline in interest margins on household lending, which the Bank estimates to be worth 1.25 percentage points.[38] At the public hearing in June, the Governor referred to the Bank's research to support the contention that

30 Ibid., p 8.
31 Ibid., p 8.
32 Evidence, p 79.
33 Evidence, p 79.
34 Evidence, p 79.
35 Evidence, p 76.
36 Evidence, p 77.
37 Evidence, p 77.
38 *Reserve Bank of Australia Bulletin June 1999*, Sydney, RBA, p 8.

the ‘average’ household customer with a loan had come out ahead as a result of the changes wrought by competition.[39]

4.19 The Committee asked the Bank whether there were negative implications of changes in bank service provision for ‘non-average’ customers with no housing loans, and the Governor admitted that the end of cross-subsidisation meant there were , indeed, certain ‘distributional consequences’.[40]

> Because the reduction in margins has not been offset by the increase in fees, on average, bank customers have gained from increased competition in banking. But this does not mean that all bank customers have gained. The benefits seem clearest for borrowers, especially household borrowers. Depositors with low balances and a high number of transactions could be worse off.[41]

4.20 The Bank rejected outright the proposal there was a role for government to intervene and regulate banks on the matter of fees and charges, despite its acknowledgement that competition was not benefiting all bank customers. However, the Governor qualified his position by saying:

> But obviously if there was gouging going on – if the fees were going up much faster than other benefits were accruing – then the situation would be different.[42]

Bank profits

4.21 The KPMG’s survey report claimed that in the 1998 financial year the major banks[43] posted a combined operating profit after abnormals and before tax of $7.8 billion, representing a decrease of 5.1 per cent from the 1997 financial year.[44] Indeed, after-tax operating profit as a proportion of total assets declined from just under one per cent at 0.99 per cent in 1997 to 0.85 per cent in 1998.[45]

4.22 The Reserve Bank’s report noted that bank profitability has remained high in recent years, despite the fact that operating income relative to assets has

39 Evidence, p 77.

40 Evidence, p 78.

41 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 8.

42 Evidence, p 80.

43 Including the ANZ Banking Group, the Commonwealth Bank of Australia, the National Australia Bank and the Westpac Banking Corporation.

44 *KPMG 1999 Financial Institutions Performance Survey.*Sydney, KPMG, p 32.

45 Ibid., p 52.

declined since the early 1980s.[46] The Bank report proffers as an explanation the fact that banks have been able to reduce costs; relative to assets, bank expenses have fallen from 4.0 per cent in 1980 to 2.5 per cent in 1998.[47] New technology has enabled staff reductions, as well as a diminution in the number and size of bank branches.

4.23 The RBA report notes that bank staff numbers have been able to be reduced because customers now rely less on labour-intensive activities than they used to. It further suggests that part of the explanation for this is that fees have encouraged individuals and businesses to change their banking habits and to exercise greater economy in the use of transaction services and bank accounts[48]. Indeed, a number of recent press reports have argued that bank service fee structures seem to be encouraging customers away from labour-intensive practices, such as visiting bank branches.[49]

4.24 The above points were emphasised in the Bank report's conclusion, which summarised that:

> Banks have maintained their profitability in the face of falling interest margins, mainly by cutting costs, rather than by raising fees. The imposition of fees may have had its largest impact in deterring customers from many labour-intensive services, rather than by directly raising large amounts of revenue.[50]

4.25 At the June hearing, the Governor reiterated that bank profitability had been maintained by sharp cost cutting rather by the imposition of fees. [51] He acknowledged that bank cost cutting including, for example, the closure of bank branches in country areas, had created serious problems.[52] He also implied that banks were aiming for unreasonably high profits when he said:

> Any business, whether it is a bank or any other business, if it is aiming for extremely high rates of return on equity – if it is aiming for 18 or 20 per cent in an environment of two per cent inflation – it seems to me there are an awful lot of very useful things that

46 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 8.

47 Ibid., p 9.

48 Ibid., p 9.

49 See, for example, Hans van Leeuwen's 'Divergent bank fees test frontiers in cyberspace', *Australian Financial Review*, June 22, 1999.

50 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 10.

