Rotman School of Management
UNIVERSITY OF TORONTO

Rotman

CASE STUDY

The Toronto-Dominion Bank and Canada's "Little Bang" of 1987

MGT 2917
Canadian Business History
Professor Joe Martin

This case has been prepared by Ashwini Srikantiah 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.

Copyright 2012 by the Governing Council of the University of Toronto. To order copies or request permission to reproduce materials, write to the Rotman School of Management, Business Information Centre, Toronto, M5S 3E6, or go to www.rotman.utoronto.ca/bic. No part of this publication may be reproduced, stored in any retrieval system, used in a spreadsheet, or transmitted in any form or by any means, whether by photocopying, recording or by electronic or mechanical means, or otherwise, without the written permission of the Rotman School of Management.

Introduction

It all started with lunch and a gathering at the sandbox. In late 1983, Dick Thomson, CEO of Toronto-Dominion Bank (TD) and Robin Korthals, TD's President, were invited to lunch with a trio of principals from the Toronto-based investment bank of Loewen, Ondaatje, McCutcheon & Company, founded in 1970. After lunch, the firm's partners, Chuck Loewen, Chris Ondaatje, and Fred McCutcheon asked Thomson and Korthals to join them around "The Sandbox" – a literal box of sand in the centre of a conference table at Loewen. The three investment bankers proceeded to draw a picture in the sand. It was a picture of a discount brokerage that would move high volumes of equity trades at low prices for customers; a picture of the large and virtually untapped market for this service in Canada; a picture of a partnership between their investment bank and TD.

Later that afternoon, as Thomson and Korthals walked back to the TD Tower, Korthals said to Thomson, "I think we should do the deal."[1] Thomson replied, "I agree." That alliance around the sandbox marked the start of Green Line, TD's discount brokerage arm.

Back in 1983, TD was the smallest of Canada's large banks – fifth among the "Big Five" and a little more than half the size of the Royal Bank of Canada, Canada's largest bank. As the underdogs, Korthals, Thomson and the rest of the executive team were continually looking for opportunities to grow their deposits, and they hoped that Green Line would eventually help. Neither of them could have anticipated just how helpful Green Line would be.

By the mid-1990s, Green Line had grown to capture over 70 per cent of the Canadian discount brokerage market, and became the conduit for TD's push into the United States through the bank's acquisition of Waterhouse Securities in 1996. In an even broader context, the Green Line venture foreshadowed the start of Canada's "Little Bang" – a series of provincial and federal regulatory changes that would, for the first time in Canada's history, allow commercial banks and investment banks to come together under one roof.

This case explores the early days of Green Line and the strategic decisions TD Bank made as it entered into the securities industry, against the backdrop of Canada's "Little Bang."

Banking in Canada: A snapshot from 1983

At the start of 1983, the Canadian financial system was defined by its longstanding traditional structure: the Four Pillars. Chartered banks, life insurance companies, trust companies and investment dealers, all operated as separate sectors, with laws prohibiting companies from doing business in more than one sector. Strict federal regulations guided chartered banks and insurance companies, while provincial regulations governed trust companies and investment dealers. These regulations prevented each financial sub-sector from competing with firms from other sub-sectors – in other words, a chartered

---

[1] Interview with Robin Korthals – August 24, 2011

bank could not offer insurance services to its customers, even if it had the resources and capabilities necessary to do so. The Four Pillars structure also offered a level of security to customers because it required them to separate their deposits, investments and insurance among different institutions. However, not everyone supported the Four Pillar structure – and in the case of the chartered banking sector, some argued that tight federal regulation fostered an oligopolistic business environment that gave chartered banks an unfair market advantage.[2]

Canada's chartered banks were typically viewed as large, risk-averse institutions, and most of them were comfortable with the Four Pillars structure. In fact, when the Bank Act was revised in 1980 to explicitly restrict the banks from dealing in securities, the banking sector did not argue. On the contrary, it supported this regulation, for fear that if its members made bad investment recommendations they would lose their customers in their primary area of business: banking. The Canadian Bankers Association responded to the Bank Act Revision of 1980 by affirming its position within Canada's financial sector: "Banks will be prohibited from offering equity and bond plans and RRSPs except where the funds for this purpose are handed over to arm's length management."[3]

The Bank Act Revision of 1980 introduced another significant change: it allowed foreign banks to operate in Canada "on [the] same footing and with the same competitive opportunities as domestic banks."[4] This had significant implications for Canadian chartered banks: they could no longer enjoy the security of being one of only a few players. Banks from New York, London, and Tokyo now had the potential to enter the Canadian market and vie for Canadian customers. The Canadian banks would have to do something to stay competitive, but the question was what.

TD Bank in 1983

In 1983, the smallest of Canada's Big Five Banks was Toronto-Dominion (TD). It was formed in 1955 following a merger between the Bank of Toronto and the Dominion Bank. Before this amalgamation, the Dominion Bank was the fourth largest in Canada and The Bank of Toronto, although 15 years older than the Dominion, was the eighth largest. Unlike other Canadian banks, neither the Toronto nor the Dominion pursued a strategy of mergers and acquisitions early in the 20th Century, relying instead on organic growth. By the middle of the century, both banks realized they needed to be larger in order to compete,[5] and they convinced the Minister of Finance to permit the first major bank merger in three decades. Soon after, this event rendered TD the fourth largest bank in Canada, larger than the Bank of Nova Scotia but much smaller than the Canadian Bank of Commerce.[6]

---

[2] Whittington, Les – pg. 14
[3] MacIntosh, Robert – pg. 270
[4] Boreham, Gordon – "Changing Landscape of the Financial Services Industry"
[5] TD's official history, *100 Years of Banking in Canada, The Toronto-Dominion Bank,* by Joseph Schull states that "If the Bank of Toronto and The Dominion Bank were to continue to compete effectively they had to reduce the gap in size between themselves and their larger rivals." P. 192
[6] In 1961, the Canadian Bank of Commerce, the country's third largest bank, merged with the sixth largest Imperial Bank, surpassing the Bank of Montreal as the second largest bank in Canada.

