In the beginning of 2003, there were 10 banks operating under a license from the Bank of Lithuania, 4 foreign bank branches and 2 foreign bank representative offices.

In 2003, the Board of the Bank of Lithuania granted a permission for the Latvian bank AB RIETUMU BANKA to establish a representative office in Lithuania and a permission to operate a representative office and revoked the permission to operate the Vilnius branch of Norddeutsche Landesbank Girozentrale, which terminated its operation after the acquisition of the Agricultural Bank of Lithuania. In the beginning of 2004, ten banks with a network of 117 branches, three foreign bank branches, and three representative offices of foreign banks operated in Lithuania. Besides, in the previous year the Board of the Bank of Lithuania granted licenses to operate four new credit unions, thus, in the beginning of 2004, the number of operating credit unions grew to 57 credit unions (excluding the Central Credit Union). In 2003, the Board of the Bank of Lithuania registered changes in the Articles of Association of 4 banks related to the increase of the share capital.

Over the year, the market share of the three largest banks contracted from 74 per cent to 71.2 per cent, and the remaining market share was divided among the smaller banks and foreign bank branches. In the previous year, the largest market share losses of banks fell to AB Hansabankas (the market share contracted by 1.6 percentage points) and AB Vilniaus bankas (by 1.1 percentage points). Among banks that increased their market share, UAB Sampo bankas and the Vilnius branch of the German bank VEREINS–UND WESTBANK AG can be distinguished, which increased their market share over the year by 1.4 percentage points and 1.3 percentage points, respectively.

The development of selected items of the balance sheet in the banking system is presented below.

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

No.	Item	01-01-2003	01-10-2003	01-01-2004	Change over Q4 (%)	Change year-on-year (%)
1	Assets	17 221.2	19 816.9	22 010.2	11.1	27.8
2	Loans granted	7 933.2	10 201.7	12 088.8	18.5	52.4
3	Specific loan provisions	86.1	72.8	67.5	–7.3	–21.6
	Specific loan provisions/loans granted, %	1.08	0.71	0.56	–	–
4	Deposits and letters of credit	11 677.4	12 874.3	13 573.9	5.4	16.2
	of private companies	3 753.9	4 124.2	4 505.6	9.2	20.0
	of natural persons	6 877.6	7 295.9	7 887.4	8.1	14.7
5	Shareholders' equity	1 730.5	1 931.6	2 089.0	8.1	20.7
6	Profit (loss) for current year	146.8	182.6	235.5	–	–

According to the unaudited data after closing balances for 1 January 2004 presented by banks, operating domestic commercial banks were characterised by the following:|

- assets totalled LTL 22 billion, increasing over the year by LTL 4.8 billion (27.8 %). A more rapid growth of the assets of the banking system was slowed down by the fall of the US dollar exchange rate over the year by 16.6 per cent;
- total loans granted to customers amounted to LTL 12.1 billion, increasing in comparison to 1 January last year by LTL 4.16 billion (52.4 %);
- deposits totalled LTL 13.6 billion, increasing over the year by LTL 1.9 billion (16.2 %).

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

In 2003 all domestic commercial banks and foreign bank branches were in compliance with prudential requirements set by the Bank of Lithuania. On 1 January 2004, the capital adequacy ratio in the banking system was 13.16 per cent and exceeded the minimum 10 per cent capital adequacy requirement set by the Bank of Lithuania; the liquidity ratio was 42.5 per cent and was also higher than the minimum required 30 per cent.

LOANS

In 2003, the growing economy, the processes of privatisation and absorbing the structural funds of the European Union, reduced interest rates, growing expectations of economic entities related to the future membership in the European Union and other factors increased the demand for credit resources and banks, in their own turn, reacted to this by pursuing an active credit policy based on customer needs.

Over the year, the asset composition of banks reflected a trend of the credit portfolio increase by banks: the share of loans granted to customers in bank assets went up by 8.85 per cent.

As mentioned, loans granted to bank customers grew over the year by LTL 4.16 billion or 52.4 per cent, which was the highest rate of growth of the bank loan portfolio over several recent years. The comparative weight of long–term loans in the bank loan portfolio made up 77.6 per cent on 1 January 2004.

Loans to natural persons and legal entities of Lithuania prevailed in the bank loan portfolio. As the loans granted to non–residents went down by LTL 52 million or 18 per cent in 2003, the share of non–residents in the bank loan portfolio decreased to 1.9 per cent on 1 January 2004.

