IIAC LETTER

Industry Proves Resilient Through the Early COVID Period

Canada's securities industry, like most others, has been significantly impacted by the COVID-19 pandemic. A necessary rapid transition to remote based operations combined with a massive sell-off in equity markets, fragile credit markets and lost investor confidence brought about an operating and business environment few would likely ever have imagined.

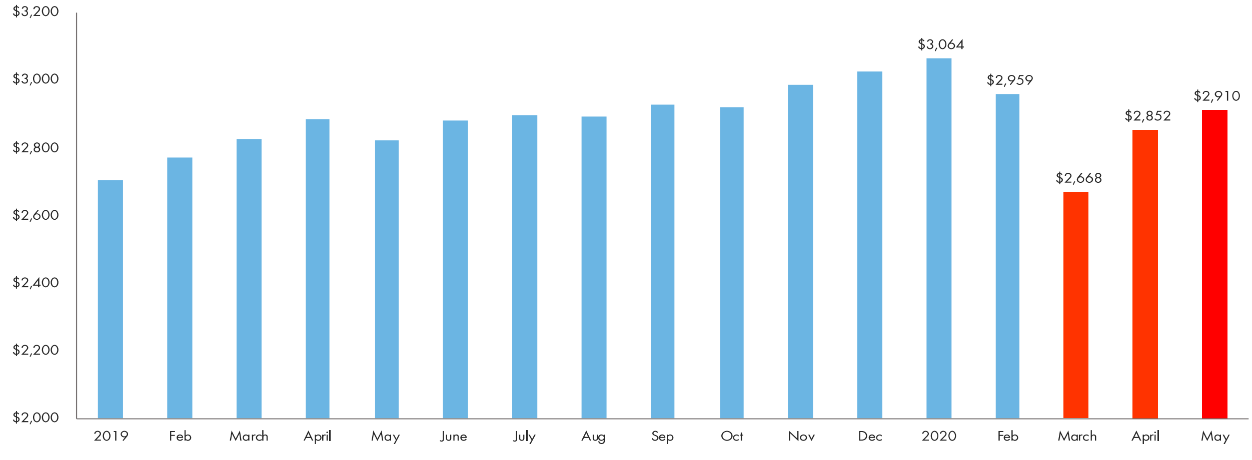
Industry data now available covering the early COVID period of March through May provides further insight of the pandemic's impact on industry performance. The data reveals that, despite setback in some areas, the industry overall appears to have weathered the early days of the pandemic well. This can partly be attributed to the massive industry restructuring stemming from the financial crisis but is also a testament to the dedicated professionals who comprise the industry today.

As the pandemic lingers it remains unclear what the longer-term effects on industry composition and performance will be. What is certain is that a vibrant securities industry will be depended on for Canada's economic recovery.

INDUSTRY PERFORMANCE DURING THE EARLY COVID PERIOD (MARCH – MAY 2020)

The abrupt collapse of equity markets in March resonated strongly within our industry. The value of client assets managed by dealers tumbled by nearly $300 billion, or roughly 10 per cent, in the span of just a few short weeks as client portfolios plummeted **[See Figure 1]**.

Figure 1: Client Net Equity Positions
($ Billions)



Source: IIROC Monthly Financial Reports, IIAC Compiled

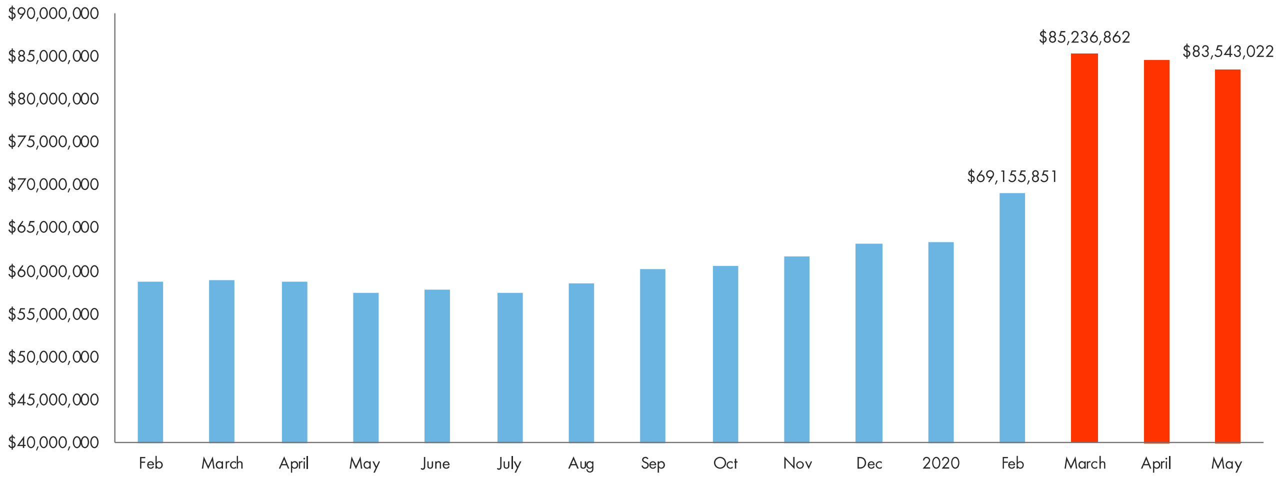
It is important to note, however, that the 10 per cent industry AUM decline was substantially less than the 25 per cent drop in the TSX/S&P Composite Index during the same period (end of February to End of March). This is likely attributed to the diversification benefits within industry holdings as well as decisive action taken early on by advisors to preserve client portfolios.

