1. BANKING DEVELOPMENT

At the end of 2001, there were 9 banks operating under a license from the Bank of Lithuania, 4 foreign bank branches and 5 foreign bank representative offices. On 25 January 2001, a Vilnius Branch of the German VEREINS–UND WESTBANK AG, which previously had a representative office in Lithuania, was registered and started operating. Following the Law of the Republic of Lithuania on the Amendments to the Law on Approving the Statutes of Turto Bank, the Board of the Bank of Lithuania revoked the license of AB Turto Bank in July 2001. In addition, in 2001 the Board of the Bank of Lithuania revoked the license of Bank HANSABANKAS which was merged with the Lithuanian Savings Bank to become AB Bank Hansa–LTB.

Development of selected items of the balance sheet in the banking system
LTL million

No.	Balance sheet item	Amount 1 Jan 2001	Amount 1 Oct 2001	Amount 1 Jan 2002	Change over Q4 (%)	Change over the year (%)
1.	Assets	13,095.3	14,162.4	15,343.0	8.3	17.2
2.	Deposits and letters of credit	8,596.1	9,808.8	10,415.7	6.2	21.2
	private companies	2,470.4	2,715.5	3,077.8	13.3	24.6
	physical persons	5,043.3	5,908.7	6,357.1	7.6	26.1
3.	Granted loans	5,519.1	5,809.8	6,507.0	12.0	17.9
4.	Shareholders' equity	1,308.9	1,416.4	1,427.4	0.8	9.1
5.	Profit (loss) for current year	52.7	–41.3	–23.3		

According to the unaudited financial statements for 1 January 2002 presented by the banks, operating domestic commercial banks were characterised by the following:
- assets totalled LTL 15.3 billion, increasing over the year by LTL 2.25 billion (17.2 %);
- total loans granted to clients amounted to LTL 6.5 billion, increasing over the year by LTL 988 million (17.9 %);
- deposits totalled LTL 10.4 billion, increasing over the year by LTL 1.8 billion (21.2 %);
- including individual deposits of LTL 6.4 billion, increasing over the year by LTL 1.3 billion (26.1 %);
- including deposits in the national currency of LTL 5.7 billion, increasing over the year by 27.2 per cent;
- including deposits in foreign currencies of LTL 4.7 billion, increasing over the year by 14.6 per cent.

2. COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

In 2001 most banks were rather cautious in their operations, which is proved by their compliance with the prudential requirements with a sizeable reserve; according to the unaudited statements presented on 2 February 2002, the capital adequacy in the banking system was 15.5 per cent and exceeded the minimum 10 per cent capital adequacy requirement set by the Bank of Lithuania; the liquidity ratio was 47.9 per cent and was also considerably higher than the minimum required 30 per cent.

While all domestic commercial banks and foreign bank branches were in compliance with all prudential requirements as on 1 January 2002, there were some violations of these requirements in the course of the year. On one occasion in 2001 the liquidity ratio was violated, and the large exposure requirement was violated on four occasions. Enforcement measures were applied by the Board of the Bank of Lithuania to three banks.

3. LOANS

The share of loans in banking assets at net value increased over the year from 40.6 to 41.3 per cent. The largest loan portfolio growth was recorded in the last quarter of 2001 and especially in December. This growth of the loan portfolio was to a large extent related to the changes in the Law on Profit Tax whereby the previous provision on exemptions on invested profit were abolished. In addition, the share of long–term loans increased from 60 to 67 per cent.

While in 2000 credit to state and municipal enterprises and local government institutions was marked by the largest growth, in 2001 these were loans to private companies and individuals, LTL 830 million and LTL 143 million, respectively.

Over the whole of 2001, the quality of the loan portfolio was characterised by a rather consistent improvement. This was mostly influenced by the improved financial standing of some borrowers, recovery in domestic economy and the write–offs of bad loans and their transfer to non–systemic accounts.

The development of loan portfolio quality in the banking system is presented in the table below.

