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How Toronto Became the Financial Capital of Canada: The Stock Market Crash of 1929

Canadian Business History
Professor Joe Martin

This case was prepared by Darren Karn under the direction of Professor Joe Martin as the basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation.

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Introduction

In the United States, events surrounding the great stock market crash of 1929 are well documented and recounted. However, far fewer stories and details about the experience and effects of the crash can be found in Canada.

This case recounts the events in Montreal and Toronto surrounding October 29, 1929 – the day the North American markets crashed. The following pages examine the events of that infamous date in the context of the histories of the Montreal and Toronto stock exchanges, and the substantial fallout from the crash.

In addition to outlining the events of the stock market crash, this case also investigates the interactions between those businesses most closely involved with the stock market – the brokerage houses and the banks. These two players were complicit in encouraging the irrational exuberance demonstrated prior to the crash. During the late 1920s, most investors purchased their shares on margin, enjoying margin requirements seldom higher than 10%, a figure the brokerage houses were only too happy to encourage as commission receipts ballooned. The banks were the first source of capital for the margin accounts opened by the brokerage houses. These same banks only half-heartedly attempted to stem the easy flow of money. Individual managers enjoyed significant flexibility in approving loans to brokerage houses, while personal relationships and fees for lending money often trumped financial prudence.

Following the crash, these relationships between the banks and brokerage houses grew even closer. Brokerages struggled to service their debts while the underlying shares -- the security for their loans – became worthless almost overnight. Although the total average industry losses through 1932 were about 70%, many industries were hit much worse, losing upwards of 90% of their pre-crash value. The brokerage houses relied heavily on their bankers, sometimes resorting to begging and pleading, to negotiate the terms of repayment, often earning themselves a few months' reprieve.

Ultimately some brokerage houses failed, particularly those in Montreal. Toronto's financial community generally weathered the storm better than Montreal due to the quick recovery of the gold mining sector (based in Toronto) following the crash. The Toronto-based Standard Stock and Mining Exchange was the biggest mining exchange in Canada, and Toronto began to emerge as the country's hub for mining finance. This development served to benefit Toronto greatly and became a considerable advantage in the period following the crash. Toronto's strength in mining finance was an advantage that paid exceptional dividends, particularly in 1934, when U.S. President Franklin Delano Roosevelt raised the price of gold substantially. Indeed, this recovery buoyed the Toronto Stock Exchange, which ended up surpassing Montreal in trading volume by the end of the Depression, a position Toronto never relinquished. Although Montreal remained Canada's financial capital for the time being, the shift to Toronto had begun.

Pick a Stock, Any Stock

In 1929, James Armstrong Richardson was serving as President of Richardson and Sons, a 70-year-old family firm with interests in grain and financial services. He was past-president of the Winnipeg Grain Exchange and a director of a number of major Canadian Corporations– including Canadian Pacific Railroad, Canadian Bank of Commerce, International Nickel, Great West Life and Canadian General Electric. He was also a member of several exchanges and boards of trade, including the Winnipeg Grain Exchange, Montreal Stock Exchange, Toronto, Montreal, Minneapolis and Chicago Boards of Trade.[1] As one of the most respected financial men in Canada, Richardson was a man to whom people listened.

One of his listeners just happened to be the Right Honourable Winston Churchill. Although Churchill was not yet Britain's Prime Minister, he had nevertheless developed an impressive political resume by 1929, having been First Lord of the Admiralty and having just completed his posting as Chancellor of the Exchequer, the cabinet minister responsible for all of the country's economic and financial matters.

On October 24, 1929, Richardson sent a letter to Churchill in New York, one of the stops on the British statesman's tour of North America. In his letter, Richardson offered to meet and guide Churchill on his upcoming visit to Winnipeg. Ever on the lookout for a good tip, Churchill agreed to meet Richardson in Winnipeg to discuss the markets. Churchill was an admirer of Richardson and was looking to the Manitoba executive for advice. Upon the completion of his trip, Churchill spoke highly of Richardson:

"At Winnipeg we were taken charge of by a Mr. Richardson, who is the leading grain merchant. A very good specimen of a new world business man, the owner of immense properties and undertakings from nickel and copper to a fleet of thirty-seven aeroplanes."[2]

As a director of several large corporations, the founder of Western Canadian Airlines (a precursor to Air Canada) and president of his respected brokerage house, Richardson was eminently qualified to provide someone of Churchill's status with opinions about the market.

While Richardson acknowledged the volatility in the markets in October 1929, he could not resist recommending that Churchill buy almost any share on the market:

"We have, though, just gone through a severe panic in the New York stock market and there are all kinds of attractive investments that can be made at present for anyone who is in a position to take advantage of them and who is prepared to put the stock away quite regardless of day-to-day fluctuations in the immediate future.

Among these stocks I regard International Nickel as one of the most attractive [...]. In fact, there are so many good stocks selling cheap at the present time that all one has to do is to pick out some of the good ones to put their money into."[3]

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[1] Who's Who in Canada, 1929.
[2] The Great Dominion, Winston Churchill in Canada, 1900-1954 by David Dilks, Thomas Allen Publishers, Toronto, 2005

It was hard not to agree with Richardson. One of the great bull markets in history had been underway for the better part of three years, and although some cracks had begun to show, investors could not have predicted what was to come. (See Exhibit 1 'Quarterly Stock Prices, 1926-1929'.) International Nickel appreciated more than 50% between 1928 and 1929 with similar gains reflected in several other companies and sectors. The Royal Bank and Bank of Montreal saw their shares rise from approximately $250 in 1926 to over $350 in 1929. Utilities like Shawinigan Water (a precursor to Hydro-Quebec) saw its share price double over the same time period, while oil and other mineral stocks (British American, Imperial Oil, Noranda) enjoyed four- to five-fold increases. As Richardson pointed out, any investor could make money under these conditions, "all one has to do is pick out some of the good ones."

The events of the following week would prove Richardson wrong. And while Churchill was on the floor of the New York Stock Exchange on October 29, all he could do was watch helplessly as prices tumbled ever lower. The good times of the Roaring Twenties had come to an end.

The Evolution of Stock Exchanges in Canada

A stock market's basic function is to link savers with investors and provide a location where these parties can freely negotiate the exchange of assets. To that end, stock markets allow companies to raise money by selling partial ownership of the company (shares) to anybody who is willing to buy them and for the subsequent owners to sell their shares, as they wish. As the central location for these activities, stock markets therefore provide the necessary liquidity for a capital market to function.

Although the origin of tradable financial instruments traces back to Florence in the 14th Century, when the city sold bonds to its citizens, stock markets did not become important until much later – with exchanges in London being formalised in the 1600s. Stock exchanges were not typically needed until joint-stock companies began to form. As the need arose to finance larger projects (coal mines, canals, steam railroads for instance), no single individual was willing to bear the entire risk of those ventures. Accordingly, the risk was shared across multiple owners of the firm, with each owning shares of the company. Markets then arose for these owners to trade their ownership shares.

In Canada, stock exchanges formed much later, even compared to New York. Canadian exchanges did not become material entities in the business landscape until well after 1850, when Canada passed legislation allowing the easier formation of joint-stock companies.[4] Even then, the exchanges had humble beginnings, as most of the capital used to fund new Canadian companies came from the more established economies of London and New York where the shares would often be listed[5].

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[3] October 24, 1929 letter from James A. Richardson to the Right Honourable Winston Churchill, Richardson Archives, Winnipeg.

[4] Joint-stock companies are limited liability companies, providing further protection for the stock owner.
[5] Michie

The Montreal Stock Exchange

Montreal is home to Canada's oldest stock exchange, incorporated in 1874. Despite the exchange's official founding date, the trading of securities is believed to have actually started in Montreal shortly after the Napoleonic Wars – likely beginning with the establishment of several banks, the first being the Bank of Montreal, founded in 1817 (the first joint-stock Canadian company).[6]

Since companies were being founded with public capital, it followed that the men (and they were almost exclusively men) contributing this capital wished to trade their shares of companies. In the early days, they conducted these trades informally.

Until 1840, trading of securities (almost always bank securities) was conducted directly between shareholders, with employees of the bank acting as intermediaries. However, the 1840s were marked by commercial growth in Montreal, and more modern stock trading practices evolved. One indication of this evolution was the formation of the Board of Brokers in 1848, which traded both securities and staples (with specialised commodity exchanges like the Corn Exchange forming in 1862).[7] Those who began to specialise in securities, and less in commodities, later formed the Board of Stock Brokers, which called itself the Montreal Stock Exchange in 1870, before incorporating in 1874.

Although trading activity increased in the 1840s, Montreal business executives seemed to have difficulty creating a formal exchange. Throughout the 1840s and 50s, the Montreal Board of Trade rented rooms for 30 minutes a day, six days a week, for "meetings on change."[8] During these early days securities trading was slow, since brokers were more active in commodities. The Companies Act of 1850 made it easier to form joint-stock companies (previously, an Act of Parliament was required to form such a company), greatly increasing the potential for a securities market.[9]

The first recorded trade on the Montreal exchange took place on September 25, 1867, but on many days no trades occurred at all. For these early issues, funds were solicited from the public through newspapers, where IPOs were announced, and the broker's name was listed therein.[10] Slowly, but surely, a securities business grew in Montreal.

