against earnings in five of the seven years under review. In 1978, the calculations worked out in such a way, that what the banks charged against their current year's earnings was exactly their actual loan loss experience. In 1979, the banks charged $450 million against their earnings when their actual loan loss experience was $406 million. The banks therefore charged $44 million too much against their earnings and thereby understated their actual earnings in that year.

In 1980, the actual loan loss experience rose very substantially; the five-year average experience, rising more slowly to $592 million, did not compensate for the banks' actual loan loss experience of $749 million. The difference of $157 million meant that the banks did not charge enough, and therefore overstated their 1980 earnings. In 1981, the five-year average loan loss provision rose by 39 per cent to $820 million, whereas the banks' actual loss experience rose by only 14 per cent. Consequently, the banks' overstatement of earnings declined to only $32 million. For 1982, there were several estimates given to the Committee that indicated that the banks' actual loan loss experience could approach $1,500 million, an increase of 75 per cent over 1981. The five-year average loan loss experience may rise to as much as $1,000 million, implying a difference of $500 million in 1982. Thus, given these estimates, the banks could overstate their earnings in 1982 by $500 million.

It must be remembered that, when the five-year average loan loss experience charged against earnings does not equal the actual loan loss experience, the difference has to be added to or subtracted from shareholders' equity. In the case of 1979, the banks were able to increase shareholders' equity by $44 million, because they charged too much expense against the current year's earnings. However, in five of the seven years under review, the banks did not charge enough expense against earnings. In the case of 1980, the difference of $157 million was deducted from shareholders' equity. For this reason, it is very important to assess these two factors and their impact on capital. On the basis of the estimate for 1982, bank shareholders' equity could be reduced by $500 million in a period when earnings have decreased and, when, at the same time, capital markets make it difficult for banks to raise new equity through new issues.

It is often important to relate the actual loan loss experience to the average common shareholders' equity outstanding, including the reserve for future loan loss appropriations. When actual loan losses are related to average common shareholders' equity, it can be seen that actual loan losses have risen quite significantly in relation to average equity. In 1975, as noted in Table 3.4, loan losses represented 7.58 per cent of total shareholders' equity, but rose to 9.60 per cent in 1980 before falling slightly to 9.37 per cent in 1981. Both 1980 and 1981 were significantly above the 1975 to 1979 average. As indicated above for 1982, the actual loan loss experience could rise to as high as 13.0 per cent of total shareholders' equity, which would be the highest level in recent history. A similar experience will likely occur in 1982 for actual loan losses as related to average assets. This ratio of actual loan losses as a percentage of average assets would therefore increase to approximately 0.55 per cent, almost double the 0.28 per cent in 1981, and would be the highest level in recent history.

It should be evident from this dicussion that the calculation of the five-year average loan loss provision needs to be reviewed by the Minister of Finance, so as to shorten or eliminate this averaging process. Then earnings would better reflect the actual experience incurred by the chartered banks in any one year.