BANK OPERATIONS

According to the audited financial statements for 1 January 2006, total assets of operating domestic commercial banks and foreign bank branches made up LTL 44.8 billion at the end of 2005, increasing over the year by LTL 15.7 billion, i.e. 53.9 per cent.

Total loans granted to customers amounted to LTL 26 billion, increasing in comparison with 1 January 2005 by LTL 9.1 billion, or 53.67 per cent. The amount of deposits held with domestic banks made up LTL 25.1 billion on 1 January 2006 and increased over the year by LTL 7.3 billion or 40.7 per cent, of which, deposits of individuals made up LTL 13.8 billion, up by LTL 3.9 billion or 40.2 per cent. The debt of domestic banks to parent credit institutions increased by LTL 5.1 billion, or 2.2 times in 2005.

Dynamics of some asset and liability items in the banking system

Item No.	Balance sheet item	Amount (LTL million) 01 01 2005	Amount (LTL million) 01 01 2006	Change year-on-year (%)
1	Assets	29,150.8	44,848.7	53.9
2	GS	2,721.3	3,549.3	30.4
3	Other debt securities	588.2	1,540.7	2.6 times
4	Loans to financial institutions	1,760.2	4,226.9	2.4 times
5	Loans to customers	16,897.7	25,957.2	53.6
5.1	Loans to private companies	11,063.9	15,621.4	41.2
5.2	Loans to natural persons	4,448.5	8,539.2	92
5.2.1	Housing loans	3,438.6	6,413.5	86.5
6	Loan impairment (specific provisions)	120.5	269.8	2.2 times
7	Loan impairment (specific provisions)/ granted loans, %	0.71	1	–
8	Deposits and letters of credit	17,859.5	25,133.4	40.7
8.1	Of private companies	6,419.5	9,610.9	49.7
8.2	Of individuals	9,811.9	13,757.5	40.2
9	Shareholders' equity	2,508.1	3,206.2	27.8

A downward trend in the concentration of the assets managed by banks observed for several consecutive years was not very prominent in 2005. Over the year, the asset market share of the three largest banks (AB SEB Vilniaus bankas, AB bankas Hansabankas and AB bankas NORD/LB Lietuva) dropped from 67.6 per cent to 67.1 per cent. AB SEB Vilniaus bankas lost the largest asset market share over the year (2.98 percentage points), while among those banks that increased their market share the most were AB bankas Hansabankas (3.4 per cent), Nordea Bank Finland Plc Lithuania branch (1,76 percentage points) and AB Sampo bankas (1.66 percentage points).

LOAN PORTFOLIO

As mentioned above, total loans to bank customers grew in 2005 by LTL 9.1 billion (53.6%). In addition, bank loans to financial institutions, among which subsidiary leasing companies prevail, went up by LTL 2.5 billion or 2.4 times over the year.

According to the data as of 1 January 2006, the loan portfolio of the Lithuanian banks, including loans to financial institutions, accounted for 42.5 per cent of Lithuania's GDP of 2005. In 2005, the largest share of new loans was similarly distributed between businesses and households. The largest amount of loans was issued to private enterprises (over the year, their share grew by LTL 4.6 billion or 41.2%), and the share of loans to individuals slightly smaller (LTL 4.1 billion or 92%). A quite obvious upward trend was observed in the volumes of borrowing by individuals last year. Housing loans continued prevailing among the loans granted to individuals, however, the growth of other loans (mostly consumer) to individuals was also quite significant last year. Over the year, housing loans granted by banks to individuals grew by LTL 3 billion, or 86.5 per cent, while other loans increased by LTL 1.1 billion, or 2.1 times.

Housing loans granted by banks to individuals gained popularity last year only, and their volume and comparative weights, compared to other countries of the region, remain among the lowest. Taking into consideration the fact that the real estate market has a cyclical nature, banks should pay particular attention to the housing loan portfolio, since active expansion of banks in the area of housing loans might condition higher accumulation of credit risk in banks in the future. The quality of housing loans granted by banks might be negatively affected both by a potential deterioration of the economic situation in the country, by the decline of the real estate prices and by a significant growth of interest rates. Currently, banks have a sufficiently good capital base to offset possible risks, which allows banks to bear additional decrease of the asset value of LTL 701.9 million without violating the capital adequacy ratio.

