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# Development of a Canadian Services Producer Price Index for Securities Brokerage

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# Outline

- Overview of financial services index development in Canada
- Canadian brokerage service lines
- Industry structure and size
- Comparison: industry and products
- Turnover/Output
- Securities Brokerage Services Price Index (SPSPI)
  - Development overview
  - Consultation, results and recommendation
  - Service line coverage and data collection
  - Index calculation
  - Lessons learned
- Conclusion
- Next steps



Commodity	Industry			
	Banking and other depository credit intermediation	Non-depository credit intermediation	Activities related to credit intermediation	Financial investment, services, funds and other financial vehicles
Banking and other depository credit intermediation services - explicit charges	X			
Deposit intermediation services indirectly measured (FISIM)	X			
Residential mortgage intermediation services indirectly measured (FISIM)	X	X		
Other loan intermediation services indirectly measured (FISIM)	X	X		X
Non-depository credit intermediation services - explicit charges (fees)	X	X		
Other services related to credit intermediation	X		X	
Investment banking services	X			X
Security brokerage and securities dealing services	X			X
Portfolio management services (MER)	X			X
Investment counselling services				X
Holding company services and other financial investment and related activities	X			X
Trusted pension fund services				X
Mutual funds (cost of service) and other similar services--loads & trailers				X