The impetus behind the establishment of the MSE was different from that of stock exchanges in London or New York, which were launched to handle a dramatic increase in government borrowing. Instead, the MSE developed out of a gradual increase in the trading of a handful of securities for banks, insurance companies, and various gas and rail utilities.[11]

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[6] McKeagan 61
[7] McKeagan 61
[8] McKeagan 68
[9] McKeagan 69
[10] Mckeagan 71
[11] McKeagan, 72

The Toronto Stock Exchange

Beginning in fits and starts, several Toronto-based exchanges appeared and disappeared in the years before the formal exchange was established. Between 1852 and 1870, three separate exchanges were founded: The Toronto Exchange in 1854, the Toronto Stock Exchange in 1861 and the Toronto Stock and Mining Exchange in 1868.

Before the establishment of these exchanges, securities were traded by private individuals or through a company issuing shares, similar to the situation in Montreal. Stock brokers existed at this time, and worked in a similar manner to a real estate agent without access to a Multiple Listings Service – the broker had to find and then match willing sellers and buyers, charging a commission if a sale could be negotiated. The selling broker then had to negotiate the price, as there were no formal listings of stock prices.[12]

Like its Montreal counterpart, Toronto's first exchange (the Toronto Exchange) was very much commodity-based, while securities trading was a secondary objective. However, there was not much grain to trade in Toronto at this time, and the exchange soon folded. The Toronto Stock Exchange came into being in October 1861, as recorded in the original TSE minute book. The objectives of the exchange were described at the time as:

being the establishment of a medium of communications between the members, so as to facilitate the negotiation of bills of exchange, stocks, shares, bonds, debentures, mortgages and other loans: Thus establishing a reliable market for the benefit of the public.[13]

Thirteen issues were listed on the exchange, with two trades taking place the first week.

Business was slow on the early TSE – starting with just 13 issues in 1861. Listings dropped to 12 in 1866, before growing to 18 in 1868. About half of the listed issues were from banks, with the next largest category being bonds and debentures.

The TSE failed during 1869 as banks collapsed across Upper Canada. It was around the same time that a new exchange was founded – the Toronto Stock and Mining Exchange. It was established on the basis of the gold mining boom in Madoc, Ont.[14] However, the subsequent mining bust saw this exchange disappear at the end of the year.[15] By the end of 1869, no exchanges were operating in Toronto – the market for securities was too small to support organized trading.[16]

In the fall of 1871, a group of brokers once again attempted to establish an exchange in Toronto – eight of the original 24 TSE members rejoined, despite the fact that the remaining originals had left the stock brokering business.[17] A bull market for bank shares in 1870 provided some investor confidence in

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[12] Whiteside 65
[13] Whiteside, 66
[14] Gold was first discovered in Madoc, a town north of Kingston, Ontario, in 1866.
[15] Whiteside, 69
[16] Whiteside, 69
[17] Whiteside, 72-73

securities and more listings became available for trades on the TSE for the new organisation – 34 securities were listed in September 1871. At this time, the exchange saw itself as providing two main services to the public: to serve as a self-regulating local trading forum with regular meetings, and to supply information on locally traded securities.[18]

The makeup of the exchange during these rejuvenated years was still heavily biased toward banks and emergent mortgage companies. These two players together occupied more than three-quarters of the listings through 1900. During these formative years, as land values increased, mortgages provided the largest and most secure capital investment, providing stability to Ontario's financial system.

By the late 1920s, both the MSE and TSE (and even the Standard Stock and Mining Exchange, which was founded in Toronto in 1908 to handle junior mining issues) had become prosperous going concerns. One indication of stock exchange success was the amount that brokers were willing to pay to become trading members. As trading volume increased on the exchanges, brokers were quick to realise that substantial profits could be made. Since each exchange maintained a fixed number of memberships, the cost of membership grew with the success of the exchanges.

The experience of brokers on the SSME was similar to that of brokers on the MSE and TSE (some of whom held memberships in more than one exchange). The cost of a membership in the SSME in 1921 was approximately $1100. By 1928, memberships were selling for $100,000 – a 100-fold increase in just seven years. Brokers were making huge sums of money on the upswing in the markets throughout the 1920s.

Apart from the investors who seemed possessed by animal spirits during the bubble, brokers also contributed to the run-up in stock prices before the crash. Several unethical practices artificially buoyed the market – from brokers partnering with mining promoters to falsely report the extent of mineral findings (both to run up the price of the stock and to purposely make it crash), to brokers executing trades for clients but not actually registering the transaction, so that they were able to sell more shares "on the market" than were actually ever issued.

When not engaging in those more fraudulent actions, brokers also took great liberties when promoting their share issues. In a May 1933 speech, Henry R. Jackman – noted investor, founder of the philanthropic Jackman Foundation and Member of Parliament from 1940 to 1945, spoke thusly:

It was common practice in 1928 and 1929 to issue securities on the basis, not of earnings of those peak years, but to draw a line through the increasing earnings of the prosperous period of 1921-1928 ... and project that line to a point which would measure the supposed earnings of 1931-32 and to sell securities on that basis.

Canada's stock exchanges had come a long way from their humble beginnings. While business on the exchanges had boomed during the 1920s, that business was not always conducted in good faith. The stage was set for a catastrophic crash – a crash that arrived in October 1929.

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[18] Whiteside, 74

The Crash of October 1929

The most infamous day in 1929 is known as Black Tuesday, or October 29. But the fantastic bull market of the previous few years first showed signs of cracking the week before Black Tuesday, on Wednesday October 23.[19] The markets opened that day to heavy trading volume, with Montreal and Toronto struggling to keep up with the news in New York (the exchanges were not connected to one another by ticker until 1931, so news was passed over the telephone or by brokers' private wires). Toronto, better connected to New York, received the bad news before Montreal, and by the afternoon, three of the most popular stocks (International Nickel, Brazilian Traction and Hiram Walker) were down more than 8%. The tension then carried over to the following day, since known as Black Thursday, with stocks on the MSE losing up to 25% and TSE 20%. In Toronto, it was near impossible for traders on the floor to get a bid.[20]

That Thursday afternoon several prominent US bankers led by those from JP Morgan and Company met to discuss the brewing crisis and injected between $20 and $30 million dollars into the market as a stabilising measure and to prop prices up. Their efforts worked, albeit temporarily.

The following day's headlines told the story – *The Globe* led with "Stock Speculators Shaken in Wild Day of Panic," noting that a record for "all-time" trading volume was set on the NYSE, TSE and MSE. The NYSE often wondered when the exchange might trade five million shares in a day – on October 24, nearly *thirteen* million shares changed hands.

With markets rebounding slightly on Friday and remaining stable for the most part on Saturday, it seemed like the worst had passed and that the actions of the bankers in New York on Thursday, which had amounted to walking on the floor and buying shares methodically up to the limit of their pool of funds, had had the desired effect. A short decline before trading ended on Saturday, however, seemed to rekindle Thursday's feelings of malaise. When markets opened on Monday, a notable lack of confidence could be seen. Although the total volume was approximately two-thirds of Black Thursday, many issues still dropped precipitously. A palpable feeling of unease bordering on panic was in the air when the markets closed on Monday.[21]

The panic picked up on Tuesday – the worst day of the crash, when even the most steadfast investors, including the bankers who had propped up the market the previous Thursday, tried to find willing buyers on whom to dump their shares. Sixty-two Canadian stocks fell to their lowest levels of the year, with even the exchange stalwarts Brazilian Traction and International Nickel losing 11 and 10 points each.[22] Again, *The Globe* reported on the events, "*Utter Collapse in Stock Market Narrowly Averted"*. The NYSE set a new trading record, with a turnover of 16.4 million shares. Toronto and Montreal posted

[19] The Globe headline the next day read 'Stock Market Panic Threatens New York in Last Hour'
[20] Fetherling, 108-111
[21] Fetherling, 120
[22] Fetherling, 127

record turnovers themselves, 331,000 on the TSE and 525,000 on the MSE. On the TSE, 106 issues closed lower, with only 5 advancing. Losses ranged from 10 to 50 points across the board.[23]

The Banks and the Brokerage Houses Part I: Buying on Margin

After the crash, companies began to have trouble covering their debts, and stock brokerages were certainly no exception. The primary reason behind brokerage insolvency post-crash was the practice of buying on margin – both by clients and on the brokerage's own account.

Similar to a mortgage on a house, buying stock on margin means buying shares with borrowed money. For example, if an investor wanted to purchase $100 of stock, depending on the volatility or quality of the underlying shares, he could borrow up to $90 of that $100. The broker would lend him the $90, and the investor would put up $10. The assumption was that the stock would continue to appreciate (and from 1926 to 1929, no-one thought to argue against that premise), so all the investor would ever have to do is sell the shares, pay off the loan, and collect the difference.

