LIETUVOS BANKAS

INFORMATION ON CREDIT AND PAYMENT INSTITUTIONS ACTIVITY AND THEIR SUPERVISION IN 2011

The suspension of activity of AB bankas SNORAS at the end of 2011 showed that the domestic banking system is ready and capable to withstand stress situations. Banks had accumulated sufficient reserves of liquid assets and could use them, when necessary, to repay deposits.

Although the banking system declined in terms of the key assets and liabilities indicators after the elimination of AB bankas SNORAS from the group of operating banks at the end of 2011, the growth of assets and deposits has still been recorded after the elimination of this bank's factor.

According to the audited data as of 1 January 2012, the assets of operating banks of the country amounted to LTL 79 billion and declined over the year by LTL 2.7 billion or 3.3 per cent (after excluding the factor of AB bankas SNORAS, the annual growth of assets would comprise 6.6 per cent or almost LTL 5 billion).

AB bankas SNORAS factor also had an important impact on deposit dynamics. After the announcement of a moratorium to AB bankas SNORAS in November 2011, the decline of deposits was observed in the banking system, however, in December assets and deposits in operating banks increased. This was determined by the transfer of insurance compensations for the depositors of the bank in bankruptcy in the amount of LTL 4 billion to the banking system. Around 77 per cent of these funds were transferred to the accounts of individuals and enterprises in banks and only 23 per cent of them were paid in cash (this reflects that the public continues to be confident about the banking system).

Table 1. Dynamics of some performance indicators of the banking system

No.	Indicator	Amount 01-01-2011, LTL million	Amount 01-10-2011, LTL million	Amount 01-01-2012, LTL million	Change in Q4, %	Change in Q4 (after elimination of AB bankas SNORAS), %	Change year on year, %	Change year on year (after elimination of AB bankas SNORAS), %
1.	Assets	81,706.6	83,202.7	78,970.6	–5.1	5.2	–3.3	6.6
2.	Debt securities	8,196.3	8,446.8	5,664.1	–32.9	–15.1	–30.9	–16.0
3.	Loans to customers	58,338.1	57,724.9	54,009.4	–6.4	–0.3	–7.4	–0.2
3.1.	To private enterprises	27,842.4	27,443.7	25,114.9	–8.5	–0.2	–9.8	0.4
3.2.	To financial institutions	2,892.9	2,421.2	2,152.6	–11.1	2.4	–25.6	–6.7
3.3.	To natural persons	25,035.9	24,597.0	23,499.1	–4.5	–1.7	–6.1	–3.3
3.3.1.	Housing loans	19,847.6	19,800.0	19,555.1	–1.2	–0.3	–1.5	–0.7
4.	Loan impairment	5,014.9	4,499.0	3,980.9	–11.5	–7.3	–20.6	–17.8
4.1.	Loan impairment (granted loans), %	7.92	7.23	6.86	–	–	-	-
5.	Deposits and letters of credit	45,442.8	45,840.8	43,174.1	–5.8	8.5	–5.0	10.3
5.1.	Of private enterprises	13,403.3	13,828.8	14,246.5	3.0	15.4	6.3	21.9
5.2.	Of financial institutions	1,233.5	1,210.2	1,263.0	4.4	14.9	2.4	15.4
5.3.	Of natural persons	26,081.8	26,131.5	25,128.6	–3.8	13.7	–3.7	14.8
6.	Shareholders' equity	5,912.4	6,868.1	6,854.1	-0.2	12.8	15.9	29.0
7.	Profit (loss) for current year	–276.2	707.2	1,116.2	–	–	–	–

Over 2011, loans to customers contracted by LTL 4.3 billion or 7.4 per cent, however, the largest impact on this decline was made by the already mentioned AB bankas SNORAS factor. After excluding this factor, in 2011 the total loan portfolio remained almost unchanged over the year, declining by 0.2 per cent or LTL 108 million to LTL 54 billion.

