LIETUVOS BANKAS
EUROSISTEMA

Activities of financial market participants

Banking Activity Review

2020

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Due to the global coronavirus (COVID-19) pandemic and various related social and economic restrictions, 2020 was an exceptional year for the whole economy, including residents, businesses as well as banks. First of all, banks had to adapt to the new working environment and ensure business continuity under the pandemic in a very short time. They also had to focus on dealing with liquidity problems of their current customers whose income was severely affected by the quarantine. This was significantly facilitated by the agreements reached by banks on temporary moratoria, according to which all borrowers complying with certain criteria could apply for the postponement of loan repayments for 6 or 12 months without changing the terms and conditions of loan agreements or interest rates. Banks postponed loans for the amount of €0.5 billion according to these moratoria and even larger amount of loans was postponed according to individual bilateral agreements with customers. At the end of 2020, the majority of the postponed repayment terms had already expired. However, in response to the unfavourable epidemiological situation in the country and new strict quarantine restrictions, in the beginning of 2021, banks agreed on the extension of moratoria for businesses and households to 31 March 2021. Nevertheless, as indicated by banks, relevance of such moratoria for customers has declined significantly, compared to 2020, and only individual applications for moratoria are received. The possibility to postpone loan repayments as well as various state aid programmes reduced the negative effect of the coronavirus on the loan portfolio quality. Another exceptional aspect of bank activities in 2020 partially related to the coronavirus crisis was a record growth of deposits. Deposits grew by almost €7 billion over the year (27.6%). On the other hand, banks were unable to find opportunities to invest such a large inflow of funds safely and effectively, therefore, the majority of them were directed to accounts with the Bank of Lithuania and other credit institutions. The net value of the loan portfolio declined by €0.9 billion (4.4%) in 2020, which was determined by a substantial contraction of the corporate loan portfolio. Housing loans, on the contrary, grew rapidly. Owing to negative consequences related to the coronavirus, bank profits dropped: in 2020, the profit earned by banks was €280 million (16.4%) lower than in 2019. The profit was negatively affected by a slight decline in bank income and at the same time by higher expenses, particularly those related to the deterioration of the loan portfolio quality and a larger amount of funds held with the central bank and other credit institutions. The banking sector retained a high capital and liquidity level throughout 2020.

BANKING SECTOR DEVELOPMENTS

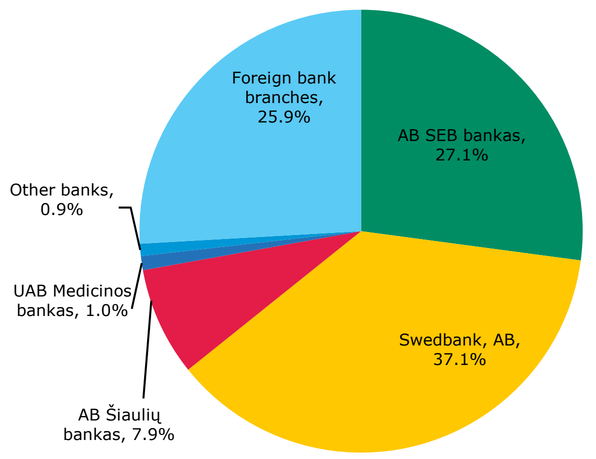
As of 1 January 2021, 11 banks held a banking or a specialised bank licence in Lithuania, while 6 banks operated as foreign bank branches.

In 2020, a specialised bank licence was issued to 1 bank (Crius LT, UAB). In addition, in the beginning of 2021, a specialised bank licence was issued to UAB SME Digital Financing, which was already the seventh specialised bank licence issued in Lithuania. Currently, the Bank of Lithuania, together with the European Central Bank (ECB), is examining 6 more applications for a specialised bank licence.

In 2020, 2 foreign bank branches terminated their activities (Lithuania branch of Svenska Handelsbanken established in Sweden and Lithuania branch of AS Industra Bank established in Latvia).

Despite the rise in the number of market participants in the recent three years, the banking sector remains concentrated: although the new market participants are growing, for now they are still unable to create stronger competition for market old-timers. The largest banks, AB SEB bankas and Swedbank, AB, hold 64.2% of the market. Foreign bank branches account for 25.9% of the market, with the Lithuanian branch of Luminor Bank AS holding the largest share.

Chart 1. Banks and foreign bank branches that operated in Lithuania on 1 January 2021 by assets



Source: Bank of Lithuania.

Table 1. New banking sector participants in the period of 2018 to 2021

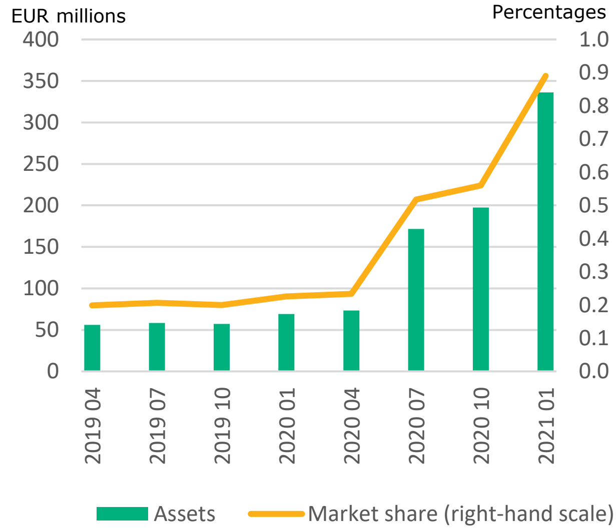
Name	Status
Revolut Bank UAB	Licence issued in 2018, operations started in 2020.
AB Mano bankas	Licence issued in 2018, operations started in 2019.
UAB GF bankas	Licence issued in 2019, operations started in 2020.
European Merchant Bank UAB	Licence issued in 2018, operations started in 2019.
AB Fjord Bank	Licence issued in 2019, operations started in 2020.
PayRay Bank, UAB	Licence issued in 2019, operations started in 2020.
AS Inbank branch	The established branched started operations in 2019.
Crius LT, UAB	Licence issued in 2020, operations not started.
UAB SME Digital Financing	Licence issued in 2021, operations not started.

Source: Bank of Lithuania.

Six banks that started their activities in the course of several recent years currently occupy 0.9% of the market, while their assets and market share are growing consistently. It should be noted that after obtaining licences banks do not start active operations immediately, as this usually happens around one year after authorisation is obtained. Four banks licensed in previous years started their operation in 2020. It is expected that banks that started their activities could contribute to the reduction of market concentration in the future. They could also stimulate FinTech development, boost competition that is beneficial to consumers and increase attractiveness and availability of services.

Chart 2. Assets of banks that were licensed since 2018 and started their operation

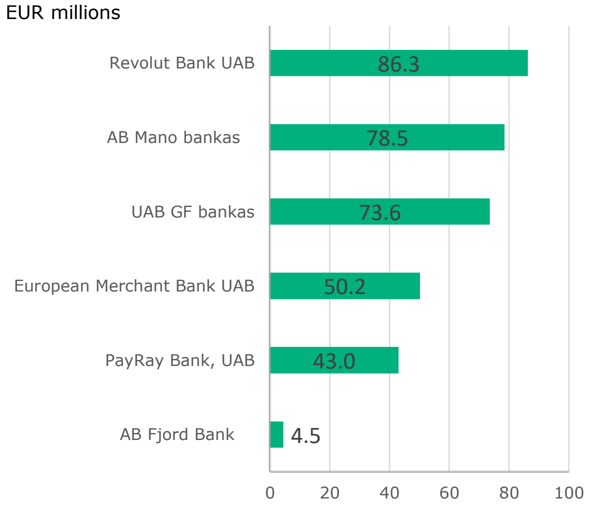
(1 April 2019–1 January 2021)



Source: Bank of Lithuania.

