



SECURITIES COMMISSION OF THE REPUBLIC OF LITHUANIA

2010

**SECURITIES COMMISSION ANNUAL
REPORT AND TRENDS OF MARKET
IN FINANCIAL INSTRUMENTS
EXECUTIVE SUMMARY**



Trends in the market of financial instruments

Stock Exchange. For investors at NASDAQ OMX Vilnius (OMXV) the year 2010, similarly to the previous was a year of success as the OMXV index value during 2010, as compared to 2009, increased by 54.49 percent. During the reporting period the OMXV turnover reached LTL 4 bn while its capitalisation was reported at LTL 18.8 bn.

This acceleration in the index growth as well as in other indicators is undoubtedly associated with the overall improvement in corporate performance and a markedly more optimistic investor outlook of the prospects of Lithuanian economy.

Primary equity and bond market. In 2010, eleven equity issues to be paid by additional shareholder contributions offered investors to acquire shares of LTL 973.5 m in issue value. The comparison of the reporting year to the previous years shows some decline in fund generating as the results for 2010 were by LTL 56.2 m down from 2009.

During the reporting year issuers in Lithuania placed for public or private offering total 99 issues of debt securities of LTL 1.036 bn in nominal value, i.e., by 21 percent less than in 2009.

The bond redemptions from investors in 2010 exceeded the volumes of bond placements. Volumes of investment into corporate debentures during the year under review decreased by about LTL 1.25 m accounting as of the end of the year at nearly LTL 1.95 bn, of which the value of publicly distributed and outstanding bonds was LTL 759.1 m.

Pension and investment funds. During the accounting year the increase in the value of the 2nd pillar pension funds in Lithuania on average was recorded at 8.83 percent. For pension funds of conservative investment strategy the year 2010 was quite changeable as the significant adjustments in the bond market markedly affected their portfolio value; nevertheless as of the beginning of the year pension funds in this risk range managed to reach a positive result with an increase in the unit value by 3.08 percent. The value of pension funds assigned to other risk groups was increased in proportion to their risk degree: the value of small equity share pension funds increased on average by 6.11 percent, that of medium equity share and equity pension funds – by, respectively, 10.54 and 18.95 percent.

The total assets of 2nd pillar pension funds during 2010 increased by 18.4 percent (by LTL 593.6 m) and reached LTL 3,856 m. In 2010 the “Sodra” transfers to pension funds accounted for LTL 324.7 m. As compared to 2009, the total value of transfers decreased by nearly 48 percent.

As of the end of 2010 total 1,035,000 persons were parties to the agreements on accumulation of part of the State social insurance contributions – by 38,000 more than last year. During 2010, 42,000 new participants joined the pension accumulation system.

During the reporting period also the 3rd pillar pension funds recorded some increase in their membership (13 percent or 2,700), and at the end of the year total 23,900 persons used 3rd pillar pension funds as a vehicle for their future pension accumulation.

During 2010, as a result of the overall increase in the market value and the increased number in participants, the total assets of the 3rd pillar pension funds augmented by nearly 25 percent and, as of 31 December 2010, were recorded at LTL 99.2 m, where the 3rd pillar pension fund unit value increased on average by 14.42 percent.

Five new CIUs were incorporated during the year (of which 2 umbrella CIUs consisting of 7 sub-funds), and 2 funds terminated their activities upon resolutions of their management companies.

At the end of 2010, the number of CIUs participants was recorded at nearly 38,870. During the year under review the total asset value of Lithuanian CIUs increased from LTL 446.95 m to LTL 602.02 m (by 34.7 percent). This increase was mainly accounted for by the number of distributed fund units exceeding redemptions in addition to their overall positive investment return.

Financial brokerage firms and management companies: key performance indicators. During 2010, FBFs earned total LTL 0.5 m in profits (net profit in 2009 was LTL 0.9 m). Four FBFs completed 2010 at a profit, while five firms incurred losses. The FBFs net profits decreased mainly due to the decline in the value of financial instruments acquired for own funds of the FBFs.

For 6 out of 12 management companies (MCs) the year 2010 was the year that generated profit. According to the financial statements the MCs' net profits were by LTL 3.9 m on top of the 2009 data (LTL 2.2 m and LTL 6.1 m, respectively for 2009 and 2010). This increase in net profits was achieved mostly by a reduction in the general administrative costs: during the reporting period such costs accounted for LTL 17.8 m, i.e., by 14.4 percent less than in 2009.