What was also witnessed was a quick recovery in industry AUM. By the end of May client asset levels were nearly back to where they were at the end of February before the March market meltdown. By comparison, the S&P/TSX Composite's month-end close for May remained 7 per cent blow its February mark.

The industry did experience the customary flight to safety typical during times of uncertainty. Clients seeking shelter from the market's abuse reduced their risk holdings and poured into the security of cash **[See figure 2]**.

The value of cash positions held in cash and margin accounts jumped 23 per cent from $69 billion in February to over $85 billion in March. We further see that these cash positions remained high in April and May despite the more settled market conditions. This could be explained by investors' preference to stay on the sidelines until more information about the pandemic, including its impact on corporate earnings, became known. However, it could also represent new cash coming into the industry from investors seeking opportunities from the market sell-off.

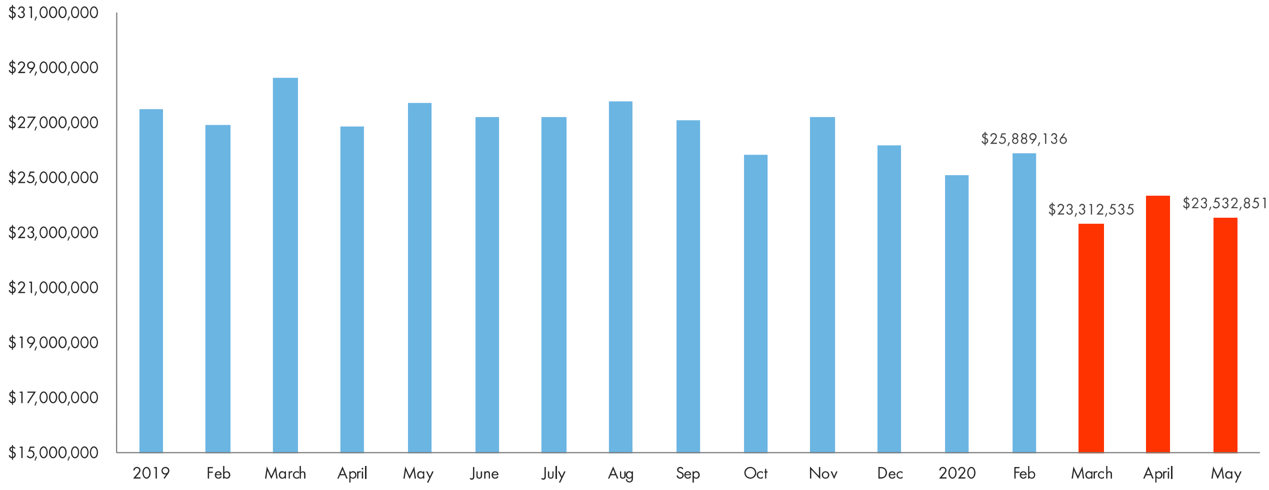
Figure 2: Client Cash Balances*
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled
* Includes client free-credits in Cash and Margin Accounts Only

Client's aversion to risk was also evidenced by the lower levels of margin borrowing in the industry during the period. The amount of margin debt outstanding at the end of May stood at $23.5 billion, down more than $2 billion from February's level **[See figure 3].** However, contrasting margin debt levels with overall assets in the industry reveals, that, Canadian's as a group have historically avoided excessive leverage in their portfolios. This conservatism undoubtedly contributed to stemming the bruising during the market collapse.