Chart 3. Banks that were licensed since 2018 and started their operation by assets

(1 January 2021)



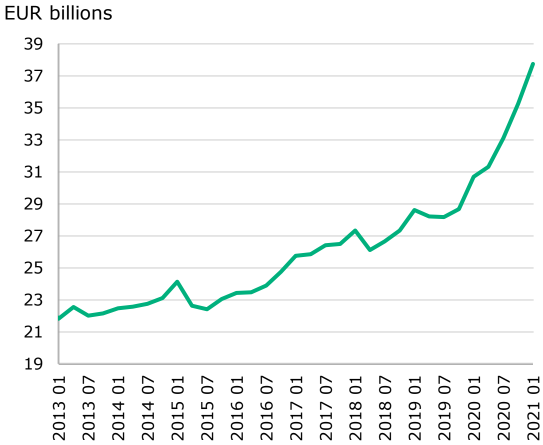
Source: Bank of Lithuania.

ASSETS AND LIABILITIES

The previous year was exceptional for the dynamics of bank assets and liabilities: deposits grew significantly, whereas banks directed these new funds to accounts with the Bank of Lithuania or credit institutions instead of lending. Bank assets in Lithuania grew by €7.1 billion (23.0%) over the year, to €37.7 billion. The largest rise among bank asset items was observed in funds held with the central bank, which grew by €4.8 billion (67.2%) to €12 billion, and funds held with other credit institutions, which increased by €2.9 billion (almost 8 times) to €3.3 billion. Thus, the liquid monetary funds accumulated by banks amounted to €15.3 billion and comprised 40.6% of bank assets, increasing over the year by as much as 15.9 percentage points. Debt securities, another bank asset item, increased by €0.4 billion (29.7%) during the period under review and amounted to €1.8 billion (4.8% of bank assets). The net value of loans granted to customers, the asset item that comprises the largest share of bank assets, went down by €0.9 billion (4.4%) to €19.6 billion, whereas the share of the loan portfolio in bank assets declined by as much as 14.8 percentage points over the year, to 51.8% (for more details on loans, see the chapter "Loan Portfolio").

Chart 4. Assets of the banking sector

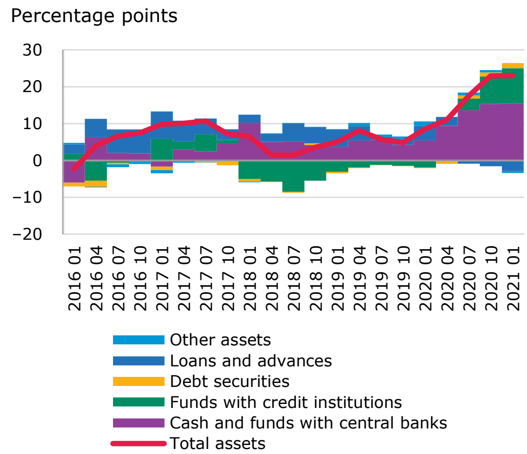
(1 January 2013–1 January 2021)



Source: Bank of Lithuania.

Chart 5. Contributions to asset growth

(1 January 2018–1 January 2021)

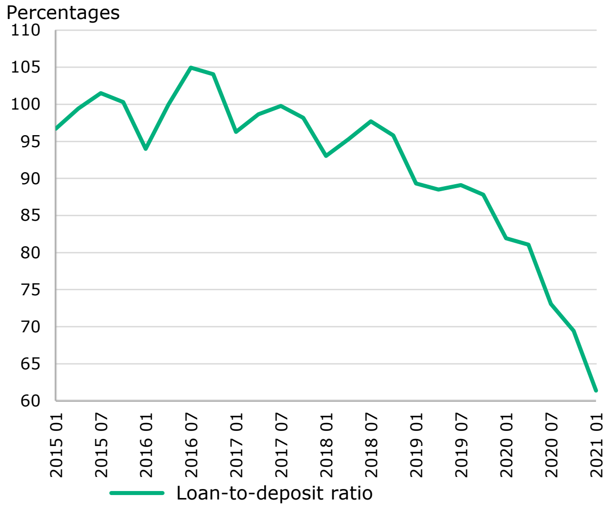


Source: Bank of Lithuania.

The rise in liabilities was determined by a record growth of deposits. Customer deposits increased by €6.9 billion (27.6%) over the year, to €31.9 billion. Customer deposits prevailed in bank financing structure: as of 1 January 2021, they accounted for as much as 90.2% of bank liabilities (for more details on deposits, see the chapter "Deposits in banks"). Liabilities to credit institutions (mainly parent institutions) stood at just €1.7 billion (5.0% of total liabilities). Bank liabilities to central banks amounted to as little as €180 million (0.5% of total bank liabilities).

A rapid growth of deposits resulted in the further decline of the loan-to deposit ratio. As of 1 January 2021, the loan-to-deposit ratio reached 61.4%, declining by as much as 20.6 percentage points over the year. This ratio has been declining consistently for several years, however, last year its fall was especially significant. Such a low value of this indicator shows that banks have large funds for crediting activities, however, at the same it is a sign that these funds are not used efficiently. In the future, banks will need to search for ways to utilise the accumulated surplus of funds efficiently or will face a significant decline in profitability.

Chart 6. Dynamics of the loan-to-deposit ratio
(1 January 2015–1 January 2021)



Source: Bank of Lithuania.

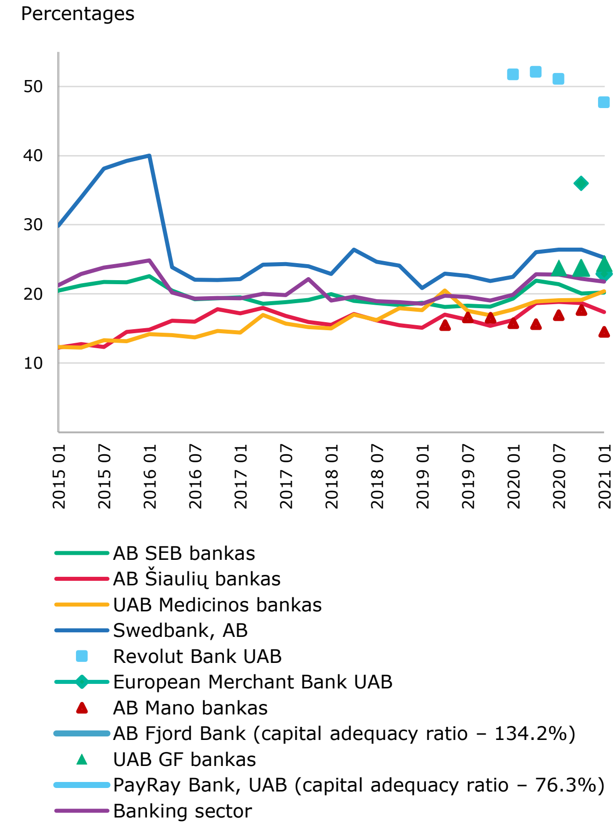
COMPLIANCE WITH REQUIREMENTS

Bank capital adequacy level remained high throughout 2020. As of 1 January 2021, the capital adequacy ratio of banks was 21.8%. Banks operating in Lithuania predominantly had capital instruments of the highest quality; therefore, their common equity tier 1 capital (CET1) ratio stood at 21.4%. Lithuania's banking sector is also characterised by a high leverage ratio: as of 1 January 2021, it was 6.7%. Although this ratio is on a downward trend due to the growth of bank assets, this is not considered as a real increase of the leverage risk, as the rise is observed only in non-risky asset types (funds with central banks or parent credit institutions).