Of course, the investor would have to pay interest on the loan from the broker – but with ever increasing stock prices (and with some paying dividends upwards of 7%), paying the interest was of little concern – rates at the time hovered between 4 and 6%.

Obviously, a margin transaction involves risk – if the share price decreases, the broker must call the investor and ask them to put up more money. As one can imagine, nobody really thought that share prices could depreciate any significant amount – not more than 10%, and certainly not 50% or more in the span of two days. From 1929 to 1932, as the crash gave way to a deep depression, 50% declines would have been welcome. Unfortunately, from peak-to-trough, the outcome was much worse.

Exhibits 2 and 3 illustrate the decline of Canadian stocks, first individually and then by industry, from the peak of the market in 1929 to its trough in 1932. October 1929 was only the beginning. Between their highs in 1929 and their lows three years later in 1932, Canadian stocks lost 70% of their value. Losses would have been much greater if not for the Telephone/Telegraph, Food and Allied Products and Banks sub-sectors. The shock to the markets was extreme.

When investors bought on margin, they borrowed the money from the broker. The brokers, in turn, funded some of their margin business out of their own accounts. With the bull market of the 1920s, brokerages needed outside sources of capital to fund their clients' margin accounts and they borrowed from both Canadian and American banks. The brokers typically lent this money to their clients at a rate between 0.5 to 1% more than they were paying the bank providing perhaps an incentive to grow the risky margin business of the firm.[24] In 1921, for example, the Toronto-based brokerage house Deacon &

[23] The Globe, October 30 1929, pg 1
[24] Saywell, 188

Company was capitalised at $135,000, with loans in Canada of $625,000 and New York of $800,000.[25] By 1929, this firm and others like it were leveraged even more.

When revenues were driven by commission, it was understandably quite attractive for the salesmen of a brokerage house to encourage new prospects to invest in the market when they had to pay only a fraction of the total cost. As evidenced by Deacon & Company's capital structure, increasing stock prices, cheap money and commissioned brokers all contributed to exceptional leverage.

When stock prices crashed, brokers looked immediately to their clients to cover the margin. In some cases, investors could cover their position by selling their shares and covering the losses with other cash. In many cases, however, investors were ruined and liquidating clients' positions only furthered the devaluation of the one asset the brokerages held as security against the outstanding loans.

As shown in Exhibit 2, a selection of the most popular and widely-held companies saw their share prices fall by upwards of 90 percent, with pulp and paper companies like Price Brothers and Abitibi Paper slipping into bankruptcy. Margin accounts had to be covered – yet suddenly the brokerages found themselves unable to service the loans they had obtained from the banks. Brokerages could neither recover the outstanding debts from their clients (who were broke), nor could they sell the underlying shares (which were worthless and risked further devaluing the securities). With a catastrophic drop in volume, the brokerages' remaining source of income – commissions – evaporated. (See Exhibit 4 – Index of Stock Exchange Volumes – 1926 to 1932). Given the disastrous economic reality that began to unveil at the end of 1929 and in the early 1930s, the banks called the brokers loans. The banks, however, had not been silent bystanders up to this point.

Although the crash of October 29, 1929 was generally unexpected, there were occasional voices of caution in Canada. In 1927, the general manager of the Bank of Nova Scotia informed his management that share prices had moved well out of line with earnings and assets. Correspondingly, he warned his branch managers against advancing any further funds for margin accounts:

> *...These, as well as the high prices of stocks, are signals that we cannot ignore; consequently, we feel that the time has come for us to cut down our loans against stocks. Managers will, therefore, consult us before making loans to customers against such securities.*[26]

Shortly thereafter, the Canadian Bankers' Association warned that the banks were issuing too many call loans (business loans which could be demanded at any time by the bank), and that loans should not be advanced to encourage speculation. In recognition of these factors, the banks encouraged brokers to increase their margin requirements from 10 to 20%.[27]

In 1928, banks became even more cautious, with the Bank of Nova Scotia again warning branch managers to examine their margin accounts carefully and that the maximum allowable margin should

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[25] Saywell, 170
[26] Saywell, 172
[27] Saywell, 173

not be less than 30%. For non-dividend paying securities or those selling above "intrinsic value" (effectively the entire market at this point), the margin should be 50%.[28]

The attitude of the brokers, however, was often in stark contrast to that of the bankers (or, as will be seen, among those in upper management at the banks). At Deacon & Company, the younger traders could not separate themselves from the emotions of the bull market – they bought and sold at the maximum margin. Unfortunately for the conservative bankers, the brokers were in a competitive fight for commissions. Common knowledge dictated that a broker either let his clients buy on margin or lose them to a firm that would.[29]

As the rush to invest in the market continued in 1929, even the banks could not obey their own directives on lending. In June, 1929, the general manager of the Bank of Nova of Scotia was at it again – his reports indicated that margin loans had increased substantially. Infuriated, he wrote "notwithstanding our many warnings, these loans are at their highest point. It must be distinctly understood that it is reductions we want, and not increases." Much to the bank's chagrin, the branch managers apparently treated brokers the same way that brokers treated their clients – they allowed them to buy on margin or else risked losing them.[30]

The Banks and the Brokerage Houses Part II: Foreign Exchange and The Gold Standard

While the crash in October 1929 was catastrophic on many fronts, no brokerage houses in Canada failed in the immediate aftermath. Although many brokerages were technically insolvent, the Canadian banks (technically insolvent as well, see below) were generally quite lenient when it came to demanding full and immediate repayment. The banks clearly understood that brokerage houses were struggling, and pushing for full repayment of loans would have pushed the latter into bankruptcy long before a significant portion of the loans could be repaid. Brokers, however, also borrowed from American banks, taking advantage of the more plentiful sources of capital available south of the border. The American banks were generally less forgiving, especially following the abandonment of the gold standard by Britain in September 1931.

The gold standard was used mainly between 1875 and 1914, and then again during a portion of the inter-war years. The standard represented a monetary system in which a government would allow its currency to be freely converted into a fixed quantity of gold, and vice versa. While the gold standard represented the first formalised exchange rates in financial history, the system was flawed in that it required countries to hold large reserves of gold in order to manage the volatility surrounding the supply and demand of its currency.[31]

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[28] Saywell,173
[29] Saywell, 173
[30] Saywell, 173
[31] Investopedia, http://www.investopedia.com/terms/g/goldstandard.asp#axzz1csvPVRqj

In 1931, Great Britain became worried that this fixed system of exchange was hurting its economy, as it could not keep enough gold in reserve. On September19, 1931, Great Britain decided to abandon the gold standard - a decision with far-reaching consequences across the Commonwealth, particularly in Canada.

The Canadian dollar immediately depreciated, given the weakness of the country's economy vis-à-vis that of the United States or England. Therefore the value of businesses conducting their operations in Canadian dollars suffered as well. As a consequence of the abandonment of the gold standard and in recognition of substantial market uncertainty, the Montreal Stock Exchange (followed by the TSE) immediately instituted minimum price restrictions on its listings. While the MSE opened for business on September 21, the exchange announced that no transactions could be completed at prices less than that of the most recent sale completed on Saturday, September 19 (the last day the market was open). Shortly after opening, short selling was also banned.[32]

This ruling effectively froze the stock market, since no-one was willing to pay the minimum prices for the securities (as the shares were worth much less). As a result, a gutter market formed, where listed securities were traded well below the imposed minimum price. No official records of these transactions remain, as the activity was not sanctioned by the exchanges, nor were its members allowed to participate in any gutter transactions.

In Montreal, the minimum price ruling did not apply to securities trading at less than $3 – it was reserved for more established and valuable companies. By September 22, minimum price limits were lifted on four of the MSE's most important international stocks: CPR, Brazilian Traction, International Nickel and Twin City Rapid Transit.[33]. Short selling was permitted on select stocks on February 19, 1932, and the ban was fully lifted on July 27. Finally, almost a year later on September 6, 1932, the last of the minimum price restrictions was lifted at the MSE.[34]

The abandonment of the gold standard by Great Britain on September 21, 1932 had a significant impact on both stock exchanges and their members. The effect on brokers was twofold: First, on the reduction of trading volumes meant a reduction in commission income (see Exhibit 5 – 'Commissions earned by FH Deacon and Company'). And second, a suddenly devalued Canadian dollar meant that loans obtained from American banks were much more expensive.

Following the British decision to abandon the gold standard, a general loss of confidence in the global financial system occurred, and some world currencies suffered – especially that of Canada. As world money markets ceased to function, Canada – a borrowing nation – was unable to even borrow for short terms from New York. Investors began to grow weary of Canada's suddenly weak financial position (high debt, low gold reserves), and the value of the dollar fell substantially in the fall of 1931.[35] (See Exhibit 6 – 'Canadian-US Dollar Exchange Rate'). On September 19, US funds were available at a 1.75 to 2%

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[32] Bergithon, 55
[33] A Minneapolis, St Paul Minnesota Company
[34] Bergithon, 57
[35] A History of the Canadian Dollar, 43

premium to the Canadian Dollar. On the 21st, the premium was 6%. By December 15th, the premium rose to nearly 25%.[36]

Of course, the US lenders immediately called their loans. With security prices already in the doldrums, Canadian brokerage houses had few remaining options to meet their obligations.

