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Recent developments in noninterest income at commercial banks

Activities that generate noninterest income have always been an important component of a successful operating strategy for banks. The challenges posed by historically low interest rates and increased competition from new entrants in the banking marketplace are likely to continue, increasing the need for sound and well-managed noninterest income strategies.

Income that banks generate from activities outside of their core business of taking deposits and making loans is classified as noninterest income. This type of income is often referred to as "fee income" since fees constitute the majority of noninterest income. Noninterest income has often been viewed as having favorable properties for bank profitability. For example, if the activities that generate it are less connected to general economic conditions, then noninterest income could help to lower the volatility of revenue and profits at an institution. Noninterest income can also help to diversify the revenue stream of a bank and reduce its dependency on net interest margin, an especially important consideration when interest rates are expected to stay at relatively low historical levels.

Composition of noninterest income

Banks report elements of noninterest income to regulators for a number of income statement categories on the Consolidated Reports of Condition and Income (Call Reports) and on holding company reports like the FR Y-9C and the FR Y-9LP. Approximately 60 percent of industry noninterest income in 2017 occurred in the following five categories:

- Service charges on deposit accounts – overdraft-related fees, account maintenance charges, ATM fees, and other revenue directly related to deposit accounts
- Fiduciary activities – income from administering investments of clients
- Interchange fees – fees earnings from bank card and credit card transactions
- Trading revenue – income from exposure to various financial instruments (equity securities and indices, interest rates, foreign exchange, etc.)
- Investment banking – fees and commissions from securities brokerage, revenue from underwriting debt and equity securities, and merger/acquisition services

Certain types of noninterest income are produced by a relatively small number of banks. Some activities require a high level of specialization and/or large economies of scale or scope in order to be profitable. Activities directly connected to capital markets—like trading revenue or securities underwriting—tend to be concentrated in certain geographical areas and are rarely performed by small banking organizations.

The uneven distribution of noninterest income across the banking sector is illustrated in the following table, which reports the share of total noninterest income produced by the five listed categories. The column at left in the table shows the breakdown of noninterest income for the entire banking industry. Service charges and revenue from fiduciary activities are the two largest sources of noninterest income for the aggregate industry, accounting for 30 percent of the total.

Share of Total Noninterest Income

	Total for the Industry	***Total for All Community Banks***	***Average Community Bank***
Service charges	15%	19%	38%
Fiduciary activities	15%	12%	3%
Interchange fees	12%	10%	10%
Trading revenue	11%	0.5%	0.1%
Investment banking	5%	3%	2%
Other fee income	42%	55%	46%

The middle column reports the results when the universe is restricted to community banks (defined as institutions with average assets of less than $10 billion). Service charges on accounts are responsible for a larger percentage of total noninterest income at community banks than they are for the aggregate industry (19 percent versus 15 percent). Moreover, activity related to capital markets, such as trading revenue, drops to almost zero for this category of banks.

The data shown in the first two columns in the table reflect the distribution based on aggregate totals — either measured across the entire industry or across all community banks. The column at right reports the share of noninterest income at the average community bank. Differences between the results shown in the middle and right columns highlight the uneven distribution of noninterest income across firms. For example, service charges are responsible for nearly 40 percent of noninterest income at the average community bank. However, this category only accounts for 19 percent of the noninterest income produced by all community banks. Fees and commissions from fiduciary activities, which generate 12 percent of total noninterest income at community banks, are only responsible for 3 percent at the average or typical community bank.

Aggregate trends in noninterest income over time

Variation also exists in the distribution of banks with respect to their ability to produce noninterest income. Larger banks are often able to participate in wider range of business activities that generate fee income than smaller institutions can. As a result, noninterest income — measured as percent of revenue — typically increases as the size of the bank increases.

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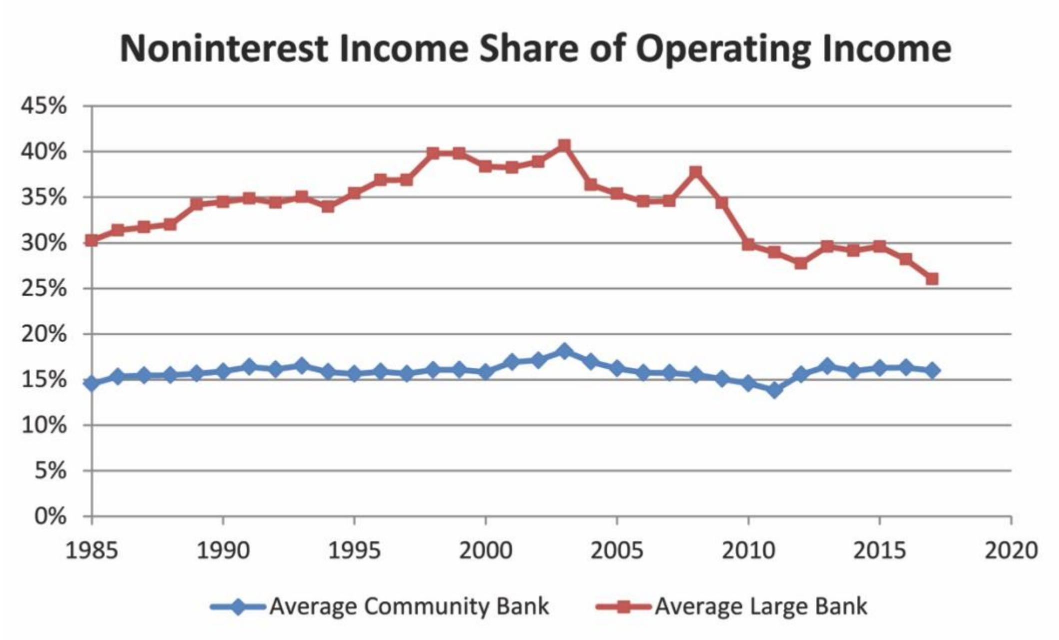
Noninterest income was 16 percent of operating income (defined as interest income plus noninterest income minus interest expense) at the average community bank in 2017, compared to 26 percent at the average large bank with assets greater than $10 billion.



The adjacent chart[1] displays the noninterest income share of operating income for the average community bank and the average large bank back to 1985. The average community bank, using the inflation- adjusted definition, has seen very little variation in the amount of operating income produced by noninterest income activity over the last 30 years. As noted above, noninterest income was 16 percent of operating income at the average community bank in 2017 and the level has fluctuated between 14 and 18 percent since 1985.

[1] Note that the definition of a community bank is adjusted for inflation and varies over time—the cutoff between community banks and large banks starts out at roughly $4 billion in 1985 and steadily rises over time until it reaches $10 billion in 2017.

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