BANK OPERATIONS

Assets and loans of the banking system declined in 2009, whereas the relatively rapid growth of deposits fully offset the abrupt withdrawal of deposits from banks in Q4 2008.

According to the audited financial statements for 1 January 2010, total assets of operating domestic banks made up LTL 84.2 billion, decreasing over the year by LTL 5.5 billion, i.e. 6.1 per cent. Loans granted to customers decreased over the year by LTL 9.9 billion (13.8%) and made up LTL 61.6 billion. Deposits held with banks made up LTL 41.1 billion on 1 January 2010 and increased over the year by 7.4 per cent or LTL 2.8 billion. The largest impact on the annual increase of deposits was made by the increase of LTL 1 billion (89%) in the funds of government institutions held with banks.

Dynamics of some asset and liability items in the banking system:
LTL million

No.	Balance sheet item	Amount 01-01-2009	Amount 01-01-2010	Change year-on-year (%)
1	Assets	89,749.2	84,239.6	–6.1
2	Debt securities	5,971.5	7,760.3	30.0
3	Loans to customers	71,440.9	61,557.5	–13.8
3.1	Of which, to private companies	37,342.6	31,097.3	–16.7
3.2	Of which, to financial institutions	3,890.5	1,944.7	–50.0
3.3	Of which, to individuals	28,601.6	26,939.7	–5.8
3.3.1	Of which, housing loans	20,772.4	20,341.3	–2.1
4	Loan impairment	870.9	4,747.4	5.5 times
4.1	Loan impairment/ granted loans, %	1.2	7.2	–
5	Deposits and letters of credit	38,231.3	41,072.5	7.4
5.1	Of which, by private companies	10,605.8	11,404.4	7.5
5.2	Of which, by financial institutions	1,227.4	1,591.9	29.7
5.3	Of which, by individuals	24,138.6	24,746.3	2.5
6	Shareholders' equity	6,778.9	4,992.3	–26.4
7	Profit for current year	867.3	–2,979.1	–

The concentration of three banks that have the largest market share declined in 2009 in all major market segments: the share of the asset market went down by 1.3 percentage points to 64.2 per cent, the share of loans declined by 0.6 percentage point to 65.9 per cent and the share of deposits decreased by 0.4 percentage point to 65.7 per cent. Meanwhile, the market share of foreign bank branches grew over the year in all major segments.

In 2009, as the bank loan portfolio shrank and the comparative weight of loans in assets declined, the share of liquid assets grew: the comparative weight of funds in banks and debt securities went up. Over the year, the share of loans in bank assets declined by 6.5 percentage points to 73.1 per cent, the share of funds held with banks grew by 3.5 percentage points to 10 per cent, and the share of securities went up by 2.6 percentage points to 9.7 per cent.

Over the year, funds in banks and other credit institutions grew by LTL 2.6 billion (45%). The whole cash flow to foreign banks went to parent banks, in which the funds of the Lithuanian banks increased over the year by LTL 3.2 billion and made up LTL 6 billion. Bank investment into debt securities went up significantly in 2009, increasing by LTL 1.8 billion (almost 30 per cent). It should be noted that the largest investment of banks was made to Treasury securities.

With the rise of funds held with foreign banks and investment into securities of foreign issuers, the share of bank assets invested abroad continued to increase. Over the year, the share of assets invested abroad expanded from 11.9 per cent to 17.4 per cent. The largest share of bank assets consists of assets denominated in foreign currency, which constantly increased also in 2009. Over the year, the share of assets denominated in foreign currency grew by 8.5 percentage points and made up 72.9 per cent.

In 2009, the composition of financing sources of banks changed quite noticeably, whereas the trends of this change were opposite to those of previous years. As banks were quite successful in attracting deposits in the local market, albeit expensively, and the operation volumes contracted, debt to banks (including parent banks) declined, after growing for quite a long time. In 2009, debt to banks and other credit institutions declined by LTL 6.7 billion (17.1%).The largest share of funds repaid to banks was allocated to parent banks, to which the Lithuanian banks repaid LTL 6.1 billion over the year. The decline of the net debt to parent banks (difference between debt to parent banks and funds held with them) was even larger at LTL 9.3 billion.

Owing to the recent rapid decline of debt to foreign banks, dependency of the Lithuanian banking system on foreign financing declined: the funds received from non–residents made up 46.2 per cent of the banking system's liabilities on 1 January 2010 (they made up 52.2 per cent in the beginning of the previous year).

