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Address for communications :

The Editor, JASSA
13-15 O'Connell Street
Sydney N.S.W. 2000

Secretary
Mrs J.A. Crivelli
Telephone 28 5376

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THE SECURITIES INDUSTRY IN CANADA

By D.R. Brown, Melbourne

(After experience in the securities industry in Australia, Mr. Brown spent 7 years working with Canadian and U.S. brokerage houses. He has now returned to Australia and is engaged in the Melbourne office of a Sydney firm of sharebrokers.)

There is an old saying among securities industry employees in Canada which is "When Wall Street sneezes, Bay Street catches a cold".

This is because Canada's economy is closely allied to that of its U.S. neighbour and much of the securities industry is based on the same systems. A change in the U.S. Federal Reserve Bank Rate will automatically send Bank of Canada officials into collaboration and similarly the Canadian Bank rate will move in the same direction.

Many Australians believe Montreal to be the financial centre of Canada when in fact, it is Toronto and this article will largely focus on the operations of the securities industry in that city.

There are six Canadian Stock Exchanges of which the Toronto Stock Exchange is by far the largest, handling almost 40% of the share volume but 70% of the dollar volume of all exchanges. Montreal has two exchanges, both housed in the same building and have their trading floors adjacent to each other. Traders or operators of the brokers who are members of both exchanges must change their identity buttons before crossing the line that separates one floor from the other. The Montreal Stock Exchange is the larger, its list consisting mainly of the larger Canadian industrials, while the Canadian Stock Exchange concentrates on junior industrials and mining stocks. The two exchanges have recently released plans to merge.

The remaining exchanges are situated in Vancouver, Calgary and Winnipeg. The latter two are quite small having less than 2% of share and dollar volume. The Vancouver Stock Exchange is the fastest growing by virtue of the fact that it is basically a mining exchange and in the last decade it has been the scene of many speculative booms and busts.

The Toronto Stock Exchange was erected in 1937 on its present site on Bay Street and is now dwarfed by new 50-floor office complexes. There are 125 seats available, which are sold to member firms with no firm allowed more than two seats. Incorporation of members was permitted in 1953. Individual seat holders are entitled to one vote in election and procedural matters. They are subject to the disciplinary provisions of the by-laws and regulations, as they are accountable for the acts of the firm or corporation on whose behalf they hold the seat. Recent sales have been in excess of $125,000 and member firms may be members of more than one exchange. A Board of Governors is elected each year and two of the fifteen elected must be from the public.

Located on the large trading floor of the Toronto Stock Exchange are eleven trading posts, including two posts where less active stocks are traded. The posts are of island-type and on the six faces of every post, ten or in some cases fifteen separate stocks are listed. Generally speaking, companies engaged in the same general type of business are posted together, although oil and mining stocks are interspersed on every post. Post clerks handle quotation changes by telephoning the new quote to the Master Quote Board located beneath the trading floor. There a control operator, punches the new quote into the master control unit and it automatically changes the electronic figures on the trading post.

Telephone booths are situated around the edges of the floor rising in tiers against the walls. Telephone clerks are not permitted on the trading floor and hence, in a busy market or in arbitrage situations, orders and reportings are often transmitted from the clerk to operator and back via handsignals.

The specialist system of the New York Stock Exchange was given a trial in Toronto some years ago but it was discontinued when it was found to be not applicable to Canadian markets. However, it was replaced by a system which could well suit Australian exchanges. It entails granting operators a "professional" status. The Toronto Stock Exchange system recognizes Registered Traders, that are the only traders who can make and immediately execute trading decisions for accounts in which they and/or their members have a financial interest.

Registered traders are assigned at least one face of a post and are responsible for maintaining a fair market in the companies listed on that face. They must execute orders from the public before their own account, and must be willing to buy and sell odd-lots or broken-lots at the prescribed premium or discount. There are no odd-lot brokers in Canada.

