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Banking Activity Review

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8 June 2017[1]

In early 2017, Lithuania's banking sector continued to implement the previously-initiated consolidation processes; meanwhile, the system's financial situation remained stable. New and current financial market participants exhibit interest in a specialised banking licence. Bank assets in the first quarter continued to grow as a result of the increasing loan portfolio. The amount of deposits after the end-of-the-year hike in the fourth quarter naturally decreased, but a clear growth trend is still visible. According to the data reported by banks, all of them complied with the supervisory capital and liquidity requirements in the first quarter; however, for some banks, strengthening their capital continues to be a priority area. Three banks paid out dividends for 2016, but this did not have a significant impact on their capitalisation and financial sustainability. The loan market continued to grow, but the quality of the loan portfolio was good. If there were reasons to believe that lending might become too active, the Bank of Lithuania would adopt macroprudential policy instruments. Q1 2017 was profitable for banks, resulting in the greatest quarterly profit over seven years. More profit was earned from the banks' main activities. System profitability was sufficiently large, while its efficiency increased.

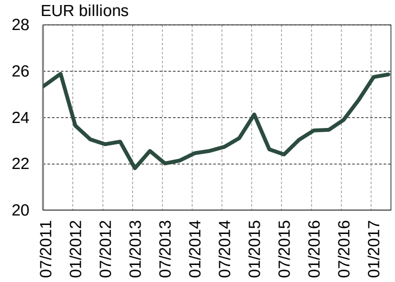
1. BANKING SECTOR DEVELOPMENTS

Previously-initiated processes continued in the banking sector. As of Q1 2017, six banks and eight foreign bank branches[2] operated in the country; their number remained unchanged over the year. There were no significant new changes in the banking market, and processes that had begun previously – continued. Last year, the banking merger deal between *DNB ASA* and *Nordea bank AB* was initiated in the Baltic countries took place; according to the latest data, bank representatives plan to end it by Q3 2017. The European Central Bank (ECB) and related national supervisory authorities continues to assess this process.

As of 1 January 2017, with coming into force of the amendment to the Republic of Lithuania Law on Banks (providing the opportunity to establish a specialised bank), the Bank of Lithuania actively communicated with potential new participants of the banking sector – participants of the currently-being-reformed credit union sector and new Lithuanian financial market participants. One credit union was issued permission to come together as a bank.

Chart 1. Assets of the banking sector

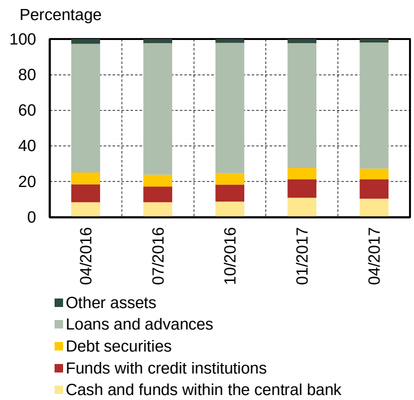
(1 July 2011–1 April 2017)



Source: Bank of Lithuania.

Chart 2. Asset composition

(1 January 2015–1 April 2016)



Source: Bank of Lithuania.

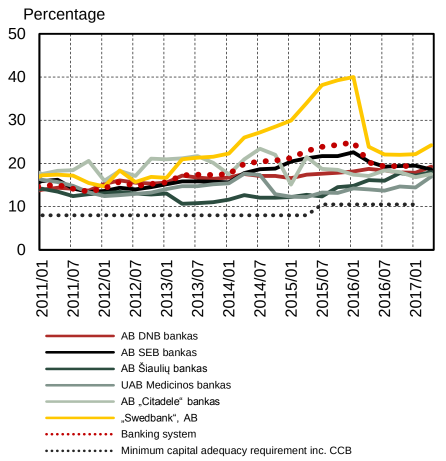
2. ASSETS AND LIABILITIES

At the beginning of this year, bank assets grew at a stable rate. In Q1 2017, it stood at EUR 25.9 billion, and over the first three months of this year increased by EUR 102 million (0.4%). In the first quarter there was no one clear factor that led to asset growth; therefore, the structure of bank assets did not change significantly. As has been common recently, the client loan portfolio increased the most – EUR 219 million (for more details, see Section 4) and funds with credit institutions, which primarily consist of bank funds held in parent banks – growing by EUR 170 million. Funds held in the central bank's accounts dropped by EUR 157 million. In different periods, fluctuation in the aforementioned accounts can be explained by bank-made decisions on liquidity management. Other changes in the items of the asset report did not have a significant influence on general changes in assets.