The Resolution of the Board of the Bank of Lithuania No. 114 of 28 July 2005 "On the Approval of Minimum Loan Evaluation Requirements, which became effective from 1 October 2005, established essentially new criteria for the evaluation of loans, provided more freedom to banks in this area and simultaneously increased their responsibility in the evaluation of loans and the assumed credit risk. In order to ensure that the bank credit risk evaluation does not weaken, last autumn the Bank of Lithuania proposed domestic banks and foreign bank branches to follow conservative principles in the valuation of assets and to assess the level of the risk assumed reasonably, taking into consideration potential unfavourable market changes. Banks were recommended to make sufficient general provisions on the potential risk–related losses.

The volume of asset depreciation of banks (specific provisions) calculated in accordance with 39 IAS requirements increased in 2005. However, the quality of the loan portfolio of banks continued to be sufficiently good. On 1 January 2006, the ratio of the loan impairment (specific provisions) and the loan portfolio made up 1 per cent (0.7% a year ago), while the ratio of loans with regular payments overdue for 60 or more days to the loan portfolio comprised 0.6 per cent.

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

According to the data for 1 January 2006, the liquidity ratio of the banking system stood at 42.92 per cent, 13 percentage points above the Bank of Lithuania's established minimum. On 1 January 2006 the bank capital adequacy ratio comprised 10.31 per cent (the established minimum ratio is 8 per cent.).

According to the data of 1 January 2006, domestic banks (without foreign bank branches) could additionally reduce the loan value without violating the capital adequacy requirement by LTL 701.9 million or 2.5 times (currently the loan impairment makes up LTL 271.3 million) or assume additional asset risk of LTL 8 billion.

All commercial banks and foreign bank branches complied with all prudential requirements set by the Bank of Lithuania.

SHAREHOLDERS' EQUITY

Bank shareholders' equity grew by 27.8 per cent in 2005 and amounted to LTL 3.2 billion on 1 January 2006. The registered authorised (share) capital of banks went up by 17.1 per cent to LTL 1.6 billion. Five domestic banks increase their authorized capital in 2005. AB bankas Hansabankas increased its authorised capital the most. The authorized capital was also increased by AB Sampo bankas, AB bankas NORD/LB Lietuva, AB Ūkio bankas and AB □iaulių bankas. In addition to the authorised capital and the increase in the issue differential, the bank capital base was also strengthened by the subordinated loans received. In 2005, the Board of the Bank of Lithuania allowed three banks to include subordinated loans in Tier 2 capital: AB Sampo bankas (LTL 18 million), AB bankas NORD/LB Lietuva (LTL 8.6 million) and AB Ūkio bankas (LTL 3.8 million).

The share of the authorised capital of the Lithuanian banks held by foreign investors declined by 1.6 percentage points to 85.8 per cent in 2005, and the Scandinavian capital prevailed in the banking system of Lithuania, same as earlier.

PROFITABILITY AND BUSINESS EFFICIENCY

According to the data of audited financial statements presented by banks on 1 January 2006, in 2005 the performance of all domestic commercial banks and foreign bank branches was profitable. The total audited profit of the domestic banks for 2005 was LTL 354 million. When comparing bank performance and profitability or business efficiency indicators in 2005 and in previous years, it should be taken into consideration that from 1 January 2005, after the changes of IFRS, changes were also made in bank accounting and it affected both bank performance results and various indicators.