The largest brokerage house in Montreal, McDougall and Cowans, declared bankruptcy on October 5, followed the next day by two others (Greenshields and Company and Watson and Chambers).[37] Both firms had borrowed from American lenders, principally due to the fact that funds could be acquired from the United States at 4.5% interest as opposed to the 6% in Canada. With shattered confidence in the Canadian financial system, the drop in value of the Canadian dollar, and the minimum price restrictions effectively freezing trading, these houses had no means to raise the funds required to repay these loans. They could not increase the margin requirements from their already broke clients, and they could not sell their own investments to cover the loans. Effectively paralysed, the brokers turned to the Canadian banks for help.

Notified of the dire situation at Canadian brokerage houses, representatives of the Canadian Bankers Association met with Prime Minister R.B. Bennett on October 4, and urged the government to intervene. Bennett declined to act. The association met again the next day and decided that the only way to save the two firms was to close the exchange. However, they then decided that such a move would harm the rest of the Canadian credit system. And so McDougall and Greenshields went under, dragging the smaller Watson and Chambers house down with it. The houses were beyond broke – McDougall and Cowans, valued at over $50 million at the height of the market, owed almost $20 million to their creditors, and were owed almost $6 million by their margin clients.[38]

McDougall and Greenshields were able to reorganise their debts under receivership. McDougall even rejoined the MSE on March 21, 1932, with Greenshields later also negotiating a deal with its creditors. Suffice it to say that the reputation of the brokerage community was battered as it struggled to restore business.[39]

Interestingly, no brokerage houses in Toronto failed at this time. The TSE claimed that its system of periodic audits installed in 1929 prevented collapse, but the evidence suggests that Toronto auditors and bankers were more willing to turn a blind eye to the problems and insolvencies of the Toronto houses. These actions are intriguing, given the state of the banks themselves at the time.

Recent work[40] has shed light on the state of the largest Canadian banks following the crash of 1929. Between 1930 and 1935, nine of the ten largest banks in Canada (all of which survived the Depression) were technically insolvent at some point. Thus, while the banks were turning that blind eye toward the

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[36] Bergithon, 57
[37] Bergithon, 57; Armstrong, 173
[38] Armstrong, 174
[39] Armstrong, 175
[40] Brean et al, 253

brokers, they themselves enjoyed a degree of regulator forbearance that kept them afloat in the lean years after the crash.

The TSE also strove to remove the minimum price restrictions as quickly as possible, as it was believed that the restrictions simply undermined investor confidence, implying hidden weakness in value. This move may have helped encourage transactions (and therefore commissions) compared to the scenario on the Montreal exchange. Toronto could only remove the minimums from those stocks primarily listed in Toronto. Many of the exchange's largest issues were from the MSE, which was more reluctant to remove minimums following the collapse of McDougall and Cowans (and a subsequent run on the Royal Bank because of it).[41]

After the abandonment of the gold standard, understandably all the securities that were held by the brokerages as collateral against their loans from the banks dropped in value. In fact, the only act that was keeping the pretence of value of this collateral was the fact that the exchanges had instituted minimum price requirements. A meeting between Beaudry Leman, president of the Canadian Bankers Association, and W.E.J. Luther – Chairman of the MSE, resulted in Leman telling Luther in no uncertain terms that the exchanges must maintain the system of minimum prices otherwise the banks would be forced to demand repayment on virtually all brokers' loans. Both the MSE and TSE continued with the minimum prices.[42] Although he had made astute decisions as Chairman of the MSE, Luther soon found himself in as much trouble as the brokerage houses he was trying to save. (See Appendix 1).

Gold Mining – Toronto's Economic Advantage

A mining boom, particularly British Columbia's 1890s gold rush in Rossland and Rainy River, increased the demand for start-up capital and therefore the supply of mining stocks. The Toronto and Montreal Stock Exchanges were not keen to accommodate the boom in mining share issues – seen as too speculative, risky, or short-lived – and so an alternate solution was found: the Toronto Stock and Mining Exchange was founded in 1896 with 25 members. The following year, its rival, the Standard Stock and Mining Exchange, was established. The two exchanges soon realised they could not compete in such a small market, and they therefore merged under the name of the SSME in 1899. The SSME enjoyed a wild ride of mining booms and busts in the ensuing 35 years (and was home to some of the loosest ethics, as detailed in the following section) before merging with the TSE in 1934. The founding of the principal mining exchange in Canada in Toronto was crucial to the city's later supremacy as a mining stock trading centre – long before Toronto passed Montreal in trading of industrial stocks to become the financial centre of Canada.[43]

Mining stocks were highly influenced by changes to the price of gold, which had languished throughout the Depression at $20 an ounce. In 1934, Roosevelt, the President of the United States, raised the price

[41] Armstrong, 176
[42] Armstrong, 173
[43] Neufeld, 478

of gold to $35 [$587 in current dollars] by executive order, effectively creating a boom in gold stocks overnight.[44] An index of 17 mining companies had slipped into the 90s by October 1929, having already fallen from 130 the previous July, before bottoming out below 50 in June, 1932 .(See Exhibit 7 'Weighted Monthly Index of Mining Stocks, 1927-1935'). One year later, the mining index bounced back to over 100 with gold stocks doubling and base metals tripling. The increase in gold prices pushed the index over 140 in 1934, bringing some semblance of a return to the pre-crash boom times.[45] Indeed, the boom times were back for Ontario's gold mines, led by the Dome[46] and Hollinger Mines in the Porcupine area, as well as mines at Kirkland Lake, Red Lake and Little Long Lake.

In 1934, the Toronto Standard Stock and Mining Exchange – long the country's leading mining share market – merged with the TSE amidst burgeoning trading activity.[47] This increase in mining activity due to the U.S. decision to raise the price of gold to $35 an ounce was not necessarily reflected positively in the larger exchanges, which were much more heavily weighted in non-mining sectors. Despite the fact that trading volumes continued to increase in 1934 on the SSME (or, after merging with the TSE, the mining section that represented the former SSME listings), volumes actually decreased on the MSE and the non-mining sectors of the TSE. (See Exhibit 8 'Index of Stock Exchange Volumes, 1930-1934').

In contrast to this flurry of activity in Toronto was the situation on the MSE, home to Canada's largest industrial and utility issues. Share volumes rebounded in 1933 but then fell precipitously in 1934 and further in 1935. Bond business also evaporated. Meanwhile, the gold mining prominence on the TSE boosted Toronto's position on the Canadian financial landscape. With the financing of Canada's mineral riches focused in Toronto, trading volume on the TSE surpassed that of Montreal for the first time in 1934 and as discussed earlier, ushered Toronto's volumes past those of Montreal ever since. (See Exhibit 9 'Trading Volume Montreal and Toronto Stock Exchanges').

Postscript – Historical Regulation of Canada's Stock Markets

When the MSE and TSE were founded, few regulations existed to govern securities markets – most rules were created and self-enforced by the stock exchanges themselves through bylaws upon which the members agreed. It was not until 1912 that legislation governing stock exchanges was introduced.[48]

Termed "blue sky" laws – these pieces of legislation dealt with the actions of stock promoters with schemes that "had no more basis than so many feet of blue sky."[49] Essentially, the first legislation was introduced to deal with disclosure regulations for new issues (as opposed to addressing any conduct of the brokers, for instance). Manitoba introduced the country's first blue sky laws, which were largely a

[44] Armstrong, 181
[45] Canada Year Book, 1928-1935
[46] The Dome Mine, just outside of Timmins, Ontario, is the longest continually-operating gold mine in North America, having opened in 1910.
[47] The merger was encouraged by George Drew the Ontario Securities Commissioner, encourage by the Attorney General.
[48] In the Province of Manitoba by the government of Sir Rodmond Roblin and called the Sale of Shares Act.
[49] Neufeld, 535

copy of laws enacted the previous year in Kansas, where they originated. Saskatchewan produced similar legislation in 1915, followed by Alberta and New Brunswick shortly thereafter.[50]

While Quebec introduced an act dealing with disclosure requirements in 1924, both Quebec and Ontario were less aggressive in bringing out early regulations. It was not until 1928 that the Security Frauds Prevention Act of Ontario was introduced. The first act of its kind, it combined anti-fraud provisions with provisions for regulating brokers and salesmen.

Six provinces came together in 1929 to compose a uniform securities legislation based largely on Ontario's law – the result was the Security Frauds Prevention Act of 1930. The new act was adopted by all provinces except New Brunswick, representing the only time in Canada's history where uniform securities regulation existed across most of the land. Throughout the remainder of the 1930s, individual provinces crafted their own unique regulations.[51]

A constant tension existed between the provinces and the federal government over which body ought to hold responsibility for regulating federally-incorporated companies. The federal government believed that better investor protection could be achieved by federal oversight through a reform of the Companies Act and therefore challenged provincial legislation (the Security Frauds Prevention Act of 1930, which most provinces had accepted). The federal government challenged some of the provincial authorities, namely the broad rights provided under the SFPA to investigate companies and individuals suspected of misconduct. At the trial of *Lymburn v. Mayland*, the Alberta case used by the federal government to challenge the SFPA, it was ruled that provincial laws could not interfere with the actions of federally-incorporate companies at the time. Therefore, the SFPA was ruled *ultra vires* (beyond the powers) of provincial legislators. The federal government had won its jurisdiction.