Despite the fact that the growth of deposits held with banks in 2009 was largely affected by the funds attracted in the local market, deposits held in foreign currency grew (LTL 2.9 billion), whereas deposits in litas even declined slightly. Still, it may be observed that an obvious trend of decline in litas–denominated deposits and increase in euro–denominated deposits was prominent in the first half of 2009, whereas the situation changed completely in the second half of the year and litas–denominated deposits started to grow. This change may have been determined by stronger confidence in the national currency and wider interest rate spreads on litas–denominated deposits and foreign currency–denominated deposits.

BANK LOAN PORTFOLIO

The loan supply narrowed in 2009 due to the rise in credit risk of borrowers and subsequent tightening of lending standards. According to the data of the Loan Risk Database, banks granted new loans in the amount of LTL 6.8 billion in 2009; however, owing to a rapid decrease of loans granted in the previous years and an increase in specific provisions, the banking system loan portfolio contracted over the year by LTL 9.9 billion (13.8 %). In 2008 it grew by LTL 11.3 billion.

The signs of economic recovery are currently still marginal and the credit risk of borrowers remains, therefore, in the nearest future bank lending standards should not change significantly. It is expected that the trend of loan portfolio contraction will remain, however, the rate of decline should become slower. This is evident from the undrawn credit facilities showing the loan portfolio growth potential. They declined by LTL 3.9 billion (36.8 %) in 2009; however, the decline in Q4 of the previous year was not pronounced and made up LTL 0.2 billion (2.7 %). The fall in crediting volumes could be slowed down slightly by the interest rates of interbank loans in litas (VILIBOR) that were declining recently and by business support programmes. However, loans granted according to these programmes currently amount to only about LTL 180 million, i.e. 0.3 per cent of the banking system loan portfolio.

The decline of loans to businesses was larger (LTL 6.2 billion) than that of other segments of the loan portfolio in 2009, therefore, the share of these loans in the loan portfolio declined over the year by 1.8 percentage points and made up 50.5 per cent on 1 January 2010.

Loans to individuals were declining at a significantly slower rate than loans to businesses in 2009. Among loans to individuals, housing loans declined by 2.1 per cent over the year, whereas their share in the loan portfolio went up by 4 percentage points over the year. This was determined by several reasons: First, partial redemptions of these loans are relatively small; second, the portfolio quality of these loans deteriorated relatively insignificantly in 2009.

In 2009, the interest rates on loans in litas were significantly higher than the interest rates on loans in euro, therefore, the loan portfolio composition by currency changed: the share of loans in litas in the loan portfolio went down over the year by 9.1 percentage points and made up 26.3 percent of the loan portfolio on 1 January 2010.

The decline in economic activity, the fall in real estate prices, an increase in the number of company bankruptcies, the rise in unemployment, lower wages and conservative assessment of bank loans determined a significant deterioration in loan quality in 2009.

According to the data of the Loan Risk Database, the liabilities of companies that went bankrupt last year or are being restructured to banks made up LTL 2 billion at the end of 2009 (6.5 per cent of the portfolio of loans granted to private companies). In 2008, the liabilities of companies that went bankrupt or were restructured to banks made up only LTL 0.3 billion.

Specific provisions of banks for loans increased by LTL 3.9 billion in 2009 and made up LTL 4.7 billion on 1 January 2010. The ratio of specific provisions for loans to the loan portfolio went up over the year from 1.2 per cent to 7.16 per cent, the indicator of impaired loans increased from 3.41 per cent to 15.77 per cent, the indicator of loans overdue for more than 60 days rose from 1.14 per cent to 3.53 per cent, whereas the indicator of non–performing loans grew from 4.55 per cent to 19.3 per cent.

The data available on 1 January 2010 show that banks are capable of absorbing credit risk losses for the amount of LTL 2.4 billion or could increase the current risk-weighted assets by LTL 26 billion without violating the capital adequacy ratio.

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

Liquidity ratios of the banking system of Lithuania were constantly above 40 per cent in 2009. According to the data of 1 January 2010, the liquidity ratio was 49.86 per cent. It was the highest since September 2001 and exceeded the minimum ratio established by the Bank of Lithuania (30 per cent) by almost 20 percentage points. Liquid assets of the banking system rose by LTL 3.3 billion over the year, whereas current liabilities declined by more than LTL 2.6 billion over the year.

