U.S. Producer Price Index for Securities Brokerage (NAICS 523120) and Investment Advice (NAICS 523930)

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Agenda

- Definition of the service being priced
- Pricing unit of measure
- Market size
- National accounts concepts
- Pricing methods
- Quality adjustment
- Evaluation of comparability with turnover/output measures
- Summary
Definition of the Service – Securities Brokerage

- Primary output for **securities brokerage** is the provision of assistance with the purchase or sale of securities.

- Industry activity includes:
  - Bringing together buyers and sellers of securities
  - Facilitating trades without taking possession of securities
  - Providing margin loans that use the value of securities held in brokerage accounts as collateral
  - Assisting clients with purchasing mutual fund shares
Types of Securities

- **Equities** – securities that represent ownership interest in a company
- **Exchange traded funds (ETFs)** – securities that track indexes, commodities, or baskets of assets, but trade like stocks on an exchange
- **Closed-end funds** – investment vehicles that pool investors’ money into diversified portfolios, but have a set number of shares authorized by the investment management company
- **Options** – contracts that give the holder a right to buy or sell an underlying asset at a specific price on or before a certain date
- **Bonds** – debt instruments through which investors lend money to corporate or government entities for a defined period of time at a designated interest rate
Primary output for **investment advice** firms is the provision of investment advisory services, including financial planning and portfolio analysis, on a fee basis.

Industry activity includes:

- Establishing and defining the client-planner relationship
- Gathering client data, including goals
- Analyzing and evaluating the client’s financial status
- Developing and presenting financial recommendations and/or alternatives
- Implementing and monitoring financial planning recommendations
Wrap Accounts

- Provide clients with both investment advisory services and trade execution in exchange for a program fee
- Compensate investment professionals for their advice, not the number of transactions generated
- Clients generally pay a single fee that is based upon the assets under management
Wrap Accounts

Non-discretionary wrap accounts
- The adviser suggests changes to the securities holdings within the account, but the client has the final say whether or not the changes are made.
- Classified in NAICS 523930, Investment Advice

Discretionary wrap accounts
- The adviser has the authority to make changes to the account’s composition of assets without consulting the client.
- Classified in NAICS 523920, Portfolio Management
Pricing Unit of Measure

■ Securities Brokerage

▶ Unit of measure is typically **per trade or per traded share**
▶ For flat fees charged for all trades made during a set period of time, the unit of measure is **per month, per quarter, or per year**
▶ The unit of measure for mutual fund sales is **per mutual fund transaction**. For margin lending, the unit of measure is **per loan**.

■ Investment Advice

▶ Unit of measure is typically **per customized financial plan**
▶ For managing clients’ assets in non-discretionary wrap account, advisers receive a fee **per month, per quarter, or per year**
Market Size

- **Securities Brokerage**
  - U.S. industry turnover - $119.8 billion in 2012
  - Top 4 firms account for ~34% of turnover

- **Investment Advice**
  - U.S. industry turnover - $32.86 billion in 2012
  - Top 4 firms account for ~29% of turnover
National Accounts Concepts

- U.S. GDP by industry and input-output data are published at the NAICS three-digit level, 523, which includes:
  - Security and Commodity Contracts Intermediation and Brokerage
  - Securities and Commodity Exchanges
  - Other Financial Investment Activities

- Input-output data are published at the NAICS four-digit level for:
  - 5231, Securities and Commodity Contracts Intermediation and Brokerage
  - 5239, Other Financial Investment Activities
# National Accounts Concepts

- **Industry Accounts - PPIs used as deflators for securities commissions**
  - Equity securities brokerage
  - All other securities brokerage

- **PPIs used to create Personal Consumption price indexes**

<table>
<thead>
<tr>
<th>PCE Series</th>
<th>PPI Index Code and Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange-listed equities</td>
<td>523120101- Brokerage services, equities and ETFs</td>
</tr>
<tr>
<td>Other direct commissions</td>
<td>523120102- Brokerage services, all other securities</td>
</tr>
<tr>
<td>Over-the-counter equity securities</td>
<td>523110201- Dealer transactions, equity securities</td>
</tr>
<tr>
<td>Other imputed commissions</td>
<td>523110202- Dealer transactions, debt securities and all other trading</td>
</tr>
<tr>
<td>Portfolio management and investment advice services (fixed weighted average of these two industry PPIs)</td>
<td>523920- Portfolio management</td>
</tr>
<tr>
<td></td>
<td>523930- Investment advice</td>
</tr>
</tbody>
</table>
Pricing Methods

