LIETUVOS BANKAS
EUROSISTEMA

Banking activity review 2014

ISSM 2335-8327 (ONLINE)

Gedimino pr. 6, LT-01103 Vilnius
Ph. (+370 5) 268 0029, Fax (+370 5) 262 8124
www.lb.lt
info@lb.lt

12 March 2015

Bank sector review

Key performance indicators

7 banks and 8 foreign bank branches operated in Lithuania at the end of 2014. As of 1 January 2015, the assets of the banking sector amounted to EUR 24.1 billion (LTL 83.3 billion), an increase of 7.4 per cent year on year. This growth was driven by the significant amount of deposits, which flooded into banks with the approaching adoption of the euro, most of which was directed by banks into their accounts with the Bank of Lithuania. The amount of customer deposits held with banks as of 1 January 2015 stood at EUR 16.3 billion (LTL 56.2 billion), with a significant increase (11.7%) recorded in the last quarter of 2014. The change in the portfolio of loans granted by banks continued to be moderate, decreasing by a mere 0.2 per cent — to EUR 14.7 billion (LTL 50.9 billion) over a year. The operations of banks in Lithuania were profitable, the sector's total profit amounted to EUR 213.5 million (LTL 737.1 million) and was by 6.2 per cent lower than in 2013.

Key performance indicators of banks
(EUR)

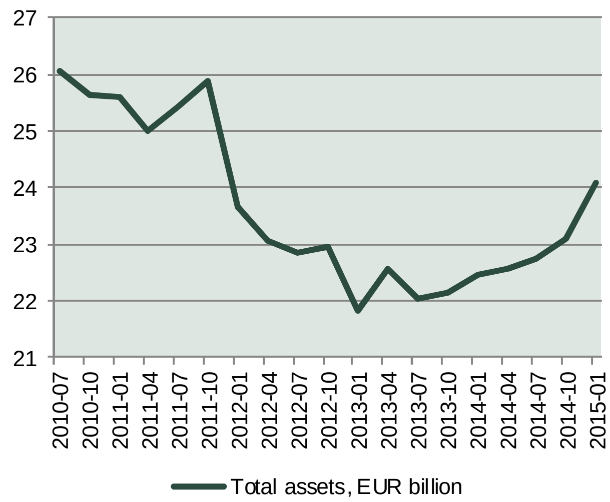
Indicator	01/01/2014	01/10/2014	01/01/2015	Change in Q4	Change over year
	Amount, EUR millions			%	
Assets	22 468,2	23 108,4	24 129,8	4,4	7,4
Debt securities	2 281,5	2 159,8	2 077,1	-3,8	-9,0
Leasing	1 010,7	974,3	993,2	1,9	-1,7
Loans granted to customers	14 775,2	14 885,2	14 742,1	-1,0	-0,2
Private enterpirses*	6 827,8	6 703,5	6 524,6	-2,7	_
Financial institutions*	139,3	158,2	129,9	-17,9	_
Natural persons*	6 603,9	6 897,9	6 947,9	0,7	_
Housing loans*	5 611,5	5 675,7	5 731,4	1,0	_
Loan impairment	640,7	576,9	522,0	-9,6	-18,5
Loan impairment to granted loans ratio, %	4,2	3,7	3,4	–	–
Depostis	13 787,2	14 568,9	16 279,5	11,7	18,1
Private enterpirses*	4 651,9	4 637,5	4 962,3	7,0	_
Financial institutions*	232,7	456,3	363,8	-20,3	_
Natural persons*	8 120,5	8 528,3	9 796,0	14,9	_
Shareholders' equity	2 325,5	2 458,7	2 496,3	1,5	7,3
Profit (loss) of the current year	227,6	179,2	213,5	19,1	-6,2
Net interest margin, %	1,5	1,6	1,6	_	_

*As of 1 October 2014, the principles of classification of customer group categories were subjected to changes, thus the loan and deposit data by customer group are not directly comparable to the data of previous periods.
Source: The Bank of Lithuania.