By 1980, the Toronto-Dominion Bank had slipped in relative size and had fallen to fifth place, behind the Bank of Nova Scotia. "You have no idea how hard it was to be a small bank," recalled then-President Robin Korthals in an interview.[7] Because of its small size, TD rarely had large corporate accounts; it lacked the capital to provide large loans. Thomson, Korthals, and other members of TD's management team were constantly seeking ways to drive up the bank's deposit base. This is one of the reasons that the sandbox proposal for a discount brokerage service by Loewen, Ondaatje and McCutcheon was so appealing.

In 1983, about 40 per cent of Canadian families owned investments in equities, and since many households were disillusioned with mutual funds due to their poor performance in the late 1970s, this percentage seemed to be growing. Furthermore, equities markets in New York and Toronto set new performance highs as North America began to emerge from the recessionary period of the early 1980s, the worst since the Great Depression.[8] Thomson and Korthals felt that equities presented a great opportunity: if they could attract and convince families to let Green Line handle their equity transactions, the same customers would eventually open deposit accounts with the bank.

The prospect was appealing but as yet untested in Canada. In fact, the only similar example to which they could point was south of the border. Bank of America's acquisition of the discount brokerage giant Charles Schwab earlier that year could be viewed as a precedent. But this merger was so recent that the results were still inconclusive.[9] Before TD Bank could experiment with its own discount brokerage, it needed government approval to work around the traditional Four Pillars and offer equity brokerage services under a commercial bank roof. But because the Four Pillars had defined Canada's financial industry for so many years, the proponents of the sandbox alliance wondered if this goal was even feasible.

Ontario's securities industry enters a period of 'creative destruction'

By 1983, significant changes were afoot in the securities industry. Whereas the banking and insurance pillars were traditionally regulated at the national level, the other two pillars, (trust companies and investment dealers) fell under provincial domain. In April 1983, the province of Ontario (which housed Canada's largest concentration of investment dealers) deregulated its brokerage commission rates. It took its cue from New York: in the mid-1970s, the New York Stock Exchange abolished fixed minimum commission rates due to pressure from the institutionalization of public securities markets.[10] In other words, the exchange was increasingly fueled from "investment by mutual funds, pension funds,

[7] Interview with Robin Korthals – August 24, 2011
[8] TD Bank Annual Report, 1982 – pg. 17
[9] As it would turn out, the results of this merger proved grim: the cultures of Bank of America and Charles Schwab ended up being so vastly different that the acquisition simply did not work, and Bank of America sold Charles Schwab back to its owners in 1987, less than four years after purchasing it. This highly publicized failure became 'evidence' that most banks clung to, in support of their tightly held belief: it was not their business to be a brokerage house. But, as Charlie Baillie, former President and CEO of TD Bank said in an interview: "Just because it *didn't* work, didn't mean that it *couldn't* work."[9]
[10] Karmel, Roberta S.

insurance companies, bank trust departments and the like" in contrast to the retail-based origins of the public market. [11]

In Ontario, this deregulation meant that investment bankers no longer had the same guarantee that their salaries would reflect the high returns per transaction that had previously been ensured by fixed minimum commission rates. In addition, research reports -- which until that point had been the key value added service offered by investment bankers to clients -- became an optional step in the consumer's investment process. As described by The Ticker Club of Toronto, "This era was…the beginning of a sea of change within the investment business. Investment dealer research departments, deprived of their main source of revenue from institutional trading commissions, drifted rudderless. All too many wound up in the welcoming arms of the investment dealers' corporate finance departments, finding and promoting issues as distinct from evaluating them…"[12]

In truth, TD bank and the other commercial banks had been simply brokering investment transactions for years. As long as these transactions were "unsolicited", they were considered completely legal, even prior to Ontario's securities deregulation. TD, and most other banks, simply took a customer's orders, relayed them to an investment dealer, and passed the investment certificate back to the customer once the investment bank had purchased the shares. These banks did not provide research reports or analyst recommendations – they merely facilitated the sales transaction for customers who knew what they wanted. However, no chartered bank had gone so far as to turn this practice into a revenue stream – at best it was an ad hoc afterthought for customers who asked. By deregulating securities commission rates across the province, Ontario sent two very clear signals to the market: (1) all customers should have access to securities investments without facing prohibitive fees; and (2) investment banks could no longer make exorbitant gains from the booming stock market.

The next month, the sandbox alliance that TD forged with Loewen, Ondaatje, McCutcheon & Company sought approval from the Ontario Securities Commission (OSC), initiating the process for the formation of Green Line. "The switch to negotiated commission rates in April has raised policy and legal issues concerning the activities of banks and trust companies under existing securities legislation," stated the OSC. "Deregulation may result in significant changes in the nature and economics of the brokerage industry."[13]

According to Dennis Slocum, a business writer with the Globe and Mail, "The Toronto-Dominion Bank's plan to promote a brokerage service that includes low-cost stock trades through discount brokerage houses has raised the issue of whether it is in the public interest to permit financial institutions to expand their securities activities."[14] At exactly the same time, Charles Schwab and Co. Inc. of Chicago (under the umbrella of Bank of America) also submitted an application to the OSC – to own four per cent of the votes and 90 per cent of the equity of Schwab Canada. "This application raises questions related

---

[11] Langevoort, Donald C.
[12] Short History of the Ticker Club of Toronto [get full citation from Joe]
[13] Slocum, Dennis - Globe and Mail
[14] Slocum, Dennis – Globe and Mail

to the ownership of, or investment in, the securities industry by non-residents and in particular by non-resident financial institutions," the OSC said.[15]

On June 20, the OSC held meetings and hearings as part of a process that continued for months. The Ontario Investment Dealers' Association (IDA) opposed the views espoused by TD senior executives and board members. Other influencial players from the banking sector (including the redoubtable Robert MacIntosh, then President of the Canadian Bankers Association) supported TD's position. The Investment Dealers' Association staunchly defended its financial pillar in Canada's economic system and, according to IDA President Andrew (or Andy) Kniewasser, the outcome was crucial for the survival of the securities industry: "If the industry has ever been prepared for anything, it is this hearing. It is a matter of life and death," he said.[16]

Ultimately, the commission ruled in TD's favour. In November 1983, it concluded unanimously that "the involvement of financial institutions in providing discount brokerage services did not "materially impair" the performance of the securities industry's underwriting role.[17] Toronto-Dominion Bank was permitted to establish Green Line as a discount brokerage service, but it was prohibited from offering any front-office services in which full-service investment banks were experts. In other words, it could not provide research reports or analyst recommendations to aid customers with investment decisions.