[1] The Review has been prepared based on unaudited data. Should system participants adjust their statements for this or other important reasons, the data of the Review after this date may be revised.
[2] Reports from seven branches are received for supervisory purposes, as the branch of *Telia Finance AB* in Lithuania, *Telia Finance Lietuva*, is so far not engaged in operations.

Chart 3. Capital adequacy ratios of banks

(1 January 2011–1 April 2017)



Source: Bank of Lithuania.

Table 1. Capital adequacy ratios of banks

(as at 31 March 2017)

	Capital adequacy ratio (%)	
	Q4 2016	Q1 2017
AB DNB bankas	17.9	19.3
AB SEB bankas	19.5	18.6
AB Šiaulių bankas	17.2	18.0
UAB Medicinos bankas	14.4	17.0
AB „Citadele" bankas	16.8	17.6
„Swedbank", AB	22.1	24.3
Banking system	**19.4**	**20.4**

Source: Bank of Lithuania.

Table 2. Capital adequacy ratio requirement set by the Bank of Lithuania

	Requirement (%)
AB DNB bankas	Set by the ECB
AB SEB bankas	Set by the ECB
AB Šiaulių bankas	12.9
UAB Medicinos bankas	13.9
AB „Citadele" bankas	14.5
„Swedbank", AB	Set by the ECB

Note: The Bank of Lithuania and the ECB, which perform supervision, annually assess and define the requirements. The ECB, which performs direct supervision, sets capital adequacy requirements which are not publicly released, by decision of the ECB.

Source: Bank of Lithuania.

Table 3. Liquidity coverage ratios of banks

(as at 31 March 2017)

	Liquidity coverage ratio (%)	
	Q4 2016	Q1 2017
AB DNB bankas	181.4	186.0
AB SEB bankas	200.1	175.5
AB Šiaulių bankas	338.6	368.7
UAB Medicinos bankas	830.5	879.8
AB „Citadele" bankas	160.5	164.6
„Swedbank", AB	288.5	295.4
Banking system	**266.2**	**264.1**

Source: Bank of Lithuania.

After the expected hike at the end of the year, in the first quarter there was a drop in customer deposits at banks. In the first quarter of 2017, bank liabilities increased by EUR 183 million (0.8 %) – to EUR 23.7 billion. Nearly all of the Bank of Lithuania's liabilities (96%) are customer and parent bank deposits – they were the reasons for the changes in this quarter. After the customer deposit hike, common at the end of the year, in the first quarter the amount slightly dropped (for more details, see Section 5) – they contracted by EUR 230 million. In the same period, parent bank deposits increased by EUR 400 million and only a small part was a result of changes in other liabilities.

3. COMPLIANCE WITH REQUIREMENTS

The state of the banking sector's capital continues to be stable. As of 31 March 2017, the capital adequacy ratio of the banking sector stood at 20.4 per cent. Compared to Q4 2016, total capital adequacy ratio of the banking sector increased by 0.6 p.p. Based on data submitted by banks, the values of the capital adequacy ratio of nearly all banks increased. Only the value of the capital adequacy ratio of *AB SEB bankas* decreased by 0.9 p.p. over the quarter. Such a change was the result of dividends paid out by the bank for 2016. Three banks paid them out: *AB SEB bankas, Swedbank AB, and AB Šiaulių bankas.* The decision to pay dividends had no major impact on the banks' financial standing and ability to comply with the capital adequacy requirements.

According to the data submitted by banks, they complied with established capital requirements. All banks operating in Lithuania, based on submitted supervisory reports, complied with Pillar I minimum capital adequacy requirement (8.0%), Pillar II capital requirement, which is set on an individual basis, and the combined capital buffer requirement. The latter is comprised of the capital conservation requirement (2.5%), the countercyclical capital buffer (0%), and the capital buffer of other systemically important institutions (0.5–2.0%). Pillar II capital requirements for banks (see Table 3) will be effective in 2017 until a new supervisory review and evaluation process is carried out. By decision of the ECB, individual Pillar II capital ratio requirements of the three major banks in Lithuania are not published; however, they are set according to the same principles and these banks comply with them with a sufficient margin. The Bank of Lithuania continues to hold the position that for local capital banks the issue of strengthening capital is still a priority.