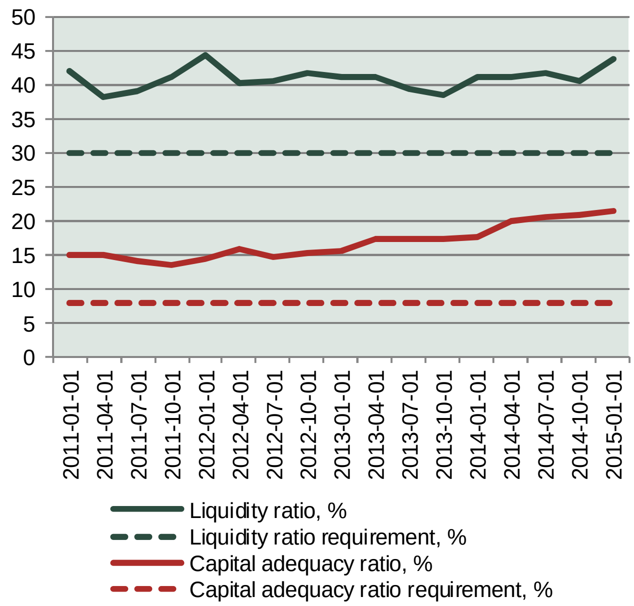
Regulatory requirements

In 2014 all banks complied with the established capital adequacy and liquidity ratio requirements. As of 1 January 2015, the overall capital adequacy ratio of banks was 21.3 per cent (well above the established ratio of 8%); while the overall liquidity ratio was 43.6 per cent (the ratio is 30%). Following the annual supervisory review and assessment process of banks operating in Lithuania, the application of tighter capital adequacy ratio requirements were extended for two banks. Due to the sensitivity to taking additional losses, the application of an individual capital adequacy ratio of 10 per cent was extended for *UAB Medicinos bankas*, which, after the last inspection conducted by the Bank of Lithuania, was instructed to reduce the risk related to real estate. The application of an individual capital adequacy ratio of 11 per cent was extended for *AB bankas FINASTA* due to persisting uncertainty about the Bank's selling process, changes in its management and business model. These two banks complied with the capital adequacy requirements set for them in 2014.

Assets of the banking sector



Compliance with bank ratios



Source: The Bank of Lithuania.

The regulatory and economic environment

Some requirements for banks in Lithuania are changing from 2015. The national liquidity ratio is being replaced with the liquidity coverage ratio (LCR). This ratio reflects the coverage of banks' short-term liabilities with liquid assets; its minimum established value is 100 per cent. After approving amendments to the Law of the Republic of Lithuania on Banks, which are to implement the Capital Requirements Directive IV (CRD IV) of the European Union (EU), the plan is that, alongside the minimum capital adequacy ratio of 8 per cent, an additional capital conservation buffer of 2.5 per cent will be applied as of July of this year, because of which the minimum required capital adequacy ratio of banks will increase to 10.5 per cent. In addition, the Bank Recovery and Resolution Directive (BRRD) is coming into force in 2015. It provides for the uniform procedure for bank recovery and resolution. Although the time limits for their implementation have already expired, both the CRD IV and the BRRD have not yet been transposed into national law. The package of laws implementing the CRD IV is to be adopted by the Seimas during the spring session of 2015.

When Lithuania joined the euro area, the supervision of the three largest banks operating in Lithuania (*AB SEB bankas, Swedbank, AB, and AB DNB bankas*) was taken over by the European Central Bank (ECB), which carries it out in cooperation with the Bank of Lithuania. Lithuania's major banks became part of the Single Supervisory Mechanism (SSM). The supervision of smaller banks in Lithuania will further be the responsibility of the Bank of Lithuania, while the participation of the ECB in the supervision of these banks will be indirect and proportionate to the size of the institution and the levels of risk exposure.

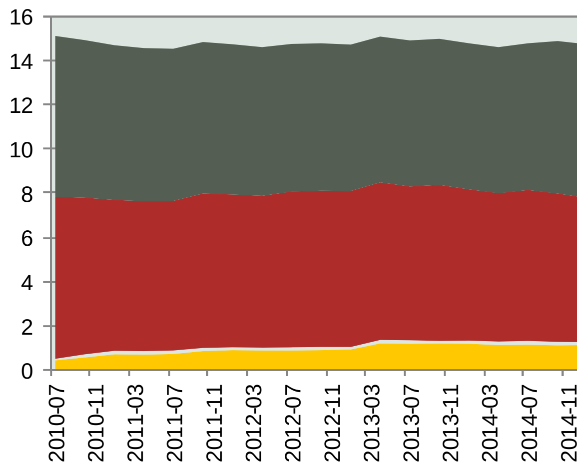
Political and economic issues in Russia in 2014 started raising concerns to Lithuania's economic entities, urging accordingly for higher prudence in the assessment of the related risk for the banking sector. In the assessment of the Bank of Lithuania, the influence of the Russian crisis is limited and will not significantly affect the loan portfolios of banks. The asset positions of the banking sector, which are sensitive to Russia's imposed restrictions, represent a minor portion of banks' assets, while banks ended the year 2014 without incurring material losses associated with these positions.