Since the capital base of the banking system strengthened significantly and the capital requirement for risk amortisation grew slower in 2009, the capital adequacy ratio increased by 1.25 percentage points to 14.15 per cent. The capital allocated for credit risk amortisation made up the largest part of the capital requirement and amounted to LTL 3,881 million. Meanwhile, the capital allocated for market risk and operational risk amortisation amounted respectively to LTL 328 million and LTL 313 million.

The capital requirement for covering market risk increased over the year by LTL 158 million. Such growth was largely determined by the increased capital requirement of foreign currency positions. Foreign exchange risk remained the most significant risk. The amount of LTL 227 million or 69 per cent of the whole capital required for covering market risk was allocated for this risk.

On 1 January 2010, the overall open position in foreign currencies (excluding euro) was short and made up 0.84 per cent of the capital. The capital requirement for the euro position amounted to LTL 225.4 million according to the data of 1 January 2010. In 2009, the ratio of the euro position of the system to capital increased gradually from 9 per cent to 39 per cent. The growth of the euro position in some banks has been determined by the increasing prevalence of the euro in asset composition (loan currency change from litas to euro, growth of funds in euro in parent banks).

The amount of LTL 313 million or 6.9 per cent of the banking system‘s capital requirement was allocated for covering operational risk. The capital requirement for covering operational risk increased by LTL 35 million in 2009. The largest impact on the increase of the capital requirement for covering operational risk was made by the increase of capital requirements for some banks as well as slightly higher average income of the previous three years, which directly affected the size of the operational risk.

All banks were in compliance with the prudential requirements set by the Bank of Lithuania.

SHAREHOLDERS’ EQUITY

As banks (excluding foreign bank branches) operated with losses in 2009, the bank shareholders’ equity declined by LTL 1,317 million (19.4%) and made up LTL 5.5 billion on 1 January 2010. This decline was offset by the increase of the authorised capital by LTL 966 million through additional contributions of bank shareholders, increase of reserve capital by LTL 190 million and the coverage of financial losses for the current year by LTL 690.6 million.

In addition, banks strengthened the capital base in 2009 by attracting two subordinated loans in the amount of LTL 101.8 million and by using the hybrid capital instrument for the first time: debt securities of indeterminate duration in the amount of LTL 72.5 million were placed.

The authorised registered (share) capital of the banking system went up by LTL 1 billion in 2009 and made up LTL 4.6 billion on 1 January 2010. In Q4 2009, three banks registered an increase in the authorised capital (for the total amount of LTL 856.6 million) through additional contributions. Banks also plan to increase the authorised capital in 2010.

The Scandinavian capital prevailed in the banking system of Lithuania, as in previous years. Owing to the said authorised capital increases, the share of the authorised capital controlled by non–residents went up by 2.3 percentage points in 2009 and made up 87.4 percent of the authorised capital on 1 January 2010.

PROFITABILITY AND BUSINESS EFFICIENCY

According to the data of audited statements submitted by banks, the banking system suffered losses in 2009. The total loss of the banking system was LTL 2.98 billion. In 2008, the banking system earned a profit of LTL 0.87 billion. If additional contributions of the shareholder of AB SEB bankas for covering a part of the losses of its subsidiary bank in 2009 were excluded, the total loss of the banking system in 2009 would be even larger and amount to LTL 3.67 billion.

Profit of Operating Banks:
LTL million

No.	Bank	Profit
1.	AB DnB NORD bankas	–402.6
2.	AB Ukio bankas	–75.0
3.	AB SEB Bank	–855.6
4.	AB bankas FINASTA	–6.7
5.	Siauliu bankas AB	–30.1
6.	AB bank SNORAS	8.7
7.	UAB Medicinos bankas	0.4
8.	AB PAREX BANKAS	–91.5
9.	Swedbank, AB	–1,053.0
	TOTAL (banks):	**–2,505.5**
10.	AS “UniCredit Bank”, Lithuania Branch	3.3
11.	MP Bank hf. Baltic Branch	–0.7
12.	BIGBANK AS Branch	4.4
13.	Allied Irish Banks, p.l.c., Lithuania Branch	–2.7
14.	Danske Bank A/S Lithuania Branch	–433.9
15.	Svenska Handelsbanken AB Lithuania Branch	–3.9
16.	Skandinavska Enskilda Banken AB, Vilnius Branch	0.3
17.	Nordea Bank Finland Plc, Lithuania Branch	–40.5
	Total (foreign bank branches):	**–473.6**
	TOTAL:	**–2,979.1**

2 banks and 3 foreign bank branches earned a profit last year, whereas the remaining 7 banks and 5 foreign bank branches suffered losses. The main factor that determined sizeable losses in the banking system last year was more than ten times higher, compared to 2008, expenses related to depreciation of assets, which amounted to as much as LTL 4.4 billion in 2009. The result of the banking system before asset depreciation expenses was positive in 2009 and amounted to LTL 1.26 billion, i.e. it is almost the same as in 2008 (LTL 1.35 billion).

