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# Annual Report

ISSN 1648-9020 (online)

The 2017 Annual Report was approved by the Board of the Bank of Lithuania on 18 April 2018. It was prepared on the basis of data from the Bank of Lithuania, Statistics Lithuania, the European Central Bank, the Statistical Office of the European Union, the International Monetary Fund, etc. The cut-off date for the data included in this report was 1 January 2018.

## ABBREVIATIONS

AB	public limited liability company	OECD	Organisation for Economic Cooperation and Development
ABSPP	asset-backed securities purchase programme	P2P	peer-to-peer
APP	asset purchase programme	PSPP	public sector purchase programme
CBPP	covered bond purchase programme	RE	real estate
CSPP	corporate sector purchase programme	SEPA	Single Euro Payments Area
ECB	European Central Bank	SMP	securities market programme
ESRB	European Systemic Risk Board	SSS	securities settlement system
EU	European Union	TLTRO	targeted longer-term refinancing operation
EURIBOR	Euro Interbank Offered Rate	UAB	private limited liability company
GDP	gross domestic product	UK	United Kingdom
HICP	Harmonised Index of Consumer Prices	US	United States of America
ICO	initial coin offering	VAT	value-added tax
IMF	International Monetary Fund		
IPO	initial public offering		
IT	information technology		
KYC	know-your-customer		
LCCU	Lithuanian Central Credit Union		
LTRO	long-term refinancing operation		
MFI	monetary financial institution		
MoU	memorandum of understanding		
MRO	main refinancing operation		
MTPL	motor third party liability		

Totals/percentages in some tables and charts may not add up due to rounding ('Total' and 100%).

# Contents

## **FOREWORD 4**

## **STRATEGIC DIRECTIONS 5**

- To become a centre of excellence in economics and finance 5
- To become a financial sector partner, promoting innovation and sustainable growth 6
- To create a competitive and advanced payments market in Lithuania 7
- To enhance application of financial asset investment strategies 8
- To be one of the top three most efficient central banks in the Nordic-Baltic region 9

## **I. REVIEW OF THE ECONOMY AND FINANCE 10**

## **II. KEY FUNCTIONS OF THE BANK OF LITHUANIA 13**

- Monetary policy of the Eurosystem 13
- Macroprudential policy 16
- Management of financial assets 19
- Payments 21
- Supervision 23
- Settlement of disputes between consumers and financial market participants 28
- Bank resolution 29
- Cash 30
- Handling of statistics 31
- Treasury agent 32

## **III. ORGANISATION OF ACTIVITIES 33**

## **IV. RESEARCH ACTIVITIES 34**

## **V. OTHER IMPORTANT EVENTS DURING THE REPORTING PERIOD 35**

## **ANNUAL FINANCIAL STATEMENTS OF THE BANK OF LITHUANIA 36**

# Foreword



In 2017 we continued strengthening the resilience of the domestic financial system, encouraging competition in the payments market, looking for new forms of supervision and fulfilling our role as a centre of excellence. As part of the Eurosystem, we remained active in shaping the euro area monetary policy and stimulating its economic growth.

*Last year's robust bank lending to households and firms supported economic momentum. Banks operating in Lithuania saw a rise in both assets and profits, while non-performing loans returned to their pre-crisis level, putting the banking sector on a sustainable footing. After a two-year period of loss-bearing results, the credit union sector also recorded gains.*

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For the latter 2017 marked a shift towards significant changes, and ultimately the credit union sector welcomed the new year having undergone a radical transformation. Stricter requirements not only entailed greater security within the sector, but also strengthened cooperative banking activities, which certainly have the potential for enhancing the provision of financial services in various parts of the country.

In early 2017 Lithuania also introduced the possibility to establish a specialised bank. With local and foreign businesses showing avid interest, we expect the domestic market to see an influx of new participants whose arrival will increase the scope of financial services as well as boost competition.

Sharing its expertise and technical resources, the Bank of Lithuania has been actively contributing towards ensuring that Lithuania becomes the FinTech hub in the Nordic region. Trying our hand at innovation, we have been developing a regulatory sandbox and blockchain-based solutions, which will open the window of opportunity for corporates to test their products that might be used by millions of people in the future. FinTech has a lot of promise when it comes to attracting foreign capital and generating value added. Thus we have been striving to not only create a favourable regulatory environment but also showcase Lithuania's potential for the global investor scene.

Bearing in mind that financial innovations also entail a certain degree of risk, we have been taking necessary steps to ensure that our market remains closed for unreliable entrants.

A wind of change has swept through the payment service market as well. From 1 February 2017 banks and credit unions started offering their clients the basic payment account service, which is aimed at increasing accessibility and expansion of financial services, reducing costs and encouraging non-cash payments. Through its payment system CENTROLINK, the Bank of Lithuania has opened up the possibility for the most cutting-edge innovation in the field of payments – instant payments, available 24/7/365, including weekends and holidays. We expect that the general public will be able to start using them already this year.

In carrying out our supervisory mandate, we seek to maintain a constructive and open dialogue with market participants. Last year the Bank of Lithuania began announcing its inspection plans as well as information about future regulatory developments, which was met with strong market support. We have been also carrying out on-site visits – a new form of supervision – during which supervisors collect information, consult financial institutions and offer methodological support. Taking a lenient approach, they impose no sanctions if violations are detected.

In 2017 the Bank of Lithuania put forward proposals regarding the tax and pension system reform, shared its views on income inequality, inflation and other issues of public interest. Research papers by our experts at the Centre for Excellence in Finance and Economic Research were published in various internationally-acclaimed journals.

Finally, to bring financial benefit for the society, the Bank of Lithuania transferred €11.17 million to the state budget from its profit generated in 2017.

**Vitas Vasiliauskas**  
Chairman of the Board of  
the Bank of Lithuania

A handwritten signature in black ink, consisting of a series of loops and a long horizontal stroke at the end.

