Accepted Manuscript

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PII: S0378-4266(16)30139-X
DOI: 10.1016/j.jbankfin.2016.07.019
Reference: JBF 4997

To appear in: *Journal of Banking and Finance*

Received date: 23 September 2012
Revised date: 12 May 2016
Accepted date: 24 July 2016

Please cite this article as: Barry Williams , The impact of non-interest income on bank risk in Australia, *Journal of Banking and Finance* (2016), doi: 10.1016/j.jbankfin.2016.07.019

The impact of non-interest income on bank risk in Australia

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Abstract:

The relationship between bank revenue composition and bank risk in Australia is modelled using data drawn from Australian bank confidential regulatory returns. It is found that those banks with lower levels of non-interest income and higher revenue concentration are less risky, consistent with previous international evidence. Evidence is also found supportive of increased risk due to too-big-to-fail effects, with this risk increase being offset by a decline in large bank risk after the crisis of 2007-2008. Non-interest income is generally found to be risk increasing, but some types of non-interest income are risk reducing when bank specialisation effects are considered. It is also found that the 2008 financial crisis changed some aspects of the relationship between bank risk and revenue composition.

1. Introduction.

The importance of the twin issues of bank income diversification and bank risk have been highlighted by the Global Financial Crisis (GFC). The relevance of increased understanding of the factors that determine bank risk have been emphasised by the large costs imposed upon a number of stakeholders in the banking system by the negative outcomes of bank portfolio choice. Prior to the GFC, the impact of bank income diversification upon bank risk had attracted increased academic attention in response to regulatory changes, mainly in the United States. This was particularly in response to the introduction of the Gramm-Leach-Bliley Act which allowed bank holding companies to offer both commercial and investment banking. As discussed by DeYoung and Torna, (2013) and Engle, *et al.*, (2014) a number of commentators have blamed the GFC on increased non-traditional activity in the banking