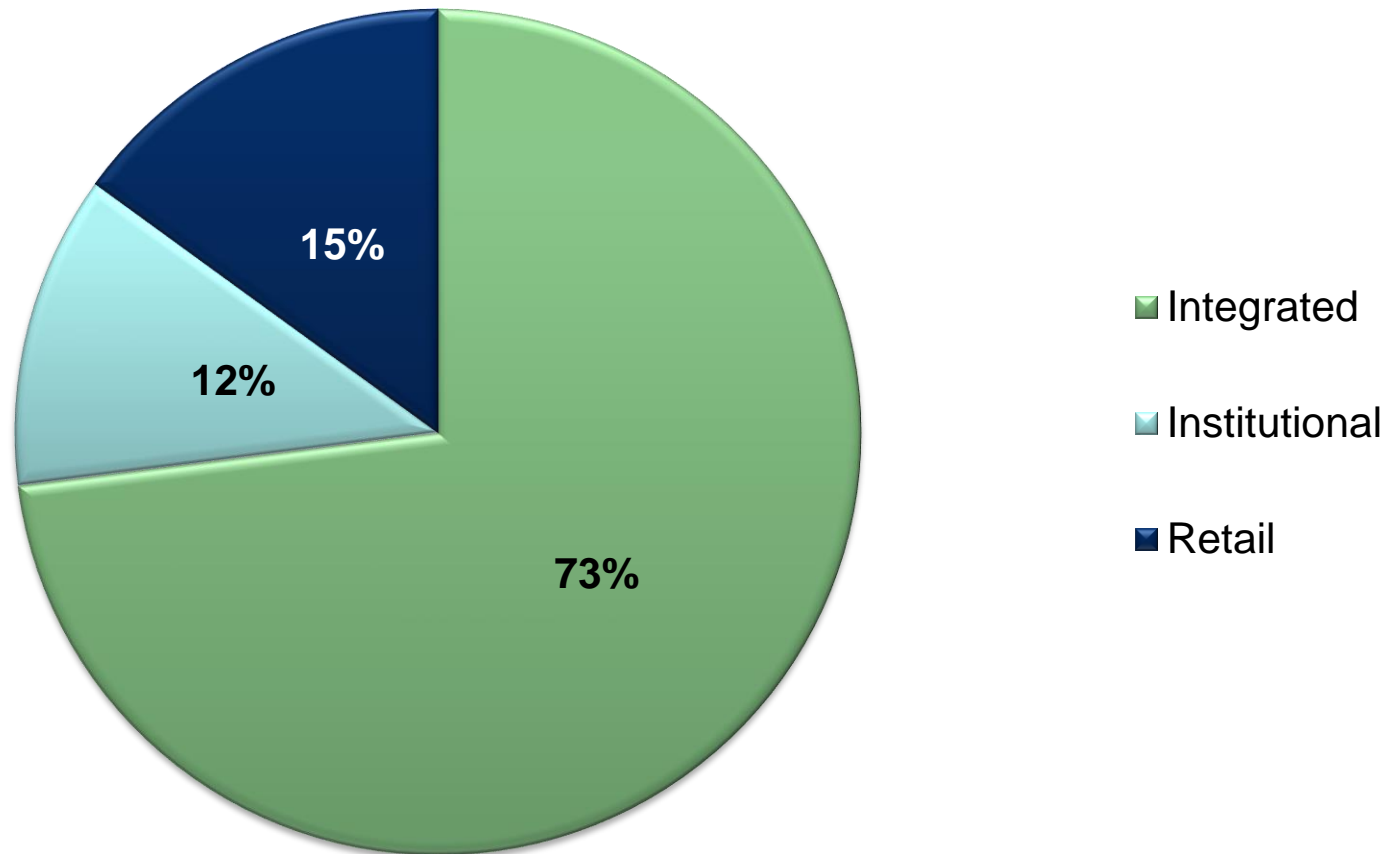


# Canadian brokerage service lines

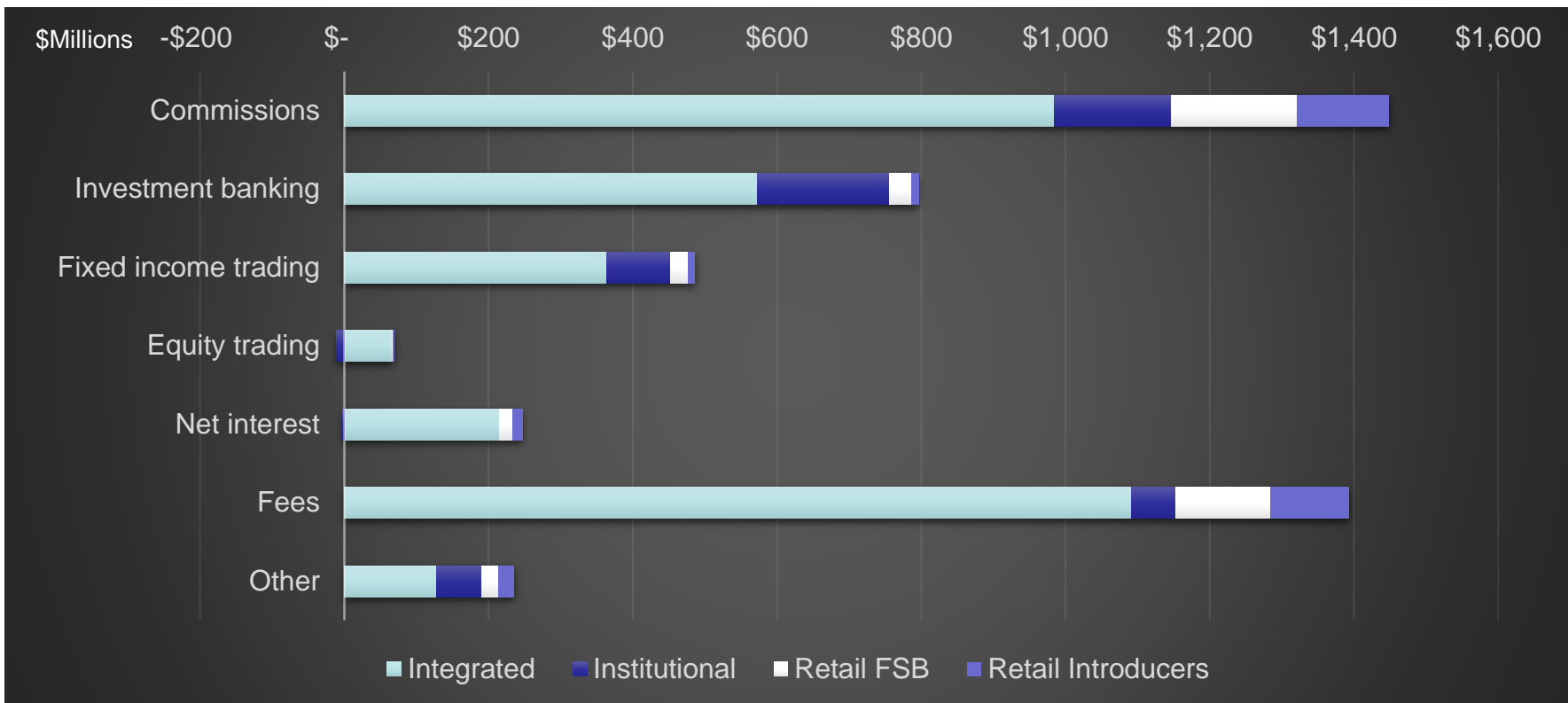
- Transaction Based (Commissions)
  - Full Service, retail and institutional
  - Discount
- Fee-Based Brokerage (Fees)
  - Non-discretionary
  - Discretionary
- Mutual Fund Sales
  - Commissions (front and back end)
  - Fees (trailer fees)
- Margin Lending (Net Interest)
- Foreign Exchange (Other)