After the start of the coronavirus pandemic, sustainable bank capital adequacy ratio was supported by the decisions of bank shareholders to refrain from dividend payments and to allocate all profits for 2019 for the strengthening of bank capital. Thus, bank capital was increased by €293.4 million, which comprised around 16% of the capital base at that time. Owing to higher uncertainty, supervisory authorities, the Bank of Lithuania and the ECB, also recommended to refrain from dividend payments. Banks were also recommended to limit dividend payments in 2021, as coronavirus-related uncertainty still prevails. Thus, the profit earned in 2020 should be mainly allocated by banks for capital strengthening this year as well. After shareholder meetings are held and profit distribution decisions are made, capital adequacy ratios should be on an upward trend as of 1 January 2021.

Chart 7. Capital adequacy ratios of banks*

(1 January 2015–1 January 2021)



Source: Bank of Lithuania.

* Current year profit is not included.

Table 2. Capital adequacy ratios and requirements set by the Bank of Lithuania

(1 January 2020–1 January 2021)

Name	Actual value, %		Requirement, %***
	01/01/2020	01/01/2021**	
Swedbank, AB	22.5 26.2*	25.3	9.8
AB SEB bankas	19.3 22.8*	20.2	10.0
AB Šiaulių bankas	16.2 21.2*	17.4	9.6
UAB Medicinos bankas	17.8	20.4	9.8
Revolut Bank UAB	51.7	47.7	11.2
European Merchant Bank UAB	55.0	22.9	8.0
AB Mano bankas	15.8	14.6	10.1
UAB GF bankas	–	24.4	8.0
AB Fjord Bank	–	134.2	8.0
PayRay Bank, UAB	–	76.3	8.0
Banking sector	19.9 23.7*	21.8	–

Source: Bank of Lithuania.

Notes: The indicated capital requirements include Pillar 1 and Pillar 2 requirements. In response to the COVID-19 outbreak, banks were exempted from compliance with the combined capital buffer requirement. The Bank of Lithuania and the ECB, which carry out supervision, assess and define the requirements on an annual basis.

*Including the current year profit. Following the European Banking Authority's explanation, some banks took advantage of the possibility to retrospectively include the current year profit, which was not paid in dividends at the decision of the shareholder meeting, into capital.

**As during shareholder meetings in 2021 bank shareholders took decisions to refrain from dividend payments from the profit for 2020, bank capital indicators as of 1 January 2021 will be recalculated.

***Pillar II requirements for banks that started their activities in 2018-2020 will be set for the first time in 2021-2022.

All banks complied with their capital adequacy requirements indicated in Table 2. Currently, banks are subject to the Pillar 1 capital requirement of 8.0% and the Pillar 2 capital requirement which is set individually. In response to the coronavirus outbreak, the ECB and the Bank of Lithuania granted a temporary exemption from compliance with the combined capital buffer requirement to the supervised institutions. The latter is comprised of the capital conservation buffer requirement (2.5%), the countercyclical capital buffer requirement (0.0%) and the other systemically important institution buffer requirement (0.5-2.0%).

Liquidity situation in all domestic banks remained good in 2020, whereas liquidity ratios increased considerably. The coronavirus pandemic that started in March as well as the quarantines in spring and at the end of the year did not result in the deterioration of the liquidity situation in banks. On the contrary, the liquidity situation improved in all domestic banks. Customer deposits grew rapidly, whereas crediting slowed down, therefore, banks continued to accumulate and increase the reserves of liquid assets, which resulted in a fast growth of the liquidity coverage ratio (LCR). The banking sector's LCR rose from 272% to 743% over the year and from 571% to 743% in Q4 2020. This rise was mainly determined by an obvious growth of deposits.

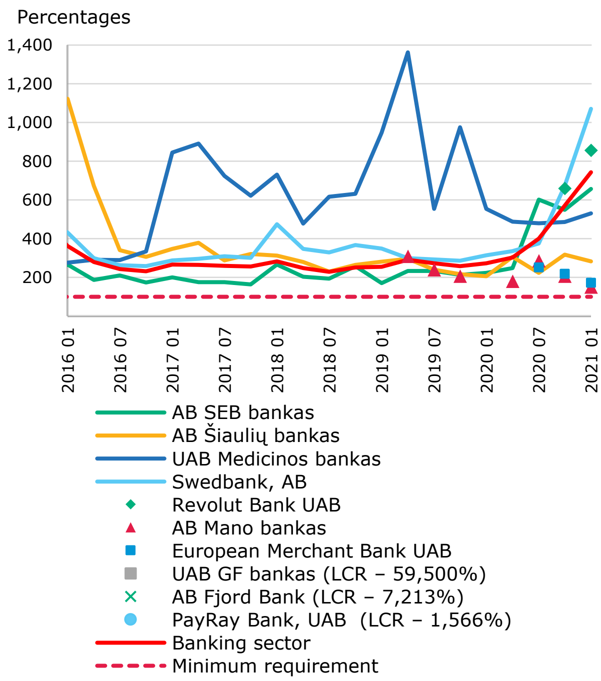
Surplus liquidity in major banks grew during the first quarantine and continued to grow even faster from Q3, when bank liabilities were increased by loans from parent institutions that complied with the minimum requirement for own funds and eligible liabilities (MREL) established by the Single Resolution Board (resolution authority) (amounting to €1 billion). This resulted in the growth of liquid assets and cash inflows, especially in major banks. In most banks, the LCR was no less than two times higher than the established minimum of 100%. The LCR in Lithuania's banks significantly exceeded the average of the EU states, where LCR indicators of major banks were lower than 200%. The banking system's liquidity also increased due to the fact that the Lithuanian banks took advantage of particularly favourable conditions under the ECB programmes and borrowed €180 million.

The funding sources of Lithuania's banks are very reliable and more stable than those of the banks of the EU countries. Retail deposits are used to finance 62% of bank assets (excluding branches). This is much higher than in major EU banks, where retail deposits are used to fund just 30% of assets.

Liquid assets of the Lithuanian banks consist of highest quality and very liquid assets. In 2020, same as in Q4, the largest increase was observed in bank funds held with the central bank, which comprised 84% of liquid assets of banks. Another part of liquid assets consisted of Government securities and cash.

Chart 8. Liquidity coverage ratios of banks

(1 January 2016–1 January 2021)



Source: Bank of Lithuania.

Table 3. Liquidity coverage ratios of banks

(1 January 2020–1 January 2021)

Name	01/01/2020	01/01/21
Swedbank, AB	314.2	1070.7
AB SEB bankas	223.5	657.1
AB Šiaulių bankas	206.1	283.1
UAB Medicinos bankas	554.6	531.7
Revolut Bank UAB	397.4	857.1
European Merchant Bank UAB	800.0	172.0
AB Mano bankas	196.2	150.7
UAB GF bankas	–	59,500
AB Fjord Bank	–	7,213
PayRay Bank, UAB	–	1,566.3
Banking sector	272.4	743.3

Source: Bank of Lithuania.

All new banking sector participants that started their activities in 2020 – AB Fjord Bank, UAB GF bankas and PayRay Bank, UAB, – had particularly high LCR indicators, since they have not yet started more active crediting, while liquid assets held with the central bank comprised the largest share of assets of these banks.

THE LOAN PORTFOLIO[1]

DEVELOPMENTS IN THE LOAN PORTFOLIO

Under the circumstances of the coronavirus pandemic, banks directed their lending mainly to housing loans, which continued to grow fast, while lending to businesses contracted. In 2020, the portfolio of loans and other advance payments grew by €0.9 billion (4.4%), to €21.4 billion. This change was mainly determined by the rise in bank funds with other credit institutions of €1.8 billion. The net value of the loan portfolio (excluding funds with credit institutions) went down by €0.9 billion (4.4%) to €19.6 billion.