The development of loan portfolio quality in the banking system

Date	Loan provisions/granted loans, %	Category III, IV, V loans/total loans, %
1 Jan 1997	20.68	32.1
1 Jan 1998	18.52	28.25
1 Jan 1999	5.92	12.46
1 Jan 2000	4.47	11.92
1 Jan 2001	3.73	10.79
1 Jan 2002	2.55	7.45

Crediting remained the main source of income for the banks, making up 42.8 per cent of total earnings (51.7 pre cent including loans to banks and other credit and financial institutions).

4. DEPOSITS

Individual deposits have remained the fastest growing source in the liability structure for several years; in 2001 their share increased from 43 to 46 per cent.

At the end of 2001, in comparison with the start of the year, balances in the accounts of private resident companies were higher by LTL 496 million (22 %) (increasing by LTL 303 million in Q4 2001 only) and were on average 21 per cent higher each month compared to the respective levels of 2000.

5. CAPITAL

Last year, after the privatisation of the Lithuanian Savings Bank, the share of foreign investors in the bank share capital increased significantly, which added to the continuing trend of the growing share of foreign investors in bank capital:
on 1 January 1996 foreign investors held 16 per cent of the capital in operating banks;
on 1 January 1997 – 25 per cent;
on 1 January 1998 – 32 per cent;
on 1 January 1999 – 39 per cent;
on 1 January 2000 – 35 per cent;
on 1 January 2001 – 58 per cent;
on 1 January 2002 – 81 per cent.

According to the data of 1 January 2002, in six out of nine commercial banks foreign investors held more than one half of the share capital. In addition, negotiations with the German bank Nord/LB are currently going on concerning the sale of state–held 76 per cent in the Lithuanian Agricultural Bank. In the event of a successful completion of the negotiations, the proportion of commercial bank share capital held by foreign investors would go up to 89 per cent.

6. PROFITABILITY AND EFFICIENCY

The total unuadited result of the domestic banking system in 2001 was a loss of LTL 23.3 million. According to the unaudited financial statements, six banks and one foreign bank branch earned a profit of LTL 115 million, while three banks (AB Bank Hansa–LTB, AB PAREX BANKAS and UAB Sampo Bankas) and three foreign bank branches (Merita Bank Plc Vilnius Branch, Norddeutsche Landesbank Girocentrale Vilnius Branch and VEREINS–UND WESTBANK AG Vilnius Branch) incurred a total loss of LTL 138.3 million.

Regardless of the decline in the real interest margin (from 5.2 to 4.3 per cent), the majority of the banks improved their results, while foreign bank branches have so far failed to ensure profitability of their operations. In August 2001, the Lithuanian Savings Bank revalued its tangible assets, which resulted in additional expenditure of LTL 85.5 million. This not only changed the expenditure structure of the whole system but also was the major factor in causing a negative result for 2001.

The 2001 and 2000 results of the banking system are presented below.

Results of operating banks

No.	Bank	Profit for current year (LTL million)	
		2000 (audited)	2001 (unaudited)
1.	AB Lithuanian Agricultural Bank	7.3	8.5
2.	AB Bank Hansa–LTB	–32.6	–114.0
3.	AB Ukio Bank	4.0	4.1
4.	AB Vilniaus Bank	82.2	92.6
5.	AB iauliu Bank	1.9	2.4
6.	AB Bank Snoras	3.9	5.1
7.	UAB Medicine Bank	1.4	1.6
8.	AB PAREX BANKAS	–4.6	–7.3
9.	AB Bank HANSABANKAS	–3.7	
9.	UAB Sampo Bank	1.3	–10.1
	Total banks	**61.1**	**–17.1**
10.	VEREINS–UND WESTBANK AG Vilnius Branch	–	–2.2
11.	Kredyt Bank S.A. Vilnius Branch	6.2	0.7
12.	Merita Bank Plc Vilnius Branch	–3.3	–4.0
13.	Nord/LB Vilnius Branch	–11.3	–0.7
	Total foreign bank branches	**–8.4**	**–6.2**
	Total	**52.7**	**–23.3**

Because of the declining market interest rates and slow growth of the loan portfolio for two consecutive years, bank interest earnings were LTL 11.5 million lower than in 2000. Earnings from services and commissions increased by LTL 53.3 million, and their share expanded from 19 to 22 per cent. This shows that the banks compensated for the shortage of interest earnings by developing other banking operations and services. The resumed growth of the loan portfolio during the last quarter of 2001 after two years of sluggish development shows that banks may expect increased interest earnings in early 2002.