Prerequisites of Registered Traders are five years experience and the payment of $25,000 to the Toronto Stock Exchange by the member firm, for each Registered Trader associated to it. Most houses pay a modest retainer salary for the execution of its clients orders and then participate in profits or losses to an agreed percentage e.g. 60/40. Registered Traders work in close co-operation with order traders in providing liquidity but must maintain a responsibility to see that high ethical and trading standards are adhered to. In this regard, he cannot take out the complete offering or fill in the complete bid when acting on his own account.

Trading is continuous from 10 a.m. to 3.30 p.m. after which no further business in listed stocks can be transacted. Daily share volume averages over $2\frac{1}{2}$ million shares with a dollar value exceeding $20 million. Marketable parcels for industrial shares selling under $25 are 100 shares and 25 shares if selling above $25. Mining shares selling under $1 trade in 500 lots and 100 if selling above $1. Operators must state the size of their intentions when buying or selling in the open market, failure to do so, entitles him to buy or sell one marketable parcel only.

If a number of member firms are trying to buy or sell a stock, operators must establish which firm is entitled to buy or sell at a given time. If no one is entitled to be the established buyer or seller then it is an open market and every bidder or offeror acting for a client has equal entitlement to whatever trades at that price. Therefore, should one or two parcels come available at the price of an open bid (or offering), all bidders (offerors) are given the chance to match for it.

Should there be an established buyer or seller, then there is no participation by other member firms in up to ten marketable parcels. The established buyer or seller is entitled to the first ten parcels to trade at that price. After the established buyer or seller is filled or has traded ten parcels, another operator becomes established as the buyer or seller; or the market becomes open and others participate on an equal basis. There are four ways to become the established buyer or seller.

Assuming a buyer, these are:-

1. Bid a price at least one minimum bid higher than the current bidder(s)
2. Be first to bid a price which is being bid by others when the present buyer gets off the bid; has been filled; purchased ten parcels or cancelled his bid.
3. Be first to bid after the stock trades at other than the bid price. (Crosses at any price do not count).
4. Buy one marketable parcel at the offering and then bid. Operators using this discretion or technique are able to "keep the floor".

The "established buyer or seller" does have the advantage in that the operator is able to move away from the post and still participate in trading and it also prevents trades being executed between friends without the market being informed.

Crosses or marriages must take place in the square in front of the post-face where the stock is traded. They must be at or within the prevailing quoted market, announced to the floor as "Bought and Sold -----" and the ticket initialled by another trader. Marriages between clients and "professionals" (includes house account, partner's account or any employee account) are prohibited unless consent is obtained from the client.

On rare occasions when a large influx of orders to buy or to sell has made it impossible for operators to work out an opening price, a "Delayed Opening" is declared. Floors Governors and Toronto Stock Exchange Floor Officials will carry out a matching of all buy and sell orders in the delayed stock which have entered the market. Should a severe imbalance arise, the

Toronto Stock Exchange quite often approaches the broker to the issue in order to obtain a balance.

Canadian investors have many more opportunities and trading techniques than their Australian counterpart. These include:-

"Buying on margin" - where Toronto Stock Exchange rules require 60% safety margin in stocks trading at $2 or more. Margin loans are made by brokers at interest rates 1% above the prime rates of the chartered banks.

"Short Sales" - 60% of the present market value of the short position must be put up as margin in addition to the proceeds of the sale which are held by the broker. Short sales must be disclosed to the broker and must be executed only on up-ticks i.e. a short sale cannot take place below the trade price of the last preceeding sale. Scrip is borrowed for delivery either from other brokers via the Toronto Stock Exchange Loan Post; the broker to the issue or from the broker's own account or margin loan securities.

"On-stop orders" - both buying and selling. Settlement of transactions take place three days after the trading date. Strictly speaking, all clients who have not paid for purchase after the third day can be sold out on the fourth day and liable for losses. Delivery and settlement between brokers is performed by the Toronto Stock Exchange Clearing House. Briefly this entails:-

Trade Day	- Clearing sheets are prepared by computer for all trades.
Day 1	- Brokers receive two copies of clearing sheets and check off items. A corrected copy is returned and the computer prepares delivery instructions.
Day 2	- Delivery instructions of net deliver or receive positions in each stock are issued to each broker. If a broker is unable to deliver by the next day, he must submit a Fail. When a fail is made the broker must put up cash equal to the value of the stock which has been failed. The broker is debited this amount on settlement date by the Clearing House.
Day 3	- Brokers deliver stock certificates as required and receive from, or pay a certified cheque to the Clearing House.