Loans to households, which comprised the largest share (55.7%) of the bank loan portfolio, grew by €0.7 billion (6.6%) over the year, to €10.9 billion. Such growth of the portfolio of loans to households reflects active granting of housing loans, which went up by €0.6 billion (7.7%) over the year, to €8.8 billion[2]. Loans to households other than housing loans grew by €43 million (2.1%), to €2.1 billion. Contrary to the growth of housing loans, the growth of the portfolio of consumer loans to households declined over the year and turned to negative in Q4 2020 (declining by €27 million).

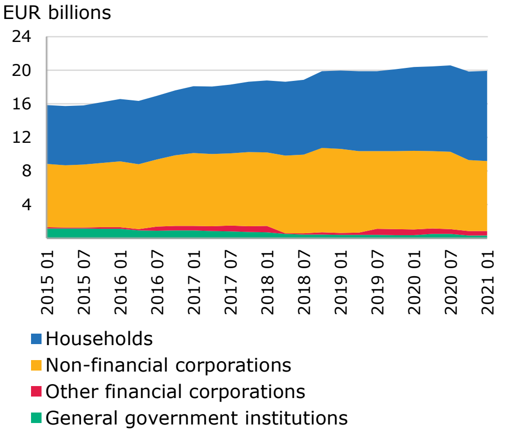
Loans to non-financial corporations, another important part of the bank loan portfolio (comprising 39.9% of the portfolio), decreased by €1.4 billion (15.2%) over the year, to €7.8 billion. This change was partially affected by the loan transfer transaction performed by Danske Bank A/S Lithuania branch[3]. With the effect of this transaction excluded, loans to enterprises declined by €1.2 billion (13.6%). The decline in the business loan portfolio that continued in recent years and was related to the risk level acceptable to banks was also accelerated this year by higher uncertainty about the coronavirus crisis. The largest decline was observed in loans to enterprises operating in wholesale and retail trade (more than €0.5 billion), manufacturing, electricity, gas, steam and air conditioning supply (more than €0.2 billion each) and transport and storage sectors. The balance sheet value of loans to the real estate sector, which comprise the largest share of loans to enterprises (29.7%), decreased insignificantly, however, with the effect of the above-mentioned transfer of loans by Danske bank A/S Lithuania branch excluded, this sector was one of only several sectors where the loan portfolio was growing. On the other hand, the need of businesses for borrowed funds was reduced by substantial state aid measures and internal reserves of enterprises (reflected by the record growth of the volume of enterprise deposits). The total value of bank loan commitments to non-financial corporations increased in the last three quarters and reached €2.7 billion (it went up by €405 million or 17.6% over the year).

The loan portfolios of other financial corporations and the general government declined by €121 million (to €525 million) and €175 million (to €342 million) respectively over the year. The change of loans to the general government was significantly influenced by the above-mentioned transfer of loans by Danske Bank A/S Lithuania branch. With its effect excluded, loans to the general government contracted by just €18 million.

[1] Including the leasing portfolio.
[2] The data for the beginning of 2020 were adjusted by adding the housing loan portfolio of Danske Bank A/S Lithuania branch, which was accounted for as held for selling in the course of the transaction and was temporarily excluded from housing loans.
[3] In 2020, Danske Bank A/S Lithuania branch transferred the loan portfolio taken over from Danske Bank Estonia branch to another credit institution.

Chart 9. Bank loan portfolio net value

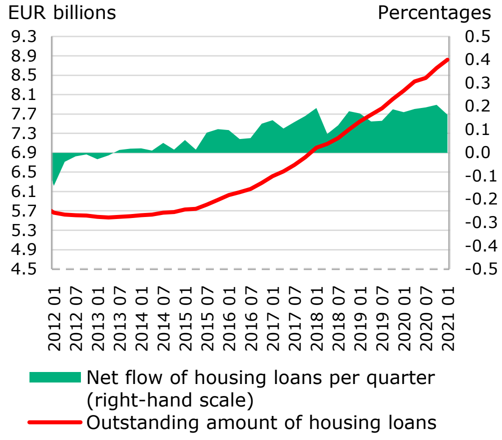
(1 January 2015–1 January 2021)



Source: Bank of Lithuania.

Chart 10. Housing loan portfolio net value

(1 January 2012–1 January 2021)



Source: Bank of Lithuania.

LOAN PORTFOLIO QUALITY

The banking sector has been quite resilient to the impact of the coronavirus crisis up to now. Nevertheless, some indicators show that the loan quality has deteriorated. Over 2020, the volume of forborne loans increased significantly (by 1.6 percentage points) and comprised 3,1% of the total loan portfolio. Their growth was observed in the first three quarters of 2020 and was related to loan restructuring (postponement of payments) due to the coronavirus pandemic. This shows that the unfavourable economic environment and restrictions of activities resulted in the rise of the number of borrowers facing financial distress. Loan restructuring by banks had a positive effect, as the overdue loan indicators improved. The share of loans to non-financial corporations overdue for more than 30 days declined by 0.2 percentage point (to 0.8%), whereas that of loans to households went down by 0.5 percentage point (to 1.0%).

The volume of business loans whose credit risk increased significantly since the initial recognition increased in 2020: the share of such loans in the total business loan portfolio went up by 4.7 percentage points to 11.6%. On the other hand, the rise in this indicator was determined not only by the growing number of these loans, but also by the decline in the calculation base (total business loan portfolio). The share of such loans in the household loan portfolio went down by 1 percentage point to 8.6%.

The changes of loans whose credit risk increased significantly since the initial recognition and non-performing loans show that the credit risk of the business loan portfolio rose over the year, despite the postponements of loan repayments and state aid measures. Owing to the continuing effect of the pandemic on the economy and still prevailing uncertainty, the same trend should remain in the coming quarters, especially considering the fact that the terms of loan repayment moratoria are nearing their expiry.

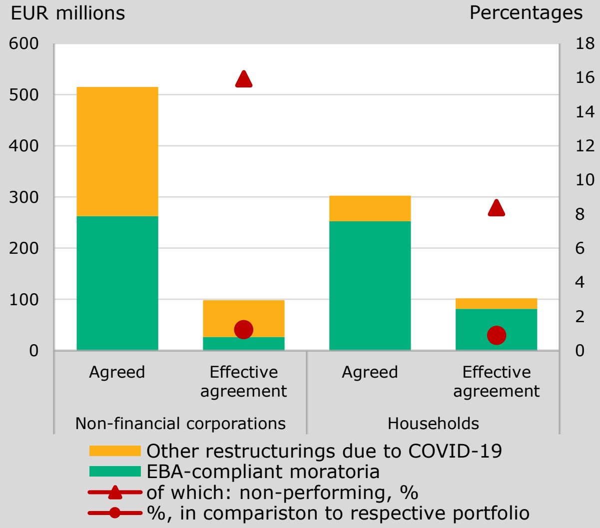
Box. Loan moratoria

In April 2020, in order to facilitate the situation of customers facing difficulties due to the coronavirus crisis, credit and financial institutions that are members of the Association of Lithuanian Banks signed moratoria on a temporary postponement of credit obligations of private and business customers. It was agreed to postpone loan repayments by enterprises for up to 6 months (the moratorium is applicable to business loans amounting to no more than €5 million on the scale of a group of enterprises), whereas housing loan payments by private customers were postponed for up to 1 year and their leasing and consumer credit payments – for up to 6 months. These agreement was also joined by several institutions that are not members of the Association. The initial deadline of the loan moratorium of 1 July 2020 was extended by joint agreement to 30 September 2020, whereas on 18 January 2021, the deadline was extended to 31 March 2021.