Operational expenses, as previously, accounted for the largest share of expenses, at 38 per cent of total expenses. Interest expenses accounted for 30 per cent, and specific provisions for 9 per cent of total expenses. The fastest growth in 2001 was recorded in other banking expenses (65 per cent) that were primarily related to the revaluation of assets of the Lithuanian Savings Bank referred to above.

7. CREDIT UNIONS

On January 1, 2002, there were 41 credit unions in Lithuania, with the total of 10758 members. Three new credit unions were registered in 2001 (("Jonavos zeme". Jurbarkas ir Ukmerge credit unions), which was the fewest since 1996.

Development of the main items of the consolidated balance sheet of credit unions

No.	Balance sheet item	Amount (LTL thousand)		Change over the year (%)
		1 Jan 2001	1 Jan 2002	
1.	Assets	15,293.6	33,839.5	2.2 times
2.	Granted loans	8,811.8	21,063.7	2.4 times
3.	Deposits	10,292.6	26,514.1	2.6 times
	Including members and associated members	8,283.5	20,675.9	2.5 times
4.	Share capital	2,450.1	4,013.0	63.8
5.	Profit for current year	42.9	361.8	–

In 2002, the activities of credit unions expanded fast:
- assets increased by 2.2 times and on 1 January 2002 made up 0.22 per cent of total assets in the banking system; the assets of three credit unions (Panevežys "Ūkininku viltis", Pakruojis farmers and Šilute) exceeded LTL 3 million and accounted for 32 per cent of total assets of credit unions;
- granted loans increased by 2.4 times and made up 62.2 per cent of total assets. On January 1, 2002, 21 credit unions held specific provisions (LTL 157.7 thousand);
- investment in Government securities increased by 2.5 times;
- deposits increased 2.6 times, of which the largest share (78 per cent) were deposits of members;
- the total share capital of the credit unions grew by 63.8 per cent to reach LTL 4 million.

Last year, 32 credit unions earned a profit, while 9 credit unions incurred losses. According to the unaudited financial statements, not yet approved by the general shareholders meetings, in 2001 credit union profit was LTL 361.8 thousand (in comparison, in 2001 it was LTL 42.9 thousand). These results were mostly influenced by the reduction of specific provisions due to improved loan portfolio structure.

Similar to previous years, the main source of income was interest earnings (84.1 per cent of total earnings). Interest expenses and operational expenses accounted for the largest share of expenses, 50.4 and 41.8 per cent, respectively.

On January 1, 2002, all credit unions complied with the prudential requirements of the Bank of Lithuania.

In the course of 2001, inspections were carried out in 28 credit unions, and enforcement measures were applied to 2 credit unions.

SUPERVISION OF CREDIT INSTITUTIONS IN 2001

In performing supervision of credit institutions, the Bank of Lithuania aims at implementing internationally accepted requirements reflected in the Core Principles for Effective Banking Supervision of the Basle Committee. In 2001, the World Bank and the International Monetary Fund (IMF) carried out the Financial Sector Assessment Programme (FSAP) in Lithuania. One of the components of the programme is the assessment of the implementation of the Core Principles for Effective Banking Supervision and the IMF's Principles of Transparency in Monetary and Financial Policies. In participating in the programme, the Bank of Lithuania analysed the recent changes in banking regulations, supervisory practices and carried out a detailed "self–assessment".

Last year the Bank of Lithuania continued the harmonisation of its legislation with the European Union (EU) directive requirements. After approving the new capital adequacy rules meeting the requirements of EU directives in 2000, the assessment of market risk in banks was introduced in 2001, and capital charges to offset those risk were set.