In Q1 2017, the liquidity level of banks remained high, while the liquid asset reserves — sufficient. The composition of bank liquid assets remained the same – comprised of particularly high quality and liquidity financial instruments: cash, funds with the Bank of Lithuania, and securities of the governments of European Union (EU) countries. The financing basis of banks was stable, despite the slight decrease in customer deposits, seen in the first quarter. Banks compensated this decrease in deposits by drawing in financial funds from parent banks. The banking system's dependence on public sector financing did not change and was still insubstantial. In monitoring the banks' liquidity situation and to be sure that banks ensure compliance with liquidity coverage requirements, the Bank of Lithuania assesses on a permanent basis the values of the liquidity coverage ratio (LCR) – the key indicator of liquidity, set in Capital Requirements Directive IV and in the Capital Requirements Regulation. According to the data submitted by banks, the value of this indicator is large across all banks operating in the country and is met with a sufficient margin – as of 31 December 2017, the banking sector's LCR was 264 per cent (the required minimum in Lithuania is 100%). The LCR values of almost all banks improved over the first quarter, with the drop in net cash outflows and growth in bank liquid assets. *UAB Medicinos bankas* and *AB Šiaulių*

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bankas stood out, as their LCR, due to the aforementioned reasons, increased the most; for AB SEB bank, its LCR decrease was a result of the growing loan portfolio.

4. THE LOAN PORTFOLIO[3]

Loan portfolio developments

Loan growth rate at the beginning of the year remained strong. The net value of the portfolio of loans granted to bank customers[4] (hereinafter 'loan portfolio value') increased by EUR 219 million (1.2 %) over the first quarter of 2017 – to EUR 18.3 billion.[5] Changes in the loan portfolio value was equally affected by households and other financial corporations, while the loan portfolio of corporation and general government institutions remained nearly unchanged over the first quarter. The portfolio of household loans increased by EUR 122 million (1.5 %) in the period under review, to other financial corporations – by EUR 126 million (22.0 %). The value of the household loan portfolio, as usual, was affected by housing loans, which in the period under review grew by EUR 104 million (1.6%). The growth of the portfolio of loans to other financial corporations increased as a result of several large loans to funds operating in the real estate sector, the positions of which were earlier presented in accounting next to non-financial corporations.

Compared to the previous year, development of the loan portfolio is still rapid. Over the year, the entire portfolio grew by 7.9 per cent; the value of both household and corporate loans increased at a similar pace – 7.8 per cent each. The housing loan portfolio grew by 7.1 per cent.

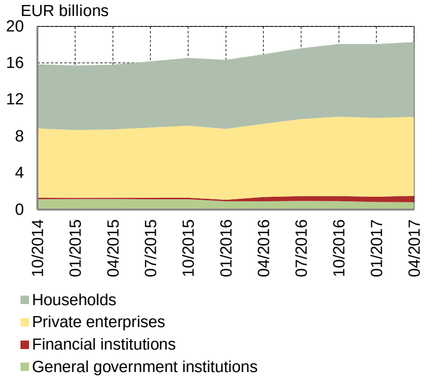
Although the loan market continues to expand, there is currently no significant imbalance. However, the Bank of Lithuania constantly monitors the situation and, if any significant issues were to arise regarding the sustainability of the condition of loan market, apply macroprudential policy instruments to manage the situation.

Loan portfolio quality

The share of the loan portfolio with signs of increased risk slightly dropped. The share of non-performing debt instruments contracted by 0.04 p.p. – to 3.79 per cent, while the balance of such loans was 2.2 per cent less than at the beginning of the year. The volume of written-off bad loans was lower than in previous periods and amounted to 0.3 per cent of the balance of non-performing loans at the beginning of the year. Due to the favourable economic environment, new lending, and with banks dealing with problematic loans, the balance of non-performing loans issued to households and business undertakings over the first quarter of the year decreased respectively by 3.4 and 1.4 per cent, amounting to 4.61 and 6.18 per cent of the total value of this loan portfolio. The balance of household loans past due for more than 90 days decreased by 2.4 per cent and at the end of the quarter amounted to 3.0 per cent of the total value of loans issued to households. The balance of past due loans of business undertakings decreased by 3.9 per cent – to 3.88 per cent in the corporate loan portfolio. The largest share of problem loans was issued prior to the earlier financial crisis; 69 per cent of loans issued to business