Loan moratoria made it possible to take swift decisions on the postponement of loan repayments for businesses and private entities, whose activity (income earned) was restricted or otherwise suffered during the coronavirus crisis, without performing a comprehensive loan risk assessment.

Chart 11. Loan restructuring due to coronavirus

(1 January 2021)



Source: Bank of Lithuania.

The majority of loan moratoria expired by 31 December 2020. At the end of the year, loans with effective agreements on the postponement of repayments according to the conditions of moratoria compliant with the requirements of the European Banking Authority's (EBA) Guidelines[4], amounted to €93 million (0.4% of the loan portfolio), of which, €81 million (0.8%) were loans to private entities and €12 million (0.2%) were loans to business customers. After considering the expired cases of restructuring, the total amount of loans under a moratorium compliant with the EBA's requirements amounted to €493 million and comprised 2.4% of the loan portfolio, of which, €241 million (2.2%) were loans to households and €248 million (3.4%) were loans to non-financial corporations. The volume of moratoria compliant with the EBA Guidelines was one of the lowest in the European Union, as banks conducted the usual individual loan restructuring (especially, for business customers).

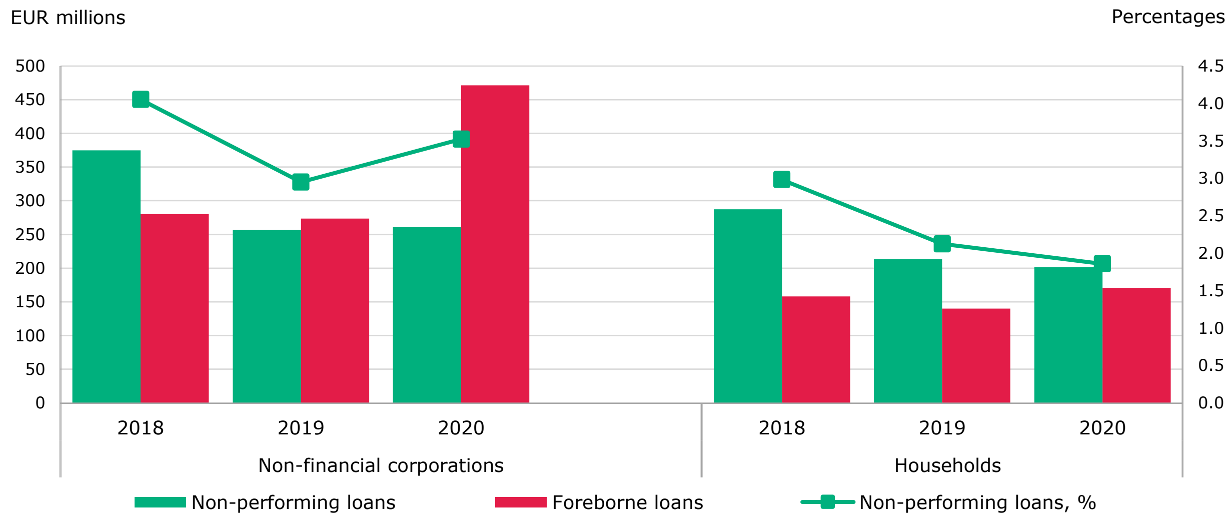
The share of loans to households with postponed repayments in the bank loan portfolios fluctuated from 1.0% to 5.5%. Substantially larger differences can be observed in the comparison with the share of loans to non-financial corporations with postponed repayments (which fluctuated from 1% to 33%), as smaller market participants postponed a higher percentage share of loans. The largest part of EBA-compliant moratoria was applied to accommodation and food services (15%), wholesale and retail trade (14%) and manufacturing (13%) sectors. In terms of absolute value, around one-third of EBA-compliant moratoria were applied to loans to enterprises operating in the real estate sector. At the end of the year, the term of EBA-compliant moratoria expired for around 80% of postponed loans, whereas the term of the majority of effective moratoria should expire in the coming months.

The share of non-performing debt instruments decreased by 0.36 percentage point, to 1.28%, while the outstanding amount of such debt instruments was 1.7% lower than in the beginning of the year. Meanwhile, with the contraction of the loan portfolio, the share of non-performing loans (i.e. those that do not have positions in credit institutions) went up by 0.49 percentage point to 2.21%. Although the portfolio of non-performing loans to non-financial corporations grew quite insignificantly (by 1.6%), a slightly larger deterioration of the non-performing loan indicator in this sector was determined by the reduced calculation base (smaller business loan portfolio). Household loan portfolio indicators have not reflected any negative consequences of the coronavirus up to now: the share of non-performing loans in this portfolio declined by 0.26 percentage point to 1.86%, the lowest level since the financial crisis of 2008.

The loan-to-special provision ratio grew by 0.16 percentage point and comprised 1.14% at the end of the year, whereas the coverage of non-performing loans with special provisions increased by 0.8 percentage point to 31.5%, of which 36.3% were business loans and 25.4% were loans to households. In 2020, banks incurred loan impairment expenses of €57 million, i.e. 2.4 times more than in 2019.

Chart 12. Loan portfolio quality

(1 January 2018–1 January 2021)



Source: Bank of Lithuania.

DEPOSITS WITH BANKS

The year 2020 was exceptional by an impressive growth of deposits with banks. Last year, deposits in banks grew by €6.9 billion (27.6%) and amounted to €31.9 billion at the end of the year. Such growth of deposits was the largest in the whole period of observations.

In 2020, deposits were growing in all sector: non-financial corporations (€2.6 billion or 37.8%), households (€3.0 billion or 20.2%), general government institutions (€1.2 billion or 47.9%) and financial institutions (€0.1 billion or 14.4%). A faster than usual growth of deposits could be explained by uncertainty about the future prevailing among businesses and households that were reluctant to spend and inclined to save for the future. The rise in profits of enterprises due to a record surplus of the current account balance and the sale of

[4] Guidelines amending Guidelines EBA/GL/2020/02 on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis.

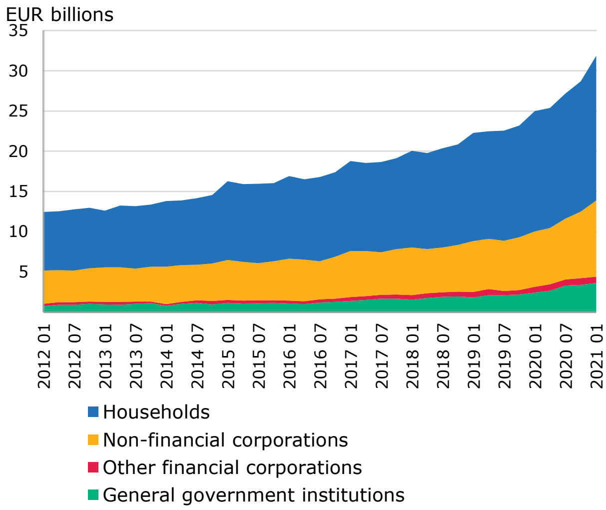
reserves as well as the state aid for enterprises during the pandemic also contributed to the growth of deposits.

This growth was observed in all quarters of the year, however, it accelerated considerably at the start of the coronavirus pandemic. The largest growth of deposits is usually recorded in the last quarter of the year, when enterprises settle with their suppliers, salaries and bonuses are transferred to employees without waiting for the new year, etc. The previous year was no exception: in Q4, deposits with banks surged by as much as €3.2 billion (11%).