By individual customer groups, the highest increase in loans was with private undertakings (LTL 2.7 billion) and individuals (LTL 1.2 billion) in 2003. Loans granted to natural persons, with housing loans prevailing, were an item of banking assets characterised by a most dynamic growth last year. In 2003, long–term loans granted by banks to individuals grew by LTL 1147 million or 2.3 times more than in 2002 and 7.4 times more than in 2001. Housing loans granted to individuals accounted for the largest part of these loans (around 82.4 per cent). Most of the housing loans were granted by AB Bankas Hansabankas, AB Vilniaus bankas together with its subsidiary AB VB Mortgage Bank, AB Bankas NORD/LB Lietuva and UAB Sampo bankas. The share of the housing loan market held by other banks was only 6.6 per cent.

In 2003, the loan portfolio quality continued to improve. The ratio of specific loan provisions to the loan portfolio declined over the year almost twice and reached the lowest level since 1994 when banks started making specific provisions.

Development of the loan portfolio quality indicators in the system of operating banks

Date	Loan provisions/loans granted, %	Loans of Group III, IV, V /total loans, %
01-01-1997	20.68	32.1
01-01-1998	18.52	28.25
01-01-1999	5.92	12.46
01-01-2000	4.47	11.92
01-01-2001	3.73	10.79
01-01-2002	2.55	7.45
01-01-2003	1.08	5.82
01-01-2004	0.56	2.64

DEPOSITS

The share of individual deposits in the composition of liabilities of the banking system went down the most (by 5 percentage points). Such development was decided by a higher need to credit bank customers, to finance which the increase in deposits was insufficient, and therefore domestic banks and foreign bank branches operating in Lithuania attracted the lacking credit resources from foreign banks (mainly, their parent institutions).

As already mentioned, deposits held with domestic banks totalled LTL 13.6 billion on 1 January 2004, increasing over the year by LTL 1.9 billion or 16.2 %, of which deposits of individuals made up LTL 7.9 billion, up by LTL 1 billion or 14.7 % over the year. The volume of deposits of individuals was also pushed down by the decline of the US dollar exchange rate. Deposits in national currency made up LTL 9.6 billion, increasing over the year by 26.8 per cent, while deposits in foreign currency totalled LTL 4.0 billion, up by 3.0 per cent over the year.

SHAREHOLDERS' EQUITY

In 2003, shareholders' equity grew by LTL 355 million or 20.5 per cent and on 1 January 2004 amounted to LTL 2.1 billion, of which, the registered share capital of banks went up by LTL 122.3 million (11 per cent) to LTL 1.2 billion.

In 2003 four banks out of ten increased their share capital: AB Bankas Hansabankas by LTL 65 million to LTL 435.3 million, AB Sampo bankas by LTL 31 million to LTL 88 million, AB Ukio bankas by LTL 16 million to LTL 106.7 million and AB Šiaulių bankas by LTL 10.3 million to LTL 48.3 million.

Moreover, individual banks strengthened their capital base by subordinated loans over the year; AB Bankas NORD/LB Lietuva received LTL 51.8 million and AB Sampo bankas received LTL 20 million. Banks were allowed to include the said loans in Tier 2 capital. Meanwhile, AB Vilniaus bankas returned subordinated loans of LTL 108 million over the year.

The share of capital owned by foreign investors has been stable for several periods. It is related primarily with the completion of the bank privatisation process. The development of the share of foreign investors in banking capital is presented below:
01-01-1996 –16 per cent
01-01-1997 –25 per cent
01-01-1998 –32 per cent
01-01-1999 –39 per cent
01-01-2000 –35 per cent
01-01-2001 –58 per cent
01-01-2002 –81 per cent
01-01-2003 –88 per cent
01-01-2004 –89 per cent

Capital from Scandinavian countries prevails in the banking system of Lithuania.

PROFITABILITY

According to the data of unaudited financial statements for 2003 presented by banks, the operations of ten banks and one foreign bank branch were profitable, they earned a profit of LTL 237.3 million, while two foreign bank branches (AB Kredyt Bank S.A. Vilnius Branch and Nordea Bank Finland Plc Lithuania Branch) incurred a loss of LTL 1.7 million over the same period. The total unaudited result of the domestic banking system in 2003 was a profit of LTL 235.5 million, which was the best achievement of the banking system of Lithuania after the restoration of the country's independence. For a comparison, over 2002 the banking system of Lithuania earned a profit of LTL 146.8 million. Comparative bank profitability indicators are provided below.