Chart 4. Bank loan portfolio net value

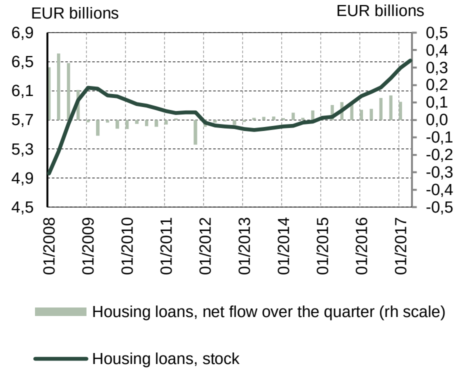
(1 October 2010–1 April 2017)



Source: Bank of Lithuania.

Chart 5. Housing loan net value

(1 January 2008–1 April 2017)

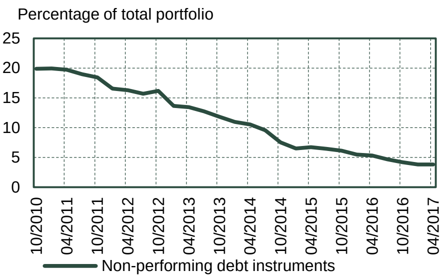


Note: As of 1 October 2014, housing loans also include loans granted to households designated for investment in one's house for one's own needs or rent, including construction and repair; therefore, the data is not fully comparable to the line of previous data.

Source: Bank of Lithuania.

Chart 6. Loan quality

(1 October 2010–1 April 2017)

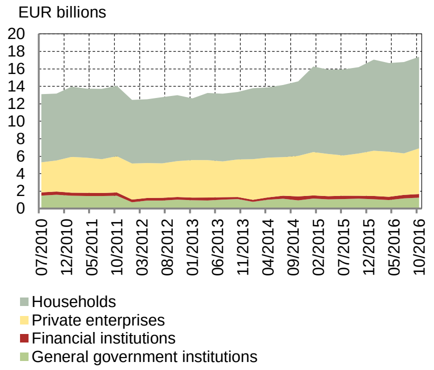


Source: Bank of Lithuania.

[3] Including the leasing portfolio.
[4] The financial statements present loan value, which is calculated by adding up the balances of loans and interest accrued and subtracting provisions formed and charges accrued.
[5] The annual growth of bank and credit union loans to the domestic economy in April 2017 was as follows: for the entire loan portfolio – 6.1 per cent, for loans to households – 8.3, enterprises – 7.7, for housing loans – 7.6 per cent. MFI balance sheet statistical data used herein is adjusted for the elimination of MFIs under bankruptcy from statistics and other technical factors. For more information, see Annex 2 'MFI loan portfolio adjustment for technical factors' of the December 2014 Lithuanian Economic Review (http://www.lb.lt/lithuanian_economic_review_december_2014).

Chart 7. Amount of deposits

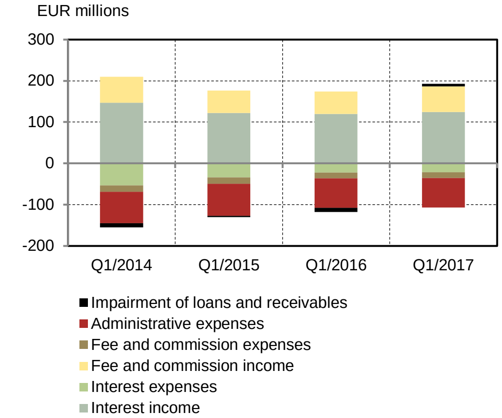
(1 July 2010–1 April 2016)



Source: Bank of Lithuania.

Chart 8. Main items of income and expenses

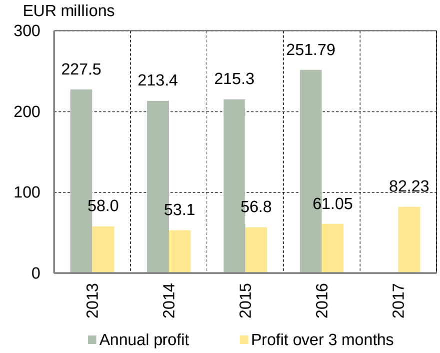
(Q1 2014, 2015, 2016, 2017)



Source: Bank of Lithuania.