- Securities Brokerage
  - Flat Fees
  - Value-Based Commissions
  - Mutual Fund Loads and 12b-1 Fees
  - Margin Lending Interest Payments

- Investment Advice
  - Flat Fees
  - Wrap Fees
Securities Brokerage
Flat Fees

- Flat fees for retail clients more prevalent over past several years
- Typically list price charged per share transacted or per trade
- Fee may be based on certain requirements
- Institutional clients also typically price using flat fees
Securities Brokerage
Value-Based Commissions

- Charged as a percentage of the total value of an individual trade
- Estimated transaction prices
  - Respondent updates current price of security and % commission fee

Example: Sale of 1,000 Shares of Stock XYZ

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Shares</td>
<td>1,000</td>
</tr>
<tr>
<td>Share Price</td>
<td>$10</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$10,000</td>
</tr>
<tr>
<td>Commission</td>
<td>5%</td>
</tr>
<tr>
<td>Total Commission</td>
<td>$500</td>
</tr>
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</table>
Securities Brokerage
Value-Based Commissions

Characteristics held constant when estimating transaction prices:

- Equities: traded stock, number of shares
- Bonds: issuer, face value, term to maturity
- Options: underlying asset, number of contracts, type of option, time to expiry, in-the-money/out-of-the-money, degree of moneyness
Securities Brokerage
Mutual Fund Loads and 12b-1 Fees

- **Loads** are value-based percentage fees charged for the purchase or redemption of shares in a mutual fund
  - Estimated transaction price
  - Name of fund, type of load, number of shares held constant
  - Value per share and percentage fee updated by respondent

- Securities brokers receive **12b-1 fees** from mutual fund companies for marketing and distributing particular funds
  - Estimated transaction price
  - Name of fund, number of shares held constant
  - Value per share and 12b-1 fee updated by respondent
Securities Brokerage Margin Lending Interest Payments

- Securities brokers loan clients funds to purchase securities in exchange for interest payments.
- Interest rate often depends on value of client’s brokerage account.
- Estimated transaction price.
Investment Advice
Flat Fees and Wrap Fees

- **Flat fees** include hourly fees and retainer fees

- **Wrap fees** are billed as a percentage of non-discretionary assets under management
  - Assets under management are adjusted based on the rate of return earned on the account for a given period
  - Respondent updates the rate of return and the management fee
  - Changes in total fees based on inflows and outflows are not reflected

**Example**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Assets:</td>
<td>$1,000,000</td>
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<tr>
<td>Rate of Return (Period N):</td>
<td>2.5%</td>
</tr>
<tr>
<td>Adjusted Assets:</td>
<td>$1,025,000</td>
</tr>
<tr>
<td>Management Fee:</td>
<td>.0025</td>
</tr>
<tr>
<td>Total Fee:</td>
<td>$2,562.50</td>
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</table>
Quality Adjustment

- Quality adjustments are applied if a broker or adviser changes the way a particular service is provided.
- Respondents are asked to estimate the cost associated with the change in service.
- Substitutions requiring quality adjustments are rarely observed in practice.
Evaluation of Comparability with Turnover/Output Measures

- US Census Bureau calculates and publishes turnover data for the securities brokerage and investment advice industries every 5 years.

- US Census Bureau publishes quarterly turnover data for securities and commodity contracts intermediation and brokerage and other financial investment activities.

- Concept of output for the financial sector is harmonious between US PPI, Census Bureau and Bureau of Economic Analysis.
Summary

- Defining and classifying firms in the financial industries can be challenging.
- Many large financial institutions provide services and account for significant revenue in many closely related NAICS industries.
- PPI divides largest firms into multiple sample units classified in various financial sector NAICS industries.
Contact Information

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