Finally, a bank may have positive earnings but pay a higher dividend than what it is actually earning. In this case, the bank would, in effect, be paying its capital back to its shareholders, and its capital would decrease by the amount the dividend exceeded its earnings on an after-tax basis.

Every one of these elements has had the effect, for certain banks, of decreasing the amount of their capital. However, to date, these adjustments have been very minor. Each of the cases, however, must be considered in light of the importance of capital to a chartered bank and the necessity for keeping it adequate to cover these various uncertainties.

3.8 COST OF NEW CAPITAL

In order for a bank to supplement its total capital, it must, from time to time, raise new equity through the public security markets. This additional capital is often required to supplement a bank's retained earnings in order to maintain adequate total-asset-to-capital ratios (leverage) at any single moment. As illustrated in Table 3.7, supplied by Burns, Fry Limited, it can be noted that, in 1981, the banks raised approximately $1.2 billion in new capital in order to prevent their leverage ratios from rising substantially further. Perhaps even more significant is that, to date, in the first six months ended April 30, 1982, the banks have raised an additional $1.0 billion in new capital. In total, they have raised approximately $2.2 billion in new capital over the last 18 months. As noted previously, this represents approximately 25 per cent of all such offerings in Canada. Wood Gundy Limited stated in its brief that "it would be imprudent to conclude that the banks can issue substantial amounts of new capital year after year, for several reasons"; these reasons are summarized below:

1. During late 1981 and early 1982, several bank issues are believed to have been either significantly reduced in size or shelved indefinitely.

2. Each year, Wood Gundy surveys at least 70 Canadian financial institutions to determine whether their bank holdings are underweighted or overweighted in their investment portfolios. Last year's survey showed that bank shares were heavily weighted in institutional portfolios. In 1981, about 80 per cent of the new issues were sold to retail or individual investors because institutions already owned sufficient bank shares issues.

3. The terms of last year's issues showed considerable ingenuity; some issues had more than one type of warrant attached, and there were some convertible issues with special features. This type of financing is sometimes an indication that the market for the shares for a particular type of corporation is becoming saturated.

4. Bank shares in recent years have been accorded lower price earnings multiples. This raises the cost of capital to the issuing corporation.

In retrospect, it might have been better if the banks had issued more capital prior to the last 18 months when leverage ratios were initially rising and bank share prices had much higher values, particularly in relationship to their book values.