Furthermore, TD (and other discount brokers) were prevented from participating in "bought deals" or underwriting corporate stock issues in other ways. This function remained the exclusive right of investment banks, and they held their domain tightly. In a speech delivered later that year, Peter Dey, then Chairman of the OSC, said: "By definition, we believe a financial segment can have only one core function – and it should be protected from competition from other segments. For the securities industry, the core function is underwriting."[18]

The Ontario Securities Commission's support of TD's discount brokerage sent ripples through Canada's financial industry and threatened investment dealers across the country. With government approval in hand, TD became Canada's first chartered bank to enter the securities business. Under the watchful eye of the rest of the industry, TD launched Green Line.

Green Line takes root

Soon after the hearing, TD purchased Loewen, Ondaatje, McCutcheon & Company's base of 800 discount brokerage accounts. By early 1984, Green Line began its operations with eight employees and one telephone line under Keith Gray's leadership.

---

[15] Slocum, Dennis – Globe and Mail
[16] Pivnick, Richard – Globe and Mail
[17] Slocum, Dennis – Globe and Mail, November 22, 1983
[18] MacIntosh, Robert – pg. 272

Gray was known as an 'intrapreneur' within TD. He joined the bank fresh out of high school in 1954, earning $100 a month as an apprentice at his local branch in the small town of Wyoming, Ontario,[19] near Sarnia. By 1970, after rising through the ranks and delivering strong results in branches across Canada, Gray was tapped to attend Harvard University's Program for Management Development. He joined Thomson, Korthals, and A. Charles (Charlie) Baillie – all Harvard MBAs – in TD's senior management ranks. MBA graduates were a rarity in the banking sector in the 1970s and early 1980s, but TD's Chairman Allan Lambert[20] and CEO Dick Thomson shared the belief that the future of banks lay in cultivating leaders through higher education.[21]

The initial concept for Green Line centered on a toll-free telephone hotline that would enable existing TD clients and new discount brokerage client base to make direct contact with a central order-taking desk at the Toronto head office.[22] In addition to the hotline, Green Line planned to give investors detailed statements to help them monitor their stock trades, safekeeping services and margin accounts. With these offerings, Green Line stayed within the rules of the historic Bank Act and the new Ontario securities regulations, while offering enough valuable information to attract prospective customers.

McCutcheon, Loewen, Ondaatje and Co.'s knowledge of back office operations and TD's extensive network of retail bank branches (hence its national client base) were both vital to Green Line's early strategy. Gray, Baillie and Korthals recognized that, in order for Green Line to succeed, they would need to engage TD bank managers across the country as front-line, customer-facing proponents of Green Line's services. Providing these managers and employees with the right incentives to encourage this behavior became an iterative process that took some time to get right. TD's lean corporate structure aided in this process. Because of its size, it had one less level of management than other banks, allowing for quicker feedback between retail branches and senior management.

In the fall of 1984, about six months into the venture, Loewen, McCutcheon and Ondaatje lost interest in the low-risk, low-reward world of discount brokerages. In an amicable separation of the original sandbox partners, TD bought out the investment bank's share of Green Line – the operation now fell entirely under TD ownership. This prompted TD's executives to focus on efficiency. They sought to develop the "cheapest execution and the broadest choice," and recognized that "if you're a good processor, you're good at discount brokerage." [23] Green Line charged a flat rate of $29.95 per transaction, regardless of volume, in order to attract a wide customer base. But each transaction initially cost it $50.[24] Green Line needed to drive down costs, and Gray understood that telephone

---

[19] Interview with Keith Gray, August 17, 2011
[20] When the Toronto and Dominion Banks merged in 1955, Lambert became General Manager of the merged bank, the youngest GM in the big Canadian banks. He played a leadership role for the next 18 years.
[21] Interview with Robin Korthals, August 24, 2011
[22] Ryans, Adrian, pg 3
[23] Interview with A. Charles Baillie, August 10, 2011
[24] Interview with Robin Korthals, August 24, 2011

communication was crucial to cost-cutting.[25] He pushed TD to invest $350,000 in a switchboard phone system that would allow Green Line to field more calls at lower costs.[26]

The plan worked. Over the next three years, Green Line enjoyed tremendous growth. By the fall of 1987, its accounts had grown from the initial 800 customers to more than 100,000, with the number of daily trades averaging 1,700.[27] However, while discount brokerages were gaining in popularity across Canada, another financial trend was spreading: Canada's "Little Bang."

Early rumblings of the Little Bang

In early 1985, the Canadian financial system became caught in a tug-of-war between Ontario and Quebec. In February 1986, the province of Quebec won a major coup. In his budget speech, Michael Wilson, the Finance Minister under Prime Minister Brian Mulroney, announced that the government would create International Banking Centers (IBCs) in Montreal and Vancouver, paving the way for these two cities to become the hub for all of Canada's international finance. [28]

Toronto, the city that had surpassed Montreal as the financial capital of Canada some years before, did not take kindly to this federal announcement. If Toronto were to lose its place as Canada's largest financial center, it would also lose a great deal of revenue for the city and the province. In the first half of 1986, in response to Wilson's announcement of IBCs, Toronto's Mayor Art Eggleton worked closely with Monte Kwinter, Ontario's Minister of Financial Institutions, on legislation related to the financial sector pillar over which the province had the most authority: investment banking.