Refusing to accept this rebuff of their legislation, Alberta and Ontario immediately appealed the decision – but not to the Supreme Court of Canada. Instead, they sought the Privy Council in London, which – to the surprise of the provinces – ruled in their favour. This victory in the appeal of *Lymburn v. Mayland* awarded jurisdiction for the regulation of securities markets to the provinces and shattered the federal government's desire to prohibit the provinces from regulating federal companies.[52] Although a new Companies Act of 1934 did include new controls on financing, the primarily responsibility for regulating securities markets fell squarely to the provinces, where it has remained to this day.[53]

Post-Crash Reaction and Regulation

Despite the introduction of these regulations before 1929, the ultimate enforcement of these laws appears to have been quite relaxed. While the most vivid examples of loose morals were on the smaller exchanges – particularly the SSME, brokers on all exchanges were guilty of taking advantage of unsuspecting clients and nascent securities regulation.

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[50] Neufeld, 535
[51] Neufeld, 536
[52] Until the current Federal Government, under the leadership of Finance Minister Jim Flaherty has pushed for federal responsibility. The provinces again won control in a recent decision by the Supreme Court of Canada.
[53] Armstrong, 214-219

It was the *Financial Post*, particularly its intrepid young editor, Floyd Chalmers, who was the catalyst for bringing about reforms to stop shady practices among brokers of the day. On November 29, 1929, with the stock market still in shambles after October's devastation, Chalmers published the first of a series of controversial articles investigating broker practices on the SSME. The lead story opened as follows, claiming that brokers on the SSME had:

...cleaned up because Canadians went into mining as a crowd of boys run to a new-found orchard from the trees of which are hanging clusters of luscious red pippins. Canadians found many rich and juicy apples in the mining orchard. For a time they feasted to their heart's desire. But they also found, as the first intoxication died, that the pest and the worm and the parasite had entered the orchard.[54]"

The story revealed that brokers were betting against their own clients and using penny mining stocks to defraud investors. A new mine promoter issued the stock on the exchange. Meanwhile, he created false engineering reports to showcase new mine properties while brokers then promoted these reports to build hype for the property, driving the penny stock price upwards. Then the brokers' real involvement began – they bought and sold the shares among themselves, further inflating the worthless mine's price, pulling in unsuspecting investors along the way. Even worse, because investors bought the shares on margin, the investors had no right to demand delivery and never received certificates. (Most investors were just in for short-term plays and so did not care about certificates.) Brokers realised that they could "execute" the transaction without actually buying or selling shares. The number of shares that was actually changing hands could total more than the number of shares outstanding for any one given issue. When brokers pulled the plug on the scheme – by no longer publishing the fake engineering reports – they made another commission on the phantom sale.[55]

The stories were not without basis. Within weeks, police caught up with many of the worst offenders, putting them out of business or into jail. The principals of the largest retail brokerage in Canada at the time – Solloway Mills and Company – were brought down after growing their firm to 41 offices across the country.[56]

Ike Solloway and Harvey Mills founded a small brokerage house in Toronto in February 1926. The company was founded with the intent to raise funds for new mining issues, and so Solloway turned to serve the small retail investor, opening an office in plain view of the streets of downtown Toronto (to drum up business, of course). The business quickly grew to employ over 1,000 employees serving 70,000 clients in only three years.[57].

Unfortunately, much of this growth was financed by Solloway's fraudulent activities. (Solloway had bought out Mills in 1928). Solloway became the poster child for corruption after betting against his clients from privileged information and for using client funds to trade on his own account instead of executing the trades his clients believed he made for them. Of course, he never forgot to charge

[54] Chalmers, 67
[55] Chalmers, 67-71
[56] Bliss, 413
[57] Armstrong, 142

commission for these imaginary trades. By 1930, the governments of Alberta and Ontario were arguing over who would get to prosecute Solloway first. Alberta succeeded, putting Solloway in jail and levying a hefty fine. Solloway spent the next several years mired in legal troubles and faced charges from defrauded clients across the country.

Largely in light of these allegations brought forward by Chalmers, the SSME implemented new practices in December, 1929 and regulations attempting to control the behaviour of member brokers soon appeared on other exchanges. The number of member audits increased and several measures were taken to prohibit broker fraud. In the wake of a stock market crash the public believed was caused by brokerage houses, unethical broker practices were slowly outlawed.

The Ontario Securities Commission and George Drew

Until 1931, Ontario regulated the securities business through the Attorney General's office. As securities regulation became more complex and time consuming, however, the government decided to create a full time Security Frauds Prevention Board to oversee markets. George Drew -- then Master of the Supreme Court of Ontario and a well-connected Conservative – was appointed as the one-man regulator. Ontario soon changed the body's name and in 1932 (about two years before the creation of the Securities and Exchange Commission in the United States) the Ontario Securities Commission was born.

Publicly, Drew and the OSC favoured self-regulation by the exchanges rather than through OSC discipline in cases of misconduct. In reality, Drew took a more active role behind the scenes, meeting regularly with exchange executives to inform them of OSC views on how to better control broker behaviour. Drew and the OSC held wide-ranging powers (the very powers that the federal government felt were unconstitutional, as noted above), and members of the public expressed a wished that Drew take a heavy-handed approach to regulation – especially when they lost money. Drew, however, was careful. He was aiming to balance hard-line enforcement with more lenient actions to prevent criticism from business that his regulation was blocking economic recovery following the crash.

While Drew walked this tightrope in the OSC's early days, the press openly complained that he was not taking drastic enough action to eliminate broker misconduct. These complaints found a sympathetic audience in 1934 with the election of a new Liberal government. Drew was soon forced out of his position for political reasons (though he later became Premier of Ontario in 1943).[58]

Conclusion

Brokers, banks and investors enjoyed hefty profits in the run up to October 1929 and were blind to the disconnect between share prices and underlying values of the respective companies. With the stock market collapse, all three of these parties were forced to the brink of financial instability – with banks doing their best to ignore the insolvency of many brokers (while likely insolvent themselves) just as most investors were ruined and could not cover their margin accounts.

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[58] Armstrong, 219-230.

The losses in market value were catastrophic in many cases – with some sectors losing over 90% of their value soon after the crash, but some positive outcomes ensued. The regulation of securities markets greatly increased following October 1929, in response to exposure of the exploitative tactics often used by brokers against clients. Governments also moved to provide better regulation of both disclosure requirements and broker behaviour. While the federal government initially tried to maintain dominion over securities regulation across Canada, power to regulate the markets was passed to the provinces in the landmark *Lymburn v. Mayland* ruling by the Privy Council in London.

The crash also signalled a shift in stock market prominence from Montreal to Toronto. The gold mining sector led Canada out of the Depression in the mid-1930s with Toronto leading the way as it became the centre for mining finance in Canada. Buoyed by this mining boom, the TSE seized the lead in trading volume from Montreal, marking Toronto's emergence as the next financial capital of Canada.

Questions

1) On December 22, 2011, the Supreme Court of Canada ruled against the federal government's request to create a national securities regulator, citing a breach of constitutionally-provided provincial powers – essentially coming to the same decision that the Privy Council had made some 80 years prior. Meanwhile, the United States has had a national regulator since the 1930s. Why does the United States have a national securities regulator while Canada has provincial and territorial regulators? Should Canada move to create a national regulatory body? Are there advantages to the current Canadian system?

2) *Plus ça change, plus c'est la même chose*. The reasons behind the financial crisis of 2008 bear certain similarities to those of 1929-31. Discuss the similarities and differences between the two financial events. What, if anything, do you find surprising? What lessons can you take away from these events?

3) Why did Toronto emerge as the larger Canadian exchange following the crash of 1929? Furthermore, why did the TSE gain at the expense of MSE, while the Chicago Stock Exchange did not gain at the expense of the NYSE?

Appendix 1: The Attempted Murder of Sir Herbert Holt, President by the Chairman of the Montreal Stock Exchange

Herbert Holt[59] was the most powerful man in Canada prior to, and during, the Depression, controlling more companies and wealth than any other man in the country. Also serving as the President of the Royal Bank in Montreal, Holt was at the centre of all business in Montreal.

By 1932, W. E. J. Luther was the former President of the Montreal Stock Exchange and the principal at the Montreal brokerage house of Craig, Luther and Company. Described as a man of unimpeachable integrity (he had been, after all, President of Canada's most important stock exchange), he also intensely felt the pressure from the stock market crash and the ensuing Depression of business activity. His brokerage was failing and he was at the end of his rope. Luther approached Holt at the banker's offices on the afternoon of May 29, 1932 and appealed to him for assistance in what he termed was "a matter of life and death" to the brokerage business. Holt, who did not have a reputation for charity, declined to assist Luther. The latter left in anger.