# 1. To become a centre of excellence in economics and finance



Organised 4 conferences on economics and financial stability



Doubled the number of economic commentaries



Devoted much attention to cybersecurity risks in the financial sector



Took part in international programmes and shared best practices

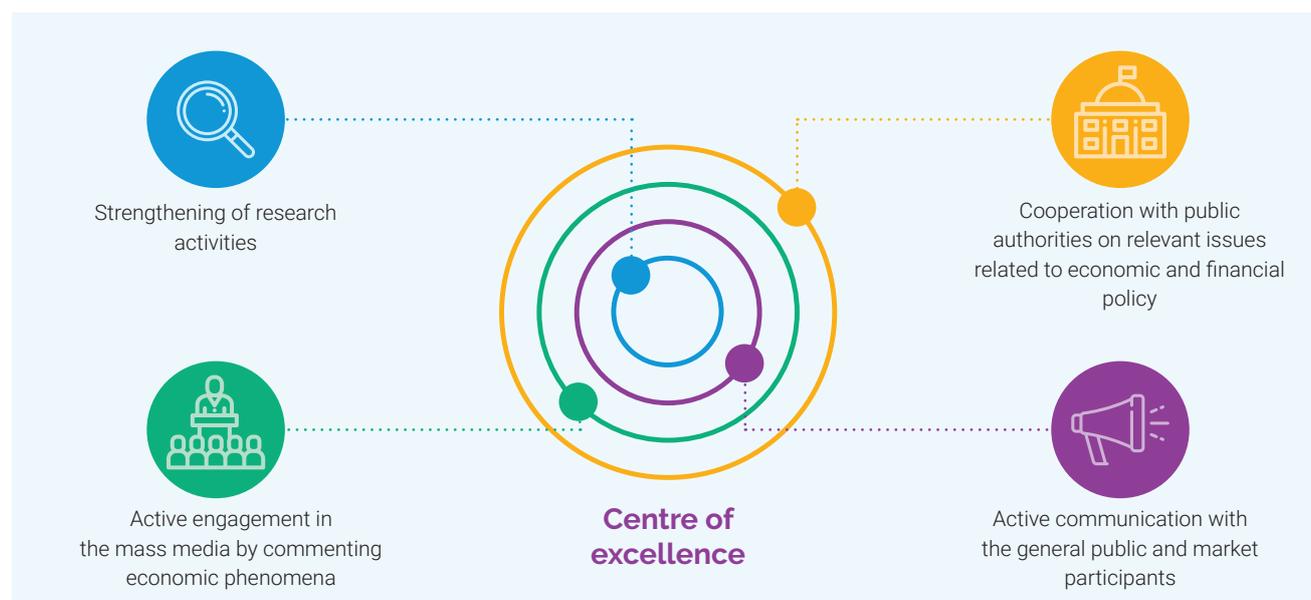
**With the aim of becoming the local centre of excellence in economics and finance, the Bank of Lithuania has been stimulating its research activities, actively participating in working groups formed by the Republic of Lithuania Government, as well as sharing analytical insights and other information with relevant authorities.** In 2017, in pursuit of its strategic goals, the Bank of Lithuania extended its range of analysis and research directions as well as developed new analytical tools for the potential economic policy response to domestic economic problems. To present the

results of research carried out at the Bank of Lithuania, it organised 18 presentations abroad and 40 presentations for local authorities, organisations and experts in economics (12 of which were open seminars for non-specialists). The Bank of Lithuania organised 11 conferences on issues related to economics and finance, e.g. an economics conference 'Income Inequality in Lithuania' and the annual Real Estate Conference. The central bank made active efforts to share best practices with foreign institutions, e.g. it organised an international seminar on cooperative banking, where the credit union reform, implemented by the Bank of Lithuania, was introduced. Taking into consideration issues related to cybersecurity, the Bank of Lithuania intensified analysis of cyber threats, dedicating to this topic a chapter in its Financial Stability Review.

**The Bank of Lithuania became more visible in the Lithuanian media and foreign publications.** In 2017, 30% of the content produced by the Bank of Lithuania centred on economic reviews and forecasts. The Bank of Lithuania was mentioned in the foreign media as well as cited in scientific publications.

**The central bank took part in more international cooperation initiatives.** In addition to providing technical assistance, the Bank of Lithuania has been also participating in the EU Twinning Project.

## Main goals



## 2. To become a financial sector partner, promoting innovation and sustainable growth

- 

Reviewed various legislative provisions and made a list of necessary amendments
- 

Started announcing inspection plans
- 

Reduced the licensing fee for banks, payment and e-money institutions
- 

Launched the Newcomer Programme – a one-stop shop for new market participants interested in obtaining licences in Lithuania
- 

Introduced the concept of regulatory sandbox and drafted amendments to relevant legislation
- 

Launched the blockchain-based platform dubbed LBChain
- 

Issued 32 licences (e-money, payment institution and P2P lending platform)
- 

Increased the visibility of Lithuania on a global scale through presentations, interviews and target events held in the UK, Israel, Singapore and Japan

**As the supervisory authority of the financial sector, the Bank of Lithuania takes active measures to ensure that the road towards positive innovation and market competition remains open.** To this end, it works in several directions.

**Strengthening the partnership with financial market participants.** With its goal to maintain regulatory hygiene, the central bank is gradually abandoning excessive and outdated solutions. It took the initiative to review relevant legislative provisions: in collaboration with market participants, it identified provisions that should be amended and is dedicated to devoting much attention to implement necessary changes. The Bank of Lithuania also seeks to ensure that its actions are predictable and communicated to market participants in advance. Thus the central bank started announcing its inspection plans and has been organising periodic meetings with market

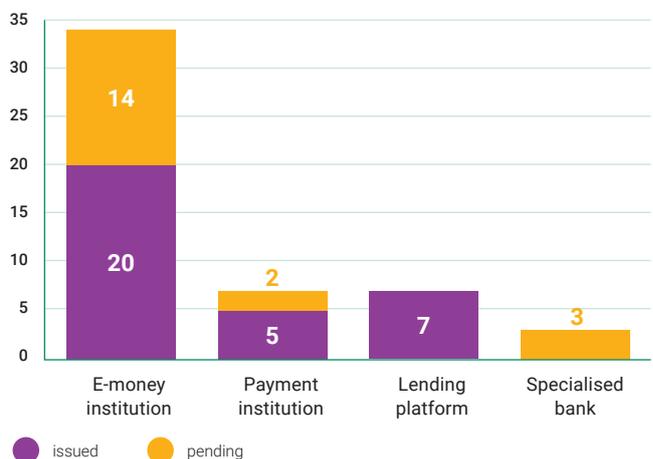
participants. It also took to new ways of fulfilling its supervisory mandate (on-site visits, etc.).

**Encouraging competition in the financial market by lifting the barriers to market entry.** Together with other public authorities, the Bank of Lithuania has been searching for ways to attract investors and foreign capital to Lithuania. For example, it improved remote customer identification processes, introduced the possibility to obtain a specialised bank licence, granted payment and e-money institutions access to its retail payment system, and reduced the fee for the licensing of credit institutions 10 times.