In addition, last year the Board of the Bank of Lithuania approved other regulations important for banking activities, including the General Provisions on the Organisation of Internal Control in Banks, which define the role of the bank council and board in the control process, the necessary elements of internal control, requirements to the bank risk identification and assessment system focusing on the bank's relations with the clients and management of related risks. Also, requirements to bank information systems, assessment of internal control, etc., were set.

Taking into account the growing scope of the application of the recent advances in electronic communications and information technologies and the resulting necessity to ensure appropriate identification, monitoring and management of risks as well as the assessment of their impact on the general bank policies, the Bank of Lithuania developed the General Provisions for the Monitoring and Management of Risks in Electronic Banking. The document instructs the banks to develop an adequate risk monitoring and management system taking into consideration their technological capacities and the scope of provided electronic banking services. In addition, the Provisions regulate the main security aspects of e–banking, development of a system for monitoring external relations in e–banking and dependence on third parties, measures to ensure confidentiality of information, consistency of transactions, records and information, and methods for customers' identification.

In 2001 the Bank of Lithuania approved the General Provisions on Stress Testing and issued recommendations to the banks on their application and adoption in the general bank risk management policy. Testing allows the banks to get a comprehensive evaluation of various aspects in their operations, their prospects, and to project possible losses in the future in the light of certain unfavourable conditions in the market. The analysis of testing results creates the preconditions for identifying the weaknesses of the bank and aid the bank management in taking adequate decisions: to provide for a strategy in unfavourable circumstances and alternative financing sources in cases of inadequacy of own capital to cover possible losses and to adjust the current business policies to minimise such possible losses.

In 2001 the Bank of Lithuania set a tighter time frame of the calculation of prudential requirements. Thus, commercial banks must ensure compliance with all 5 current prudential requirements (capital adequacy, liquidity, maximum foreign exchange and precious metals exposure, maximum exposure and large exposure requirements) on a daily basis, rather than on reporting dates.

The tightening competition in 2001 had an impact on the expansion of activities by bank subsidiaries, which increased the significance of consolidated supervision of banks and undertakings controlled by them. In early 2001 the Bank of Lithuania introduced amendments to the Rules of Consolidation of Financial Accounts and Consolidated Supervision and introduced proportional consolidation as provided by a EU directive. This method of consolidation is applied to jointly controlled undertakings, i.e. credit institutions and companies whose economic activities or assets are controlled by two or more parties under an agreement.

The Bank of Lithuania continued to focus on improving financial accounting and accountability of credit institutions through close co–operation with international auditing companies, especially in relation to the issues of implementation of the International Accounting Standard (IAS) No. 39 "Financial assets: recognition and evaluation".

In the autumn of 2001, following the Law on the Central Credit Union, the procedures of establishing the Central Credit Union were initiated. In this regard, the Bank of Lithuania adopted several legal acts defining the procedures for establishing the Central Credit Union and issuing its license, as well as requirements to the managing staff. In addition, forms of financial statements and the regulations on the calculation of prudential requirements were approved. It was established that the same methodology as applied to the banks should be used in calculating the prudential requirements for the Central Credit Union.

In 2001 the Bank of Lithuania continued to strengthen international co–operation with its counterparts in other countries. The significance of such co–operation is highlighted by the establishment of new foreign bank subdivisions in the country and the strengthening of globalisation processes. Two new agreements on co–operation in the field of banking supervision were concluded last year, with the Bank of Estonia in early 2001 and the Federal Bank Supervisory Authority of Germany at the end of the year. These agreements set the principles of co–operation in conducting joint supervision of internationally active banks, including requirements to licensing and control of capital owners, inspection, subsidiary control, application of prudential requirements, etc. Such agreements have previously been signed with the central banks of Russia, Latvia and Poland and the Finnish Financial Institutions Supervisory Authority.

In May 2001 the Bank of Lithuania hosted for the first time the annual conference of the banking supervisory group of Central and Eastern Europe, where it presented its views on the New Capital Adequacy Framework developed by the Basle Committee and the current practices used in the country, and shared its experience in co–operating with other domestic and foreign financial sector supervisory authorities.