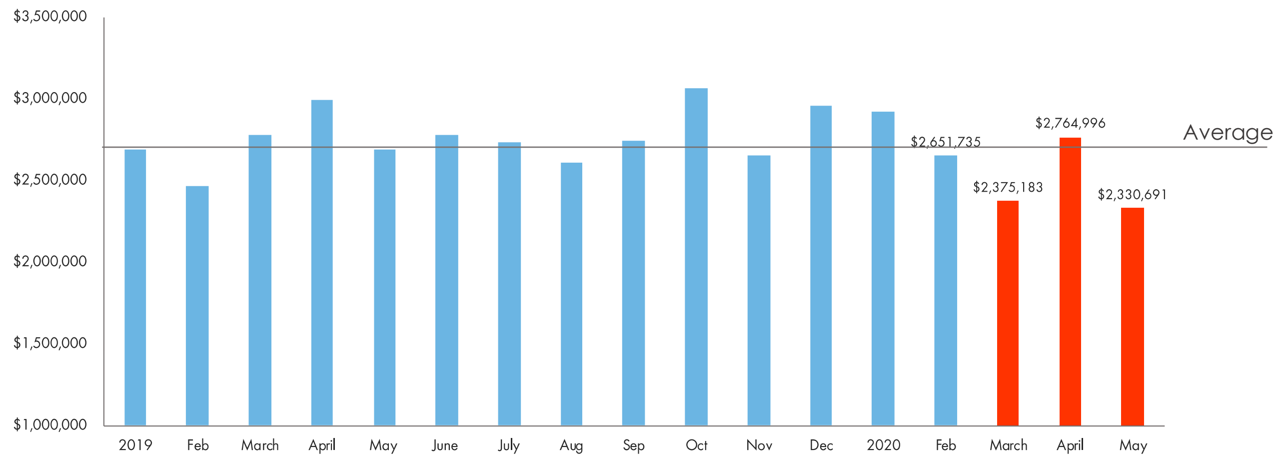
Figure 3: Customer Margin Borrowing
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled

Industry revenues were also impacted through the early COVID period, but perhaps not as adversely as many would have imagined given the market's dire performance and the impact of the pandemic on the global economic outlook. Total industry revenues fell just 10 percent in March but then rebounded strongly in April before sliding again in May **[See figure 4].**

Figure 4: Total Industry Revenues
(in $000s)

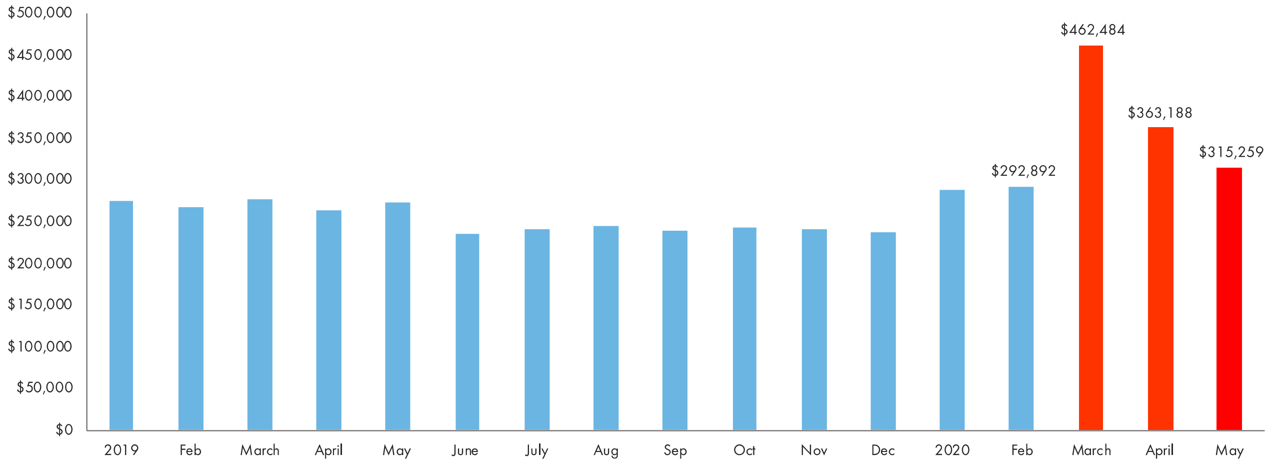


Source: IIROC Monthly Financial Reports, IIAC Compiled

Several industry businesses lines, however, benefited from the market's volatility. Client's either re-balancing portfolios or "bargain" hunting contributed to record levels of trading in March. This propelled industry commission revenues to new heights.