**Promotion of innovation in the financial market.** The Bank of Lithuania not only seeks to create an environment that would be favourable for providing financial services, but also encourages innovation in the financial market. It also aims at ensuring that businesses are willing and able to set up in Lithuania, consequently unlocking the full potential of Lithuania’s skilled labour pool and infrastructure. The central bank has been extensively researching possibilities to implement blockchain-based technologies in the financial sector. To this end, it launched LBChain, a platform that allows assessing the potential of blockchain in accelerating the emergence of various financial products and services. The Bank of Lithuania also developed a tool for submitting applications for an electronic licence, which will be made available to all market participants following the adoption of the legislative package transposing the revised Payment Services Directive (PSD2).

**Foreign capital and innovation inevitably entail certain risks (money laundering, terrorist financing, cybersecurity, etc.).** The Bank of Lithuania took effective measures to mitigate them: it has been developing the competences of its Supervision Service, increasing internal resources, maintaining close cooperation with law enforcement authorities to evaluate the shareholders and management of licensed undertakings, as well as establishing connections with foreign supervisory authorities.

### FinTech licences



### 3. To create a competitive and advanced payments market in Lithuania



Established an independent forum – the Payments Council



Added an instant payment service to its payment system CENTROLink



Signed an MoU on the provision of the instant payment service with the largest banks in the country

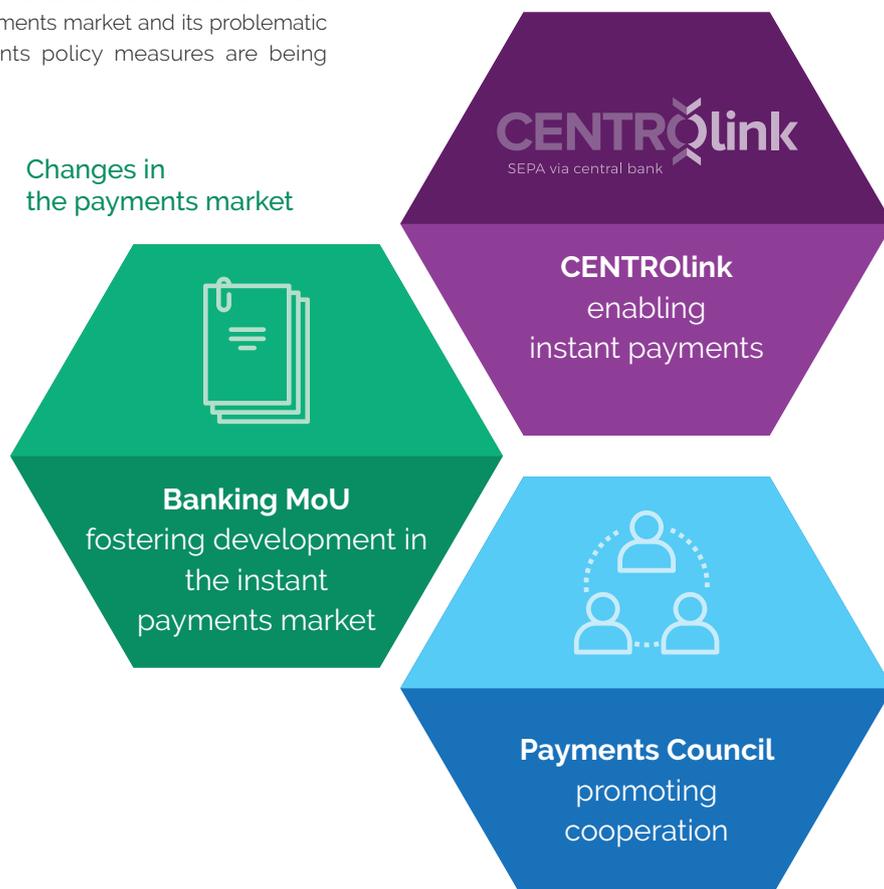
**In October 2017, the Bank of Lithuania and the Ministry of Finance of the Republic of Lithuania created an independent forum – the Payments Council.** Established in light of market support expressed during the public consultation on the National Payments Strategy, the Payments Council was created to strengthen the dialogue among payment service providers, payment service users, regulators and the academia in the course of developing Lithuania's payments market. It consists of 10 members: representatives of payment service providers, enterprises and consumers, state institutions formulating and implementing payments policies and academics. The Council aims to assess directions for the development of Lithuania's payments market and its problematic aspects, monitor how payments policy measures are being

implemented and how innovations emerging in the market are applied, formulate its position and put forward relevant proposals. The Council's three priority issues for 2018 are the development of instant payments, the centralised KYC solution and new customer identification measures.

**Seeking to open the window to instant payments in Lithuania, the Bank of Lithuania joined the first wave of the pan-European adherence to the new scheme and on 21 November 2017 added an instant payment service to its payment system CENTROLink.**

The payment infrastructure of the Bank of Lithuania is open and fully primed for working with banks, credit unions, as well as payment and e-money institutions established in Lithuania and abroad. It allows crediting funds instantly not only between payment service providers operating in Lithuania, but also between different SEPA countries.

**Seeking to encourage major banks to start offering instant payments as quickly as possible, the Bank of Lithuania, together with the three largest banks in the country, signed an MoU on the provision of the instant payment service.** The banks undertook to ensure their clients the possibility to initiate and receive instant payments by November 2019. Another three banks committed to allowing their customers receive instant payments from clients of other payment service providers.