Meanwhile, across the pond in the UK, talk of reform in the financial sector was also occurring. Prime Minister Margaret Thatcher, fresh from defeating the coal miners' union, was looking to execute sweeping reform of the British financial industry by breaking down the walls between all sectors, enabling the creation of "universal banks" modeled after the German pattern.

Historically, the UK financial system had also been the home of four distinct pillars. Rumblings about the collapse of these pillars –described in the UK as the "Big Bang" – were enough to worry Ontario investment bankers. Toronto investment banks were already smaller than those in London and New York. If the British chartered banks started to own investment dealers, it would be even harder for Canada's securities industry to compete in a global market. As a result, many of Ontario's investment banks felt the need to access a greater pool of capital, especially given that their firms were earning less after the 1983 securities industry deregulation. To ensure that this capital came from within Canada (and not from New York or London), the government needed to step in – and quickly.

---

[25] Interview with Robin Korthals, August 24, 2011
[26] Interview with Keith Gray, August 17, 2011
[27] Ryans, Adrian – pg. 5
[28] MacIntosh, Robert – pg. 265

During the same period, small shifts were starting to occur in the US financial system. During the Great Depression the United States had introduced the Glass-Steagall Act (also known as the Bank Act of 1933), which prevented the same institution from conducting investment banking and commercial banking. Although Glass-Steagall was not fully repealed until 1999, New York's fight against this Bank Act began in the late 1980s. By December 1986, the Federal Reserve Board reinterpreted Section 20 of the Glass-Steagall Act, thereby allowing commercial banks to make a foray into underwriting, albeit minimally. The board decided that banks could earn up to five per cent of gross revenues from investment banking business[29].

To this end, in February 1985, the OSC (under the leadership of Peter Dey) made a recommendation that contradicted its staunch position of the previous year. Whereas in December 1983 Peter Dey had said that each sector of the financial industry should have only one core function, by February 1985, he was recommending that a single financial institution (from any of the four pillars) be allowed to own up to 30 per cent of a securities dealer[30].

Ontario's Monte Kwinter had amassed the conditions of a "perfect storm" to turn Dey's recommendation into law. The investment dealers' weakened position, the threat of international competition, and the mounting Quebec-Ontario feud, provided the combination of factors that Kwinter needed. In June 1986, Kwinter announced that Ontario would be the first province to allow banks, trust companies and foreign financial institutions to acquire up to 30 per cent ownership in a broker or investment dealer licensed in Ontario. When the *Financial Times* asked him how much consultation had taken place with the federal government before he made this decision, Kwinter responded, "about as much as took place when they decided to make Vancouver and Montreal international banking centers."[31]

The Montebello meeting

Ontario's announcement was the first spark in Canada's "Little Bang" -- a series of federal and provincial regulatory changes between 1986 and 1987 that allowed chartered banks, insurance companies, and trust companies into the securities business. On October 19, 1986, while the UK's Big Bang was exploding into law across the Atlantic, the CEOs of Canada's 'Big Six' banks had a memorable Sunday lunch at the picturesque Château Montebello retreat in Quebec. The CEOs there were dining with Michael Wilson, the federal Minister of Finance, and Stanley Hartt, the Deputy Minister. According to Michael Wilson, the chartered banks were pushing hard for deregulation on the basis that they were losing business in corporate lending. Internationally, lending was becoming more complex, with banks in London and New York offering securitized loan products. Canadian banks wanted access to the securities market so as to not be left behind.[32]

---

[29] PBS Frontline: Mr. Weill Goes To Washington
[30] MacIntosh, Robert – pg 272
[31] MacIntosh, Robert – pg. 269
[32] Interview with Michael Wilson, September 21, 2011

This lunch meeting took place just one year after Canadian Commercial Bank and Northland Bank , two "Schedule A" regional institutions, were shut down by the federal government. These banks were overly reliant on high interest, wholesale deposits, and when they proved insolvent, they spurred a run on deposits across western Canada that shook the financial industry to its core. TD Bank CEO Dick Thomson, in speaking for the group at Montebello, said that "while we were still dealing with the frightening implications of the recent run on virtually all of the country's smaller banks, the government needed to consider the possibility of failures among the Big Six."[33]

During the lunch, Wilson agreed in principle that banks should be able to increase their access to securities, either through acquisition of an investment bank, or by creating one, *de novo.* This federal support was a significant milestone in Canada's move towards increasingly universal banks. It also signaled that Wilson and others in the federal government were supportive of the legislation that Ontario had passed just months earlier.[34]

By December 1986, the federal government made its position official. In a white paper called *New Directions for the Financial Sector,* Thomas Hockin, the Minister of State for Finance, advocated sweeping deregulation of a magnitude similar to that of the UK's Big Bang: "The government is proposing that, in principle and subject to the ownership policy described below, there be no restrictions on common ownership of regulated financial institutions. Such institutions will be allowed to hold financial subsidiaries in other pillars (including securities dealers) or to be affiliated with other financial institutions through a holding company structure."[35]

In a 2011 interview, Hockin recalled the immensity and weight of the questions parliament was considering in this period. Under domestic and international pressure to open up Canada's financial industry, what ownership rules should the government put in place? Should banks be allowed to own insurance companies? Should non-financial conglomerates be permitted to own banks? Should big institutions be allowed to buy other big institutions? And how should foreign ownership factor into the equation?