Profitability indicators of operating banks

No.	Bank	Profit for 2005 (LTL million)
1.	AB bankas NORD/LB Lietuva	43.0
2.	AB Ūkio bankas	19.7
3.	AB SEB Vilniaus bankas	106.8
4.	AB iaulių bankas	8.1
5.	AB bankas Snoras	40.7
6.	UAB Medicinos bankas	2.1
7.	AB PAREX BANKAS	7.2
8.	AB bankas Hansabankas	107.9
9.	AB SEB VB Mortgage bank	4.8
10.	AB Sampo bankas	8.2
	TOTAL banks:	**348.5**
11.	Bayerische Hypo– und Vereinsbank AG Vilnius branch	1.7
12.	Nordea Bank Finland Plc Lithuania branch	3.9
	TOTAL foreign bank branches	**5.5**
	TOTAL:	**354.0**

The growth of bank profits in 2005 was determined by the increased volumes of bank operations and a respectively larger income base. The main areas of activity that had a positive effect on bank profitability:
- income from the significantly expanded loan portfolio, which, as in previous years, had the largest impact on bank performance and determined to a large extent the increase of net interest income of LTL 176 million (28.8%).
- banks earned more income from services and commissions, which increased by LTL 99.8 million or 23.7 per cent, compared to 2004;
- bank performance was improved by an increase of income from foreign exchange operations and operations with derivatives and other financial instruments of LTL 30.8 million (36 per cent) and the decline of amortisation and depreciation costs of LTL 23.3 million (23.3 per cent).

Several factors which exercised a negative impact on bank performance could be pointed out:
- higher operating expenses of banks (by LTL 79.8 million or 14.5 per cent); however, their growth rates were significantly lower than the growth rates of the assets held by banks and accumulated income;
- higher expenses of banks related to the impairment of loans and other assets (expenses on specific provisions); compared to 204, these expenses increased by LTL 71 million;
- the growing volume of deposits in banks resulted in higher expenses on deposit insurance contributions (by LTL 23.2 million), while the amount of taxes paid by banks increased by LTL 16.4 million;
- after the change of the accounting method of investment in subsidiary companies, non–consolidated statements of banks did not reflect the performance of subsidiary companies in 2005 (enterprises controlled by banks earned a profit of LTL 72.9 million in 2005).

The real interest margin of the banking system that had been declining quite rapidly for several consecutive years went down further by 0.25 percentage points in 2005 and reached the lowest level over the recent years (2.58%). Due to a strong competition and narrower interest margins, the return on assets of the banking system declined from 1.2 per cent to 1 per cent, whereas the return on equity remained almost unchanged and made up 13.58 per cent.

The ratio of fixed expenses and the profit from the core operations which serves as the efficiency indicator declined (improved) over the year by almost 6 percentage points to 53.9 per cent on 1 January 2006, representing the proportion of the profit (net income) earned from the core operations to cover operating and amortisation expenses.

SUPERVISION OF CREDIT INSTITUTIONS

In order to ensure stable and reliable operation of credit institutions and compliance with the established requirements, the Bank of Lithuania, as the institution of Lithuania performing credit institutions supervision, consistently conducted the supervision of credit institutions compliant with the international standards: licensed, conducted off–site monitoring and on–site inspections and applied enforcement measures, when necessary. The improvement of the legal framework was continued, special attention was paid to the preparation for the implementation of the new capital adequacy procedure, and a constant dialogue was maintained with the supervisory authorities of those foreign states that have the jurisdiction over parent banks that have subsidiary banks in Lithuania and with the banks operating in the country.

The number of banks operating in the country remained unchanged over the last year: 10 banks, 2 foreign bank branches and 3 foreign bank representative offices. Several banks changed their names: AB Vilniaus bankas to AB SEB Vilniaus bankas, AB VB Mortgage bank to AB SEB VB Mortgage bank, Vereins– und Westbank AG Vilnius branch to Bayerische Hypo– und Vereinsbank AG Vilnius branch. Over the previous year, 47 notifications were received (95 notifications in total) from the supervisory authorities of the European Union Member States about the intentions of banks licensed by these authorities to provide financial services in Lithuania without establishing a branch. The Bank of Lithuania had sent 4 such notifications.