# Canadian Industry, by firm type



# Structure and size, by revenue category



# Comparison: industry and products

Investment Industry Association of Canada Revenue Categories	Securities Brokerage Industry (NAICS)	Securities Brokerage and Securities Dealing Products (Supply-Use Tables)
Commissions	✓	✓
Fees	✓	✓
Other	✓	✓
Net interest (incl. margin lending)	✓	In Supply-Use tables under "Other Loan Intermediation"
Mutual Funds	✓	In Supply-Use tables under "Mutual Funds Cost of Service"
Equity & Fixed Income Trading	In NAICS under "Investment Banking and Securities Dealing"	✓
Investment Banking		In Supply-Use Tables under "Investment Banking and Securities Dealing"

# Turnover/Output

## Turnover:

- Quarterly Survey of Financial Statements
  - Enterprise level program
  - Largest brokerage firms in Canada fall under NAICS 52211 – Banking

## Output:

- Output commodity – Security brokerage and securities dealing services (partial coverage) – allocated to two industries:
  - Banking and other depository credit intermediation
  - Financial investment, services, funds and other financial vehicles
- Output is calculated using the following data sources:
  - Quarterly Survey of Financial Statements
  - Investment Industry Association of Canada
    - Data from Investment Industry Regulatory Organization of Canada





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# Securities Brokerage Services Price Index (SBSPI)

## Program Development

# SBSPI development overview

- Industry research
  - Main activities of the industry
  - Existing sources of data
  
- Pilot development
  - Industry consultation
  - Questionnaire development
  - Questionnaire testing
  - Launch of pilot
  - Post pilot follow-up



# Price determining characteristics

Characteristic	Examples
Person Conducting Transaction	Specialist, registered representative, floor broker, self, etc.
Specific Type of Security	TD common stock, 5 yr. T-bond, GM 30 year bond, etc.
Quantity Purchased	100 shares of stock, 5 option contracts, 10 T-bills, etc.
Market Value of Security	Price per share, option premium, etc.
Type of Client	Retail, institutional, government, other broker, etc.
Trading Volume of Client	Trades less than 10 times/yr, trades large volumes frequently, etc.
Account Status of Client	Total account value over \$100,000, etc.
Type of order	Limit, market, stop, etc.
Order placed through	By telephone, by registered representative, by modem, by Super Dot, etc.
Additional services provided	Research if provided, will raise commission rates charged.
Additional charges	Fixed fee cover transfers and clearing costs, versus odd lots.
Payment for order flow	Brokers with seats on the exchange versus “introducing” broker.



# Consultation questionnaire

## Types of:

- Clients
- Services by line
- Research and advice included in price
- Discounts offered, by type of client
  - factors considered: amount and frequency
  - Offers made to institutional clients
- Transactions executed for free
  - factors considered: when to provide
- Contractual agreements / structure
- Special accounts offered to institutional clients / e.g. where they might be able to execute their own trades

## By type of client, or transaction:

- Services provided
- Fees charged
- Pricing factors taken into consideration
- Research and advice included in price