Later that evening, Luther showed up at Holt's Montreal home and confronted him on the doorstep, catching Holt off guard. (It was a rare moment in several ways, because Holt was usually surrounded by a cadre of four armed bodyguards). While the words exchanged between the two men remain unknown, Luther proceeded to shoot Holt three times. Figuring he had killed Holt[60], Luther returned to his own home. He committed suicide in his garage by inhaling carbon monoxide fumes from his car. The next day, Craig, Luther & Company failed.[61]

One would think that the shooting of one of the most powerful men in Canada would be front-page news. Not one newspaper, however, reported the incident. Details continue to remain scant in today's scholarship – even the Royal Bank's archives do not contain an account of what happened. Illustrative of the extent of Holt's power and the banks' control over the brokerage houses, the curious affair of Holt and Luther is but one example of the lengths to which brokers went to sustain their failing businesses.

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[59] Little information remains about him or his empire, despite the fact that he presided over the Royal Bank from 1915 to 1934 and remained as Chairman until his death in 1941. His most prominent holding of the time was the Montreal Light, Heat and Power Company. One of the "electricity trusts" of the day, Holt operated the company in such a way that kept electricity prices unnaturally high (by colluding with the Shawinigan Water and Power Company) during the Depression. As a partial reaction to his behaviour, the Quebec Government passed a bill in 1944 to nationalise MLHP as the basis for what is now Hydro-Quebec.

One can imagine how such a successful businessman was viewed following the stock market crash in October 1929. Holt, never one to engender himself to the public, was quoted at the time, "If I am rich and powerful, while you are suffering the stranglehold of poverty and the humiliation of social assistance; if I was able, at the peak of the Depression, to make 150% profits each year, it is foolishness on your part, and as for me, it is the fruit of a wise administration".

Unfortunately, the average Montrealer couldn't escape Holt. It was written that at the time, "We get up in the morning and switch on one of Holt's lights, cook breakfast on Holt's gas, smoke one of Holt's cigarettes, read the morning news printed on Holt's paper, ride to work on one of Holt's streetcars, sit in an office heated by Holt's coal, then, at night, go to a film in one of Holt's theatres".

[60] Holt would survive, recuperating in secrecy at a Montreal hospital.

[61] Hush, 1932

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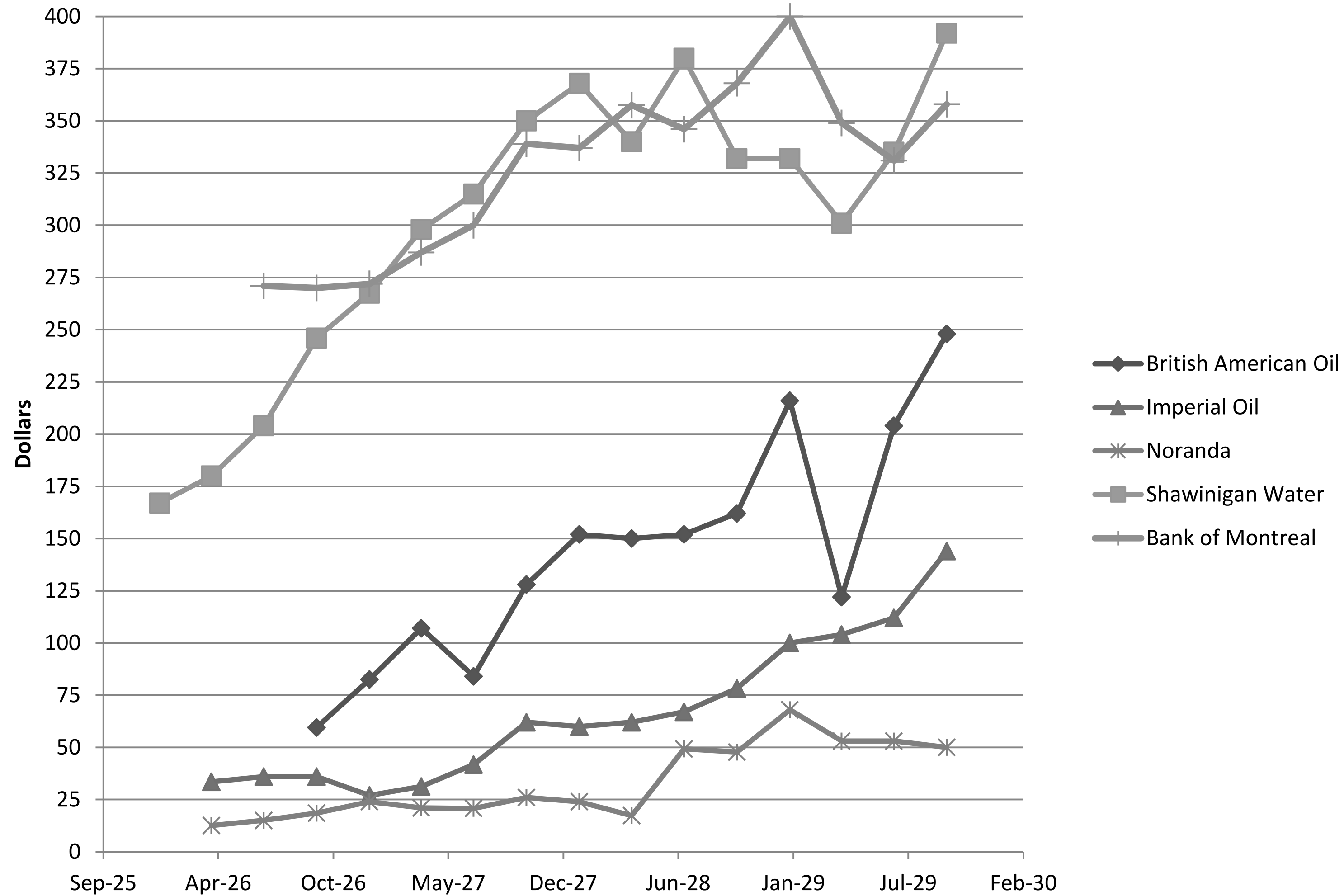

Exhibit 1: Quarterly share prices for a selection of companies from 1926-1929. The three years prior to the crash of October 29, 1929 were generally good ones for stocks, with steady price increases over the time period.

Toronto Stock Exchange		Montreal Stock Exchange	
Company	**Peak to Trough 1929-1932**	**Company**	**Peak to Trough 1929-1932**
British American Oil	89.5	Bell Telephone	59.4
Imperial Oil	82.3	Canadian Pacific Railroad	87.5
Abitibi	99.5	Price Brothers	98.35
Brazilian Traction	91.5	Montreal Light, Heat, Power	77.6
Noranda	84.7	Shawinigan Water	93.4
Hiram Walker	81.8	International Nickel	94.5

Exhibit 2: Total losses of share value, in percent, for select companies on the TSE and MSE from their peaks in 1929 to the lowest points in 1932.

Industry Classification	% Decline
Machinery & Classification	90.8
Pulp & Paper	97.5
Milling	86.0
Oils	80.3
Textiles & Clothing	75.3
Food & Allied Products	63.5
Beverages	86.1
Building Materials	87.0
Industrial Mining	93.6
Transportation	86.2
Telephone/Telegraph	55.3
Power & Traction	79.2
Banks	69.0
Total	69.8

Exhibit 3: Percent decline over the period 1929-1932 of share value by industry.