Activities of the Lithuanian Securities Commission

The principal objective pursued by the activities of the LSC is to ensure fair, transparent and efficient operations of markets in financial instruments, their sustainable development, protection of investor interest, limiting of systemic risk, as well as to contribute to maintaining stability and reliability of the overall financial system. While in pursuit of these overall objectives during 2010 continued improving the legislation governing the operations of markets in financial instruments, sought to reduce the administrative burden of the entities falling within the scope of its supervision, was issuing different explanations, guidelines and recommendations facilitating the proper implementation of the relevant legal acts by market participants. The Commission was on a continuous basis analysing trends in the development of markets in financial instruments, assessing the compliance by market participants with the principles of integrity, efficiency, security and reliability entrenched in the legal acts pertaining to financial instrument markets, and was encouraging residents to devote more attention to personal finance management.

Drafting and improvement of legislation

During 2010, the LSC continued to improve legal regulation, enhance legal certainty and thus contribute to the improvement of conditions facilitating the market development. Below are presented the principal amendments in legislation effected during the accounting period.

During the period the laws amending the Law on Securities, Law on Markets in Financial Instruments, Law on Collective Investment Undertakings, Law on Supplementary Voluntary Pension Accumulation were adopted and came into force. The principal objective pursued by the relevant amendments and supplements of the legal acts is to clearly define the liability for infringements of legal acts governing markets in financial instruments. In this connection the LSC also introduced certain measures designed to enhance the efficiency of the LSC's supervisory functions – elaborated and specified the list of the rights vested with the LSC, and established the duty for the LSC to obtain an authorisation for certain actions in relation to investigations of infringements.

In 2010, an inter-institutional task force initiated by the LSC drew up the draft Law on Collective Investment Undertakings for Informed Investors and the draft law amending the current Law on Collective Investment Undertakings. The principal purpose of such draft laws is to create conditions for a more balanced and sustainable development of capital markets and more efficient distribution of capital in economy. An innovative legal regulation better tailored to the needs of professional investors and a more advanced taxation environment would open wider possibilities for attracting funding to business circles and promote the establishment of operations of special CIUs throughout Lithuania.

During the reporting year the LSC was also drafting, amending and supplementing secondary legislation related to the area assigned to its competence.

Similarly to previous years, seeking to ensure a uniform and consistent interpretation and application of legal acts the LSC was, within the limits of its competence, issuing different official explanations on different issues. With a view to ensuring an efficient operation of markets in financial instruments, improving the

quality of investment services provided in Lithuania and protection of investor rights, the LSC was drafting guidelines intended to specify and interpret the legal norms related to laws and the LSC's resolutions governing the market, or explain the different practical aspects related to the compliance with such legal acts.

Oversight of the market in financial instruments

Issuer supervision. One of the most important tasks facing the LSC in performing its issuer supervision function was to ensure an expedient and efficient disclosure of issuer information provided for in legal acts on the issuer performance, financial status, securities issued or intended to be issued, compliance with the rules on fair trading in securities, also the transparency and reliability of the market.

Quite conventionally, the assurance of the proper disclosure of material information and the compliance of accounting and financial statements with the International Accounting Standards (hereinafter – IAS) further remained the priority focus of the LSC in its fulfilling the issuer supervision function. The LSC was acting as an authority supervising the disclosure of material events, assessing the sufficiency of the disclosure by issuers to potential investors of the information on securities issued or intended to be issued in prospectuses as well as in periodic information, was approving circulars of takeover bids, etc.

During 2010, the LSC carried out five comprehensive inquiries with a view to assessing the compliance by issuers with requirements of legal acts governing the disclosure of material events. Furthermore, in 2010, for the first time ever the LSC carried out 3 inspections and initiated 3 legal actions regarding a violation of Article 26 of the Law on Securities governing the provision of information to holders of the issuer's securities.

In 2010, guided by the provisions of the Methods for the selection of companies drawing up their financial statements according to the IAS and the International Financial Reporting Standards, the LSC selectively inspected the compliance of 4 companies' annual accounts for 2009 with the requirements of the IAS.

Oversight of the regulated market. With a view to ensuring that managers of issuers and persons closely related to them properly notify transactions concluded on their own account in securities of issuers managed by them the LSC was exercising a systematic supervision of trading exercised by such persons. Thus in 2010, the LSC established 4 cases of the failure to comply with the requirements concerning the notification of transactions concluded. The overall overview of the issuer performance in terms of transactions concluded and the relevant notifications established that in 2010 the number of non-notification or inappropriate notification was significantly lower than in 2009.