The concentration of the three largest banks in terms of market share increased in 2011 in all market segments (AB bankas SNORAS factor also affected this development). The share of the banking system‘s assets held by these banks increased over the year by 8.3 percentage points (to 69.1%), the share of assets went up by 3.9 percentage points (to 68.0%), whereas their deposits grew by 12.3 percentage points (to 71.3%). The strengthening in all segments was also observed in the positions of foreign bank branches (one of the reasons for this is the fact that they are more competitive in the domestic market, as a lower number of prudential requirements are applied to them according to the EU requirements). On 1 January 2012, foreign bank branches had 19.5 per cent of the banking system‘s assets, 22.0 per cent of the loan market and 12.8 per cent of the deposit market.

Changes in the composition of assets were mainly determined by the events of the end of 2011, due to which banks increased liquidity. The largest growth was observed in very liquid assets – cash and funds at the central bank (by 3.9 percentage points to 10.1%). Funds in banks increased in 2011 by LTL 1.3 billion (to LTL 8.2 billion), whereas their share went up by 1.9 percentage points (to 10.4% of assets). The largest impact on the growth of funds in banks was made by the increase of funds held in foreign parent banks of LTL 2.3 billion.

Banks had investments in debt securities issued by various issuers, whereas the largest share of investments were made in government bonds, which made up LTL 3.5 billion or 62.4 per cent of the debt securities portfolio on 1 January 2012.The amount of the Lithuanian government securities held by banks remained unchanged in 2011 and made up LTL 3.36 billion on 1 January 2012. The portfolio of foreign government securities declined by LTL 980 million after the elimination AB bankas SNORAS. Investment into government securities of several European states, whose financial stability is uncertain, declined significantly and made up just LTL 32.6 million on 1 January 2012.

A decline was recorded in the net debt to parent banks (a difference between the debt to parent banks and funds held in them). This was determined by an increase in funds held in parent banks, whereas the debt to them declined insignificantly.

After the exclusion of the bank in bankruptcy AB bankas SNORAS from the group of operating banks, the volume of deposits held by non-residents declined significantly (by almost LTL 1 billion) in 2011 (to LTL 1.9 billion on 1 January 2012). After the decline of deposits of non-residents, deposits in foreign currency and their share, compared to total deposits, contracted, whereas deposits in national currency and their share increased in the fourth quarter from 64.8 per cent to 70.8 per cent.

BANK LOAN PORTFOLIO

The loan portfolio of operating banks made up LTL 54 billion at the end of 2011 and was equal to the loan portfolio in 2007. Portfolio developments were significantly affected by the elimination of AB bankas SNORAS, which had the loan portfolio of LTL 3.6 billion and occupied around 6 per cent of the banking system’s loan market, from the operating banks group. After the elimination of AB bankas SNORAS loan portfolio, it would be possible to state that the volume of loans of the banking system remained basically unchanged in 2011: at the end of the year, the loan portfolio was only 0.2 per cent smaller than in the beginning of the year. It should be noted that that the flow of new loans constantly surpassed, albeit slightly, the flow of repaid loans in the second half of the year. It shows higher activity of banks in crediting domestic enterprises and individuals.

After the inflow of a significant amount of money into the market due to deposit compensation, the ratio of loans to deposits of the banking system made up 129 per cent at the end of 2011 and was 12 percentage points lower than a year ago. It can be stated that the activity of the banking system became more balanced – a larger share of loans was financed from resources attracted inside the country.

Credit liabilities, which reflect the future developments of the loan portfolio, increased over the year by LTL 552 million or 9.2 per cent.

Banks credited the public sector more actively in 2011 – over the year, loans to this sector increased by more than one-fourth (it is likely that this trend will remain in 2012). The largest segments of the loan portfolio – loans to private enterprises and housing loans to individuals – remained virtually unchanged in 2011.