The entire growth of deposits in 2020 was determined by demand deposits, which grew by €7.2 billion. The balance of time deposits even declined over the year. Current deposits comprised as much as 86.8% of total deposits with banks. Banks do not pay interest for these deposits and in certain cases even apply negative interest rates. Nevertheless, deposit insurance contributions are still paid for them. Moreover, as banks do not find ways to utilise these funds efficiently, they accumulate them in accounts with the Bank of Lithuania or other credit institutions and the interest rate paid for them is negative. Thus, owing to a rapid growth of funds in accounts, including current accounts, banks *de facto* incur considerable expenses.

Chart 13. Amount of deposits

(1 January 2012–1 January 2021)



Source: Bank of Lithuania.

PROFITABILITY AND OPERATING EFFICIENCY

In 2020, the operating profit of banks contracted as a consequence of restrictions imposed on the economy due to the coronavirus pandemic: operating income of banks went down, whereas expenses, especially those related to the deterioration of the bank loan portfolio quality, went up. The profit earned by the banking sector in 2020 amounted to €279.7 million, declining by €54.8 million (16.4%), compared to 2019. Eleven banks and foreign bank branches earned a profit and 5 banks incurred a loss in 2020. Market participants restructuring, starting or terminating their activities prevailed among those that incurred a loss. Banks operating in the market for a long time and experiencing no significant changes earned a profit, although it was lower in most banks, compared to 2019.

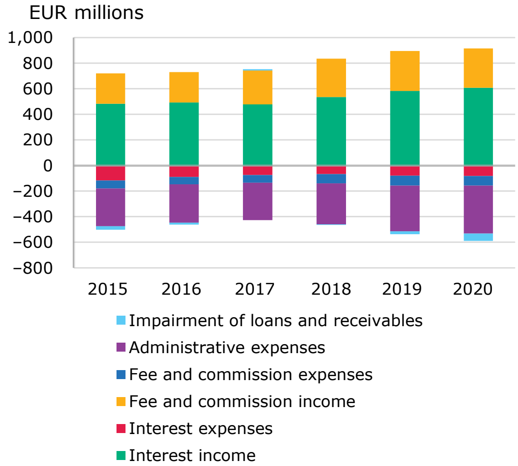
Due to the contraction of loan portfolios and the growth of deposits and related expenses, most banks earned lower net interest income. In 2020, net interest income stood at €526.1 million, increasing by €24.4 million (4.9%), compared to 2019. However, this growth was determined only by the changes in the comparative base instead of a real increase in net interest income. The main reason for this growth was a change in the treatment of interest expenses from 1 July 2020[5]. With the impact of this factor excluded, net interest income was higher by €504.4 million (just 0.5%) in 2020, compared to 2019. It should also be noted that in 2020 there were more banks earning net interest income that were not yet included in the comparative base of the year (2019). To illustrate the real change in net interest income, the data of four largest market participants holding more than 90% of the market could be used: with one-off factors excluded, net interest income of these banks declined by 4.6%.

Net interest income was negatively affected by the rise in interest expenses. Its growth was considerably influenced by the prevailing trend of the rise of interest expenses paid for own funds held with other institutions instead of those paid for financial liabilities (deposits). In total, banks incurred such expenses for the amount of €42.6 million in 2020. They increased by as much as 62.5%, compared to 2019. These expenses rise due to the growth of bank funds held with the Bank of Lithuania and other credit institutions. A large increase in deposits of bank customers contributed to the particularly fast growth of such funds.

Due to the restrictions imposed on the domestic economy, the volume of services provided by banks contracted, resulting in lower net fee and commission income. In 2020, net fee and commission income earned by banks amounted to €232.6 million, declining by €3.7million or 1.6%, compared to 2019. The most prominent fall in income of this type was registered in Q2 (during the first quarantine), when the overall economic and social activity of businesses and households decreased due to significant restrictions and banks had to close some of their branches for most of this quarter. Nevertheless, both in Q3 and Q4, fee and commission income returned to its pre-pandemic level and even exceeded it.

Chart 14. Annual change in the main items of income

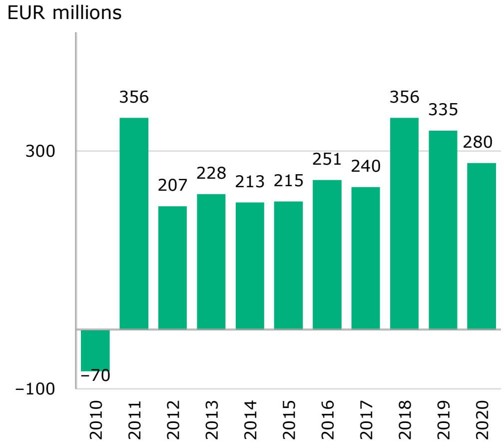
(2016–2020)



Source: Bank of Lithuania.

Chart 15. Profit of the banking sector

(2010–2020)



Source: Bank of Lithuania.

Administrative expenses increased by €20 million (5.6%) in 2020, to €375.4 million. The growth was determined by the rise in both staff expenses (€11.3 million or 5.9%) and other administrative expenses (€8.7 million or 5.3%). The growth of administrative expenses was partially related to the above-mentioned comparative base effect due to the emergence of new market participants.

The factor that made the largest contribution to the decline in bank profits was the rise in loan impairment expenses due to the deterioration of the loan portfolio quality. In 2020, such expenses by banks amounted to €56.9 million (24.0 million in 2019). Higher loan impairment expenses were incurred

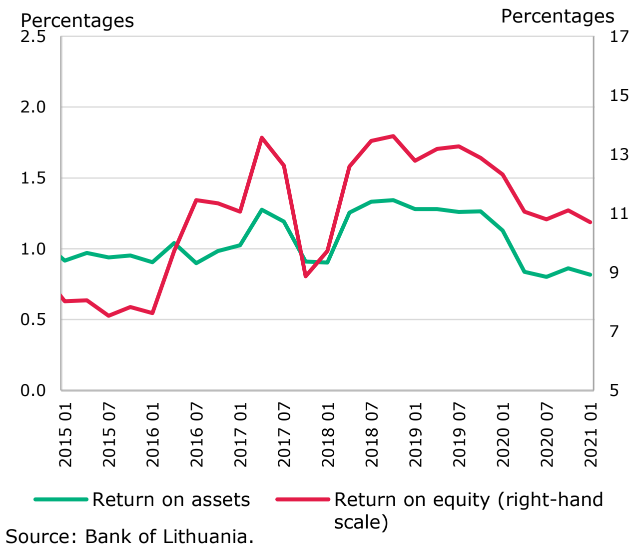
[5] Earlier, deposit insurance expenses and contributions to resolution funds were attributed to interest expenses, whereas from 1 July 2020 these expenses are calculated separately and not included in interest expenses. As of 1 January 2021, such expenses stood at €21.6 million.

by banks due to the worsening of economic prospects and a higher risk that borrowers will not repay their loans.

In 2020, bank profitability indicators deteriorated, however, compared to those of EU countries, they remained high. Regardless of the increase in administrative expenses and the decline in profits, the efficiency of the Lithuanian banking sector is still relatively high. Bank efficiency indicator, which reflects their cost-to-income ratio, comprised 48.7% as of 1 January 2021, declining (worsening) by 1.7 percentage points over the year. The EBA's comparative data for Q3 2020 (see Chart 18) show that banks operating in Lithuania which were included in the EBA's sample were the most efficient banks in the entire EU banking system. Return on assets declined by 0.3 percentage point over the year (to 0.8%), whereas return on equity went down by 1.6 percentage points (to 10.7%).