The loan portfolio

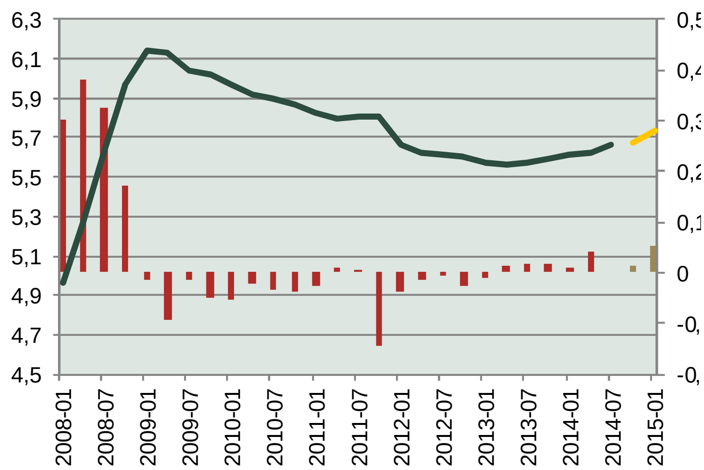
Developments of the loan portfolio

As of 1 January 2015, the loan portfolio of banks (on a net basis) amounted to EUR 14.7 billion (LTL 50.9 billion). Despite the environment of low interest rates, the total loan portfolio further did not show any marked trends of recovery, posting a decline of 0.2 per cent, or EUR 33.1 million (LTL 114.0) over the year. More active household crediting was observed, while lending to enterprises was more sluggish. The housing loan portfolio boosted by[1] EUR 119.9 million (LTL 414.0 million), or 2.1 per cent over 2014. The intensity of the crediting of this segment is closely related both to residents' financial status and expectations and the real estate financing environment. In 2014, all these factors were favourable for household crediting to expand: wages and salaries rose, interest rates were low, while part of market participants had certain expectations that after the adoption of the euro real estate prices were likely to increase. While the loan portfolio of private enterprises shrank by EUR 303.1 million (LTL 1,046.7 million), or 4.4 per cent in 2014, it should be noted that this differential was due mainly to technical reasons, i.e. changes in the rules of consolidation of financial accounts to be presented by banks and in the loan classification methodology (part of the loans that previously were assigned to loans was transferred to the portfolio of natural persons). Should this influence were eliminated, the business loan portfolio would have remained almost unchanged.

The loan portfolio of banks
(EUR billion)



Loans for house purchases
(EUR billion)



As from 1 October 2014, loans for house purchases 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 are not fully comparable to the line of previous data.
Source: The Bank of Lithuania.

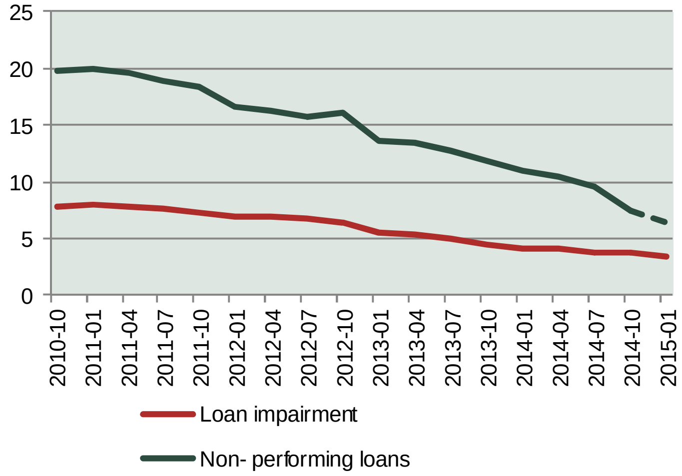
Quality of the loan portfolio of banks

Improvement of Lithuania's economic situation entails accordingly the improvement of the position of bank borrowers, which leads to the improvement of the loan portfolio quality. In addition, the loan recovery

[1] From 1 October 2014, loans for house purchases 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 are not fully comparable to the line of previous data.

procedures initiated during the crisis and currently being gradually completed contribute to that. As of 1 January 2015, the share of non-performing loans in the Lithuanian banking system accounted for 6.5 per cent of the loan portfolio (a year ago — 11.0%[2]). Due to similar reasons, the share of the formed specific provisions for loans decreased as well — from 4.2 per cent to 3.4 per cent over the year.