After the exclusion of the bank in bankruptcy AB bankas SNORAS from the group of operating banks, the share of bank loans granted to non-residents declined in half and made up only LTL 0.7 billion or 1.4 per cent of the loan portfolio on 1 January 2012.

The loan portfolio quality improved in 2011 – banks assessed borrowers as less risky, therefore, they reduced the provisions made in previous years. Specific provisions for loans formed by operating banks in 2011 declined by LTL 862 million or 17.8 per cent, however, despite this decline, they still remained significant on 1 January 2012 and made up LTL 4 billion.

The ratio of specific provisions to the loan portfolio declined over the year by 1 percentage point to 6.9 per cent. The ratio of specific provisions formed for housing loans increased over the year by 0.3 percentage point, however, the quality of this loan portfolio segment remained relatively good – specific provisions made up 3.3 per cent of the portfolio of such loans. Quality of consumer loans remained poor. On 1 January 2012, the specific provisions indicator of such loans made up 11.7 per cent. The ratio of loans overdue for more than 60 days to the loan portfolio declined over the year by 0.5 percentage point and made up 2.5 per cent on 1 January 2012.

The improvement of the loan portfolio quality is also characterised by the decline of liabilities to banks by the companies against which bankruptcy or restructuring were initiated. In 2011, the liabilities to banks by companies under bankruptcy or under restructuring made up around LTL 764 million. Lt – du kartus mažiau nei 2010 m. Liabilities to banks by all companies under bankruptcy procedure or under restructuring still remained significant on 1 January 2012 and made up around LTL 3.3 billion or 12.8 per cent of bank loans to resident private enterprises. Specific provisions made by banks for loans to the above-mentioned companies amounted to LTL 1.6 billion, with loans to enterprises in real estate and construction sectors accounting for the largest share of the said loans (around 65%).

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

Insurance compensations for AB bankas SNORAS depositors transferred to the banking system determined a significant rise of the banking system's liquidity indicator in December 2011. It increased by as much as 5.2 percentage points (to 44.05%) and was the highest in the last one and a half years (the liquidity ratio set by the Bank of Lithuania is 30%).

The average liquidity ratio of banks that have the largest market share in Lithuania's banking system – those that have foreign parent institutions and can borrow from them – made up 43.7 per cent on 1 January 2012 and was 3 percentage points higher than a year ago. The average liquidity ratio of banks that do not have foreign parent institutions remained high and made up 46.4 per cent on 1 January 2012 (although it declined by 2.6 percentage points in 2011).

According to the data of 1 January 2012, banks reported having sufficient liquidity buffers to bridge the net financing gap. Total liquidity buffers formed by banks made up LTL 18.6 billion, while the net financing gap amounted to LTL 6.6 billion, which means that liquidity buffers in banks were 2.8 times above the minimal requirement for liquidity buffer.

In 2011, banks maintained a high capital adequacy level (the banking system's capital adequacy ratio made up 13.92% on 1 January 2012). This ratio declined by 1.7 percentage points in 2011, which was mainly determined by the fact that the capital base decreased more than the capital requirement to amortise risks (especially due to the restored value of investment by some banks into subsidiary leasing companies, which started operating profitably).

After the end of the annual audit, AB bankas "FINASTA" formed additional provisions for the assets related to AB bankas SNORAS. After their formation, the bank ceased to comply with capital adequacy and other prudential requirements related to bank capital. However, the bank‘s capital was immediately restored by an additional contribution to the bank‘s reserve capital. Currently, AB bankas "FINASTA" complies with all prudential requirements with a sufficient reserve; besides, negotiations are taking place with potential investors of the bank

The capital requirement was LTL 3.6 billion on 1 January 2012. Capital allocated to amortise credit risk made up the largest share of the capital requirement and amounted to LTL 3 billion, whereas capital for the amortisation of market risk made up just LTL 503 million. Among market risks, foreign exchange rate risk remained the most significant one. To amortise this risk, 87.8 per cent of the total capital required to cover market risk was allocated.