## 4. To enhance application of financial asset investment strategies



Upgraded its strategic asset allocation to enhance risk diversification



Started to invest in new asset classes: inflation-linked US government securities and US corporate debt securities



Increased the risk budget of the investment portfolio to €150 million



Created a USD 1 billion reserve portfolio



Started to implement quantitative investment strategies

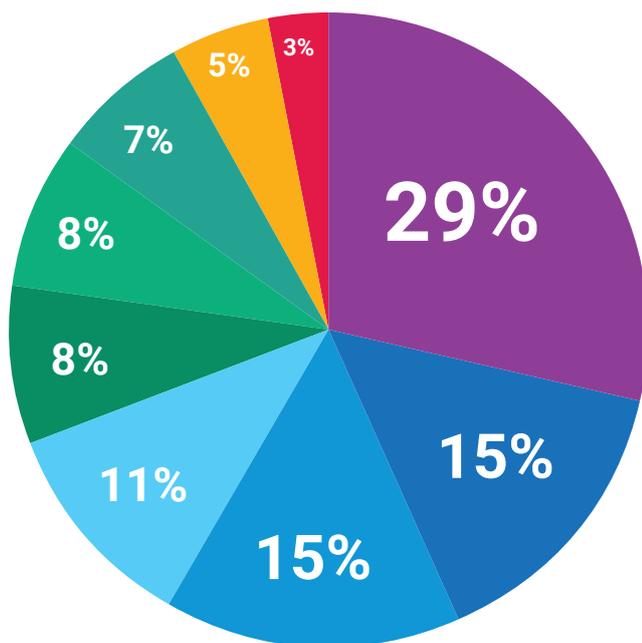
**Aiming at maximum risk diversification, the Bank of Lithuania upgraded its strategic asset allocation.** This decision was taken in view of the low interest rates, an increasing probability of their rise and other risks. The Bank of Lithuania became one of the first central banks in the world to implement a risk parity-based strategic asset allocation model.

**The Bank of Lithuania started to invest in new asset classes:** inflation-linked US government securities and US corporate debt securities. Seeking maximum diversification, the Bank of Lithuania has been using exchange-traded funds for investments in corporate securities. The Bank of Lithuania also plans to start investing in mortgage-backed securities issued by US government agencies.

**In 2017 the central bank began working on the implementation of the quantitative investment strategies project;** the Bank of Lithuania intends to computerise market monitoring and eventually trust carefully selected algorithms with part of investment decision-making.

**In addition to the diversified investment portfolio, the Bank of Lithuania created an additional USD 1 billion reserve portfolio,** which consists of investments in US government securities. The reserve portfolio is not hedged against currency risk; therefore, the portfolio's value in euro becomes more dependent on exchange rate fluctuations.

Composition of the strategic benchmark portfolio as at 31 December 2017



**The risk budget of the investment portfolio was increased from €100 million to €150 million** on the back of the increasing probability of a rise in interest rates and, in turn, a decrease in the price of debt securities, as well as seeking to boost expected return over a 3-year investment horizon. The risk budget shows the highest potential loss over a rolling 1-year horizon at a 95% confidence level. It does not include reserve, gold and monetary policy portfolio risks, which are taken for strategic purposes.

- US government debt securities
- money market instruments
- European corporate debt securities
- US corporate debt securities
- Canada government debt securities
- UK government debt securities
- inflation-linked debt securities
- equity
- China government debt securities

## 5. To be one of the top three most efficient central banks in the Nordic-Baltic region



Took a decision on the project for the new premises that would hold all Bank of Lithuania staff members under one roof



Improved the personnel administration system



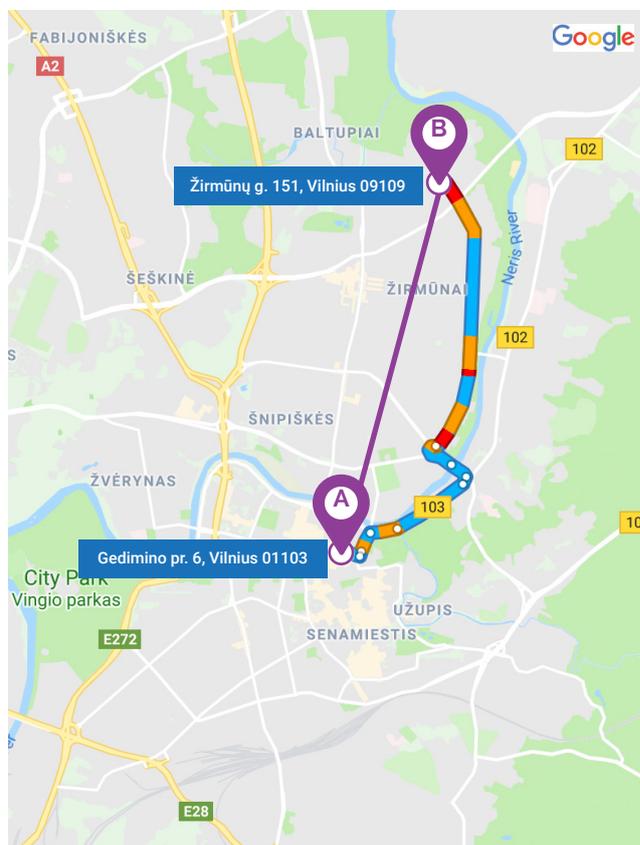
Approved the Coin Creation Strategy, which sets out measures for expanding the market for collectors

**The Bank of Lithuania seeks to be a modern and efficient organisation, managing and organising its activities based on best management practices. Pursuing its aim to optimise Bank of Lithuania internal and operational costs,** the Board of the Bank of Lithuania took a decision on the transfer of infrastructural facilities from Gediminas Avenue to Žirmūnai district. With all Bank of Lithuania structural units under one roof, the central bank expects to cut its facilities maintenance and exploitation costs by up to 30%. Having implemented new technology-based solutions, it plans to reduce the number of auxiliary staff members and outsource certain services.

**Keeping up to date with the latest technology trends, the Bank of Lithuania has been reviewing its IT infrastructure** to allow for flexibility in terms of market participants and acceleration of internal operations. It also implemented standard solutions that are widely used in the market. In 2017, the central bank improved its personnel administration system.

**Managing internal activities, the Bank of Lithuania has been strengthening its competence in project management** and implementing process management solutions to ensure a more effective path towards achieving performance targets.

**In 2017 the Bank of Lithuania adopted its Coin Creation Strategy.** By fostering and developing the market for collectors, it aims to gradually increase the total mintage of coins issued in a year and ensure the distribution of at least 80% of the mintage.



# Review of the economy and finance

## Real economy

 In 2017 Lithuania's economy grew by 3.8%.

 Economic development was mainly driven by the improved international environment, which spurred the demand for Lithuanian exports on account of a sharp upturn in international trade.

 In light of growing foreign demand and an increase in investments, Lithuania's manufacturing and transport sectors boosted their real exports of goods and services.

 Lithuania's economic expansion was largely underpinned by the construction sector, the recovery of which was driven by increasing investments in buildings and structures.

 Due to stronger price growth and stagnating employment levels, the influence of household consumption on economic growth has waned.