Indicators of the banks' loan portfolio quality
(compared to the loan portfolio, %)



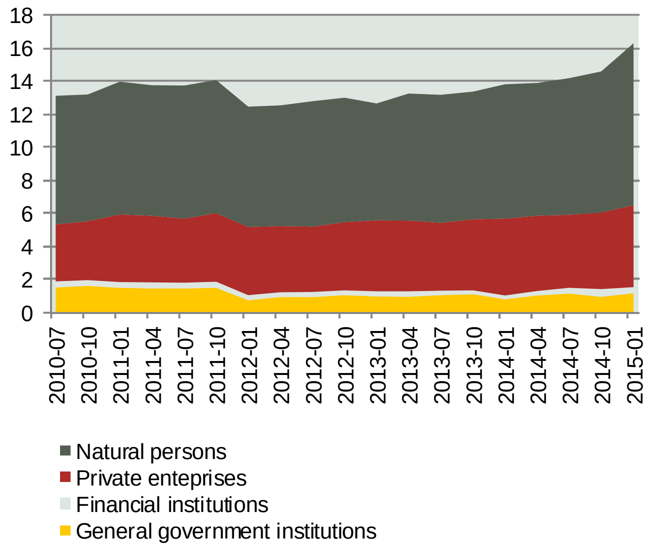
Source: The Bank of Lithuania.

Deposits with banks

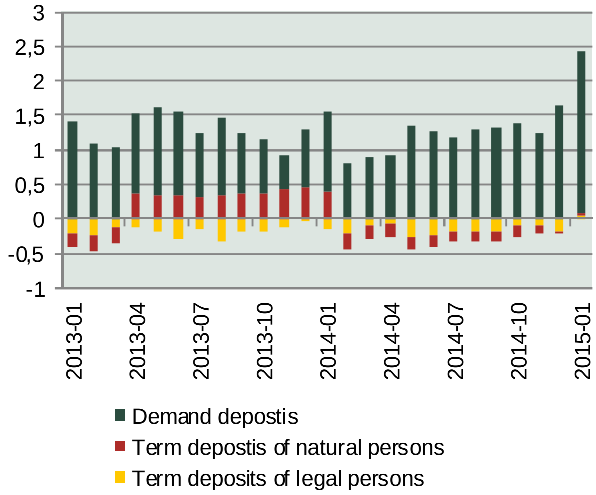
The amount of deposits with banks reached new heights again. As of 1 January 2015, customers held EUR 16.3 billion (LTL 56.2 billion) as deposits with banks. The amount of deposits boosted by EUR 2.5 billion (LTL 8.6 billion), or 18.1 per cent over the year. The enduring trend of deposit growth towards the end of 2014 was strengthened by the approaching adoption of the euro. The deposits of natural persons posted the largest increases: their amount boosted by EUR 1.3 billion (LTL 4.4 billion) over the fourth quarter of 2014 alone — such increase was significantly ahead of the quarterly change in the amount of deposits of natural persons observed to date. This activity of natural persons can be explained by the adoption of the euro: residents, seeking smooth exchange of funds, carried in advance their holdings of cash to banks. Most of these new funds taken to banks were held as demand deposits; however, the demand for term deposits by natural persons with a maturity of 6 to 12 months increased slightly as well. As shown by the example of Latvia, which introduced the euro in 2014, after 1 January 2015 the total amount of deposits may start declining again; however, at least part of these inflows are likely to stay in Lithuania's banking system, thereby supporting the general trend of deposit growth.

[2] As of 2015 a new definition of non-performing loans is being applied in the European Union, thus the loan quality indicators of banks operating in Lithuania as of 1 October 2014 are already published according to new requirements and their values are not fully comparable to the previous ones.

The amount of deposits
(EUR billion)



Change in the amount of deposits over the year
(EUR billion)



Source: The Bank of Lithuania.