The capital requirement for covering operational risk made up LTL 222 million on 1 January 2012. As reflected by the global experience, the estimation of sufficient capital requirement for covering operational risk is especially complex, since even only one significant operational risk incident may be fatal for a bank – even the whole capital of the bank may be insufficient to cover losses. It would be difficult to find an example in the global practice when a bank collapses due to a one-off credit risk event, whereas there are many such examples related to operational risk. AB bankas SNORAS collapse was most probably also a consequence of operational risk.

SHAREHOLDERS' EQUITY

After the gradual intensification of bank activity in 2011, the shareholders' equity increased by LTL 942 million. After the elimination of AB bankas SNORAS, the shareholders' equity of operating banks increased by LTL 1.5 billion or 26.0 per cent and made up LTL 6.9 billion on 1 January 2012. The largest impact on the growth was made by the profit earned in 2011.

In 2011, the authorised capital of the banking system grew by LTL 90 million and made up LTL 4.3 billion on 1 January 2012. The increase in the authorised capital by additional contributions was registered in 2011 by AB Šiaulių bankas (LTL 30 million), AB Ūkio bankas (LTL 50 million) and AB bankas "FINASTA" (LTL 10 million).

The capital of Scandinavian countries prevailed in the banking system of Lithuania, as in previous years. The share of the authorised capital controlled by non-residents remained basically unchanged in 2011 at 87.7 per cent.

PROFITABILITY AND BUSINESS EFFICIENCY

After the years 2009 and 2010, when banks suffered losses, in 2011 banks earned the profit of as much as LTL 1.1 billion (in 2010, they suffered the loss of LTL 276.2 million). The profit earned last year was very close to the record profit of the banking sector earned during the economic upturn period in 2007. However, contrary to the period of economic growth, the main profit growth driver last year was not the growth of bank income, but instead the decline of expenses for specific provisions (related to the revaluation of loans and investments into subsidiary companies) and the fall in interest expenses. The operating result of banks – the profit before tax, impairment and provision expenses – in 2011, compared to 2010, remained basically unchanged and made up LTL 850.1 million in 2011.

The annual operating result of banks slightly contracted after the end of annual audits of banks, as two smaller domestic banks decided to form provisions reaching 100 per cent for the funds held at AB bankas SNORAS.

In 2011, five banks and five foreign bank branches reported profit, while other three banks and five foreign bank branches suffered losses.

In the fourth quarter, banks earned the record quarterly profit (LTL 409 million) in the whole period of bank activity in Lithuania. However, this was basically determined by the profit of two banks, received after the revaluation at the end of the year of investments in subsidiary leasing companies, which started operating profitably.

The main income of banks operating in Lithuania – net interest income – grew last year by 13.8 per cent (to LTL 1.3 billion). The main factor of their growth was the fact that interest income declined slower than interest expenses, which are incurred by banks when they pay interest for customer deposits and other financing sources. In the nearest future, it will be hardly possible for banks to increase net interest income without increasing the interest income earned and just by reducing interest expenses, since the price of resources has reached a particularly low level, while the possibilities for it to decline further are very small.

Net income from services and commissions by operating banks rose slightly (by 0.8%) in 2011, compared to 2010, and made up LTL 596.1 million. The growth of income from services and commissions is usually directly related to the economic growth – with the growth of the country's economy, activity of economic entities increases, therefore, the need for banking services rises. Thus it is likely that income from services and commissions increased last year due to the rise in the volume of such services instead of the increase of their prices. After the initiative of the Bank of Lithuania to reduce the prices for the most necessary banking services, some banks reduced the fees for payment services.

Last year, a part of bank customers, who were earlier considered to be bad, proved their capability to expand activity and fulfil obligations; besides, banks revaluated the pledged property, therefore, the need for provisions declined. Therefore, banks reduced more earlier formed provisions than they formed new ones in 2011, thus earning LTL 368 million, of which LTL 158.5 million were related to the positive effect of loan impairment. In comparison, over the same period last year they incurred asset impairment losses of LTL 1.2 billion.