When delivery of a failed stock is available, a Put-on notice is forwarded to the Clearing House. Put-ons are settled on the day after they are received, with the fail value being credited to the broker.

The Clearing House maintains a loan post to enable brokers to borrow stock for delivery. Also, the T.S.E. requires every listed company to have as its transfer agent a trust company with an office close to the T.S.E. and scrip splitting is effected almost "while you wait". Consequently, buy-ins are kept to a minimum. There are no separate transfer forms as bearer securities are used.

Occasionally when institutions wish to sell a large holding, and his broker feels the price may be adversely driven downward to absorb the sale, he may elect to do a secondary distribution. This can be done in two ways:-

1. Internally. The broker assumes a bona fide liability of $500,000 or more by purchasing the stock for his own account. Exchange approval will be given to effect an off-floor transaction, then the broker proceeds to sell the stock to his own clients at present market price plus regular commission. Provision is made that while such trades must be reported to the

exchange immediately, taping or disclosure may be delayed until the position is unwound or for 5 days, whichever is less.

2. Externally. The broker purchases the block from the seller and announces on the ticker tape or through the T.S.E. daily bulletin, that he is offering x shares of ABC Co. as a secondary distribution at a close of trading that day. Liability must exceed $250,000. Other members are then eligible to apply for stock direct at a net price off-the-floor. Brokerage is rebated to participating buying brokers.

A volume discount, which is a brokerage rebate to the client of large size orders, is permitted pursuant to orders:-

1. placed by one client for one account for an individual security
2. filled in any trading period of five consecutive days
3. provided the total value traded during the period is in excess of $100,000, exclusive of brokerage and transfer tax.

Volume discount becomes greater in accordance with a higher total value. Many member firms assume liability either long or short in order to grant clients a larger discount. To assist large transactions, brokers use a system of block traders who are in constant touch with each other. Institutions will designate their interest of size and price of intended transactions and block traders will shop about themselves and institutions to arrange the other side.

Client advisers are known as Registered Representatives and they earn 1/3 of commission received. Institutional advisers normally have a set salary and advise in connection to new issues and portfolio changes. Larger brokers usually have more than a dozen advisers.

Historically, the T.S.E. has played a significant role in the raising of risk capital through the sale of new shares of speculative mining companies into the open market. This was done by member firms acting as underwriters, who purchased the shares at an agreed price and sold them into the existing secondary market. Manipulations often prevailed.

This practice was heavily criticized by the Government inquiry due to the Windfall debacle in 1964. As a result, the T.S.E. uses a new system of primary financing for speculative mines by means of a Fixed Price Offering. The price is determined by the underwriter, but it must not be higher than the closing price on the preceeding day. The broker will maintain a book to receive subscriptions between 9.00 and 9.30 on the day of the offer. The broker must not reserve more than 75% of the offered shares to fill the orders of their own clients. On an underwritten basis, the treasury of the company will receive an amount equal to the market price less a laid down discount of 25% at prices between 20¢ and 50¢; 20% between 51¢ and $1.00 etc.

The new financing method has dampened speculative mining activity considerably and has been a major factor in the rise of the Vancouver Stock Exchange, as mining companies and their promotors went West because the V.S.E. still allows primary distribution via open market distribution. No liability or partly paid shares are non-existent. Most companies have no par value shares therefore share splits are preferred rather than bonus issues or stock dividends. Share distributions from capitalizing reserves are considered to be dividends to the amount of the new issue and therefore taxable.

Normally, new public companies are floated by member firms acting as an underwriter and the newly issued shares will trade in the over-the-counter market before exchange listing is granted.