Bank results in 2002 and 2003

No.	Bank	Profit for current year (LTL thousand)	
		01-01-2003 (audited)	01-01-2004 (unaudited)
1.	AB Bankas NORD/LB Lietuva	–50,604	16,050
2.	AB Ukio bankas	6,156	4,924
3.	AB Vilniaus bankas	126,506	132,276
4.	AB Šiaulių bankas	3,446	4,420
5.	AB Bank SNORAS	10,545	8,285
6.	UAB Medicinos Bankas	1,219	1,462
7.	AB Parex bankas	2,800	6,008
8.	AB Bankas Hansabankas	50,129	60,939
9.	VB Mortgage Bank AB	112	916
10.	UAB Sampo bankas	–4,886	769
	TOTAL banks:	**145,423**	**236,049**
11.	Kredyt Bank S.A. Vilnius Branch (Poland)	1,797	–794

No.	Bank	Profit for current year (LTL thousand)	
		01-01-2003 (audited)	01-01-2004 (unaudited)
12.	Norddeutsche Landesbank Girozentrale Vilnius Branch (Germany)	2,270	
13.	Nordea Bank Finland Plc Lithuania Branch	–2,808	–941
14.	VEREINS–UND WESTBANK AG (Germany) Vilnius Branch	110	1,230
	Total foreign bank branches	**1,369**	**–505**
	Total:	**146,792**	**235,544**

In analysing the preliminary results of bank profitability it is evident that a significantly higher profit of 2003, compared to the result of 2002, was largely determined by special provision expenses which were lower by LTL 63 million or 75 per cent and by repaid loans which were written–off totalling LTL 63.5 million. Moreover, compared to 2002, banks earned LTL 38.1 million or 15 per cent more of net income from services and commissions, while the increase of the portfolio of loans granted to customers by LTL 4.16 billion or 52.4 per cent exhibited a relatively minor direct effect due to significantly higher competition and markedly lower interest rate margins: net interest income rose by a mere LTL 8.9 million or 1.8 per cent.

On the other hand, in 2003, compared to 2002, banks earned less income from operations in debt securities, foreign exchange operations and derivatives and other financial instruments.

Programmes of modernisation and restructuring the services provided implemented by some banks in 2003 (by outsourcing some ancillary bank services, e.g. cash collection, security, real estate maintenance, etc. to specialised companies), while enabled cutting expenses on wages and salaries by LTL 14.8 million or 4.4 per cent, so far have not rendered substantial economy of operating expenses. There was a marked increase in the operating expenses on the rent and maintenance of premises (by LTL 21.2 million or 40 per cent), the use of equipment (LTL 13.8 million or 79 per cent) and advertising and marketing (by LTL 7.9 million or 56.4 per cent).

THE CENTRAL CREDIT UNION OF LITHUANIA

The operation of the Central Credit Union of Lithuania (CCUL) started at the end of 2002 was rapidly expanding in 2003. The assets of CCUL increased 5.1 times over the year and amounted to LTL 31.9 million on 1 January 2004..

As at 1 January 2004, the CCUL held deposits in the amount of LTL 24.5 million, most of which were those of credit unions (members of the CCUL), had extended loans to credit unions (members of the CCUL) in the amount of LTL 10.4 million, and had acquired Government securities amounting to LTL 13.6 million.

The share capital of the CCUL consisted of the share of the Government of the Republic of Lithuania (LTL 4.4 million) and the shares of 48 credit unions, members of the CCUL (LTL 0.9 million), totalling LTL 5.3 million.

According to the data of unaudited statements, the CCUL earned a profit of LTL 41 thousand in 2003. The largest share of income earned by the CCUL comprised of interest income amounting to 91 per cent of total income, while the largest share of expenses consisted of operating expenses and interest expenses, comprising 46 per cent and 39 per cent of total expenses, respectively.

In 2003, the LCKU complied with all prudential requirements set by the Bank of Lithuania.

Credit unions. On January 1 2004, 57 credit unions were operating in Lithuania, with the total of 32 thousand members.