51 Evidence, p 77.

52 Evidence, p 77.

> could be done which are profitable, but they are not quite that profitable. [53]

4.26 The point about reasonable profitability was made again by the Governor in response to continued Committee questioning about the Bank's views on the role of government in monitoring the banking industry:

> There is a role for many parts of the community, including this committee and governments, to put pressure on and exhort banks to think of customers who do not have many alternatives, if in fact these people have their banking services withdrawn because banks have set themselves unreasonably high profit hurdles over which they have to pass. If they have set these extremely high hurdles, there is a very strong role for governments, political parties, consumer groups and so on to exhort banks to review the attitude they are taking to branch closures…I certainly think there is a very useful role for committees like this and for government and political parties to keep the pressure up on banks to justify why particular closures have occurred.[54]

4.27 The Committee believes this point deserves a considered response from the Australian Bankers' Association.

Conclusion

4.28 The Committee is appreciative of the work undertaken by the Reserve Bank to research trends in banks' fee income and it accepts the broad findings of the Bank's study, though it notes that the Bank has qualified its own findings by pointing out that data were limited and conclusions should be regarded as preliminary. [55] The Committee looks forward to hearing from the RBA on business fees, and will maintain a watching brief on developments relating to fees affecting household borrowers.

4.29 The Committee notes that the Bank has found that 'average' borrowers with housing loans and credit cards have gained in the overall calculus of reducing interest margins and fee rises, but is concerned about the impacts of fee rises on non-borrowers affected by increasing account-servicing and bank transaction fees. Pensioners and students, for example, are supposed to have access to 'no frills' bank accounts which are fee-free, but the

53 Evidence, p 78.

54 Evidence, pp 80-81.

55 *Reserve Bank of Australia Bulletin June 1999.* Sydney, RBA, p 2.

Committee is aware that these accounts are becoming increasingly hard to obtain, and transaction limits on them could make them unviable.[56]

4.30 The Committee is also very aware of the social costs of measures employed by banks to support bank profitability, and questions whether banks are not pursuing unreasonable levels of profit at the expense of the community. The Committee is mindful of the social and employment costs of bank closures and the general shift by banks over to less labour-intensive modes of service delivery, and will continue monitoring bank performance and representing the interests of the community to policy makers.

4.31 While the Committee has no interest in promoting the re-introduction of regulation into the banking industry, it has a firm belief in the persuasive power of public opinion to influence banking practices for the better. It therefore views with grave alarm revelations of a commercial contract between the Australian Bankers' Association (ABA) and Radio 2 UE's radio personality John Laws which threatened to impinge on the public's right of access to unbiased information about banking services.

4.32 On 22 June Mr Frank Cicutto, Chairman of the Australian Bankers' Association and Managing Director of the National Australia Bank (NAB), addressed a seminar on business ethics and apologised on behalf of the banking industry for the ABA's contract with John Laws. Mr Cicutto also acknowledged that banks need to do more than re-consider their public relations strategies: they have to respond to community concerns about their practices.[57]

4.33 However, the Committee is unclear as to whether this apology was for the sin of being found out, or represents a genuine intention to take steps to raise the standard of ethical behaviour of ABA members. Either way, the Committee believes this incident could be said to have done significant damage to public confidence in our banking institutions.

56 Tim Boreham, 'Banks hold up fees with telling effect'. *The Australian*, 9 July 1999.

57 Cicutto, F., Managing Director and Chief Executive Officer, National Australia Bank. A question of Balance. Address to the *Ethics in Business Series 1999, Melbourne, 22 July, 1999.* Unpublished paper, 17 p.

4.34 Following a meeting of the EFPA Committee on 9 August, the Chairman issued a media release on the ABA/Laws arrangement.[58] The media release stated that as the Committee does not wish to duplicate the work of at least five other inquiries on the matter, and sees considerable advantages in it reviewing the information revealed by those inquiries first, the Committee has decided to defer a specific inquiry on this issue for the moment.

David Hawker MP,
Chairman

12 August 1999

58 Hawker, D., MP, Chair, EFPA Committee. *Media Release: Economic Committee still concerned about bank ethics.* 9 August 1999, 1 p.