Chart 9. Profit of the banking sector

(1 January 2013–1 April 2017)



Source: Bank of Lithuania.

undertakings, which at the end of the first quarter were past due for more than 90 days, were issued in 2008 and earlier, while past due loans out of the loans issued in 2014, 2015 and 2016 amounted to only 2.7, 2.2 and 0.9 per cent respectively.

5. DEPOSITS WITH BANKS

At the beginning of the year the amount of deposits usually decreases. As of 1 April 2017, the customers' holdings of deposits with banks amounted to EUR 18.5 billion – a quarter-on-quarter decrease of EUR 230 million (–1.2 %). At the end of the year, the amount of deposits tends to increase more than usual – this is in part related to employer and corporation settlement by year-end – as the new year starts, the amount decreases. Compared to the same period a year ago, deposits with banks grew quite rapidly, going up by EUR 1.9 billion (11.2 %).

The growth in deposits is a result of both increasing resident income and bank crediting processes. In addition, clients trust banks and hold their funds with them despite particularly low interest rates. However, as large part of customer funds are held in current account – at end of the reporting period households held 69 per cent and corporations – 93 per cent of all funds held in accounts.

6. PROFITABILITY AND EFFICIENCY OF OPERATIONS

The profit of Lithuanian banks in Q1 2017 was positively influenced by many key factors. Over the first three months of 2017, banks and foreign bank branches earned EUR 82.2 million in profits, a year-on-year increase of EUR 21.2 million (34.7 %). 11 banks and foreign bank branches operated at a profit and only 2 market participants incurred a loss. Q1 2017 was particularly successful for the banking sector; the main items of banks' income and expenses improved: both the net interest income (EUR 6.3 million, or 6.5 %) and net income from services and commissions (EUR 6.9 million, or 17.1 %) of the banking system posted growth. Net income from services and commissions and net interest income contributed the most to growth in profit. More profit was earned from the trade portfolio. Profit was positively impacted by the fact that over the first quarter banks were able to slightly decrease administrative expenses.

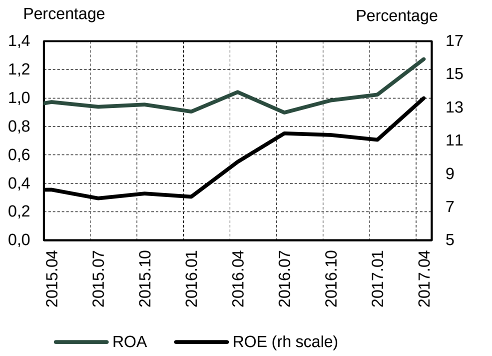
Net interest income is increased by lending and supports the low price of financing. Net interest income of banks increased by EUR 5.2 million (4.3 %) in Q1 2017, to EUR 124.7 million. Interest expenses also declined, contracting by EUR 1.1 million (–5.0 %) over the reporting period, to EUR 21.2 million. Net interest income increased by 6.3 million (6.5 %), to EUR 103.5 million. Trends from previous periods were still monitored. Interest income grew as a result of the growth in the loan portfolio, while the price of borrowed funds is no longer rising due to the still-present low interest rate environment. In the future, if lending intensity will be similar, the profit of banks in this field will be a result of changes in interest expenditure, i.e. how much and whether compared to loan prices, deposits will grow more expensive, how much the rate for contributions to the Deposit Insurance Fund will change. Currently, a new, lower deposit insurance rate is being considered.

Income from services and commissions increased by EUR 7.6 million (14.0%) and amounted to EUR 61.9 million. Respective expenditure increased by EUR 0.7 million (4.8%), to EUR 14.2 million. Net income from fees and commissions rose by EUR 6.9 million (17.1%), to EUR 47.6 millon. It is likely that the growing volume of services and some changes in services pricing will have an impact on such changes. A more detailed assessment of the impact of these changes will be possible with data from several quarters.

Banks' profitability is good and cost-to-income – improving. In Q1 2017, bank return on assets was 1.3 per cent, return on equity – 13.6 per cent.[6] Over the year, the indicator changed by 0.2 p.p. and 3.8 p.p. respectively. Return on bank assets over the year changed little, while changes in return on equity were mostly impacted by the decrease in bank property[7]; however, both indicators increased due to bank profit being greater than in the previous year. The bank cost-to-income indicator in the period under review amounted to 46.3 per cent and over the year dropped by 1.7 p.p. We can observe a long-term trend indicating an increase in bank operational efficiency. This is related to not only increasing bank profit, but also bank-initiated optimisation of operations and organisational structure.