March commissions amounted to $462 million, up a whopping 58 per cent from the prior month. Commission revenues in April and May also remained well above historical levels **[See figure 5]**. These largely helped support the industry's retail wealth business.

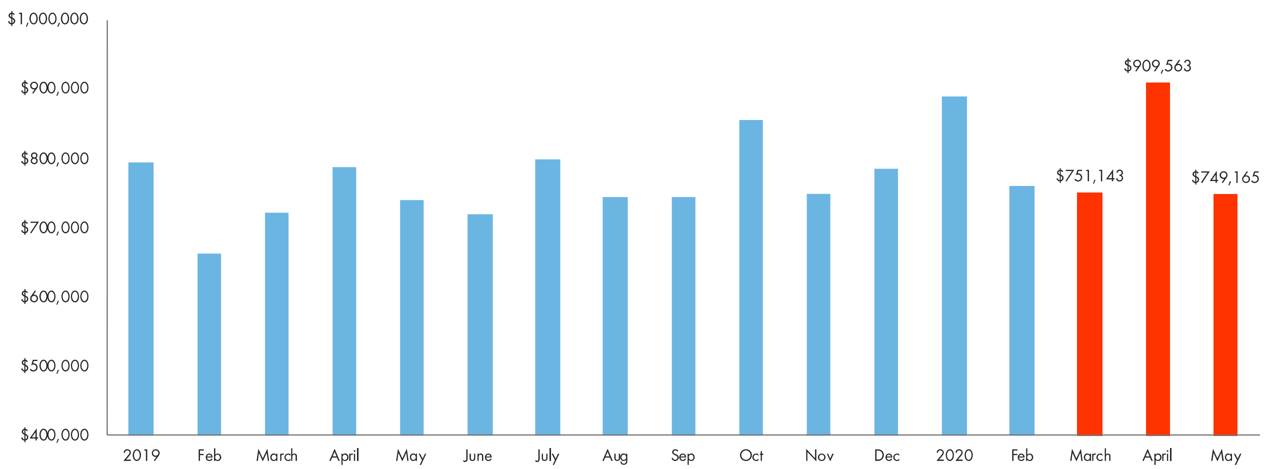
Figure 5: Commission Revenues*
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled
* excludes commissions from mutual funds

Also supporting retail wealth management firms were recurring revenues from their fee-based accounts. Industry fee revenues during the March–May period totaled nearly $2.5 billion including almost $910 million recorded in April - a new high watermark for the industry **[See figure 6]**.

Figure 6: Fee revenues*
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled
*excludes corporate advisory fees

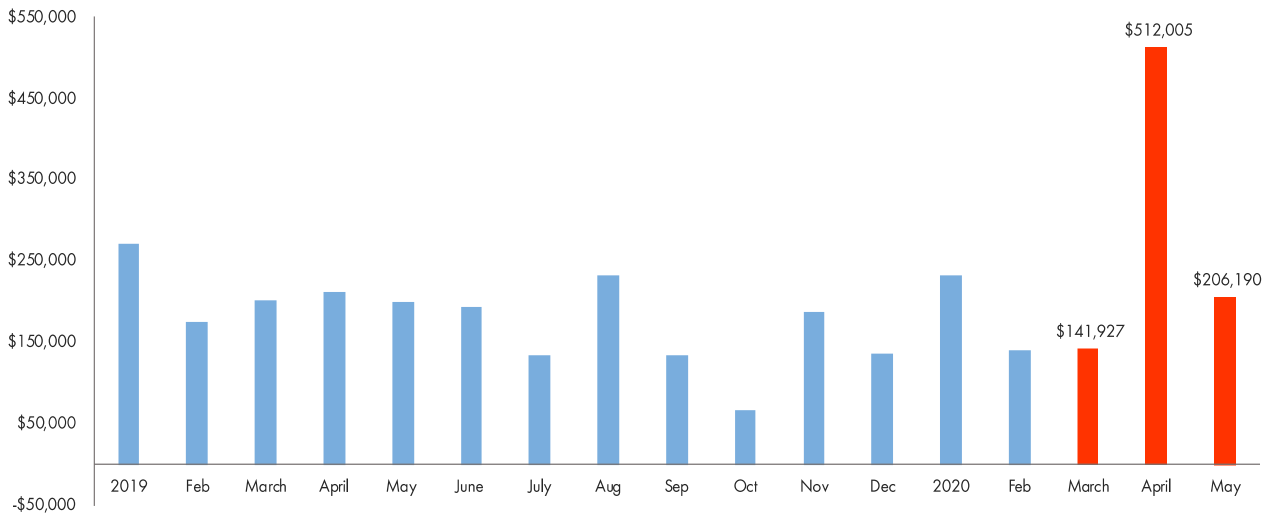
The industry's transition over the last decade to fee-based books of businesses, and the stable revenues that go along with it, has helped insulate it from unpredictable market cycles. The shift to managed account programs has also provided ancillary benefits to industry and clients, including allowing investment advisors/portfolio managers to react more quickly to market changes than conventional transaction-based accounts. Indications are that these wealth professionals were also able to effectively shift to remote-based operations in short order and continue servicing clients during this period.