The largest part of banks' depreciation expenses was determined by the increase of LTL 3.52 billion in loan impairment expenses. In 2009, as some subsidiary companies of banks (mostly leasing companies) operated with a loss, banks increased the capital of these companies by additional contributions, thus increasing investment into subsidiary companies; on the other hand, banks reviewed the value of investment into subsidiary companies and formed provisions (depreciation) in the amount of LTL 772.7 million, i.e. LTL 748.8 million more than in 2008. In addition, in 2009 AB SEB Bank wrote down the prestige that was recorded earlier, therefore, the prestige impairment of LTL 169.6 million was formed.

Last year, banks assessed more conservatively not only the loan risk, but also the risk of off–balance sheet items. Provisions for off–balance sheet items were higher by LTL 119.2 million in 2009, compared to 2008.

However, bank performance was impaired not only by asset depreciation expenses, but also by a decline in the main operating income of banks, i.e. net interest income and net income from services and commissions. Net interest income earned by banks made up LTL 1.3 billion in 2009, i.e. LTL 697.7 million or 35.4 % less than in 2008. The decline in net interest income was mostly affected by the decrease in the loan portfolio and an unfavourable situation in the market in 2009 that determined a gradual narrowing of the margin between interest income earned by banks and interest paid by banks (real interest margin).

Although banks increased various service fees, a decline in overall economic activity and a consequent fall in the demand for various banking services led to a drop in net income from services and commissions in 2009. The total income of this type earned by banks in 2009 made up LTL 648.2 million, i.e. LTL 45.8 million or 6.6 per cent less than in 2008.

Besides, last year banks earned significantly lower income from subsidiary companies. Such income, the largest part of which consists of dividends received from subsidiary companies, made up as little as LTL 23.8 million last year. In 2008, they made up LTL 135 million.

In the context of unfavourable conditions in the market and a significant decline in operating results of banks, nearly all banks started a gradual reduction of operating expenses in 2009 in an attempt to offset the continued fall of their operating income. Operating expenses declined by LTL 126.1 million (10.4 per cent) in 2009 and made up LTL 1.08 billion. Banks reduced the largest part of operational expenses (LTL 105.1 million or 14.9 per cent) by savings related to staff costs. The overall number of staff in the banking system (excluding employees in foreign bank branches) went down in the course of the year by 803 or 8.5 per cent. It is expected that the trend of reduction of operating expenses in banks will continue this year.

The tax accounting effect improved the operating result of banks by LTL 493 million in 2009, compared to 2008. In total, deferred taxes in the amount of LTL 357 million were calculated by banks due to operational losses in 2009, i.e. banks reduced the losses of the previous year by this amount.

The result of banks was also improved by LTL 234.4 million higher income from marketable financial instruments. Income from other financial instruments increased by LTL 95 million.

Due to operational losses in 2009, the return on assets and return on equity indicators were negative and, according to the data of 1 January 2010, made up respectively –4.23 per cent and –48.42 per cent.

With the fall of interest rates in the market last year, both interest expenses for interest–bearing liabilities and interest income for interest–bearing assets decreased. However, it should be noted that the price of financial resources for banks decreased slower than the rate of interest income earned by banks, therefore, the real interest margin narrowed during all quarters of 2009 and reached a new historically lowest level of 1.28 per cent on 1 January 2010.

AUDIT OF ANNUAL FINANCIAL STATEMENTS OF BANKS

Audits of the annual financial statements of all domestic commercial banks for 2009 were conducted by independent audit companies. The auditors expressed unqualified opinions in respect of the annual financial statements of all banks.

Pursuant to Article 61(4) of the Republic of Lithuania Law on Banks, banks have to publish annual financial statements and the auditor’s report within 4 months from the end of the financial year.