Furthermore, during the accounting period seeking to ensure the transparency of the market and protection of investor interests the LSC was conducting inquiries of alleged market abuse cases and in this relation carried out the investigation of one case in market manipulation and 3 investigations of insider trading. It is important to note in this relation that the LSC sought first and foremost warn the infringers, rather than immediately turn to sanctioning measures, thus preventing any further attempts of market abuse by such persons. This preventive strategy of the LSC fully justified itself as after 46 investors were issued warnings most of them did not ever attempted to violate the relevant legislation.

Licensing activity. At the end of 2010, 9 FBFs were operating under the licences issued by the LSC, also 12 MCs and 5 financial adviser companies.

During the year under review the LSC issued 3 new licenses to financial adviser companies, 1 FBF and MC licences were revoked. 2 management companies licensed in Lithuania were authorised to supplement their effective licences, one firm holding an A category FBF licence shifted to a B category licence having decided to reduce the scope of the services provided thereby. At the close of the year the LSC decided to suspend the validity of one MC until the company rectifies the situation.

As of 31 December 2010, total 620 natural persons were operating financial broker licences issued by the LSC: 288 of which were holders of the general financial broker licences, 297 – the broker-consultant

licences and 35 broker-trader licence holders. During 2010, 37 new licensed brokers were registered by the LSC, and 2 financial broker licences was revoked due to the change in the licence category. In the meantime during the accounting year the LSC was continuing its reform of the financial broker licensing system.

Supervision of management companies and pension funds (PSs) and collective investment undertakings (CIUs). In this relation the LSC carried out 2 routine and five for-cause inspections of management companies. As part of the routine inspections of the management companies the LSC also checked the performance of PFs and investment funds managed by them.

In 2010, the LCS carried out a documentary inquiry concerning the investment of the assets of the PFs managed by MCs into the investment funds managed by the same MC. Although no material infringements of the relevant legal acts were established during the inquiry having assessed other findings of the inquiry the LSC issued to MC recommendations designed to ensure the avoidance or a proper management of any conflicts of interests imminent in relation to the investment into the managed investment funds. In 2010, a Ruling of the Court confirmed the Resolution passed by the LCS on the basis of the results of an identical investigation to impose a pecuniary fine upon UAB *Finasta Asset Management* for the investment of pension assets into an investment funds managed thereby.

Supervision of the compliance with capital adequacy requirements by FBFs and MCs Stability of the operations of FBFs and MCs, their financial capability to fulfil their obligations and provide quality and professional services – all represent most important preconditions for capital market stability. In order to ensure the continuity of the operations, prior to issuing licences or in relation to exercising the oversight of the companies in operation the LSC requires FBFs and MCs to hold sufficient initial capital and comply with the statutory capital adequacy requirements.

As of the data of 31 December 2010, the total initial capital of all FBFs was LTL 32.1 m which, as compared to 2009 showed an increase by 1.0 percent, and the average capital adequacy ratio as compared to 2009 decreased by 4.5 percent – from 2.43 to 2.32 percent. The total initial capital of management companies increased by 2.6 percent, or LTL 1.6 m and accounted for LTL 63.7 m, their average capital adequacy ratio augmented by 25 percent – from 3.80 to 4.75 percent.

At the end of the reporting year one MC was recorded as non-compliant with the relevant capital adequacy requirements. Since the MC concerned failed to fulfil the obligation of the LSC to eliminate the infringements of the capital adequacy requirements, furthermore, it was failing to comply with certain other legal requirements, the LSC decided to suspend the validity of part of the MCs' licence until the company corrects the situation.

Oversight of investment services. During 2010, the LSC carried out two routine inspections of FBFs. Also, in this relation the LSC carried out 6 for-cause and 2 thematic inspections of companies providing investment services.

Following a routine inspection in respect of one company the LSC initiated an action against the company for the infringement of the requirement of the Law on Markets in Financial Instruments to segregate the client funds held on fiduciary basis from the FBF's own funds (the company was issued a warning). Furthermore, the LCS highlighted certain immaterial deficiencies in the provision of investment services established in the course of the inspection and issued the appropriate recommendations.

During the first six months of the year the LSC carried out a survey seeking to find out what new products were offered by financial institutions and identify the most popular investment products in Lithuania. The special focus of the LSC was the use of financial leverage when acquiring such products. The survey included an analysis of the financial instrument portfolio of the value exceeding LTL 2.7 bn acquired by Lithuanian investors.

The LSC also examined the practice of 9 commercial banks, 7 FBFs and 11 MCs to act upon their duty to execute orders in the best interests of the client.