## General:

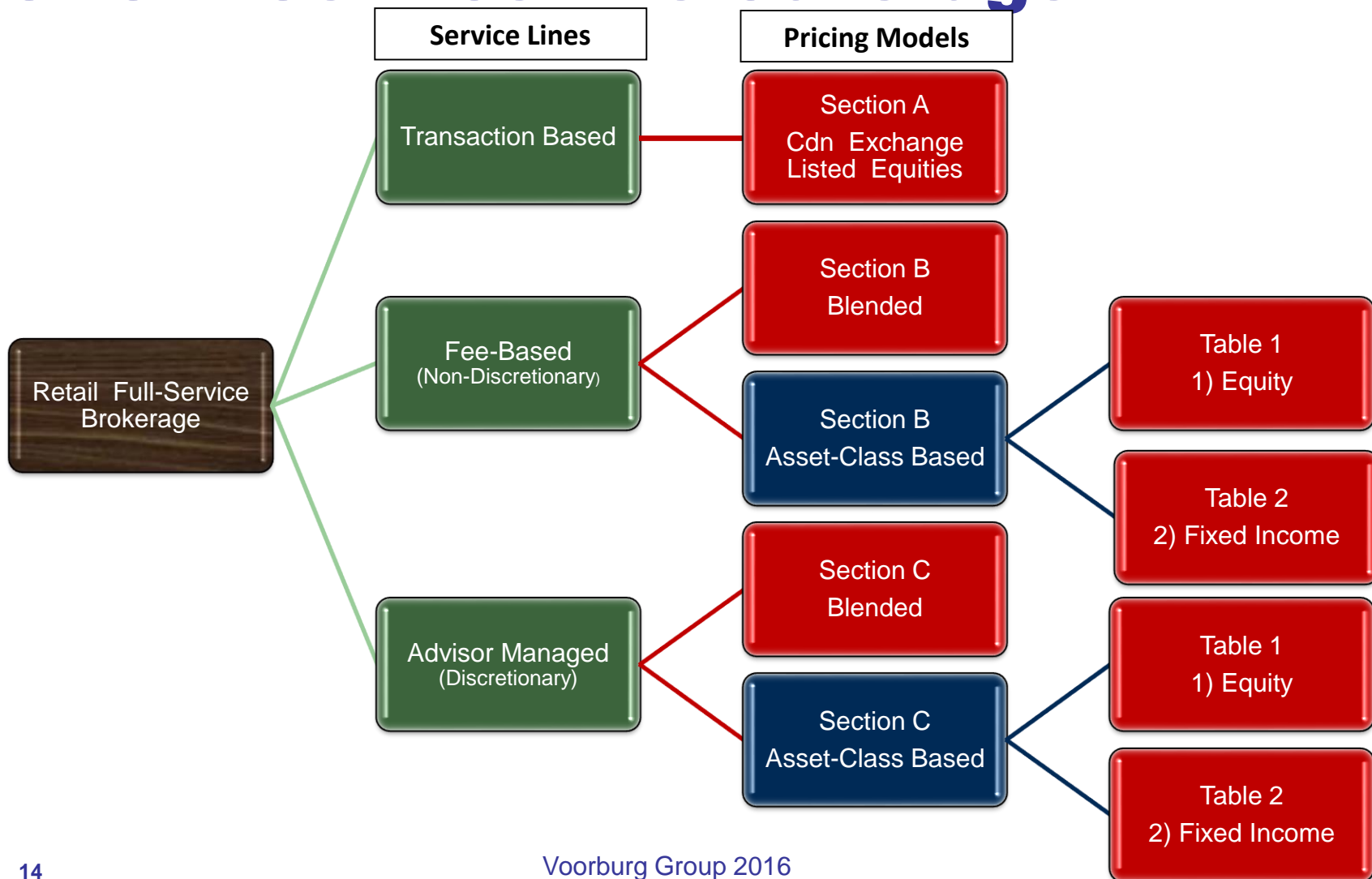
- Maximum allowable trades
- Minimum account balance requirements
- Services provided but charged separately

# Results and recommendation

- Firms can match transaction and account values to associated revenue type, for given period
- Some requested more tier ranges
- Price lists might be included in the client agreement but might differ from advertised lists
- Pricing Latitude varies significantly among firms
- In practice, free trades are rare
- “Householding” of accounts, to meet minimums, but concept is subject to interpretation

## **Recommendation: Unit value price**

# SBSPI Service line coverage





# SBSPI Data collection

<b>Account Value (or Trade Value) Range (\$)</b>  <b>A</b>	<b>Total Fees (or Commissions) (\$000's)</b>  <b>B</b>	<b>Total Value of Accounts (or Trade) (\$000's)</b>  <b>C</b>
up to \$99,999		
\$100,000 - \$249,999		
\$250,000 - \$499,999		
\$500,000 - \$999,999		
\$1 Million - \$1.9 Million		
\$2 Million - \$4.9Million		
\$5 Million - \$9.9Million		
\$10 Million +		
<b>Totals</b>		

# SBSPI calculation

1. Each tier, A, is taken to be a product providing a homogeneous level of service
2. Price is calculated as  $\frac{\text{Total Commissions}}{\text{Total Trade Values}}$  or  $\frac{\text{Total Fees}}{\text{Total Account Values}}$ , per tier

E.g., Price for service A  $\Rightarrow P_A = B_A / C_A$

3. Relatives are calculated per tier  $\Rightarrow P_{A,t} / P_{A,t-1}$
4. Relatives within each grid are weighted, using tier total fees or commissions, to come to the price of each service line
5. Index is weighted using data collected on the questionnaire



# SBSPI Lessons learned

- Population on central register should be confronted against industry list
- Target the right people in consultation
  - Subject matter: necessary to understand the idiosyncrasies of the industry
  - IT: necessary to understand if collection plans are realistic
  - From this, learn who is the right respondent for the survey
- Significant pricing flexibility, numerous account types and a very dynamic industry challenge pricing comparability and repetitiveness
- Frequent weight updates will result in an index which considers the dynamic aspects of the industry

# Conclusion

- The concepts of output and data sources line up well between national accounts and our SBSPI
- Canadian industry is highly concentrated where a handful of firms have significant industry coverage, therefore, (non-)response has a major impact on results
- Developments in regulation add another layer of complication
- Work will continue to expand coverage and address challenges with current pilot



## Next steps

- Consultation to address current pilot issues
  - Volatility in some response
  - Respondent error, and non-response
  - Record-keeping practices (SM vs. IT)
  
- Expansion of coverage using alternative data source for institutional firms



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