Furthermore, many senior bureaucrats in Canada were leery of giving up established relationships with Canada's leading investment banks when they needed new issues of government bonds underwritten. If these investment banks were taken over by Americans, senior officials in the Department of Finance were concerned about potential negative implications when the government needed the market for large underwritings.[36]

---

[33] Hartt, Stanley – pg. 74
[34] MacIntosh, Robert – pg 276
[35] Hockin, Thomas – *New Directions for the Financial Sector* – pg. 6
[36] Interview: Thomas Hockin – August 2, 2011

The Little Bang on securities

The first pillar which the federal government addressed with clearly-defined answers to the above questions was the securities industry. On June 30, 1987, the federal government passed legislation allowing Canada's investment dealers to be wholly owned (up to 100 per cent) by Canadian banks, trust companies, or insurance companies. It was also established that this date gave Canadian financial institutions a one-year head start: at that time, foreign companies were allowed to own only up to 50 per cent of a Canadian securities firm. However, as of June 1988, this ownership ceiling would be lifted – allowing foreign financial institutions to also own up to 100 per cent of a Canadian investment bank.[37]

The day after the passage of this legislation, the federal government also bolstered its commitment to an integrated financial system by establishing the Office of the Superintendent of Financial Institutions (OSFI), with Michael Mackenzie appointed as the inaugural superintendent. This new role combined the previous duties of the Inspector General of Banks and the Superintendent of Insurance. Among the superintendent's new powers was the right to issue cease-and-desist orders against financial institutions engaging in unsafe or unsound practices. The holder of the new office was also entitled to increased control over valuation of assets held by financial institutions, particularly real estate.[38]

With the creation of OSFI, the province of Ontario and the federal government formed an accord that clearly delineated their regulatory powers over the securities industry. The federal government (through OSFI) would supervise the in-house securities activities of federally-incorporated financial institutions (including banks, trust companies, and insurance companies). However, these institutions would be forced to carry out key securities activities through provincially-regulated subsidiaries.

"According to Stanley Beck, Chairman of the OSC, these activities comprised 'the heart of the securities business...[they included] the corporate bond underwriting, the equity trading, the mutual fund dealing'." [39] It is worth noting here that Ontario was the only province to establish such a clear separation of powers from the federal government. Many provinces, especially Quebec, felt that Ontario had given away too much power in this accord. The other provinces' failure to reach an agreement with the federal government led to prolonged disputes over the regulation of financial institutions entering the securities industry. This eventually worked in Ontario's favor, since the province could expedite its regulatory approval of the purchases of major investment dealers.

The rush for investment banks

In the months following the June 30, 1987 legislation, Canada's investment dealers faced a massive rush of bidders. Most of these bidders were Canadian chartered banks willing to pay high premiums to acquire an investment bank and secure a place in the lucrative securities industry. As John Cleghorn,

[37] Wood, Andrea
[38] Boreham, Gordon F. *Changing Landscape of the Financial Services Industry*, pg 193
[39] Wood, Andrea

former Chairman and CEO of the Royal Bank of Canada, recalls, it was often the investment bank that would target and approach a commercial bank, and personal relationships between key executives was a major driver behind these high-priced mergers.[40]

The first approved acquisition was Bank of Montreal's 75 per cent ownership stake in Nesbitt Thomson Deacon Inc. In August 1987, Toronto-based BMO obtained regulatory approval to put up $291 million (nominal) for this purchase – 2.4 times the book value of this investment bank.[41]. In December 1987, Bank of Nova Scotia acquired 100 per cent of McLeod Young Weir for $419 million. On March 31, 1988, Royal Bank of Canada acquired 70 per cent of Dominion Securities (Canada's leading investment dealer) for $385 million.[42] By June 1988, CIBC had also entered the fray getting into the investment banking sector. For the past year, Wood Gundy had been courting First National Bank of Chicago, but the deal was aborted after Wood Gundy lost a huge sum of money, largely due to a bet on British Petroleum. When First Chicago walked away, CIBC swooped in and gobbled up 60 to 67 per cent of Wood Gundy for $110 to $190 million.[43] That same year, National Bank of Canada purchased a 73 per cent share in Levesque Beaubien for $100 million.[44] (See Exhibit 4 for the full listing of deals during this period.)

By June 1988, five of the Big Six Canadian banks had acquired a major stake in an investment bank, all within the one year head-start window over foreign competition. This proverbial gold rush was motivated largely by the perceived attractiveness of the securities industry. Historically, investment dealers' chief function was to advise business firms and governmental departments on the types of investment securities to issue, as well as advising institutional and individual investors on the types of securities in which to invest. A securities dealers' strength was knowledge of a given industry and predictions for its growth, as published in their detailed research reports. It was commonly known that investment dealers would acquire securities at lower prices than they would sell them; this difference, or "spread" was their compensation for both expertise and risk.

By 1986, investment dealers in Canada, the US and England were considered innovators in the financial services industry. Investment dealers had created several types of "products", including options, futures, derivatives and asset-backed securities, all of which could be highly risky, but also tremendously rewarding. Securities dealers enjoyed huge profit margins, and the CEOs of investment dealers -- many of whom owned a major stake in the firm -- had the highest salaries in financial services. By taking on investment banking activities, Canada's large chartered banks gained access to the potential for significant revenue generation. Banks such as BMO were willing to pay more than double the book value of an investment bank, believing that their investment would yield an exceptionally high return.

---

[40] Interview with John Cleghorn, August 25, 2011

[41] Boreham, Gordon F. *Three Years After Canada's 'Little Bang'*

[42] RBCDS Online History (find proper citation). ALSO $ amount from Boreham, Gordon F.

[43] Confirm share: Sources = Robert MacIntosh (65%); Boreham (67%, $190million); On line history from Joe (60%, $110 million)

[44] Boreham, Gordon F. *Three Years After Canada's 'Little Bang'*

However, the cultural differences between commercial and investment banks were significant. Investment bankers were seen as traditionally driven by personal career and financial goals, with incentives in place to provide lucrative services to their clients. In contrast, commercial banks were considered to be driven by history and hierarchy, with multiple layers of approval required for most decisions. A study commissioned by the U.S. House Banking Committee said "Bankers do things slowly and by committee, while investment bankers are used to taking risks, moving quickly to take advantage of market movements."[45] Only one of Canada's Big Six banks refrained from acquiring a full-service brokerage firm – and that bank was TD.

