

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



Definition of the Service – Investment Advice

- 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

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



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

Number of Shares:	1,000
Share Price:	\$10
Subtotal:	\$10,000
Commission:	5%
Total Commission:	\$500



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

Initial Assets:	\$1,000,000
Rate of Return (Period N):	2.5%
Adjusted Assets:	\$1,025,000
Management Fee:	.0025
Total Fee:	\$2,562.50



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



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