Some areas of the institutional business also faired exceptionally well during the early COVID period. Particularly, the fixed-income business showed strong from both a trading and underwriting perspective.

Bond and Money Markets were extremely active during the period due to heightened investor demand for government backed securities. Also contributing to the flurry of activity were the policy rate actions and several new or revamped programs enacted by the Bank of Canada – all geared at supporting credit and short-term funding markets at the onset of the pandemic[1].

In April alone, 227 thousand institutional debt trades valued at $3.5 trillion were entered into CDSX by brokers.[2] This contributed to the $512 million in industry fixed income trading revenues recorded in April - a recent high for the industry and eclipsing prior monthly levels **[See figure 7]**.

Figure 7: Fixed-Income Trading Revenues
(in $000s)

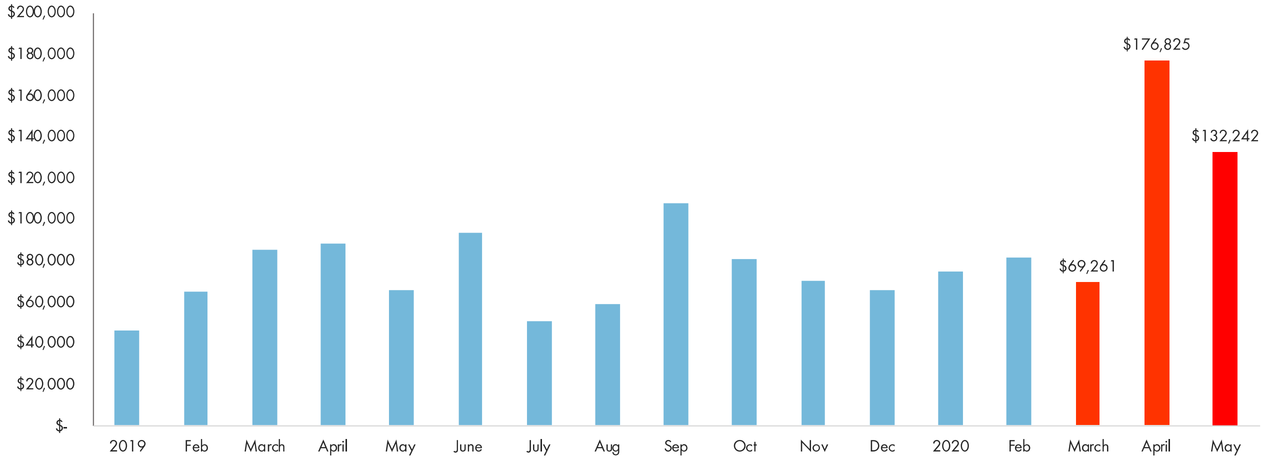


Source: IIROC Monthly Financial Reports, IIAC Compiled

Debt underwriting revenues also spiked in April and May **[See figure 8]** largely on the heels of larger provincial volumes. Corporate borrowers also came to market to meet their financing needs as well ask to take advantage of lower rates by moving out the curve, replacing short maturities with long bonds.

1 See IIAC Paper: [Functioning and Liquidity of Canadian Debt Markets to Date During the COVID 19 Crisis]
2 See April 2020 Institutional Trade Processing Report https://www.cds.ca/resource/en/318