TD during the Little Bang

By the time the Little Bang had occurred on June 30, 1987, Green Line was enjoying a 45 per cent market share in the Canadian discount brokerage market.[46] This degree of success for a chartered bank in a discount securities brokerage was unprecedented. That summer, while Canada's five other big banks were rushing to acquire a full-service investment dealer, TD decided to focus its efforts on Green Line. The bank incorporated Green Line Investor Services Inc. as a wholly owned subsidiary, and Green Line became the first bank-owned dealer to purchase seats on The Toronto, Vancouver and Montreal Stock Exchanges.[47]

In October 1987, Keith Gray heard a rumour that CIBC was making a move to buy Gardiner Group, the third-largest discount brokerage in Canada, with a 12 per cent market share.[48] Without wasting time, Gray and Charlie Baillie arranged a meeting with owner George Gardiner on October 13. George Gardiner, who had a reputation for speedy decision-making and for running a tight ship, revealed to Gray and Baillie that he was frustrated that it had already taken CIBC a month to approve the acquisition of his firm. During that meeting, Gardiner revealed that if TD's Green Line wanted to purchase Gardiner Group, he would be happy to join them – he just needed to know by Friday.[49]

Gray and Baillie pushed approvals quickly through TD Bank's lean corporate structure, and two days later, on October 15, 1987, Green Line acquired Gardiner Group for $14.8 million.[50] George Gardiner became Chairman of Green Line, and other talented Gardiner Group brokers became assets to TD. Moreover, Gardiner Group also brought with it an electronic order entry system for trading and a better understanding of how to manage back-office operations, even at high trading volumes.

By late 1988, Gardiner and Gray had also led Green Line to differentiate itself by offering superior access and convenience to its customers. Green Line moved to a 24-hour-a-day, 7-day a week service, actively selling a wide variety of financial products. This attractive combination of human capital and

---

[45] Boreham, Gordon F. *Three Years After Canada's Little Bang*
[46] Ryans, Adrian – pg.4
[47] Boreham, Gordon F. *Three Years After Canada's Little Bang*
[48] Ryans, Adrian – pg. 4
[49] Interview with Keith Gray, August 17, 2011
[50] Interview with Keith Gray

technological prowess improved Green Line's bottom line and was key to the brokerage's growth in this period.

TD Bank – Sound strategy?

Emerging from Canada's Little Bang period, it became clear that Toronto-Dominion Bank was marching to the beat of its own drum. Its highly-educated senior management team ran a lean organization that was always looking for opportunities to grow. At the time, it was the only large chartered bank with much of a securities portfolio.[51] Keith Gray described his bosses as "new-time bankers" – more like brokers than old-time bankers.[52] Senior management had a keen eye for keeping costs down while pursuing innovative activities. The tone was set at the top.

In the late 1970s, when TD's senior executives asked its board of directors for bonuses in line with those at other banks, the board established a rewards requirement. TD would have to earn a return-on-assets that was 20 per cent higher than the other Canadian banks in order for its executive team to earn their bonuses. They achieved this estimable goal for 10 straight years, until the bank grew large enough for the board to relax these incentive requirements.[53]

However, despite its appetite for risk and comfort with the securities industry, TD Bank did not take the plunge into full-service investment brokerage until it established Evergreen Investment Services in 1993. Although all of the other large Canadian banks acquired outside firms, Evergreen was built entirely in-house from scratch. At the time, TD justified this by questioning the profitability of the full-service securities industry and by assessing the prospect of a cultural fit between TD and an acquired investment bank. Measured against the two criteria of profit and fit, TD leadership felt that the purchase of an investment bank would be challenging. However, by November 2000 -- 13 years after its peers -- TD Bank executives had changed their minds. Under the leadership of Charles Baillie, who at that time served as TD Financial Group's Chairman and CEO, TD acquired Newcrest Capital, Inc. – the largest remaining independent Canadian investment bank. The acquisition cost TD $224 million.[54]

Post-Script

On June 15, 2011, UK Chancellor George Osborne announced his support for the independent report released by a group chaired by Sir John Vickers.[55] The report recommended a requirement for banks to "ring-fence" their retail services from their investment banking services. The BBC business editor, Robert Peston, said the changes would represent "the most significant reform to our banking system since Big Bang in 1986 made it much easier for our giant banks to buy stock brokers and become huge in investment banking."[56] The purpose of ring-fencing is to ensure that, in the event of a major crisis, "a

[51] Interview with A. Charles Baillie, August 10, 2011
[52] Interview with Keith Gray, August 17, 2011
[53] Interview with Robin Korthals, August 24, 2011
[54] CBC News
[55] Sir John Vickers is a British economist, and Warden of All Souls College, Oxford
[56] Peston, Robert – Blog, BBC News

retail bank could be hived off and saved by the Bank of England at less cost to taxpayers, because the investment banking part of the same bank would be allowed to fail".[57] Legislation on ring fencing is scheduled to be completed by May 2015, and banks will be expected to comply "as soon as ... possible thereafter," Osborne said in an December 2011 speech.

This regulation poses a key question for Canada's financial industry. Given that Canada emulated the UK's Big Bang with our own Little Bang in 1987, is it possible that our government will again follow Great Britain's lead and move back to a Four Pillars structure? And if it does, would this be a good thing?

Questions

1] Following the 1980 amendments to the Bank Act, what did Canadian banks have to do to stay competitive? What other options could they have explored?

2] How feasible was TD's strategy in the context of the traditional Four Pillars structure, which defined Canada's financial industry in the early 1980s?

3] Based on Michael Porter's "From Competitive Advantage to Corporate Strategy," how does TD's entry into investment banking compare with that of the other big Canadian banks?