Examination of complaints. During 2010, the LSC was examining complaints lodged by natural persons concerning allegedly illegal actions and activities of firms rendering investment services and MCs.

Total in the course of the year the LSC received 49 such complaints (54 in 2009), in respect of 29 cases

the LSC did not establish any infringement and the complaints were not awarded, in 3 cases the complaints were met and the relevant intermediaries were subjected to appropriate sanctions, on one occasion the investigation was discontinued after the parties concluded an amicable settlement agreement, 2 complaints were referred for examination to the Insurance Supervisory Commission (ISC), the examination of 14 complaints is still in progress. Also, the LSC completed two investigations concerning the complaints received in 2009, with the relevant intermediaries subjected to a fine and a warning for the established infringements.

In most cases investors were not quite assured of the professional behaviour and integrity of intermediaries in managing client financial instrument portfolios, they were also complaining about insufficient information on the character of the investment services or financial instruments offered, as well as the level of risk inherent to such instruments, were objecting to the fees imposed upon them.

Inspections, investigations and sanctioning of market participants. During 2010, the LSC conducted total 37 inspections including 4 routine and 33 for-cause inspections.

In 2010, in respect of natural persons the LCSC brought one administrative violation action for the failure to perform the duty or managers of issuers and persons closely related to them to timely and appropriately notify the deals concluded on their own account for securities of the issuer managed by them.

During the reporting year in respect of legal persons the LSC initiated 12 actions for the infringement of the Law on Securities, in 5 cases – for violation of the Law on Markets in Financial Instruments, and 2 actions concerning the violation of the Law on Collective Investment Undertakings. For these violations 6 companies were subjected to pecuniary fines, 11 were issued warnings, and in 2 cases the LSC decided not to impose any sanctions.

Actions concerning the non-compliance with the provisions of the Law on Securities were brought in view of the following infringements: 4 cases – failure to fulfil with the duty to notify material events, 4 cases for the failure to ensure by the issuers of the compliance of their financial statements with the IAS, 3 cases – violations of regulations on the provision of the information to shareholders, and 1 case – for the admission of a securities issue to trading on the regulated market without a prospectus.

Actions in relation to the infringement of the Law on Markets in Financial Instruments were instituted in view of the failure by persons closely related to managers of issuers to perform their duty to notify of transactions concluded on own account; incompliant provision of investment services, such as the failure to collect sufficient information about the clients of the firm, their financial status, investment objectives, or non-performance of the test regarding the suitability of the services to the client; failure to comply with the requirement to avoid or manage conflicts of interests; infringements of the requirements to ensure custody of the client's assets; inappropriate provision of financial portfolio statements to clients, failure to timely submit the financial or capital adequacy statements for supervisory purposes.

Actions in respect of the infringement of the Law on Collective Investment Undertakings were initiated because the management companies concerned failed to ensure a proper segregation of the assets management by the CIU, to appropriately organise and operate their internal controls; failed to comply with the capital adequacy requirements, to discharge the instructions of the LSC, or infringed the transparency requirements by failing to publish the data or documents required by law.

Total for the infringements of the legal acts governing the operations of the market in financial instruments legal and natural persons were subjected to pecuniary sanctions totalling LTL 119,300, 10 warnings were issued, and the validity of part of one management company's licence was suspended.

Participation in legal proceedings. During 2010, 2 resolutions of the LSC to impose economic sanctions (pecuniary fines) for the infringement of legal acts governing the provision of investment services were appealed to court. During the reporting period 7 legal proceedings were still pending final resolution, and in respect of 12 cases the court has passed its final decision.

Improvement of the LSC's activities

Seeking to be able to timely and efficiently respond to the dynamic development of the market in

financial instruments the LSC, during the reporting period, has been further improving its activities by focusing upon its task to enhance the efficiency and ensure a better output of its performance while meeting the expectations of users of investment services.

In 2010, the LSC has been continuing the restructuring of the institution as it reduced the number of its divisions and linked their objectives with the long-term strategic goals of the authority. In this respect the LSC developed and implemented an upgraded division performance evaluation system designed to introduce incentives to specialists of the LSC to seek best performance outcomes having regard to the strategic objectives of the institution, its values, a dynamic operating environment, as well as the needs of consumers, also to enable them to expediently identify any issues arising both internally within the institution or in the market, and be able to offer solutions to address them.

During 2010, the area high on the agenda was the improvement of the performance culture. The main values underlying the activities of the LSC – continuous professional development, responsibility, respect and cooperation, and openness – were defined with an active participation of each member of the staff.