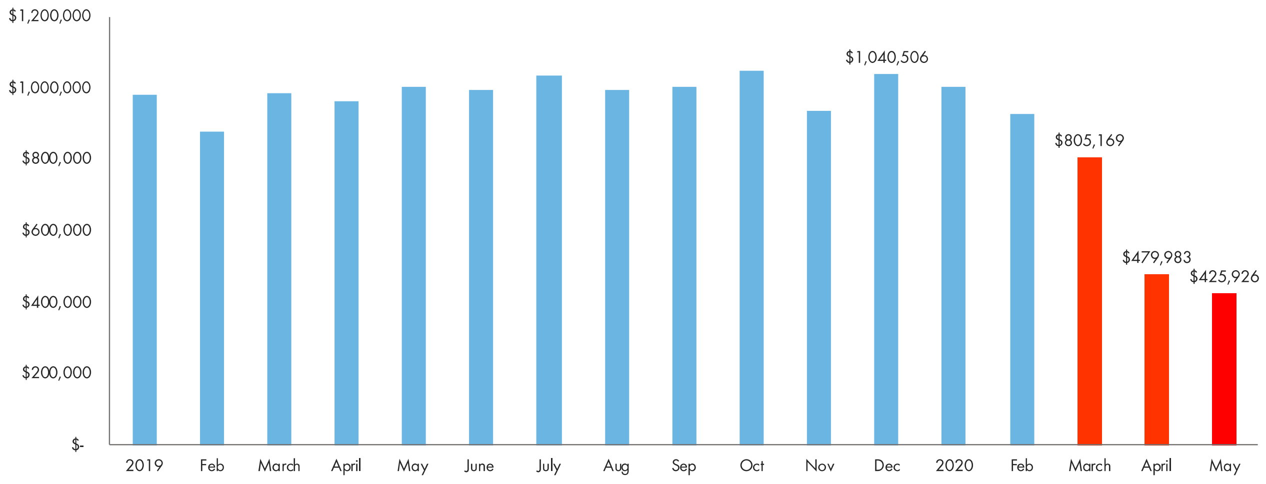
Figure 8: Debt Underwriting Revenues
($000's)



Source: IIROC Monthly Financial Reports, IIAC Compiled

While the ultra-low rate environment, brought about by three successive 50bp rate cuts in March by the Bank of Canada, may have spurred debt issuance it, however, adversely impacted other parts of the industry. Specifically, industry interest revenues plummeted in April and May to less than half of the levels witnessed earlier in the year as dealer spreads were forced to tighten **[See figure 9].**

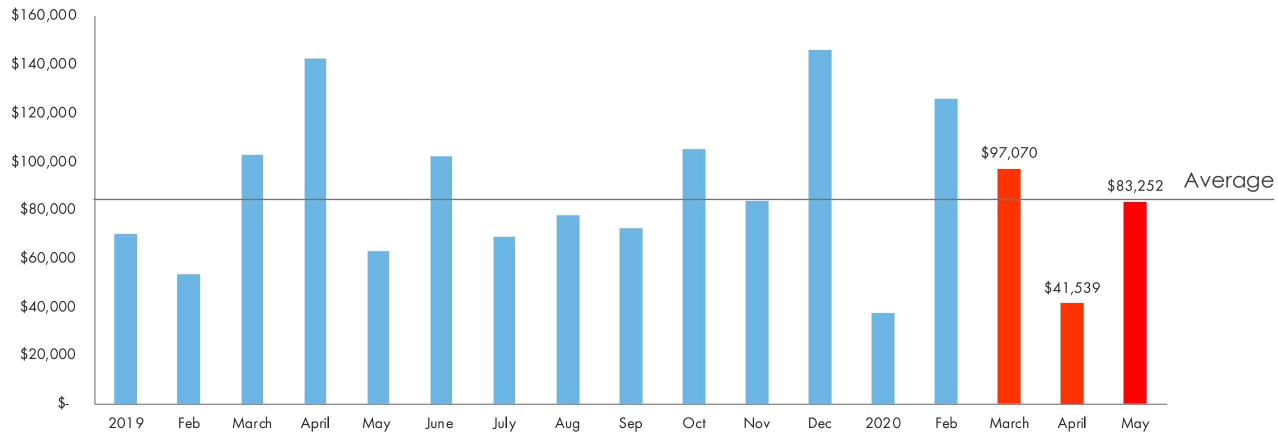
Figure 9: Interest Revenues
(in $000's)



Source: IIROC Monthly Financial Reports, IIAC Compiled

Equity underwriting revenues fluctuated during the early COVID period, but except for April, delivered good results. Collectively the industry earned $222 million in equity underwriting revenue during the 3 month period – in line with other 3 month periods of the past year **[See figure 10**].