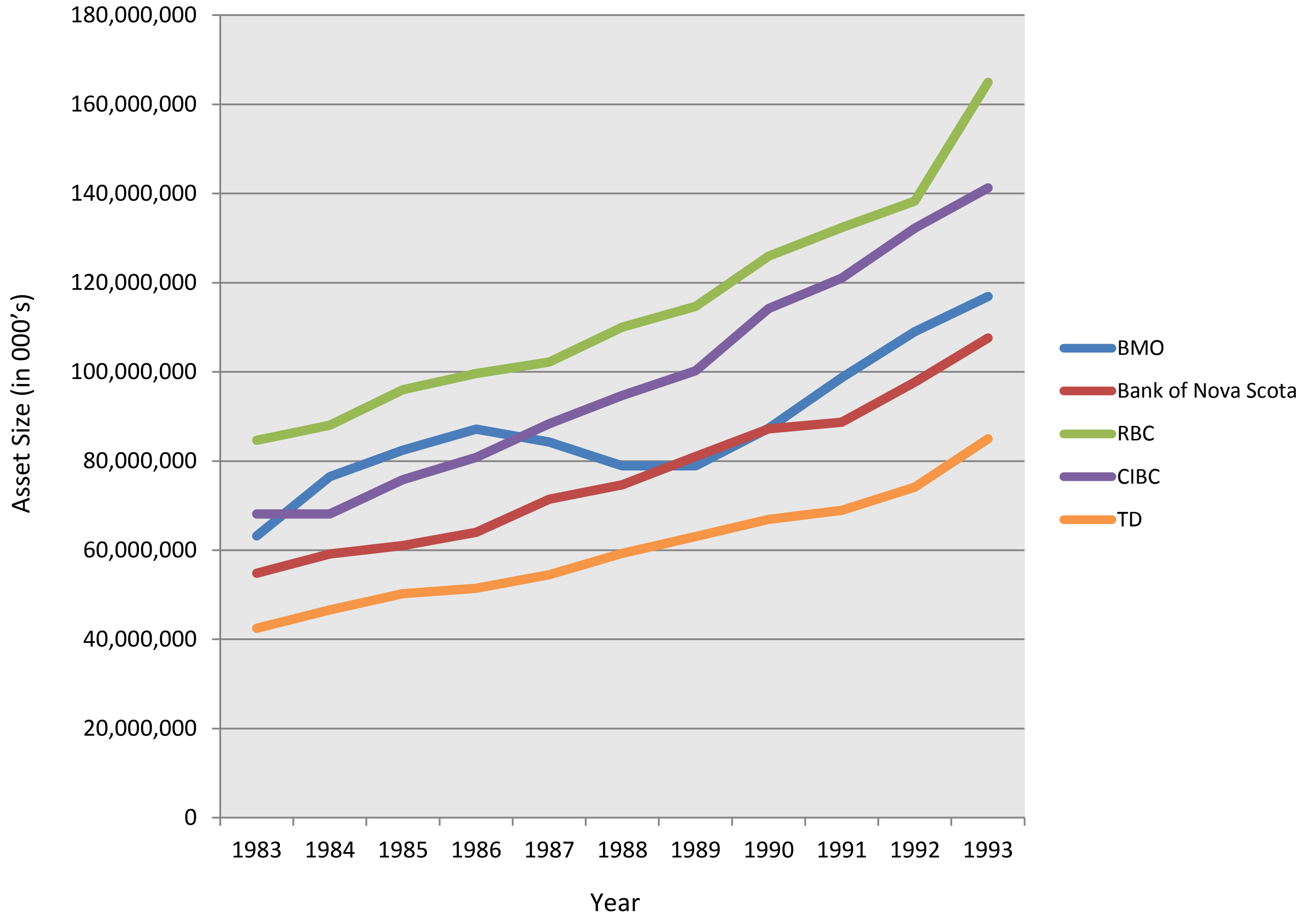
4] What ownership rules should the government set in place? Should banks be allowed to sell insurance from their branch network? Should non-financial conglomerates be permitted to own banks? Should big institutions be allowed to buy other big institutions? And how should foreign ownership be treated?

5] Do you think Canada will emulate the UK once again in establishing ring-fencing within the financial services industry? Why or why not?

[57] Peston, Robert – Blog, BBC News

Exhibit 1

Big Five Canadian Banks, 1983 – 1993
Total Assets (in '000s CAD)



Source: Report on Business Magazine June 1984 and June 1985, and FP 500 1986-1994

Exhibit 2

Big Five Canadian Banks, 1984 - 1993
Changes in Total Assets

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
BMO	0.21	0.08	0.06	-0.03	-0.06	0.00	0.11	0.13	0.10	0.07
Bank of Nova Scota	0.08	0.03	0.05	0.12	0.05	0.08	0.08	0.02	0.10	0.10
RBC	0.04	0.09	0.04	0.03	0.08	0.04	0.10	0.05	0.04	0.19
CIBC	0.00	0.11	0.07	0.09	0.07	0.06	0.14	0.06	0.09	0.07
TD	0.10	0.08	0.02	0.06	0.09	0.06	0.06	0.03	0.08	0.15

Exhibit 3

Toronto-Dominion Bank
Key Financial Measures, 1981 – 1989

Year	Total Assets (in '000s)	Total Interest Income (in '000s)	Earnings Per Share	Market Price per Common Share		
				High	Low	Close
1981		5,858,111	$ 2.35	$ 12.58	$ 8.75	$ 10.04
1982	45,038,354	6,339,943	$ 2.52	$ 11.83	$ 7.25	$ 11.42
1983	42,488,100	4,521,089	$ 2.67	$ 18.63	$ 11.38	$ 16.75
1984	46,596,816	4,841,922	$ 2.64	$ 17.50	$ 13.50	$ 16.88
1985	50,218,294	4,941,330	$ 2.94	$ 24.50	$ 16.50	$ 24.13
1986	51,447,088	4,782,215	$ 2.74	$ 26.63	$ 21.63	$ 22.63
1987	54,525,475	4,556,164	$ 0.15	$ 33.63	$ 22.50	$ 25.13
1988	59,285,378	5,193,245	$ 2.14	$ 38.25	$ 23.13	$ 36.88
1989	63,068,785	6,503,980	$ 2.20	$ 23.13	$ 10.38	$ 21.38