Chart 8. Bank profitability ratios and net interest margin

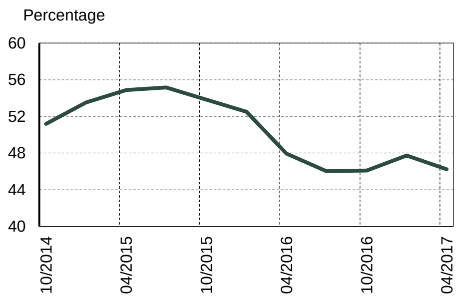
(1 January 2012–1 April 2017)



Source: Bank of Lithuania.

Chart 9. Bank cost-to-income ratio

(1 January 2012–1 April 2017)



Source: Bank of Lithuania.

7. REGULATORY ENVIRONMENT

Protection of consumer rights

There were less consumer disputes with banks quarter on quarter. Over Q1 2017, the Bank of Lithuania received 47 appeals form consumers regarding disputes with banks and their branches operating in Lithuania. Over the reporting period, a total of 29 disputes were investigated, of which 11 were settled: in 2 cases, consumer claims were satisfied in part, in 9 cases – rejected. Compared to Q1 2016, in 2017 the number of disputes decreased: in Q1 2016, 52 appeals were received, albeit the number of decisions made regarding the subject matter of the disputes and disputes settled increased. In Q1 2016, the Bank of Lithuania settled a total of 17 disputes and took 6 decisions regarding the subject matter of a dispute. This year, most appeals were regarding issues related to payment services. Disputes often arose between consumers and banks regarding the setting and application of payment fees, proper disclosure of the terms and conditions of agreements, payment operations performed using payment cards. Part of the claims received was made up of claims related to crediting services provided by banks: housing credit and consumer loans. As in previous periods, users mostly demanded changes in agreement terms and conditions (interest rates, change joint and several liability to partial, etc.), raised other issues on fulfilling of the agreement.

[6] From Q1 2017 the asset, property and efficiency indicators used by the Bank of Lithuania, seeking comparability at the EU level, are calculated according to the methods of the European Banking Authority; therefore, it cannot be directly compared to indicators previously used for analysis.
[7] In early 2016, *„Swedbank", AB*'s paid out dividends amounted to almost EUR 500 million, while in calculating return on equity the property moving average for four quarters is used.

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Annex. Key indicators of the banking sector