Chart 16. Profitability indicators of banks

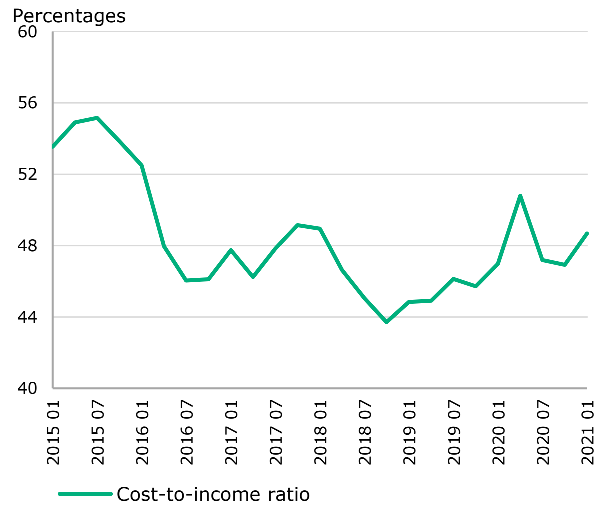
(1 January 2015–1 January 2021)



Source: Bank of Lithuania.

Chart 17. Bank efficiency indicator (cost-to-income ratio)*

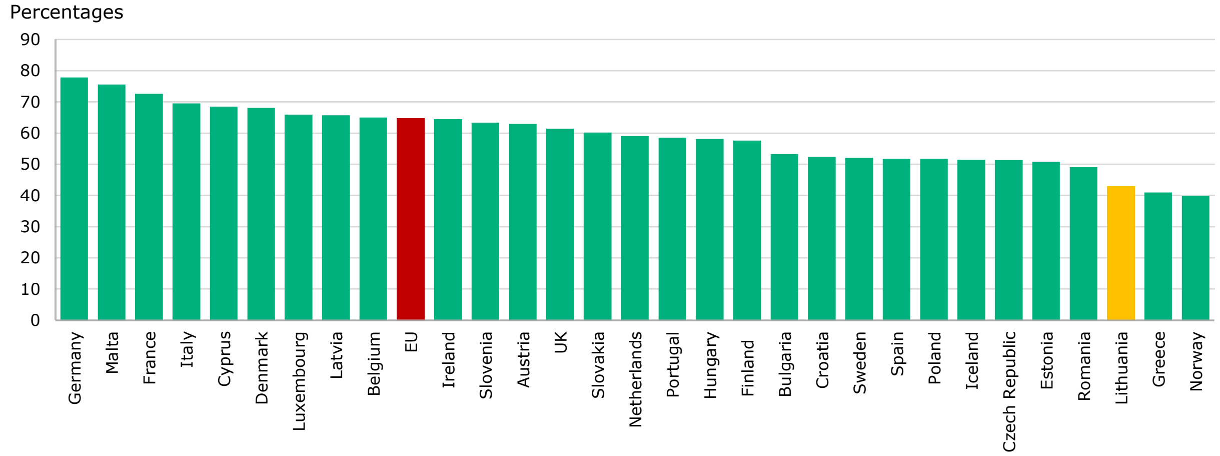
(1 January 2015–1 January 2021)



Source: Bank of Lithuania.

Chart 18. Bank efficiency indicator (cost-to-income ratio)*

(1 October 2020)



Source: EBA risk dashboard.

*Bank sample according to EBA methodology: 3 largest banks in the country; banks whose assets exceed €30 billion; banks whose assets exceed 20% of GDP.

DISPUTES BETWEEN BANKS AND CONSUMERS AND PROTECTION OF CONSUMER RIGHTS

DISPUTES BETWEEN BANKS AND CONSUMERS

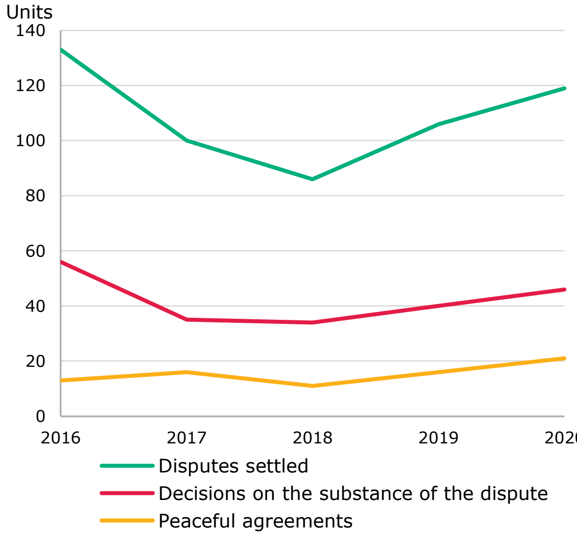
In 2020, the Bank of Lithuania investigated 119 disputes between consumers and banks. This number comprises 24% of the total number of disputes investigated at the Bank of Lithuania during this period. Compared to 2019, when 106 disputes (21% of all disputes) were settled, the number of disagreements with banks continued to grow. This growth was determined by an obvious increase in the number of disputes concerning payment services and investment services. The number of disputes concerning crediting services decreased substantially, compared to the previous year.

During the period under review, the Bank of Lithuania took 46 decisions on the substance of the dispute: the consumer's claims were fully satisfied in 1 case, whereas the claims were rejected after ascertaining that consumers raised unreasonable requirements in 5 cases. The recommendatory decision favourable to the consumer was implemented. In 21 cases, the dispute ended after reaching a peaceful agreement or a financial market participant satisfying the claim. The number of peaceful agreements is the highest since 2012, when the Bank of Lithuania was assigned the task of settling disputes between consumers and financial market participants.

The largest number of disputes (76) were related to payment services: payment accounts (31), payment card usage (22), performance of non-cash operations (9) and other payment services (14). Twenty-six disputes were related to crediting services, of which, 25 concerned the execution of real estate credit agreements. Ten disputes were related to the provision of investment services.

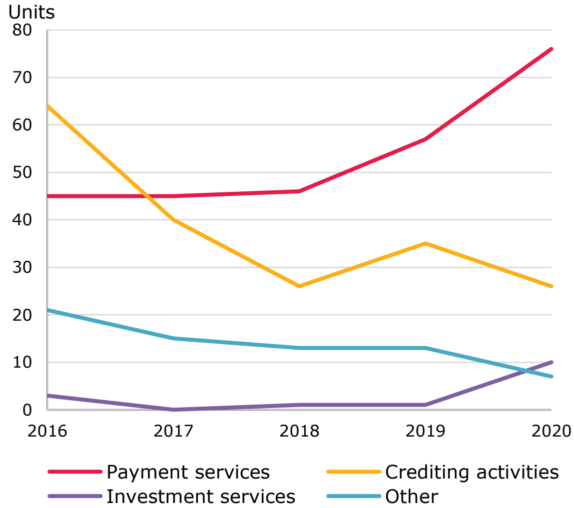
Consumers asked banks to give permission to repay credits before their maturity, renew the execution of terminated credit agreements, abandon additional fees related to the provision of crediting or payment services, return monetary funds transferred to fraudsters, etc.

Chart 19. Disputes settled and peaceful agreements (2016–2020)



Source: Bank of Lithuania.

Chart 20. Disputes by type of service (2016–2020)



Source: Bank of Lithuania.