NOTES:

- the numbers have been adjusted to reflect a 3 for 1 stock split in 1983
- in 1987, TD set aside a Special Provision for losses on loans made to 34 Less Developed Countries (LDCs). This provision came out of equity. Earnings per share before the Special Provision were reported at $3.37. The $0.15 EPS is less that the $0.86 actually paid out in dividends per common share - this is because loss realized was less than loss anticipated
- on July 31, 1989, there was a 2 for 1 stock split. Before the split, the low was $16.88

Source: TD Bank Annual Reports, 1983 - 1989

Exhibit 4

Canada's Big 5 Banks: Entry into Securities Industry

Purchaser	Purchasee	Date of Purchase	% Ownership	Cost of Purchase
Bank of Montreal	Nesbitt Thomson	August, 1987	75%	$291 million
Bank of Nova Scotia	McLeod Young Weir	December, 1987	100%	$419 million
Royal Bank of Canada	Dominion Securities	March, 1988	70% (Boreham)	$385 million
CIBC (Canadian Imperial Bank of Commerce)	Wood Gundy	June, 1988	65% (MacIntosh), 67% (Boreham)	$190 million
Toronto-Dominion Bank	Discount Brokerage of Loewen, McCutcheon, Ondaatje &Co.	October, 1984	100%	Not Available

Source: "The Changing Landscape of the Financial Services Industry in Canada" by Gordon F. Boreham

Exhibit 5

Table 1. Market Share of Financial Intermediaries (% of Assets)									
	1978	1980	1982	1984	1986	1988	1990	1992	1994
Chartered Banks	47.4	48.6	46.6	46.3	42.4	40.3	40.2	39.6	42.5
Credit Unions and Caisses Populaires	7.7	7.4	6.9	7.2	7.0	7.3	7.2	7.4	6.8
Trust Companies	8.9	9.1	9.1	11.2	11.6	12.7	12.7	10.6	5.4
Mortgage Loans	3.9	4.3	5.6	0.0	0.0	0.0	0.0	0.0	0.0
Life Insurance	11.0	10.4	10.7	11.6	12.1	12.3	12.4	12.7	11.9
Trusteed Pension Plar	11.1	11.8	13.6	15.9	16.9	17.5	18.4	18.6	18.8
Investment Dealers	2.0	1.6	1.7	1.7	2.0	0.9	0.6	0.5	0.8
Mutual Funds	1.1	1.1	1.0	1.4	2.9	3.4	3.4	5.9	9.2
P & C Insurance	2.7	2.4	2.3	2.7	3.0	3.1	2.9	2.9	2.7
Sales Finance and Loan Companies	4.2	3.4	2.5	2.0	2.3	2.6	2.2	1.9	1.9
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Sources: Statistics Canada Canadian National Balance Sheet Account, Catalogue 13-214

Bibliography

(1982). *TD Bank Annual Report.* Toronto.

The long demise of Glass-Steagall; Mr. Weill Goes to Washington. (2003, May 8). *Website: PBS Frontline*. Retrieved December 5, 2011, from http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/weill/demise.html

Baillie, A. C. (2011, August 10). (A. Srikantiah, & Joe Martin, Interviewers)

Boreham, G. F. (1989, April). The Changing Landscape of the Financial Services Industry in Canada: Some Implications for Managers. *Service Industries Journal*.

Boreham, G. F. (1990, September / October). Three Years After Canada's 'Little Bang'. *Canadian Banker*.

Cleghorn, J. (2011, August 25). (Joe. Martin, Interviewer)

Gray, K. (2011, August 17). (Joe Martin, & A. Srikantiah, Interviewers)

Hartt, S. (2005, September). From a Bang to a Whimper: Twenty years of lost momentum in financial institutions. *Policy Options*.

Hockin, T. (1986). *New Directions for the Financial Sector.* Government of Canada.

Hockin, T. (2011, August 2). Former Minister of State (Finance). (A. Srikantiah, & J. E. Martin, Interviewers)

Karmel, R. S. (n.d.). A retrospective on the unfixing of rates and related deregulation. *Website: World Federation of Exchanges*. New York City, New York, USA. Retrieved December 5, 2011, from http://www.world-exchanges.org/news-views/views/-retrospective-unfixing-rates-and-related-deregulation

Korthals, R. (2011, August 24). (A. Srikantiah, Interviewer)

Langevoort, D. C. (2008, September 2). The SEC, Retail Investors, and the Institutionalization of the Securities Markets. *Georgetown University Law Center*. Retrieved December 5, 2011, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1262322

MacIntosh, R. (1991). *Different Drummers: Banking and politics in Canada.* MacMillan.

Peston, R. (2011, June 15). Banks must ring-fence retail operations, Osborne to say. *BBC Online*. London, England.

Pivnick, R. (1983, June 20). OSC hearing held critical by dealers. *Globe and Mail*, p. B1.

Ryans, A. (1997). The Toronto-Dominion Bank: Green Line Investor Services 1996. *Richard Ivey School of Business, The University of Western Ontario*.

Schull, J. (n.d.). *100 Years of Banking in Canada - The Toronto-Dominion Bank.*

Short History of the Ticker Club of Toronto. (n.d.). Toronto, Ontario.

Slocum, D. (1983, November 22). Green Line ruling is modified by OSC. *Globe and Mail*, p. B1.

Slocum, D. (1983, May 6). Open meeting to discuss banks' securities function. *Globe and Mail*, p. B7.

Whittington, L. (1999). *The Banks: the ongoing battle for control of Canada's richest business.* Stoddart.

Wilson, M. (2011, September 21). Former Minister of Finance. (A. Srikantiah, Interviewer)

Wood, A. (1988, June). Canada's Little Bang: deregulation or reregulation? *International Financial Law Review*.