When a large issue is floated, several member firms may form a Syndicate to ensure the issue obtains wide distribution. The initiating broker acts as Syndicate Manager whilst other members form the Selling Group. The Syndicate Agreement is prepared by the Manager and will designate "Exempted Institutions" and the Selling Group is not permitted to approach them. This style of underwriting is used also for fixed interest securities.

In the marketing of new bonds and preferred shares several "sweeteners" may be used, especially in times of high interest rates. These include:-

1. Ordinary shares given as a bonus in a unit package deal.
2. Convertibility into ordinary shares on specified terms.
3. Stock purchase warrants (options), that are usually detachable.

New issues must be "blue skied" by a Provincial Securities and Exchange Commission i.e. if the prospectus is accepted by one S.E.C. then it is automatically accepted by each and the new issue can be sold in each Province.

The largest securities market in Canada is the bond market and all dealings are conducted over-the-counter. A vast telephone hook-up connects direct lines between brokers and institutions right across Canada to facilitate dealing. Large brokers may carry up to a dozen bond traders and may be linked to over 100 other trading desks, banks and institutions. The bond traders carry formidable inventories of securities and are usually prepared to deal in either direction, quite often selling bonds short. House account trading is prominent and most transactions are therefore on a "net" basis. The Bank of Canada also plays an active role in the market and is in constant touch with dealers in respect to its open market operations. There is ample scope for bond-switching and with sinking funds in wide use, the turnover in the bond market can be quite substantial.

Canadian bonded debt is estimated to exceed $75,000 million. The different issuing bodies would include:-

1. Government of Canada (including Canada Savings Bonds)
2. Provinces - Direct
3. Provinces - Guaranteed
4. Municipalities ranging from the large city to small towns.
5. Corporations
6. Religious orders
7. Governments of Australia and Jamaica and the International Bank of Reconstruction and Development, that are payable in Canadian Dollars.

The inherent qualities of all fixed interest securities determine their relative standing in the scale of yields. Federal issues usually sell on a lower yield basis than provincials and of the Provincials, Ontarios are held in highest esteem. Albertas are usually next, followed by Quebec and with the remainder ranging down to those of Prince Edward Island and Newfoundland. The best quality municipals (City of Toronto and City of Montreal) and corporate bonds tend to be equated with average grade provincials. Sinking funds and call provisions of corporates may have a big bearing on some issues. The level of interest rates is usually influenced by U.S. trends and the spread in interest rates between the two countries is most important.

All new issues of Federal Government securities (except Canada Savings Bonds) are issued on a 24 hour subscription basis. The Bank of Canada informs dealers and banks by telegram, details of a new issue such as the size, coupon, price, term, yield, date of issue and delivery, as well as the amount the Bank is alloting for refunding purposes. Subscription books close on the following day.

Treasury bills are issued weekly by competitive tender. The eligible bidders are the Bank of Canada, the chartered banks and dealers. The tender is closed at 12.00 noon each Thursday and bills are allotted in orders of rank of bids submitted. Each bidder is telephoned after 2.00 p.m. by the Bank and told the number of bills he was successful in winning; the high, low and average tender and the amount and maturity of bills to be offered the following week.

New issues of Provincial Government Direct and Guaranteed Bonds and Debentures are sold either by competitive tender or at a negotiated price through an underwriter. In either case, a full liability is undertaken by the brokers involved who purchase the securities as principals and offer them for resale. Most new issues of municipal debentures are of smaller size compared with provincials with the exception of Toronto and Montreal. Most smaller municipalities sell their issues in the form of serial bonds (a nominated portion retires each year) and use the competitive tender method. All new capital either borrowed or equity, raised by corporations is usually through brokers acting as underwriters.

The history of the Official Short-Term Money Market is similar to that of Australia. It emerged during the "Thirties" with the introduction of Treasury Bills, but it was not until 1952 did the Bank of Canada encourage large member firms or dealers to increase their inventories under repurchase agreements. In 1954, the chartered banks at the invitation of the Bank of Canada made special "day-to-day" loans available to the fourteen authorised dealers against money market securities, and the Bank of Canada became a lender of last resort. Most securities maturing within three years are recognised as money market securities.