Operating expenses of banks in 2011, compared to 2010, grew by 8.6 per cent, whereas this growth was mostly determined by the annual increase of staff expenses by 11.8 per cent.

Owing to the elimination of AB bankas SNORAS, which employed 1,178 staff members as of 1 October last year, the average number of employees in the banking system declined by 14.3 per cent in the fourth quarter to 7,020.

Contrary to the previous year, asset and return on equity indicators of banks were positive on 1 January 2012 due to profitable operation of banks: the return on assets ratio stood at 1.38 per cent and the return on equity ratio – at 15.23 per cent. The indicator that reflects business efficiency of banks – the ratio of operating expenses (operational and amortisation costs) to income from the main activity – declined (i.e. improved) according to the data of 1 January 2012, compared to last year, by 1.9 percentage points (to 57.3%).

As low interest rates still prevailed in the markets last year, the trend of decline of the lending and borrowing price remained. The real interest margin of the banking system rose slightly in 2011 from 1.3 per cent to 1.57 per cent, which positively affected net interest income of banks.

INFORMATION ON THE OPERATIONS OF THE CENTRAL CREDIT UNION OF LITHUANIA

The assets of the Central Credit Union of Lithuania (CCUL) went up in 2011 by LTL 44.1 million and on 1 January 2012 amounted to LTL 354.6 million. At the end of 2011, 62 credit unions operated in Lithuania.

Developments of the CCUL assets directly depend on the main source of financing – deposits held in it by credit unions that are CCUL members (they increased in 2011 by 12.7% to LTL 301.7 million). The portfolio of loans granted to the CCUL members went up by 55.8 per cent and made up LTL 47.2 million on 1 January 2012. During the period under review, no specific provisions for loans were formed and there were no loans with regular payments overdue for more than 60 days.

On 1 January, the largest share of free funds was invested by the CCUL in the Lithuanian Government‘s debt securities (LTL 176.6 million). In 2011, investment in debt securities increased by 22.5 per cent and made up the largest share of the CCUL assets (52.2%). A significant share of the CCUL assets consisted of funds in banks (17.8 %).

The CCUL continued to comply with liquidity and capital adequacy indicators with a significant reserve.

The Liquidity Maintenance Reserve and the Stabilisation Fund were increased further by the contributions of credit unions that are the CCUL members. On 1 January 2012, they made up LTL 11.3 million and LTL 7.9 million respectively.

The share capital of the CCUL grew over the year by LTL 18.8 million and made up LTL 29.1 million on 1 January 2012. This significant increase of the share capital allowed the CCUL to ensure compliance with prudential requirements after forming specific provisions for funds held at AB bankas SNORAS and created a possibility to help credit unions that are the CCUL members to solve similar problems and to ensure stability of the credit union system.

The CCUL (together with 57 credit unions) signed an agreement with the manager of the Entrepreneurship Promotion Fund (INVEGA) regarding the management of the micro-crediting project for the amount of LTL 50 million. Loans for the amount of 4.7 million were granted from this fund for the financing of small businesses.

According to the audited financial statements, the CCUL suffered the loss of LTL 15.3 million, whereas a year ago it earned the profit of LTL 1.5 million. The largest influence on the negative performance result of 2011 was made by provisions for the funds held at AB bankas SNORAS, which were formed in the last quarter.

REVIEW OF THE ACTIVITIES OF CREDIT UNIONS

On 1 January 2012, 74 credit unions operated in Lithuania, with the total of 128 thousand members.