Development of the main items of the consolidated balance sheet of credit unions

No.	Balance sheet item	Amount (LTL thousand)			Change over Q4 (%)	Change year-on-year (%)
		01-01-2003	01-10-2003	01-01-2004		
1.	Assets	70,119.6	108,316.3	122,980.2	13.5	75.4
2.	GS	2,636.3	2,008.3	1,903.4	–5.2	–27.8
3.	Loans granted	45,885.9	80,048.2	86,905.6	8.6	89.4
4.	Deposits	56,514.6	80,903.2	95,404.5	17.9	68.8
	Of which, members and associated members of credit unions	50,090.4	78,201.6	93,195.9	19.2	86.1
5.	Share capital	7,550.5	11,982.1	13,428.8	12.1	77.9
6.	Profit (loss) for current year	414.2	607.2	891.0	–	–

The activities of credit unions expanded rapidly last year. Over 2003:
- assets increased by 75.4 per cent and on 1 January 2004 made up 0.56 per cent of total assets in the banking system; The assets of the two largest credit unions ("Ukininkų viltis" and Pakruojis farmers) accounted for 18.4 per cent of total assets of credit unions on 1 January 2004.
- loans granted increased by 89.4 per cent and made up 70.2 per cent of total assets. On January 1 2004, 37 credit unions held specific provisions for loans (LTL 445.1 thousand);
- investment in Government securities went down by 27.8 per cent;
- deposits increased by 68.8 per cent, of which the largest share (97.7 per cent) were deposits of members;
- the share capital of credit unions grew by 77.9 per cent.

Last year, 50 credit unions earned a profit, while 7 credit unions incurred a loss.

According to the statements unchecked by credit union inspectors (independent auditors) and not yet approved by general members' meetings, the profit of LTL 891 thousand earned by credit unions in 2003 was more than twice larger than that of the last year (LTL 414.2 thousand). This can be explained by the influence of the improved quality of the loan portfolio and better efficiency of the operation of the system of credit unions.

Similar to previous years, the main source of income was interest income (89.3 per cent of total income). Interest expenses and operational expenses accounted for the largest share of expenses, 46.5 and 40.1 per cent, respectively.

SUPERVISION OF CREDIT INSTITUTIONS IN 2003

In performing the functions of credit institution supervision, in 2003 the Bank of Lithuania continued to implement the supervision system complying with the international practice, encouraged banks to improve the risk management process constantly, assess the new risks and prepare properly for operation under exceptional circumstances, specified the requirements of accounting and reporting, strengthened international cooperation and continued the process of implementing the European Union legal acts in order to prepare properly for the membership in the European Community from 1 May of the current year.

In its supervisory function, the Bank of Lithuania has focused in 2003 on strengthening risk management processes in banks. To be able to forecast more accurately the likely future development of the banking sector, the Bank of Lithuania analysed and summarised the annual information submitted by banks about the complex stress testing of key risks (credit, market and liquidity risks). The stress testing was aimed at establishing the risks that would have the strongest negative impact on the performance of banks and to what extent unfavourable market conditions could dampen the ability of banks to meet their financial obligations and ensure compliance with the minimum capital adequacy requirements. Besides, the Bank of Lithuania continued the preparation for the national implementation of the new Basle Capital Accord (Basle II). In the beginning of 2003, the Bank of Lithuania prepared the summary of the New Capital Accord, acquainted commercial banks of Lithuania with it and asked to assess the possibilities of implementing this Accord. Later, a meeting with representatives of banks was organised, during which the core principles of the New Capital Accord were discussed, the experience on how strategic foreign partners of banks intended to implement the Accord was shared and further aspects of work coordination were addressed.

The Bank of Lithuania has initiated the implementation of the new concept of the centrally managed Loan Risk Database in order to improve credit risk management and provide opportunities for banks to gradually introduce internal rating systems as recommended in the New Capital Accord. As from February 2004, following the necessary restructuring of the information systems, this database will store a wider range of data than before to cover such instruments as repurchase agreements, leased property, factoring, bill transactions, etc., which are close to loans in their economic nature. Also, more information will be available on each borrower, including some of the borrower's financial performance indicators. A more exhaustive database will provide additional opportunities for quantitative and qualitative credit risk analysis.