Treasury Bills are the highest quality instrument in the Money Market and the rate on bills establishes the level of the whole market. Other money market securities include:-

1. Short-term Federal Government issues.
2. Discount bonds, treasury bills and parity bonds of the provinces and municipalities.
3. Finance company notes or acceptance paper.
4. Corporate promissory notes and bankers acceptances.
5. Dealer's repurchase agreements or "buy-backs".
6. Term deposits, notes and guaranteed deposit receipts of banks and trust companies.
7. U.S. Bank Swaps (bank deposits in U.S. branches with foreign exchange covered forward).
8. U.S. Treasury Bills, with or without exchange cover.
9. Euro-dollar deposits.

The ultimate responsibility for the manner in which secondary trading in fixed interest securities and unlisted shares is conducted lies with The Investment Dealers' Association of Canada. In Toronto and Montreal however, day-to-day control over the trading is exercised by the Toronto and Montreal Bond Traders' Association, whose membership is composed of representatives of dealers, chartered banks and other financial institutions. Publication of quotes and the compilation of trading statistics are maintained by the joint bodies.

The Investment Dealers' Association of Canada is a national organisation of brokers and its duties include periodical audits of members' accounts and the setting of high ethical standards for the industry. Investment courses, similar to those of the Securities Institute of Australia, are conducted for members' employees and the public. The Canadian Securities Course is a prerequisite for all advisors, bond traders, block traders and floor operators.

The principal institutions of the securities industry in Canada are basically conservative with the exception of mutual funds. An approximate break up of investment funds for the life insurance companies and pension funds would be:-

Bonds	Life Companies	Pension Funds
Federal	7%	8%
Provincial	8	15
Municipal	6	10
Corporate	20	30
Mortgages	54	12
Ordinary & Preferred Shares	5	25
	100%	100%

The Canadian and British Insurance Companies Act regulates all life insurance company investments. No restrictions are made on the investments of governmental issues, but corporate bonds must fall under the legality clauses set out in the Act. Investments in ordinary and preferred shares must have paid a dividend for the five years immediately preceding date of investment. However, 7% of investment assets may be held in securities not eligible under the Act through the "Basket" Clause.

Pension fund trustees are free to invest at their own discretion, subject to the terms of the trust deeds, which are styled on the U.S. pension funds "Prudent-man law". The introduction of the national compulsory Canada Pension Plan in 1966 caused little changes in the allocation of pension monies.

Individual Canadian investors are attracted mainly to ordinary shares. Dividends from Canadian tax paying corporations attract a 20% Dividend Tax Credit. Shareholders receiving dividends from oil and mining stocks may be allowed up to a 20% depletion allowance deduction, thereby attracting individuals in high tax brackets. Canada recently introduced a capital gains tax.

Canada experienced a mining boom in 1964 whereby speculation and fraud prompted a Government inquiry. The findings recommended Provincial Securities and Exchange Commissions to be set up as watchdogs on the industry. Ontario has by far the largest S.E.C. and it was founded by Mr. John Kimber Q.C., who headed the inquiry and is now President of the Toronto Stock Exchange. Apart from granting approval to prospectuses, the S.E.C. maintains insider trading statistics, outlines for full financial disclosure, market surveillance and the screening of securities personnel.

After the mining debacle, large Canadian funds and individuals turned to New York but the S.E.C.'s brought confidence back into the Canadian market, just as the U.S. S.E.C. injected confidence into the stock market of that country after the 1929 crash. The securities industry in Australia therefore should not be fearful of a S.E.C. being established in Canberra.

With the introduction of Australians being able to invest abroad, most people tend to think of the New York and Tokyo markets. The sophistication of the Canadian market as described in this article would suggest that this market should not be entirely overlooked. Many U.S. companies or their Canadian subsidiaries are listed and the T.S.E. index has risen from around 180.00 to a high of 255.7 over the past eighteen months, outperforming the Dow Jones Index.