With a view to further improving the quality of the regulation and supervision of the market in financial instruments, the LCS continued its cooperation with market participants, also introduced an inquiry system to receive feedback from any previously inspected company, sought to involve market participants and other stakeholders into the discussion on the priorities of the institution's activities.

Investor education

During the year being reviewed the LSC was continuing its investor education programme the purpose whereof was to attract the attention of all residents to the importance of securing and creating their safe financial future, develop and overall investment culture, promote interest and discussions on the part of the public, public authorities and non-governmental organisations on the subjects related to financial education.

On 19 February 2010, a non-commercial publication "Guidebook to Financial Services" initiated jointly by the Lithuanian Consumer Institute and the Lithuanian Securities Commission seeking to assist consumers in developing their knowledge and understanding in the maze of financial services. The publication was presented to the public at the conference "Consumer protection in the financial services sector" launched specifically for the purpose.

Seeking to be able to properly assess the trends and needs of financial conduct among residents, the LSC has been several years in turn initiating surveys of the financial behaviour of Lithuanian residents. In 2010, the survey was supplemented by new questions seeking to clarify the attitude of pension fund participants to the current status in the pension system.

On 3 June 2010, the Committee on Budget and Finance of the Seimas and the LSC organised a conference-discussion "**Life-cycle pension funds: for and against**", at which presentations were offered by representatives from the World Bank, the LSC, pension fund managers, and pension system participants.

In autumn 2010, within the framework of its investor education programme, the LSC organised a cycle of seminars on personal finance management and investment. More than 1,000 residents in different locations of Lithuania attended the seminars at no charge.

During the accounting period the radio station "Laisvoji banga" broadcasted a cycle of 12 editions on the subjects of personal finance management and investment.

As of the end of 2010, the LSC was operating as a supervisory authority of 50 issuers, 9 FBFs, 2 branches of foreign FBFs, 9 commercial banks and 5 branches of foreign financial institutions providing investment services, 5 financial adviser companies, 12 MCs managing 24 2nd pillar and 9 3rd pillar pension funds, and 38 collective investment undertakings, also the operator of the regulated market AB NASDAQ OMX Vilnius and the Central Securities Depository of Lithuania.

Indicator	2006	2007	2008	2009	2010
GDP, bn at current prices	82.7	98.7	111.4	92.5	93.9
Real GDP annual percentage change	7.8	9.8	2.9	-14.7	1.3
Average annual inflation rate, percent	3.7	5.7	10.9	4.5	1.3
NASDAQ OMX Vilnius, capitalisation bn LTL	30.0	26.9	12.0	14.9	18.8
NASDAQ OMX Vilnius capitalisation/ GDP ratio, percent	36.3	27.4	10.8	16.1	20.0
NASDAQ OMX Vilnius turnover, bn LTL	7.1	3.9	1.8	3.2	4.0
NASDAQ OMX Vilnius capitalisation/ capitalisation ratio, percent	23.6	14.5	14.8	21.7	21.1
OMX Vilnius index, points at year end	492.65	514.23	179.25	261.77	409.7
Issue value of shares registered from additional contributions, LTL m	679.2	473.0	203.36	1 086.2	973.5
Increase of the capital from company funds, LTL m	967.2	69.01	389.762	49.1	-
Issue value of distributed debt securities, LTL m	7 115.0	3 527.8	2740.0	1 254.4	1 028.2
Assets of CIUs registered in Lithuania, LTL m	823.7	1 261.3	382.3	446.5	602.0
Assets of 2nd pillar pension funds, LTL m	904.9	1 688.2	2 250.5	3 262.4	3 856.0
Assets of 3rd pillar pension funds, LTL m	73.7	104.0	60.9	79.5	99.2
Units value of foreign CIUs publicly distributed in Lithuania, LTL m	614.4	1 210.9	470.1	857.82	1 430.0
Number of companies on the NASDAQ OMX Vilnius trading list	43	40	42	40	40
Number of FBFs and commercial banks providing investment services	21	22	21	19	18
Total financial brokers	270	349	482	583	620
Total issuers	504	52	52	48	50
Total management companies	12	13	14	13	12
Total CIUs registered in Lithuania	28	34	35	35	38
Total 2nd pillar pension funds	30	31	29	29	29
Total 3rd pillar pension funds	6	9	9	9	9
Foreign CIUs publicly distributed in Lithuania	46	58	63	68	68

Table 1 Lithuanian macroeconomic and financial instrument market data: summary for 2006–2010

Source: Statistics Lithuania, AB NASDAQ OMX Vilnius, LSC.