The Committee, therefore recommends that:

3. The Inspector General of Banks should provide an official definition of bank capital that precisely specifies the weights attached to components of each class of capital. Bank capital should be identified as either primary or secondary. Primary capital is to be permanent in nature, including common equity and non-redeemable preferred shares. Secondary capital would include all other forms of capital that meet minimum standards as to type and maturity, including such forms as convertible and subordinate debentures.

4. The total outstanding value of any one bank's loans to any borrower or associated group of borrowers should be limited to 25 per cent of that bank's total capital (as defined in Recommendation 3), unless otherwise approved by the Office of the Inspector General of Banks.

5. In the event that the above recommendations are implemented bank leverage ratios should not be legislated. However, the Inspector General of Banks should closely monitor long-term trends and short-run variations in the leverage ratios of individual banks.

With an official and precisely defined capital base specified for each bank, the public could be made much better aware of the financial position of the banking system. Such specifications, combined with limitations on the size of individual bank loans, would provide the constraints necessary to ensure prudent banking practices. The Committee feels that, because bank leverage ratios can be subject to significant short-run variations, any limits fixed to these ratios would impose undue burden on the banks.

Over the past seven years, the calculated loan loss provision reported in the banks' annual income statements has proven to be a poor indicator of actual loan loss experience in any particular year. Moreover, the banks' loan portfolios include loans classified as non-current and/or non-productive. The actual status of such loans is unclear, and the Committee has not had available to it the extent to which individual banks carry such loans. The Committee accordingly recommends the following:

6. The formula used for calculating the average provision for loan losses (currently a five-year moving average) should be reviewed by the Minister of Finance with a view to moving to a system that more accurately reflects a bank's actual loan loss experience in its income statement.

7. The non-current loan category as outlined in the Bank Act should be redefined, so as to classify outstanding bank loans according to their contribution to bank income. All loans on which i) future interest payments are not expected to be received or ii) interest payments have not been received for ninety days or iii) for which bank officials treat interest payments on a non-accrual basis, should be classified as non-contributing loans. All loans on which i) contractual interest payments are not made in full and, on which ii) the differential is treated on a non-accrual basis, should be classified as partially-contributing loans. All other loans should be classified as fully-contributing loans. Such information should be included in each banks annual report.

An adequate capital base is necessary to protect the interests, not only of bank depositors, but also of the banks' shareholders. The steps recommended should further