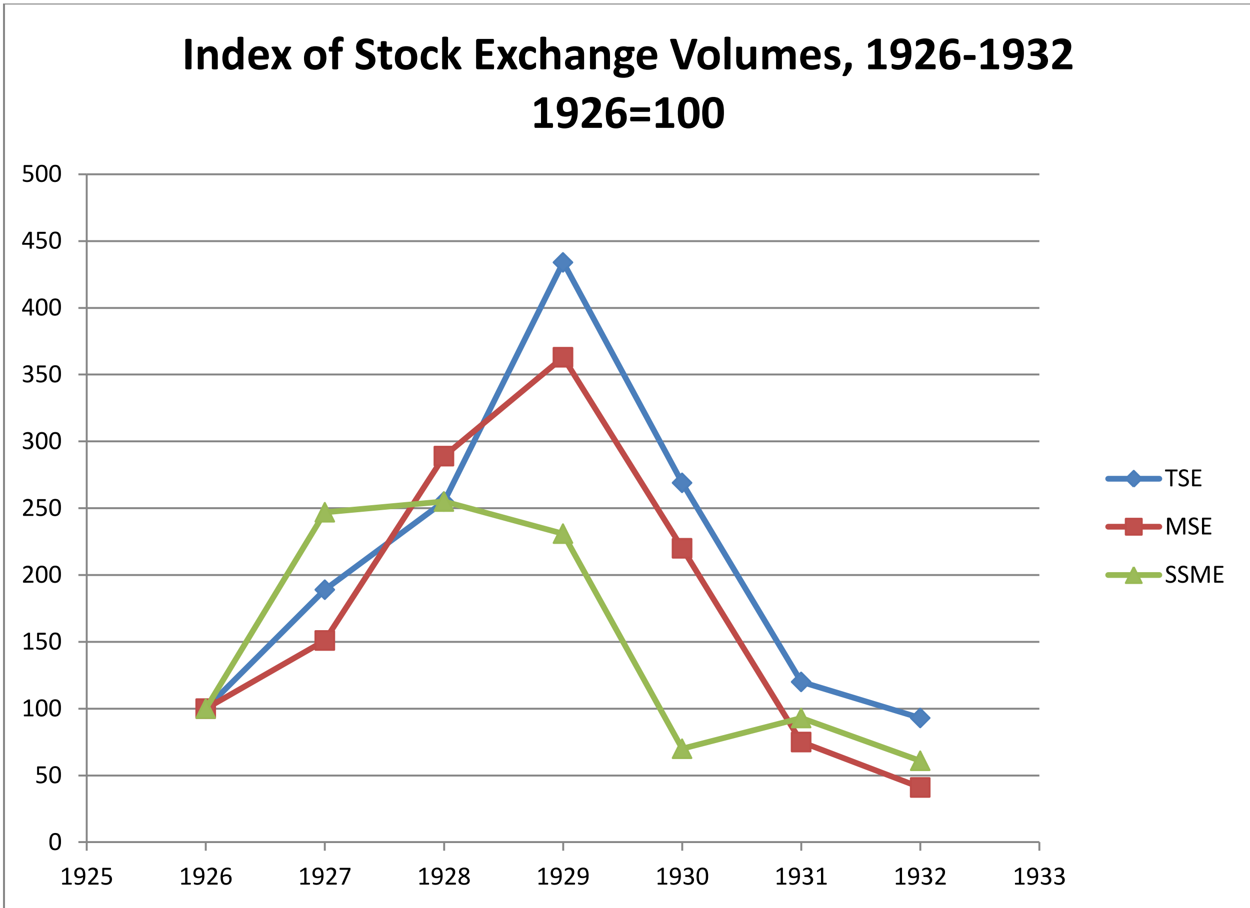

Exhibit 4: With 1926 as the base year, normalised trading volumes on the MSE, TSE and the Standard Stock and Mining Exchange (SSME). Note the drastic drops in volume following 1929.

Year	Commissions ($)
1925	72,000
1926	51,000
1927	104,000
1928	120,000
1929	187,000
1930	105,000
1931	63,000
1932	29,000

Exhibit 5: The total commissions earned by the FH Deacon and Company, from 1925 to 1932. Often considered as a barometer for brokers in general throughout the time period, Deacon and Company saw commissions drop drastically from the peak in 1929.

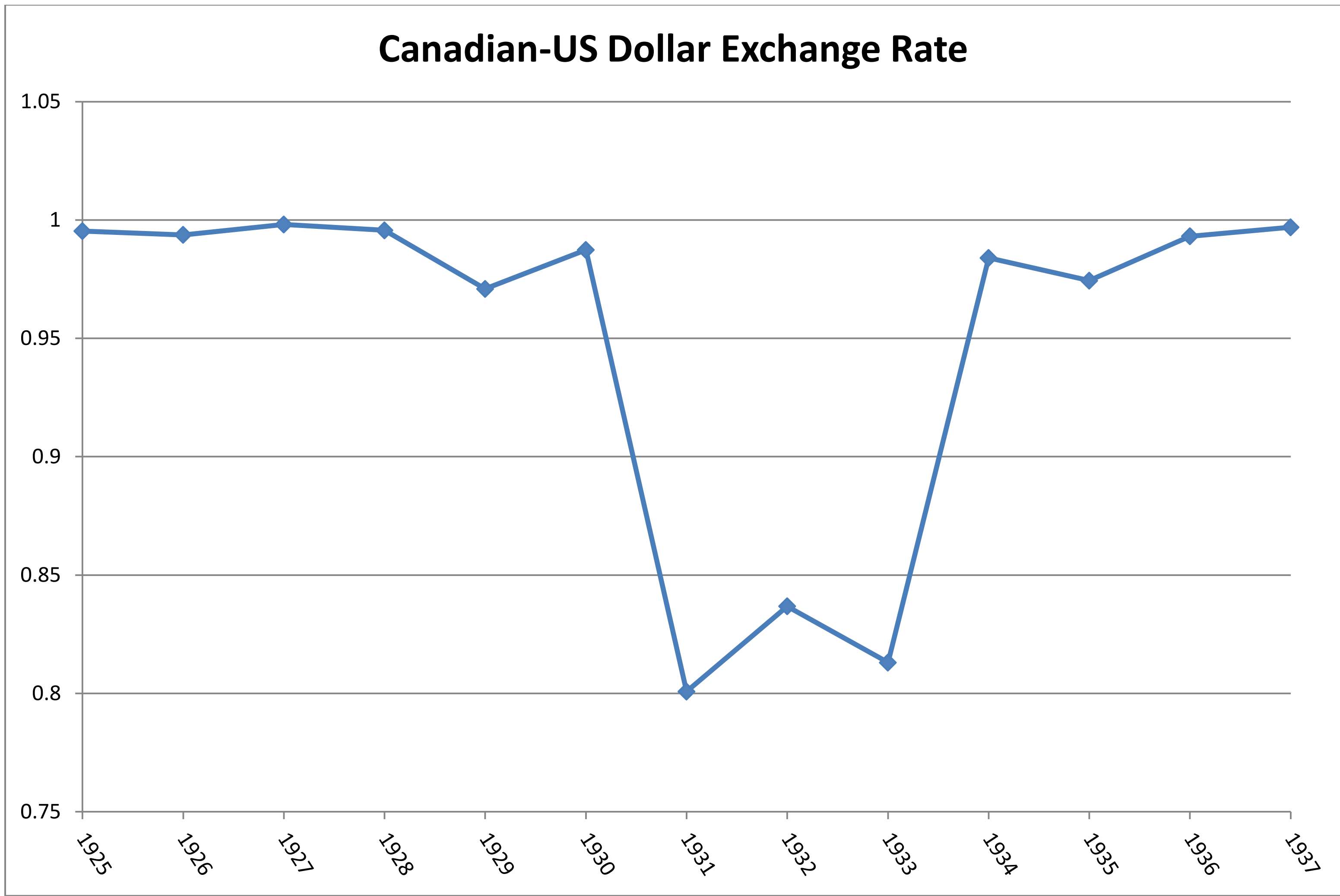

Exhibit 6: The Canadian-US Dollar exchange rate from 1925 to 1937. Note the precipitous drop in value of the Canadian Dollar in 1931 following Great Britain's abandonment of the gold standard.