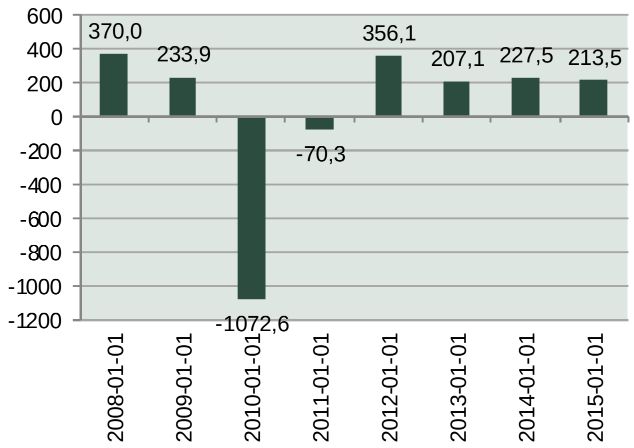
Due to the low investment return of deposits fewer market entities tend choosing term deposits as a form of saving, preferring liquidity, i.e. the bulk of their funds is held as demand deposits. As of 1 January 2015, natural and legal persons held EUR 5.1 billion (LTL 17.6 billion), or 31 per cent of the total deposit amount as term deposits.

Profitability and efficiency

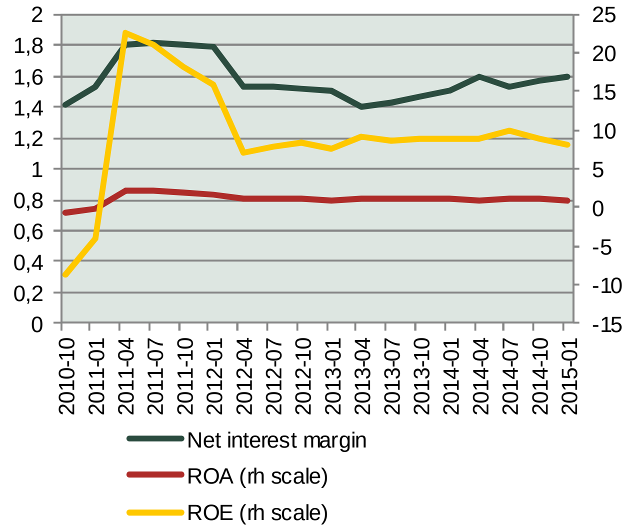
Lithuanian banking sector was profitable in 2014: 6 in 7 banks and 5 in 8 bank branches earned profits, of which 3 banks and 4 foreign bank branches improved their annual performance. The profits earned by banks and foreign bank branches totaled EUR 213.5 million (LTL 737.1 million) in 2014 — EUR 14.1 million (LTL 48.6 million), or 6.2 per cent less than a year ago. While both the net interest income and the net fee and commission income recorded growth, a significant influence on profit decline stemmed from an increase of EUR 44.5 million (LTL 153.6 million) in bank expenses related to loan impairment and administrative costs.

The changes in banks' performance indicators were marginal. As of 1 January 2015, the net interest margin of banks was 1.59 per cent (1.51% a year ago). Profits lower than a year ago and a marked increase in banks' assets led to a decline in the return on assets (ROA) from 1.02 per cent to 0.92 per cent, the return on equity (ROE) — from 8.94 per cent to 8.05 per cent.

Profit of the banking sector
(EUR millions)



Profitability indicators of banks
(%)



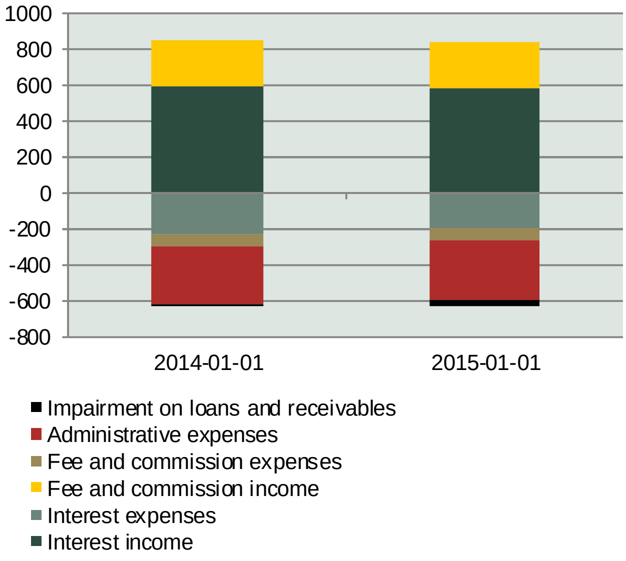
Source: The Bank of Lithuania.

Banks' net interest income boosted by EUR 26.3 million (LTL 90.8 million), or 7.5 per cent in 2014. Sluggish credit policy led to a decline of 0.9 per cent in banks' total interest income over the period under review, thus the growth in net income was due to a decline in interest expenses of even 13 per cent (these interest expenses were affected by the decision of some banks not to pay interest on deposits with a shorter maturity anymore and the choice of depositors to hold less funds as time deposits). In addition, interest income was also reduced by the lowering liabilities to parent banks and, expectantly, cheaper refinancing of already issued loans.