Table 4. Main items of the balance sheet statement

Seq No	Indicator	01/04/2016	01/01/2017	01/04/2017	Change In Q1	Change over the year
		amount, EUR millions			%	
1.	**Assets**	**23,476.0**	**25,754.0**	**25,855.6**	**0.4**	**10.1**
1.1.	Debt securities	1,550.4	1,607.4	1,509.9	–6.1	–2.6
1.2.	Equity securities	76.4	54.6	55.4	1.3	–27.5
1.3.	Financial derivatives	124.7	164.6	132.7	–19.4	6.4
1.4.	Cash	396.5	421.5	439.9	4.4	11.0
1.5.	Funds with central banks	1,572.5	2,393.2	2,236.2	–6.6	42.2
1.6.	Funds with credit institutions	2,373.7	2,686.7	2,857.0	6.3	20.4
1.7.	Loans to customers (incl. leasing)*	16,509.3	18,072.5	18,291.3	1.2	10.8
	Loans to customers (incl. leasing) (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	16,955.7	_	_	_	7.9
1.7.1.	to general government institutions (incl. leasing)	896.8	828.5	800.6	–3.4	–10.7
1.7.2.	to other financial corporations (incl. leasing)	475.3	571.1	696.9	22.0	46.6
1.7.3.	to non-financial corporations (incl. leasing)	7,990.0	8,611.8	8,610.6	0.0	7.8
1.7.4.	to households (incl. leasing)*	7,147.2	8,061.1	8,183.2	1.5	14.5
	to households (incl. leasing) (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	7,593.6	_	_	_	7.8
1.7.4.1.	o/w loans for house purchase	5,648.9	6,414.7	6,518.3	1.6	15.4
	o/w loans for house purchase (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	6,086.4	_	_	_	7.1
1.8.	Other asset positions	872.6	353.4	333.2	–5.7	–61.8
	Other asset positions (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	426.2	_	_	_	–21.8
2.	**Liabilities and equity**	**23,476.0**	**25,754.0**	**25,855.6**	**0.4**	**10.1**
2.1.	Deposits of central banks	346.4	303.0	303.0	0.0	–12.5
2.2.	Liabilities to credit institutions	3,510.6	3,918.0	4,318.2	10.2	23.0
2.3.	Financial derivatives	115.0	145.4	122.3	–15.9	6.4
2.4.	Deposits**	16,517.1	18,766.7	18,536.7	–1.2	12.2
	Deposits (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	16,662.9	_	_	_	11.2
2.4.1.	of general government institutions	988.2	1,378.2	1,508.7	9.5	52.7
2.4.2.	of other financial corporations	367.1	483.4	463.4	–4.1	26.2
2.4.3.	of non-financial corporations	5,164.8	5,742.4	5,623.5	–2.1	8.9
2.4.4.	of households**	9,996.9	11,162.6	10,941.0	–2.0	9.4
	of households (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	10,142.7	_	_	_	7.9
2.5.	Debt securities issued	38.5	12.3	5.9	–52.2	–84.8
2.6.	Other positions of liabilities	890.9	386.7	428.4	10.8	–51.9
	Other positions of liabilities (adjusted for the loan portfolio share to be sold by *Danske Bank A/S)*	745.1	_	_	_	–42.5
2.7.	Equity	**2,057.6**	**2,222.0**	**2,141.1**	**–3.6**	**4.1**

Source: Bank of Lithuania.

** Statistics on loans are presented as they are represented in the financial statements of banks, i.e. the share of loans that the* Danske Bank A/S *Lithuania branch intended to sell in the reference period is assigned to assets to be sold. In this case the sum is assigned to '1.8. Other asset positions'.*

*** Statistics on deposits are presented as they are represented in the financial statements of banks, i.e. the share of deposits that the* Danske Bank A/S *Lithuania branch intended to sell in the reference period is assigned to liabilities to be sold. In this case the sum is assigned to '2.6. Other asset positions'.*

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

Seq No	Indicator	01/04/2016	01/01/2017	01/04/2017	Change in Q1	Change over the year
		amount, EUR millions			%	
3.	**Profit for current year**	**61.0**	**251.8**	**82.2**	_	**34.7**
3.1.	Net interest income	97.2	402.0	103.5	_	6.5
3.2.	Net income from fees and commissions	40.7	180.0	47.6	_	17.1
3.3.	Administrative expenses	72.0	298.9	71.3	_	–1.0
3.4.	Impairment costs of loans and receivables	11.4	25.0	–7.3	_	–163.8

Source: Bank of Lithuania.

Table 6. Other performance indicators of banks

Seq No	Indicator	01/04/2016	01/01/2017	01/04/2017	Change in Q1	Change over the year
		%			p.p.	
4.	Capital adequacy ratio	20.2	19.4	20.0	0.7	–0.2
5.	CET1 capital adequacy ratio	19.8	19.1	19.7	0.7	0.0
6.	Liquidity coverage ratio	_	266.2	264.1	–2.0	_
7.	Leverage ratio	8.9	8.2	8.6	0.4	–0.4
8.	Net interest margin	1.70	1.68	1.60	–0.1	–0.1
9.	Return on assets***	1.04	1.02	1.27	0.3	0.2
10.	Return on equity***	9.72	11.06	13.56	2.5	3.8
11.	Cost-to-income ratio***	48.0	47.7	46.3	–1.5	–1.7
12.	Non-performing debt instruments****	5.0	3.8	3.8	0.0	–1.3

Source: Bank of Lithuania.

*** From Q1 2017 the asset, property and efficiency indicators used by the Bank of Lithuania, are calculated according to the methods of the European Banking Authority; therefore, it cannot be directly compared to indicators previously used for analysis.

******Indicators have been calculated based on actual financial statements presented by banks, i.e. they are not adjusted for the transaction of the* Danske Bank A/S *Lithuania branch. As of 1 April 2016, the share of non-performing loans with adjusted data stood at 5.3 per cent, a respective change of –1.5 p.p. over the year.*

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