In 2003, the Board of the Bank of Lithuania approved the new General Provisions for the Assessment and Classification of Doubtful Assets and Making Specific Provisions. This legal act has provided for a much more flexible and liberal procedure for classifying doubtful assets than was previously the case, providing possibilities to assess the risk on these assets more accurately (the new provisions will be effective as of 1 July 2004).. Each bank began working out and coordinating its rules on the assessment and classification of doubtful assets in observance of the minimum requirements established by the Bank of Lithuania. During the meetings held at the Bank of Lithuania, the shortcomings of these rules were discussed, comments on, and suggestions for, their further improvement were provided.

In 2003, the Bank of Lithuania has been constantly monitoring the emergence of new types of risks in banks and has made efforts to ensure timely regulation of their management. One of such risks is operating risk that is closely related to the increasing use of information technologies (IT) in providing banking services. Last year, in order to encourage banks to devote more attention to the management of operational risk and to take appropriate actions to reduce the losses on potential failures in operation, the Board of the Bank of Lithuania approved the General Provisions of Operational Risk Management. This legal act sets out the procedures of operational risk identification, assessment, monitoring and control and establishes that operational risk shall be included in stress testing by each bank.

2003 saw a further increase in the scope of Internet banking services provided by banks and in the number of their users. In view of the increasing importance of this process, the Bank of Lithuania included a new area of inspection into its inspection programme – information technologies and electronic banking. The examination of this area during inspections focuses on a bank's operations in the light of the management of risks characteristic of IT and electronic banking: the assessment of the organisation of system design, implementation, maintenance and continuity of operation, analysis of IT security risk factors and their impact on confidentiality, integrity and accessibility of information and data, the assessment of the organisational, physical and logical internal control measures and procedures applied in the bank, etc. Moreover, inspections concentrated more heavily on such business factors as the efficiency of internal control, assessment of the results of stress testing and measures to ensure prevention of money laundering.

Considering the growing volume of housing loans, the Bank of Lithuania included another new area into its inspection programme – valuation of real estate pledged for loans and related procedures. Implementing the requirements stipulated in the Republic of Lithuania Law on Mortgage Bonds and Mortgage Lending, at the end of 2003 the Board of the Bank of Lithuania approved the Procedure for the Accounting of Mortgage Loans and Other Additional Assets and the Procedure of the Investment of Temporarily Free Funds. These documents establish, inter alia, the permissible assets for investing temporarily free funds of a credit institution issuing mortgage bonds and providing mortgage loans.

In 2003, the Bank of Lithuania devoted substantial attention to the further improvement of financial accounting and reporting of banks. In order to increase the information content of financial statements and considering the requirements of coordinating the EU directives and the International Accounting Standards, the Board of the Bank of Lithuania approved the adjusted forms of the balance sheet and profit (loss) accounts of banks, annual financial statements published by banks and the minimum requirements for the explanatory letter, the Rules on

Accounting and Reporting of Foreign Currency Operations in Banks as well as the Rules of Consolidation of Financial Statements and Consolidated Supervision. The aim of these legal acts is to enhance the efficiency of consolidated supervision of banks and to have more comprehensive information about the actual scope of operations of the whole bank group, i.e. to include into the consolidated financial statements of the bank group not only the credit and financial institutions under its control but also other undertakings under its control, irrespective of the diversity of their activity (this information shall be submitted annually along with other statements submitted for bank supervision purposes and publicly disclosed in observance of the adjusted requirements for preparing statements to be published). Meanwhile, consolidated supervision requirements will be further applicable within the financial group only, i.e. to the parent bank and to the credit and financial institutions under its control.

In late 2003, in view of continuing cooperation with the international audit companies, a meeting was with representatives of these companies was arranged at the Bank of Lithuania during which the most urgent issues concerning the latest amendments to the International Financial Reporting and Accounting Standards, the methods for the assessment of doubtful assets and the regulation of further cooperation were discussed.

In 2003, the Bank of Lithuania actively participated in discussing the amendments to the legal base regulating the operation of credit institutions (the draft amendments of Republic of Lithuania Law on Banks, Law on the Central Credit Union and Law on Credit Unions), enhanced cooperation relations with the European Central Bank, joined the activities of advisory committees and working groups of other EU institutions, further expanded international cooperation with the financial sector supervisory institutions of foreign countries. During this period, the amendments to the cooperation agreement with the Bank of Russia were further coordinated and the preparation of the draft cooperation agreement with the Swedish Financial Supervisory Authority was completed.