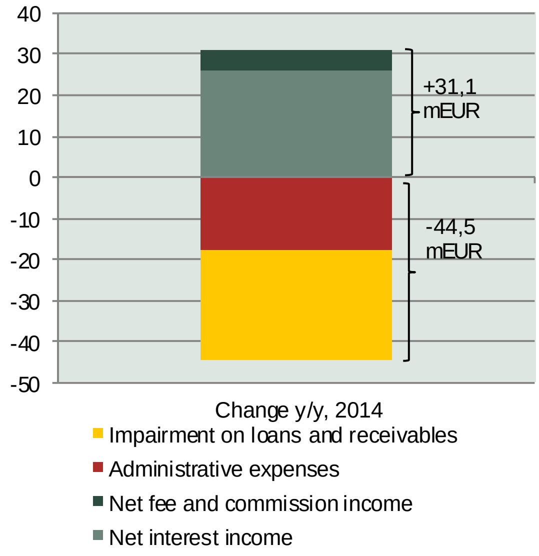
In 2014, net fee and commission income boosted by EUR 4.8 million (LTL 16.6 million), or 2.6 per cent. Fee and commission income was stable (shrank by 0.9%); however, the net result was positively affected by a 10 per cent decline in the expenses of fees and commissions. As a matter of fact, this change occurred due to technical reasons — in 2014, one bank gave up the 2013 practices, when part of the registered office's expenses was assigned to the unit based in Lithuania. Should the above-named one-off impact were eliminated, the income from services and commissions of banks operating in Lithuania would have contracted by 2.8 per cent.

Banks' administrative expenses boosted by EUR 17.6 million (LTL 60.0 million), or 5.5 per cent in 2014. Banks' expenses increased both for their staff and other administrative needs. In 2014 banks incurred expenses associated with the adoption of the euro, which, expectantly, had a significant impact on also the total amount of expenses (according to the previous preliminary estimate, banks and the Bank of Lithuania projected additional euro adoption-related expenses to amount to about EUR 29.0 million (about LTL 100 million). Moreover, growth in wages and salaries in the country may have contributed to higher staff expenses as well. Banks' loan impairment expenses rose by EUR 27.0 million (LTL 93.2 million) in 2014 — to EUR 33.6 million.

Main items of income and expenses
(EUR millions)



Main contributions to profit change in 2014
(EUR million)



Source: The Bank of Lithuania.

The Bank of Lithuania
Supervision Service
Banking Supervision Division

Contact person
Rūta Medaiskytė
Tel.: (8 5) 2680 588
E-mail address: rmedaiskyte@lb.lt

Annex

Key performance indicators of the banking sector
(LTL)

Indicator	01/01/2014	01/10/2014	01/01/2015	Change in Q4	Change over year
	Amount, LTL millions			**%**	
Assets	77 578,1	79 788,6	83 315,5	4,4	7,4
Debt securities	7 877,7	7 457,3	7 171,9	-3,8	-9,0
Leasing	3 489,9	3 363,9	3 429,3	1,9	-1,7
Loans granted to customers	51 015,9	51 395,7	50 901,6	-1,0	-0,2
Private enterpirses*	23 575,0	23 145,7	22 528,3	-2,7	_
Financial institutions*	481,0	546,4	448,6	-17,9	_
Natural persons*	22 802,0	23 816,9	23 989,7	0,7	_
Housing loans*	19 375,5	19 597,2	19 789,4	1,0	_
Loan impairment	2 212,1	1 992,0	1 802,3	-9,5	-18,5
Loan impairment to granted loans ratio, %	4,2	3,7	3,4	–	–
Depostis	47 604,5	50 303,4	56 209,8	11,7	18,1
Private enterpirses*	16 062,1	16 012,4	17 133,8	7,0	_
Financial institutions*	803,6	1 575,4	1 256,2	-20,3	_
Natural persons*	28 038,4	29 446,4	33 823,8	14,9	_
Shareholders' equity	8 029,6	8 489,5	8 619,2	1,5	7,3
Profit (loss) of the current year	785,7	618,7	737,1	19,1	-6,2
Net interest margin, %	1,5	1,6	1,6	_	_

*As of 1 October 2014, the principles of classification of customer group categories were subjected to changes, thus the loan and deposit data by customer group are not directly comparable to the data of previous periods.

Source: The Bank of Lithuania.