Table 2. Development of the key indicators*

No.	Indicator	Amount 01-01-2011, LTL million	Amount 01-10-2011, LTL million	Amount 01-01-2012, LTL million	Change in Q4, %	Annual change, %
1.	Assets	1,276.9	1,510.0	1,628.5	7.8	27.5
2.	Funds in banks	60.7	49.2	44.8	–8.9	–26.2
3.	Funds at the CCUL	276.5	271.3	312.9	15.3	13.2
	Of which, term deposits	146.1	134.1	162.2	21.0	11.1

4.	Government securities	133.1	208.0	237.3	14.1	78.3
5.	Loans granted	752.1	916.2	933.5	1.9	24.1
6.	Specific provisions for loans	14.2	26.0	28.6	10.0	2 times
7.	Ratio of specific provisions for loans to loans (%)	1.9	2.8	3.0	–	–
8.	Debt to the CCUL	30.3	52.4	47.2	–9.9	55.8
9.	Deposits	1,083.5	1,281.7	1,405.8	9.7	29.7
	Of which, by members and associated members of credit unions	1,076.2	1,271.0	1,393.3	9.6	29.5
10.	Share capital	135.8	167.4	177.8	6.2	30.9
11.	Profit (loss) for current year	–5.4	–2.2	–14.0	–	–

The growing number of credit union members had an impact on the further expansion of the volume of operations of credit unions. Credit union assets increased last year by 27.5 per cent (to LTL 1.6 billion), whereas their ratio to the banking system's assets made up 2.07 per cent on 1 January 2012. The assets of the largest credit union "Vilniaus taupomoji kasa" made up LTL 272.8 million or 16.8 per cent of total assets of credit unions. Deposits accepted by credit unions increased by 29.7 per cent, of which the largest share (99.1%) were deposits of members. The significant share of quite expensively attracted resources (LTL 312.9 million) was held by credit unions in their account with the CCUL. Funds held at the CCUL made up around 20 per cent of credit union assets in 2011. As credit unions increased their investment in government securities, investments in these securities grew by 78.3 per cent, however, loans, which increased by 24.1 per cent, still accounted for the largest share of assets (57%). On 1 January 2012, 63 credit unions held specific provisions for loans (LTL 28.6 million). The ratio of specific provisions of credit unions to loans made up 3 per cent.

The share capital of credit unions grew during this period by 30.9 per cent.

45 credit unions that operated profitably earned the profit of LTL 4 million in 2011, while 27 credit unions that operated unprofitably incurred the loss of LTL 18 million. The total result of the credit union system was the loss of LTL 14 million (the loss of LTL 11.8 million was suffered in the fourth quarter).

The operation of credit unions with a loss was determined by impairment expenses incurred in the fourth quarter of 2011 due to the funds held at AB bankas SNORAS and the holdings of the Greek government securities (LTL 15 million).

REVIEW OF THE ACTIVITIES OF PAYMENT INSTITUTIONS

After the Republic of Lithuania Law on Payment Institutions, which established that legal entities may provide payment services without a payment institution licence by 30 April 2011, entered into effect, an intensive payment institution licensing process took place in 2011, during which both activity of enterprises that provided payment services earlier was legalised and new payment institutions were established. On 1 January 2012, there were 21 payment institutions that had a licence to provide payment services issued by the Bank of Lithuania. It should be noted that as much as 19 payment institutions from this number received the licence to provide the payment service of money remittances.

Besides, almost all payment institutions provided payment services and performed other activity and only one payment institution provided only payment services, while for four payment institutions this activity comprised the main share of their activity. Therefore, income earned by payment institutions from the provision of payment services is the best reflection of the indicators of such activity. On 1 January 2012, this income made up LTL 55 million or only 4 per cent of total income of payment institutions.

All payment institutions complied with the requirement for the protection of funds of the users of payment services or funds received from another payment services provider established in the Law on Payment Institutions, by separating these funds from the funds of other natural persons or legal entities, which are not users of payment services, and holding them in accounts with credit institutions. In addition to this method, as of the date of the review two payment institutions also applied another method for the protection of the funds of users – they had concluded insurance and guarantee agreements to provide insurance for these funds.

On 1 January 2012, all payment institutions complied with the minimum own capital and own capital requirements established in the Law on Payment Institutions.