**In 2017 Lithuania's economy recorded the strongest growth in the last 6 years**, expanding by 3.8% (adjusted for seasonal and workday effects). The largest contribution stemmed from favourable developments in international trade, which enabled a significant pickup of activity in Lithuania's tradeable sector. On the back of growing foreign demand and an increase in investments, Lithuania's tradeable sector – manufacturing and transport – ramped up sales in foreign markets.

**Export growth was stimulated by both an upsurge in foreign demand and the recovery in investment**, which, in turn, boosted corporate production capacity. Investment covered not only machinery and equipment, but also buildings and structures. Hence construction was one of the sectors to propel Lithuania's economic growth in 2017. Such investment developments largely stemmed from private sector investment projects that were not financed using EU funds. Contrary to what was expected, in 2017 the flows of the latter did not recover.

**Household consumption remained one of the main drivers of economic growth in 2017**, albeit its contribution diminished in the second half of the year. This was driven by an upsurge in prices and a decline in the number of persons employed. Rising prices limited household purchasing power and consumption. Having recorded low rates in the last few years, inflation picked up and stood at above 4.0% in the second half of 2017. Household consumption was also dampened by another significant factor – a declining number of persons employed. Rising employment in 2015–2016 (estimated in terms of working hours) increased the wage fund by slightly more than 40%, while last year it led to its reduction.

## Lithuania's economic growth in 2017



# Review of the economy and finance

## Price dynamics



Average annual inflation in Lithuania stood at 3.7% in 2017.



Food price growth was mainly driven by the rise in food commodity prices and changes in excise duties.



Oil commodity prices rose considerably, contributing to a rather marked upturn in fuel prices, which stood at 8.4%.



Having decreased at a yearly rate of 3–4% over the past few years, last year administered prices decreased by roughly 0.8% on the back of tax changes and no longer sliding energy commodity prices.



Rising tensions in the labour market and the previously increased minimum wage contributed to a significant increase in labour costs. To some extent this led to a sharp rise in service prices (annual change of service prices was 5.5%).

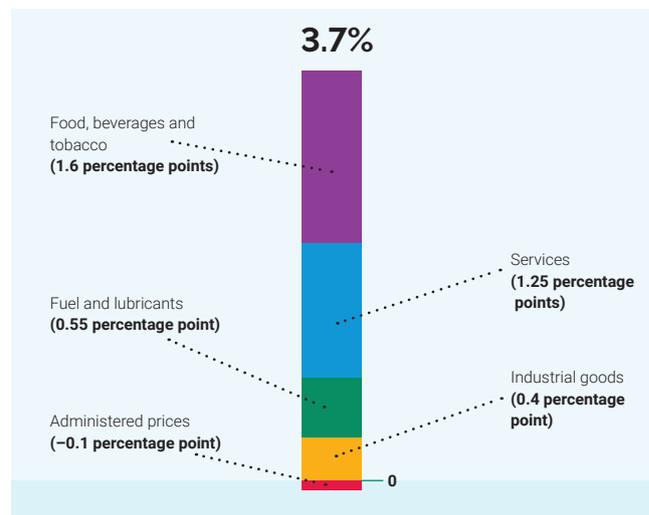
**Lithuania's and global economic activity has picked up steam, which, in turn, led to a more robust increase (3.7%) in domestic consumer prices in 2017.** Such price growth stemmed not only from the changing trends in global commodity markets, but also domestic economic factors, such as wage dynamics and certain tax changes.

**The prices of food, beverages and tobacco rose by 5.5%.** This was largely driven by such factors as the more rapid growth of global food commodity prices and changes in excise duties. On a global scale, since mid-2016 food commodity prices have been rising at a faster pace due to a larger than expected decrease in the supply of

some food commodities (specifically – milk) and buoyant demand for other food products (specifically – meat products). In addition, a significant share of headline inflation was underpinned by excise duties on alcohol, which were increased in March 2017. This rapidly translated into higher consumer prices. Rising alcohol prices alone pushed headline inflation up by approximately 0.7 percentage point.

**Administered prices, which have been putting downward pressure on inflation for quite some time, started to pick up last year due to tax changes, notably the increased VAT on heat energy and accelerating energy commodity prices.** Even though the VAT was reduced in October, its temporary increase added 0.1 percentage point to average annual inflation. Core inflation, excluding the most volatile prices (fuel, food product, and administered prices), also saw a significant upturn. On the back of the improved economic environment and rapid wage growth, annual core inflation stood at 2.9%. This mostly stemmed from the prices of services, which rose due to increased domestic demand and robust wage growth. Given that in recent years labour productivity has grown at a slower pace than wages, higher labour costs were at least to some extent transmitted into the prices of final products.

## Contributions to average annual inflation in 2017



Sources: Statistics Lithuania and Bank of Lithuania calculations.

# Review of the economy and finance

## Labour market



Declining unemployment led to an increasing shortage of labour, however the situation in the labour market varied.



The unemployment rate in the largest regions was similar to that recorded during the recent economic upswing. In the smaller regions the unemployment rate was twice as high.



The unemployment rate among individuals with tertiary education was similar to that recorded during the recent economic upswing, whereas the rate for other individuals was almost twice as high.



Government decisions and shortage of labour boosted average wage growth. Due to the shortage of highly-skilled workers, the wages of higher earners rose at the fastest pace.

### Declining unemployment leads to an increasingly noticeable shortage of labour.

In 2017 the unemployment rate stood at 7.1%, a year-on-year decrease of 0.8 percentage point. It should be noted, however, that the situation in the labour market was heterogeneous across regions and the levels of education. Recently the unemployment rate in the largest regions (Vilnius, Kaunas and Klaipėda), at 5.4%, has been similar to the level recorded during the boom of 2007. As regards the smaller regions, the unemployment rate still remained twice as high, at 9.8%. Unemployment rates for workers with different levels of education varied as well. For instance, the unemployment rate among individuals with tertiary education was similar to that recorded during the earlier economic upswing and stood at 2.9%, whereas the rate for others still remained nearly twice as high, at 10.2%. Hence, the most acute should be the shortage of highly-skilled employees in the largest regions. Meanwhile, the lack of lower-skilled labour in smaller regions should be less severe.