LEGISLATION

The main legislative amendments made in 2020 were related to the protection of borrowers facing financial difficulties. The Seimas of the Republic of Lithuania adopted the amendments to the Republic of Lithuania Law on Consumer Credit and the Republic of Lithuania Law on Real Estate Related Credit (LRERC). The Law on

Consumer Credit provides for a possibility of postponement of credit payments (excluding interest) for up to 3 months by applying to the credit provider, if the consumer credit borrower faces financial difficulties in complying with the creditworthiness assessment and responsible lending requirements established by legal acts. The consumer's right to the postponement of payments may be realised in the event of the death of a spouse, termination of marriage or loss of earning capacity, as well as in the event of job loss by consumer credit borrower or their spouse or the loss of no less than one third of their income. LRERC amendments also provide for the possibility of postponement of credit payments (excluding interest), if the borrower or their spouse loses no less than one third of income. The right to postponement of payments in other cases (death of a spouse, termination of marriage or loss of earning capacity as well as job loss by consumer or their spouse) has been already envisaged in the previous version of this law.

The Board of the Bank of Lithuania adopted the Regulations of the Procedure for the Transfer of the Rights and Obligations of Credit Providers According to Effective Credit Agreements. They are targeted at consumer credit providers, real estate related credit providers and peer-to-peer lending platform operators that grant credits in accordance with the Republic of Lithuania Law on Consumer Credit and the LRERC, when they themselves make a decision to transfer their rights and obligations according to effective consumer credit and real estate related credit agreements to a new creditor as well as when such credit providers are removed from the Public List of Credit Providers under the decision of the Bank of Lithuania.

The Consumer Credit Provision Guidelines adopted by the Bank of Lithuania were updated in a new wording. This update was made to take into consideration the amendments to the Law on Consumer Credit, practices of Lithuanian and international courts and issues raised by the financial market participants.

In order to ensure that money laundering and terrorist financing (MLTF) risk management measures applied by banks and credit unions are not only proportionate to risks, but also comply with the right and/or obligation of electronic money institutions and payment institutions to have bank accounts and use them, which is envisaged by legal acts, on 25 May 2020, the Financial Market Supervision Service of the Bank of Lithuania published its position on the right of electronic money institutions and payment institutions to use bank accounts opened with credit institutions.

In 2020, banks and other payment service providers were presented with the draft Guidelines for the Provision of Payment Services. After considering the proposals and notes received, these guidelines were adopted on 15 February 2021. The Guidelines provide explanations, best practice examples and other recommendations regarding the practical implementation of the conditions for the provision of payment services envisaged by the Republic of Lithuania Law on Payments, communication with payment service users as well as recommendations on other relevant issues related to the provision and use of such services.

SUPERVISION OF FINANCIAL SERVICES

In order to assess whether payment service providers properly notify their customers about the applicable or applied commissions for payment services, the Bank of Lithuania conducted 2 off-site investigations. It was checked whether payment service providers comply with the requirement to prepare the document containing the information on commissions and submit the report on commissions to users. During this review, certain deficiencies were identified in the information provided by one of the banks and it was urged to eliminate them.

In response to the rise in the number of complaints by payment service users related to the decisions of payment service providers to refuse to open payment accounts, to close or restrict them and/or to suspend payment transactions on the basis of the payment service provider's internal MLTF risk management procedures in 2020, the Bank of Lithuania decided to perform the analysis of such practices by payment service providers in 2021. The analysis will focus on the assessment whether access to payment services is not restricted to certain groups of payment service users due to the MLTF risk management measures applied by payment service providers.

Annex. Key indicators of the banking sector[6]

Table 4. Main items of the balance sheet statement

No.	Indicator	01/01/2020 EUR millions	01/10/2020 EUR millions	01/01/2021 EUR millions	Quarterly change, %	Annual change, %
1.	Assets	30,684.7	35,251.5	37,744.1	7.1	23.0
1.1.	Debt securities	1,410.2	1,727.3	1,829.1	5.9	29.7
1.2.	Equity securities	121.3	121.9	110.8	-9.1	-8.6
1.3.	Financial derivatives	116.2	53.1	58.7	10.6	-49.5
1.4.	Cash	506.4	438.3	447.5	2.1	-11.6
1.5.	Funds with central banks	7,162.4	9,565.3	11,975.2	25.2	67.2
1.6.	Funds with credit institutions	425.7	2,784.5	3,349.7	20.3	686.9
1.7.	Loans to customers (incl. leasing)	20,450.0	19,915.1	19,554.2	-1.8	-4.4
1.7.1.	to general government institutions	517.0	318.9	342.4	7.4	-33.8
1.7.2.	to other financial corporations	646.7	528.8	525.5	-0.7	-18.8
1.7.3.	to non-financial corporations	9,196.9	8,321.4	7,800.6	-6.3	-15.2
1.7.4.	to households	10,089.4	10,746.0	10,886.0	1.3	7.9
1.7.4.1	o/w loans for house purchase	8,062.8	8,652.8	8,816.7	1.9	9.4
1.8.	Other asset positions	492.5	646.2	419.0	-35.2	-14.9
2.	Liabilities and equity	30,684.7	35,251.5	37,744.1	7.1	23.0
2.1.	Deposits of central banks	47.8	180.0	179.6	-0.2	275.4
2.2.	Liabilities to credit institutions	1,557.9	2,330.7	1,748.4	-25.0	12.2
2.3.	Financial derivatives	118.9	67.4	74.0	9.7	-37.8
2.4.	Deposits	24,963.4	28,691.7	31,861.6	11.0	27.6
2.4.1.	of general government institutions	2,446.3	3,374.8	3,618.2	7.2	47.9
2.4.2.	of other financial corporations	684.0	838.6	782.7	-6.7	14.4
2.4.3.	of non-financial corporations	6,893.0	8,284.1	9,496.6	14.6	37.8
2.4.4.	of households	14,940.2	16,194.2	17,964.1	10.9	20.2
2.5.	Debt securities outstanding	22.2	23.1	22.2	-3.8	0.0
2.6.	Other liability positions	1,861.9	1,621.1	1,419.2	-12.5	-23.8
2.7.	Equity	2,112.5	2,337.4	2,439.1	4.3	15.5

Source: Bank of Lithuania.

[6] Should banks adjust their statements for important reasons, the data of the Review after this date may be updated.

Table 5. Main items of the profit (loss) account

No.	Indicator	01/01/2020 EUR millions	01/10/2020 EUR millions	01/01/2021 EUR millions	Quarterly change, %	Annual change, %
3.	Current year profit	334.5	213.1	279.7	–	-16.4
3.1	Net interest income	501.7	399.4	526.1	–	4.9
3.2.	Net income from fees and commissions	236.3	169.5	232.6	–	-1.6
3.3	Administrative expenses	355.5	268.6	375.4	–	5.6
3.4	Loan impairment	24.0	48.2	56.9	–	237.2

Source: Bank of Lithuania.

Table 6. Other performance indicators

No.	Indicator	01/01/2020 EUR millions	01/10/2020 EUR millions	01/01/2021 EUR millions	Quarterly change, p.p.	Annual change, p.p.
4	Capital adequacy ratio	23.69*	22.18	21.76	-0.42	-1.93
5.	CET1 capital adequacy ratio	23.29*	21.81	21.41	-0.40	-1.88
6.	Liquidity coverage ratio	272.37	570.64	743.25	172.61	470.88
7.	Leverage ratio	7.82	7.32	6.73	-0.59	-1.09
8.	Net interest margin	1.74	1.64	1.58	-0.06	-0.16
9	Return on assets	1.13	0.86	0.82	0.04	-0.31
10.	Return on equity	12.32	11.15	10.71	-0.44	-1.61
11.	Cost-to-income ratio	46.98	46.93	48.69	1.76	1.71
12.	Non-performing debt instruments	1.64	1.53	1.28	-0.25	-0.36

Source: Bank of Lithuania.

*Including current year profit. Following the EBA's explanation, some banks took advantage of the possibility to retrospectively include the current year profit, which was not paid in dividends at the decision of the shareholder meeting, into capital.