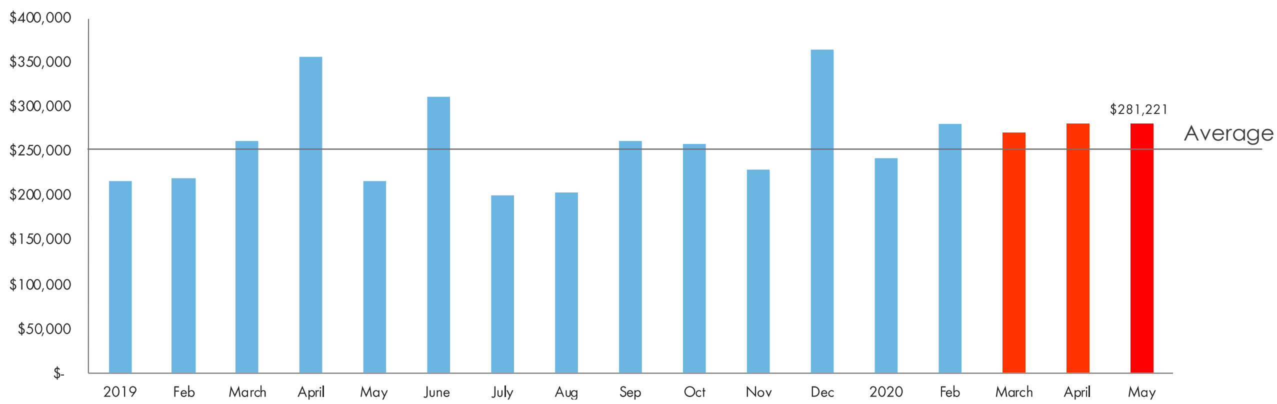
Figure 10: Equity Underwriting Revenues
($000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled

Overall investment banking revenues, comprised of debt and equity underwriting revenues as well as corporate advisory fees, held fairly steady with March, April and May each topping the average monthly level for the previous 17-month period **[See Figure 11]**. An impressive industry feat considering the headwinds investment bankers and their corporate clients endured during the period. We should note, however, that some portion of the figures may reflect transactions undertaken in the lead-up to March.

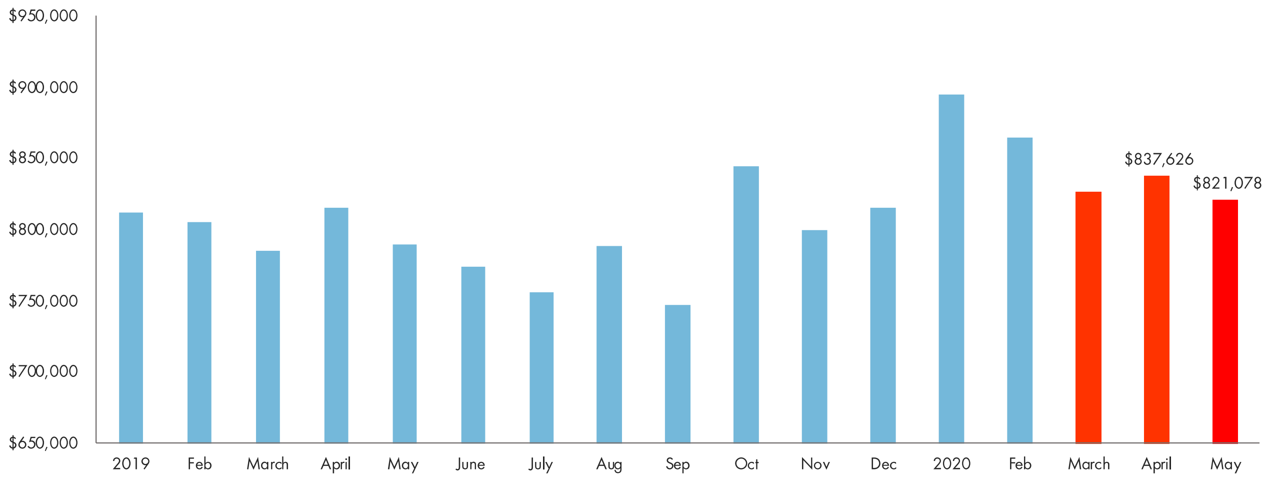
Figure 11: Investment Banking Revenues*
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled
* comprised of underwriting and corporate advisory revenues

A look at industry fundamentals further illustrates the industry's resiliency during the early COVID period. Industry operating expenses witnessed declines from the January and February periods **[See Figure 12].** Dealers worked hard to manage costs despite the unforeseen added expense of implementing business continuity plans and transitioning their workforce to remote based operations. Firms had to invest in new technologies and training to allow staff to communicate virtually with clients and colleagues. Networks were also shored up to handle the data influx and resources spent to ensure traders and front-office staff could maintain productivity while working remotely.