### The shortage of labour and government decisions led to a rapid rise in the average wage.

It received a substantial boost from the increases of the minimum wage in January and July 2016 as well as the rise in wages for workers in public administration, education and healthcare. It should be noted, however, that the increase in the minimum wage had no direct effect on annual wage growth in the second half of 2017, which, in turn, resulted in a markedly slower pace of growth. Lowest-paid workers saw the most pronounced slowdown in their wage growth; it started to lag significantly behind that of higher-paid workers. This, in part, stemmed from a weaker bargaining power of lower-wage earners, which was reflected in the still relatively high unemployment rate among people with lower education (who usually earn less). Nevertheless, the shortage of highly-skilled labour was rather significant, which fuelled the rapid wage growth for higher earners.

## Unemployment rate by region



# Monetary policy of the Eurosystem

## Decisions



In 2017 the economic situation in the euro area improved significantly, however, inflation did not achieve its aim, thus the Eurosystem continued to maintain an accommodative monetary policy stance:

- » Amid an improved economic situation, the Governing Council decided not to extend the TLTRO scheme past March 2017.
- » In June 2017 the Governing Council amended its forward guidance on the ECB interest rates, removing the reference to further rate cuts; interest rates are expected to remain at the current low levels for an extended period of time.
- » In October 2017 the Governing Council decided to extend the APP, though smaller in size, for 9 more months until the end of September 2018.
- » In March 2018 the Governing Council adjusted its forward guidance on the APP, removing reference to increasing monthly purchases under the programme; however, it continues to claim that it may extend the programme, if necessary.

### Intended for stimulating lending to the real economy, TLTROs were not extended in 2017 and consequently ended in March.

Economic growth in the euro area continued to strengthen: according to the Eurosystem staff projections, the outlook for GDP growth has been revised upwards in each quarter since December 2016. The total sum borrowed by banks over the two TLTRO stages (2014–2017) amounted to €770 billion – in March 2017 it accounted for 98% of all Eurosystem monetary policy operations.

**The decision of the Governing Council to remove the reference to lower ECB interest rates was underpinned by the significant reduction in deflation risk and the fact that risks surrounding economic growth have become broadly balanced.** This gave grounds for greater confidence that in the future the growth rate of prices will achieve the ECB's inflation aim and there will be no need to lower interest rates even further.

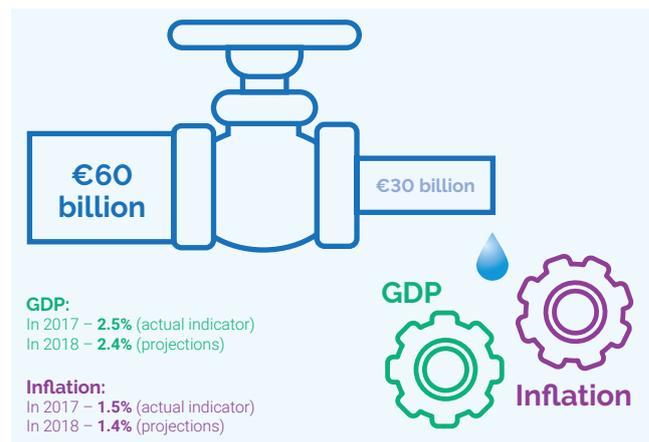
### The expanded APP was extended until the end of September 2018, although at a reduced monthly pace – in January 2018 net purchases were reduced from €60 billion to €30 billion.

The Governing Council agreed that in the context of a recovering economy, the easing effect of the monetary policy remained necessary, yet it may currently be maintained with less effort. The Council decided that the principal payments from maturing securities purchased under the APP will be reinvested for an extended period of time after the end of the net asset purchases, thus maintaining the volume of money issued and its market presence. Moreover, it was decided that for as long as necessary but at least until the

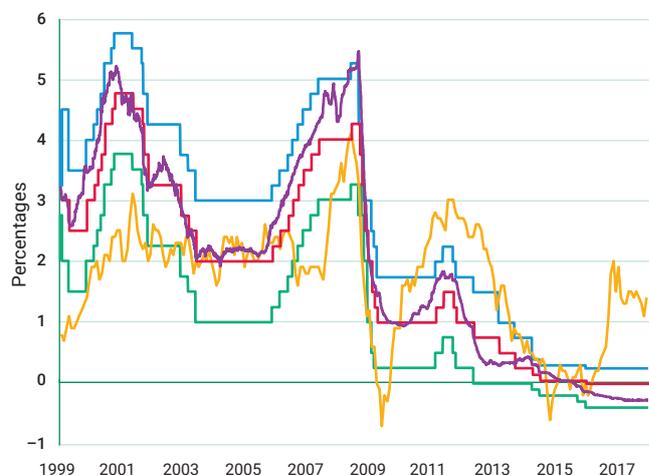
end of 2019 refinancing operations will be conducted as fixed rate tenders, i.e. with full allotment.

**The decision of the Governing Council to remove the reference to increasing monthly purchases under the APP was determined by greater confidence that financial conditions and the balance of risks surrounding the euro area growth outlook will not see significant deterioration.** This was reinforced by the fact that in March 2018 euro area economic growth projections were once again revised upwards, whereas inflation projections indicated that price growth is more likely to converge towards the ECB's inflation aim over the medium term.

### Change in the volume of monthly purchases under the expanded APP since 2018



### Key ECB interest and EURIBOR rates and inflation in the euro area



Source: Thomson Reuters Datastream.

# Monetary policy of the Eurosystem

## Impact



In 2017 the accommodative stance of the Eurosystem's monetary policy continued to exert a positive impact on the economies of the euro area and Lithuania:

- » Bank funding costs had reached historical lows in 2017.
- » The cost of borrowing in capital markets for euro area governments and corporates remained broadly unchanged at historically low levels throughout 2017; Lithuania has already reaped the direct benefits of the CSPP.
- » Bank lending continued to increase in both Lithuania and the euro area.
- » The euro appreciated; however, this was largely due to the improved outlook for the euro area economy.
- » The Eurosystem's monetary policy continued to boost economic growth in Lithuania and the euro area.

**In 2017 short-term interbank lending rates remained basically unchanged and stood at record low levels**, i.e. close to the rate on the ECB deposit facility (–0.4%).