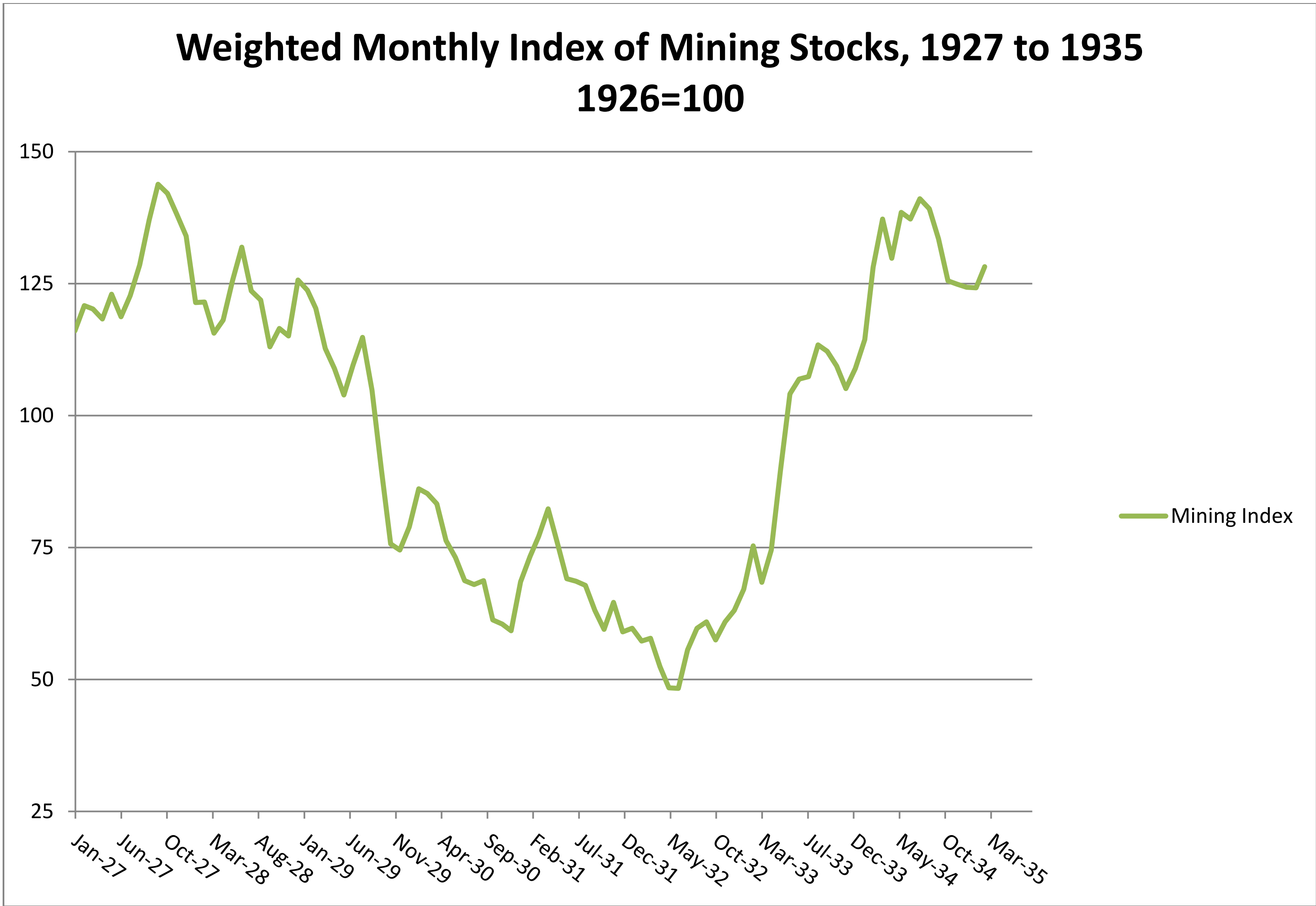

Exhibit 7: A weighted monthly index of select mining stocks from 1927-1935 (base year 1926). Mining stocks were already faltering before October 1929 and did not recover until 1933/34 when the United States announced a higher price of gold.

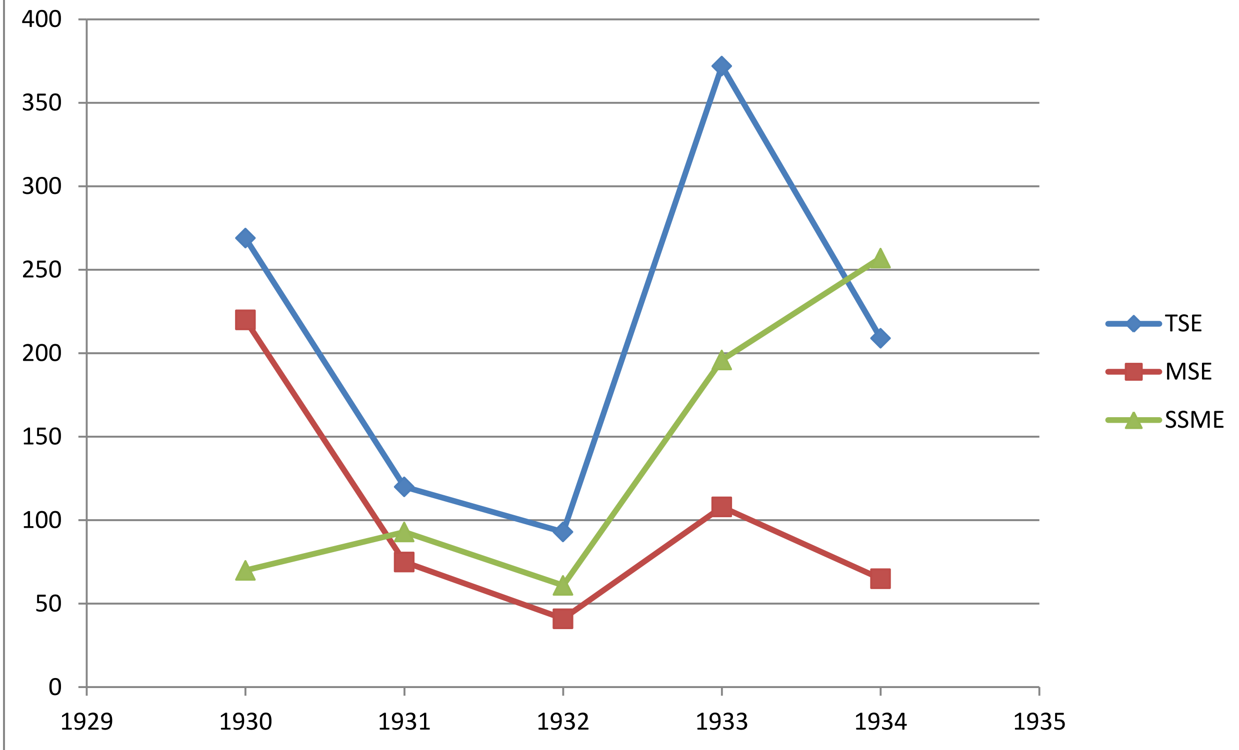

Exhibit 8: With 1926 as the base year, normalised trading volumes on the MSE, TSE and the Standard Stock and Mining Exchange (SSME). Note the unique increase in volume on the SSME from 1933 to 1934.

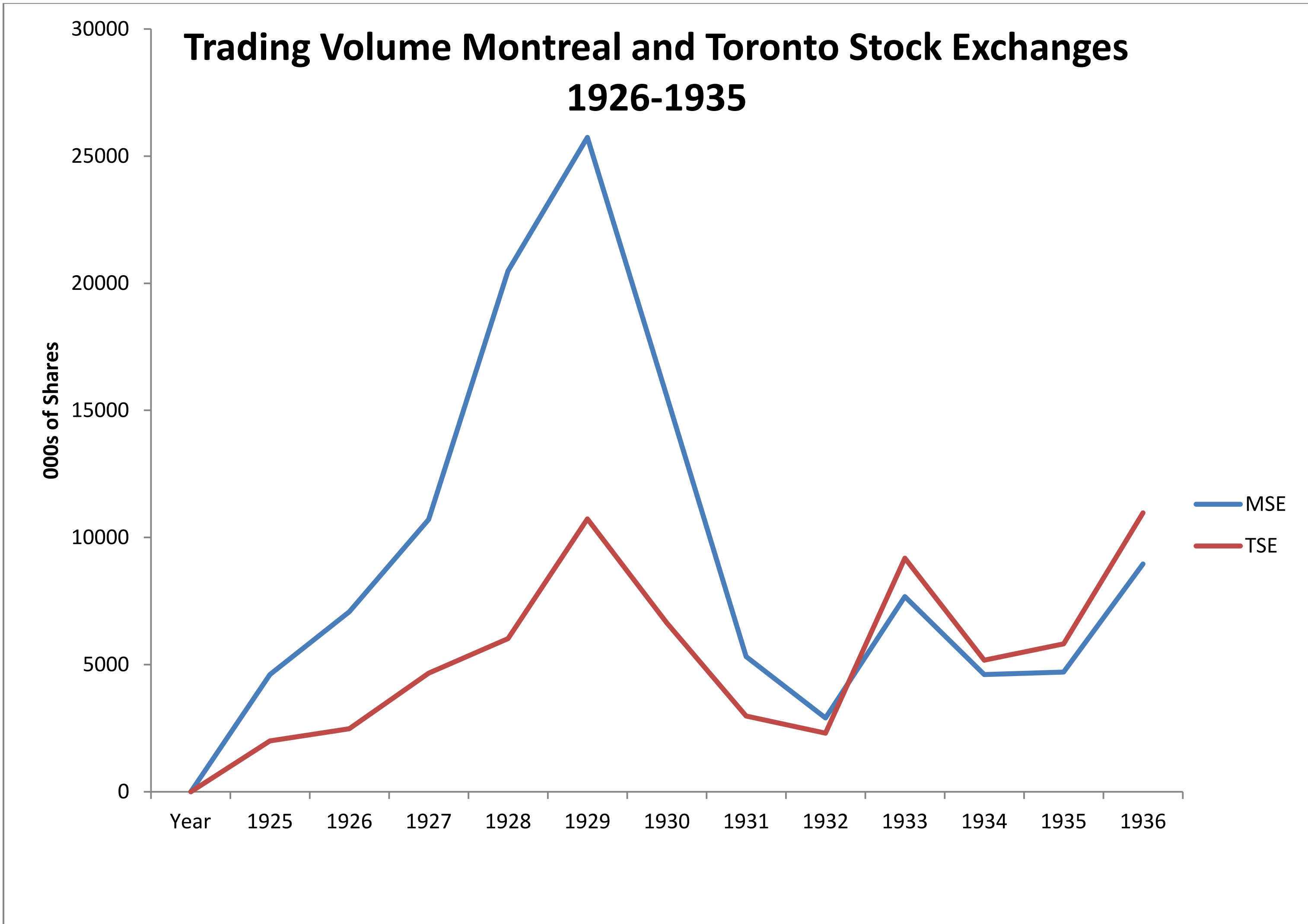

Exhibit 8: Trading volume on the MSE and TSE. Volume on the MSE fell spectacularly following the crash of 1929 while Toronto benefitted from mining wealth in 1933 onward.