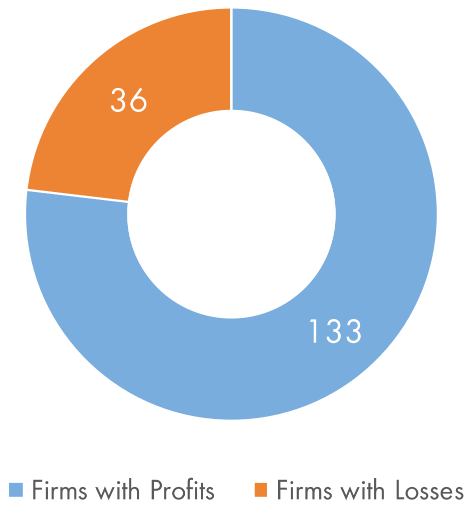
Figure 12: Operating Expenses
(in $000s)



Source: IIROC Monthly Financial Reports, IIAC Compiled

The industry's tight handle on costs combined with commendable revenue performance during the early COVID period allowed most industry firms to weather the early part of this storm. Only 37 dealers reported a loss in the month of May. Year-to-date through May nearly 80 per cent of IIROC firms remain profitable **[See figure 13]**.

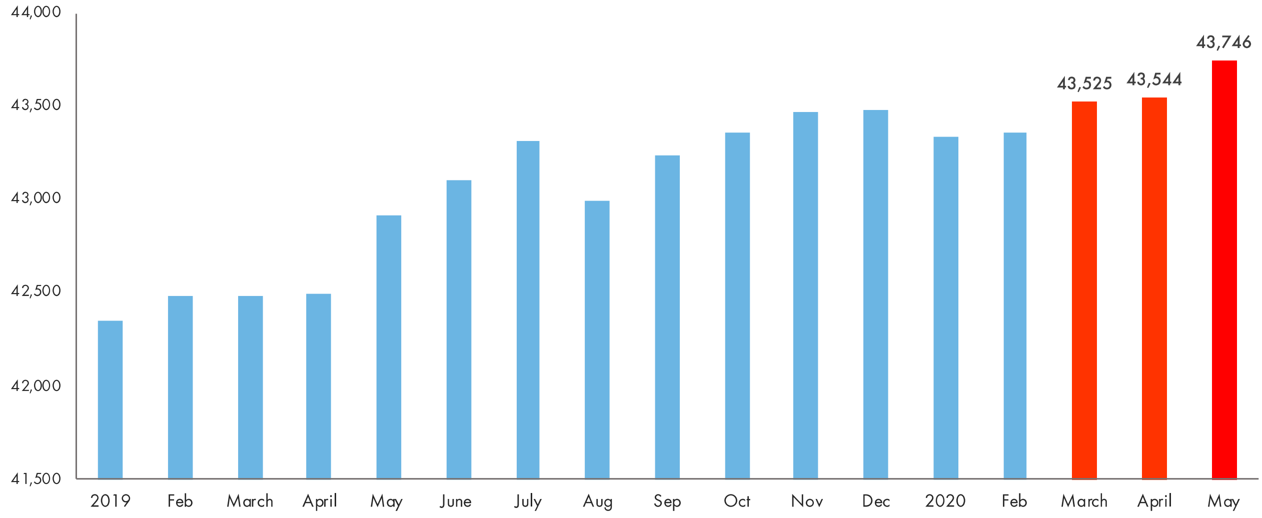
Figure 13: Number of IIROC Dealers with Profits and Losses
(Year-to-Date as at May 31, 2020)



Source: IIROC Monthly Financial Reports, IIAC Compiled

However, what our industry can perhaps be most proud of is its ability to sustain employment during a period when many other sectors of the economy were forced to shed jobs. Governmentordered workplace closures and the economic fall-out of the pandemic on Canadian businesses resulted in approximately 3 million job losses during the early COVID period. Unemployment in Canada reached an unprecedented 13.7 per cent in May. Our industry was able to buck this trend and reported marginal increases to industry head count during the period. As at the end of May IIROC dealers directly employed 43,746 professionals – a record high for the industry **[See figure 14]**. The industry of course also helped support many thousand more jobs indirectly via the various businesses that service the dealers.

Figure 14: Industry Employment
2019-May 2020



Source: IIROC Monthly Financial Reports, IIAC Compiled

CONCLUSION

The Canadian securities industry has not been immune from the effects of COVID. However, as evidenced in this report, it remained largely in good health through the first three months of the pandemic. While it is unknown how much longer our industry will have to endure, what is known is that any prospect of economic recovery in Canada will rely on well-functioning capital markets and continued resilience from securities dealers.

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Managing Director