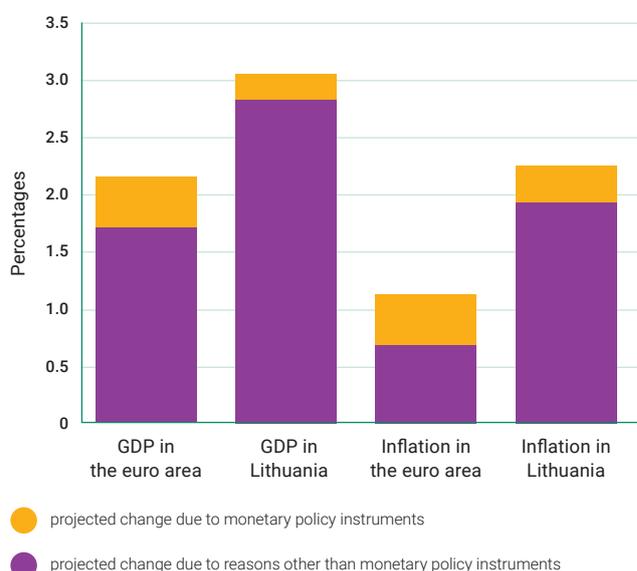
**Despite some fluctuations, average yields of 10-year euro area sovereign debt securities remained broadly unchanged in 2017, remaining at a very low level.** However, the dispersion of the yields of euro area sovereign debt securities decreased over the same period: the interest rates on debt securities with higher yields declined, whereas on those with lower yields – increased. The narrowing of the dispersion of yields was primarily led by the mitigating risk of Euroscepticism as pro-European forces won the national elections in the Netherlands and France. The dispersion also decreased on account of stronger economic growth in the euro area and the ongoing APP. In 2017 the yields of euro area investment grade corporate bonds remained broadly unchanged, while the decrease of yields was observable only for speculative grade corporate bonds (by 76 basis points). Lithuania has also started to reap the direct benefits of the CSPP: in 2017 AB Lietuvos energija became the first Lithuanian company with debt securities purchased under the Eurosystem's quantitative easing programme. From their issuance to the end of 2017, the company's bond yields had declined by 38 basis points.

**Lending to the private non-financial sector in the euro area continued its upward trend:** in December 2017, lending to households and non-financial corporations grew by 2.9% and 3.1% respectively (in December 2016 – 2.0% and 2.3% respectively). As previously, lending in Lithuania increased at a faster pace compared to the euro area: in December 2017 – by 7.5% and 5.2% respectively.

**Throughout 2017 the nominal effective exchange rate of the euro increased by 6.3%.** On the one hand, the increase in the euro exchange rate was partly due to the fact that i) the monetary policy stance of the Eurosystem trade partners became relatively more accommodative compared to the euro area, and ii) the euro area investment environment turned more attractive. On the other hand, a large share of the euro appreciation was driven by robust internal demand in the euro area, which slightly restrained its negative contribution on the euro area GDP growth and inflation.

**The accommodative monetary policy of the Eurosystem stimulates Lithuania's economy mainly through the tradable sector:** stronger demand in the euro area and a significant depreciation of the euro already prior to the announcement of the expanded APP render support to our country's exports.

## Projected impact of the Eurosystem's monetary policy instruments on real GDP growth and inflation in the euro area and Lithuania in 2016–2019 (yearly average)



Sources: ECB, Thomson Reuters Datastream and Bank of Lithuania calculations.

# Monetary policy of the Eurosystem

## Measures



To implement its objectives, the Eurosystem uses a set of monetary policy instruments, consisting of open market operations, standing facilities and minimum reserves.



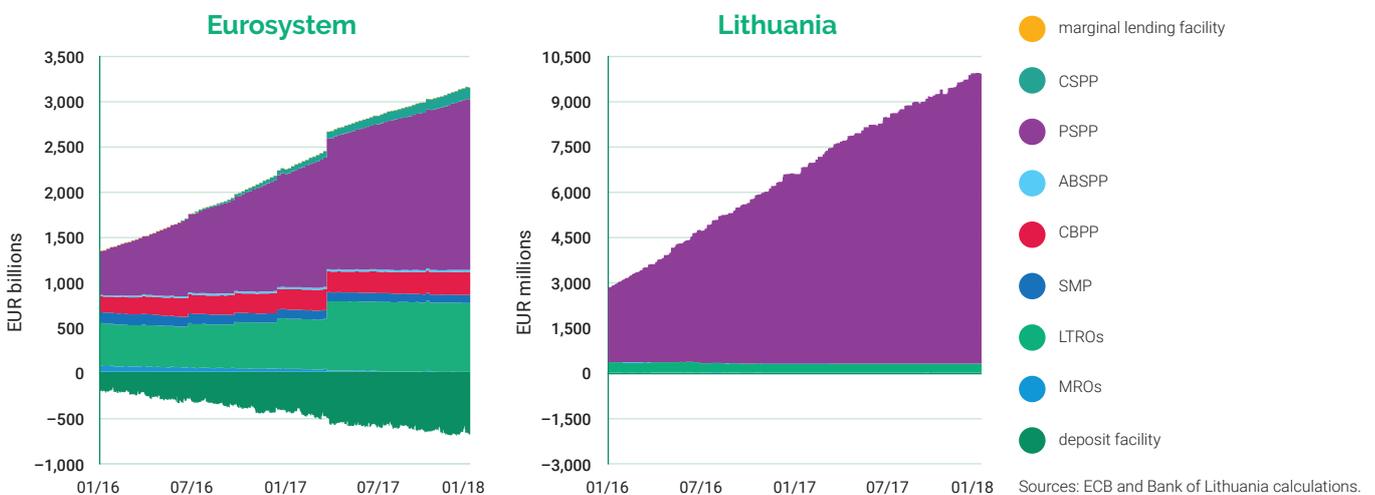
In 2017 the Eurosystem injected into the financial market €900.3 billion, of which €3.4 billion was injected by the Bank of Lithuania. To this end, it also used non-standard monetary policy measures:

- » the expanded APP
- » TLTROs

**In 2017, the Eurosystem carried out 115 open market operations via tenders.** The amount outstanding, borrowed by counterparties, at the end of 2017 was €3.37 billion via MROs, and another €760.6 billion through LTROs, including TLTROs. The largest operation was TLTRO – €233.5 billion. In 2017 the Bank of Lithuania's counterparties did not participate in the new LTROs, hence the total amount borrowed remained unchanged and stood at €0.3 billion.

**Under the expanded APP, which includes the third CBPP, the ABSPP, the CSPP and the PSPP, the Eurosystem increased the securities portfolio held for monetary policy purposes by €732.0 billion – to €2,386.0 billion.** In 2017, on account of monthly purchases of the government securities of the Republic of Lithuania and bonds of the European supranational institutions, the Bank of Lithuania increased the respective securities portfolio by €3.4 billion – to €9.7 billion, of which government securities of the Republic of Lithuania accounted for €1.7 billion, bonds of the European supranational institutions – €8.0 billion.

## Liquidity-providing and liquidity-absorbing monetary policy operations of the Eurosystem



## Volumes of minimum reserves, current accounts, recourse to deposit and marginal lending facilities

Indicators	Region	Volume at the end of the year, EUR	Annual change, %	Annual average, EUR	Highest value, EUR	Lowest value, EUR
Minimum reserves	Eurosystem	123.8 billion	4.2	121.7 billion	123.8 billion	118.8 billion
	Lithuania	211.7 million	7.6	203.4 million	211.7 million	196.7 million
Current account holdings	Eurosystem	1,185.8 billion	33.4	1,157.3 billion	1,351.3 billion	871.4 billion
	Lithuania	5,077.4 million	104.6	2,738.7 million	5,077.4 million	2,135.2 million
Recourse to deposit facility	Eurosystem	695.8 billion	64.0	587.1 billion	709.2 billion	403.9 billion
	Lithuania	0.0 million	0.0	0.0 million	0.0 million	0.0 million
Recourse to marginal lending facility	Eurosystem	0.3 billion	73.8	0.3 billion	1.5 billion	0.0 billion
	Lithuania	0.0 million	0.0	0.0 million	0.0 million	0.0 million

# Macroprudential policy

## Analysis of systemic risks

The key risks to Lithuania's financial system, which inched up over the year, are imbalances in the Nordic countries as well as the potential snapback in risk premia and its influence to parent banks.

Although the rapid growth of the RE market and lending in Lithuania is a lesser risk, it is becoming increasingly more relevant.

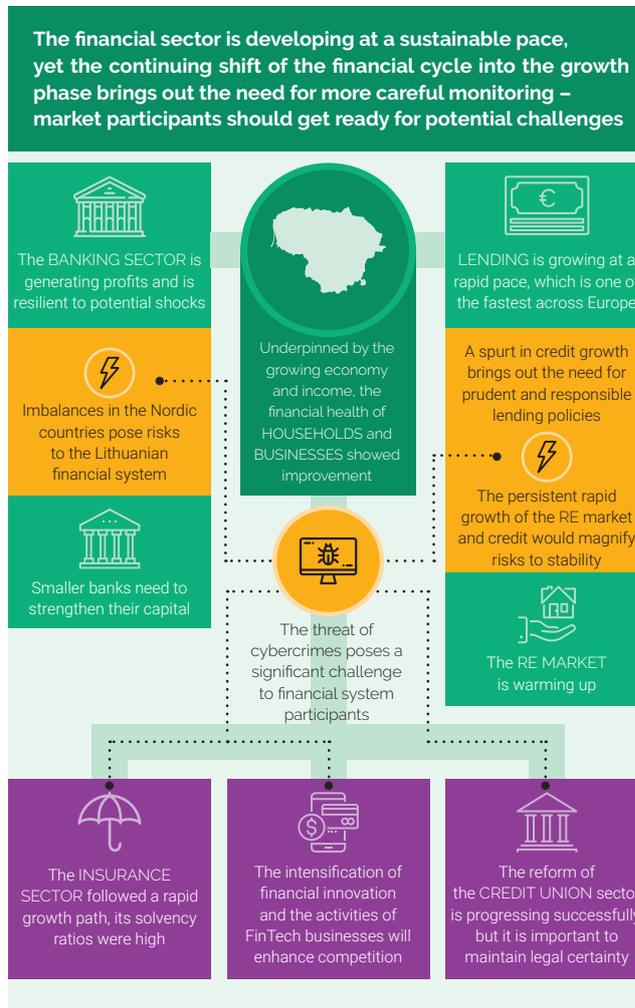
Cybersecurity risks are not subsiding; over time this could significantly influence the stability of Lithuania's financial system.

**Imbalances in the Nordic countries and the potential negative impact of the snapback in risk premia on parent banks have increased over the last year.** The annual growth rates of house prices in Sweden and Norway has been already scaling back and even dropping in separate regions. Uncertainty over future RE price developments is also rising, thus the scenario of a more rapid decline cannot be disregarded. Given that household indebtedness in Sweden and Norway still remains high and continues to grow, the falling housing prices could lead to bank losses and an overall economic slowdown.

**A rather large share of Nordic banking activities is financed with resources from international financial markets.** With global economic recovery gaining momentum, the tightening of the monetary policy stance in individual regions is possible, which, in turn, could raise borrowing costs in international markets, making borrowing more expensive for Nordic banks. If this were to persist, the parent bank sector could encounter unexpected losses and start changing lending policies; hence Lithuania could potentially see a slide in credit volumes and a ramp up in loan costs.

**With parent banks facing new challenges and Lithuanian depositors feeling alarmed, liquidity of banks operating in Lithuania could deplete.** However, the potential impact of this risk on banks operating in Lithuania is mitigated by the active implementation of macroprudential policy measures in the Nordic countries and the decreased indebtedness of Lithuanian banks to parent banks.

**The ongoing rapid pace of loan growth in Lithuania could lead to imbalances in the RE market.** The recent rise in credit and RE market prices outpaced the growth of the domestic economy; if such a trend were to persist, the relative indebtedness level would pick up, which, in turn, would enhance the adverse effects of



unfavourable shocks. The results of the quantitative house prices assessment indicate that for the first time since 2009 housing prices have been adequately assessed against other macroeconomic indicators. Sentiments regarding the development of the RE market remain optimistic: households and other RE market participants expect that the activity in the market will maintain momentum; more of them anticipate a rise in prices rather than a decrease. However, the risk of rapid growth in RE prices and lending is mitigated by the still large housing supply, the sustainable financial situation of households and macroprudential measures implemented by the Bank of Lithuania.

**Amid a rise in the number of cyber attacks, challenges related to cybersecurity are not subsiding.** This is of particular relevance to participants of the Lithuanian financial system as they are more and more keen on providing services online so as to make their activities more efficient. Challenges related to cybersecurity will continue to remain relevant to financial system participants, yet potential adverse effects should be reduced by security-increasing initiatives.

# Macprudential policy

## Credit and the real estate market



In 2017 credit continued to grow stimulated by lending to both households and non-financial corporations.



Crediting of individual business sectors grew at uneven rates, mainly driven by individual large-scale loans.



Growth of the housing loan portfolio remained among the strongest in Europe.



In 2017 house prices rose at the fastest pace since 2008.



RE market activity has been stabilising, yet still remains strong.



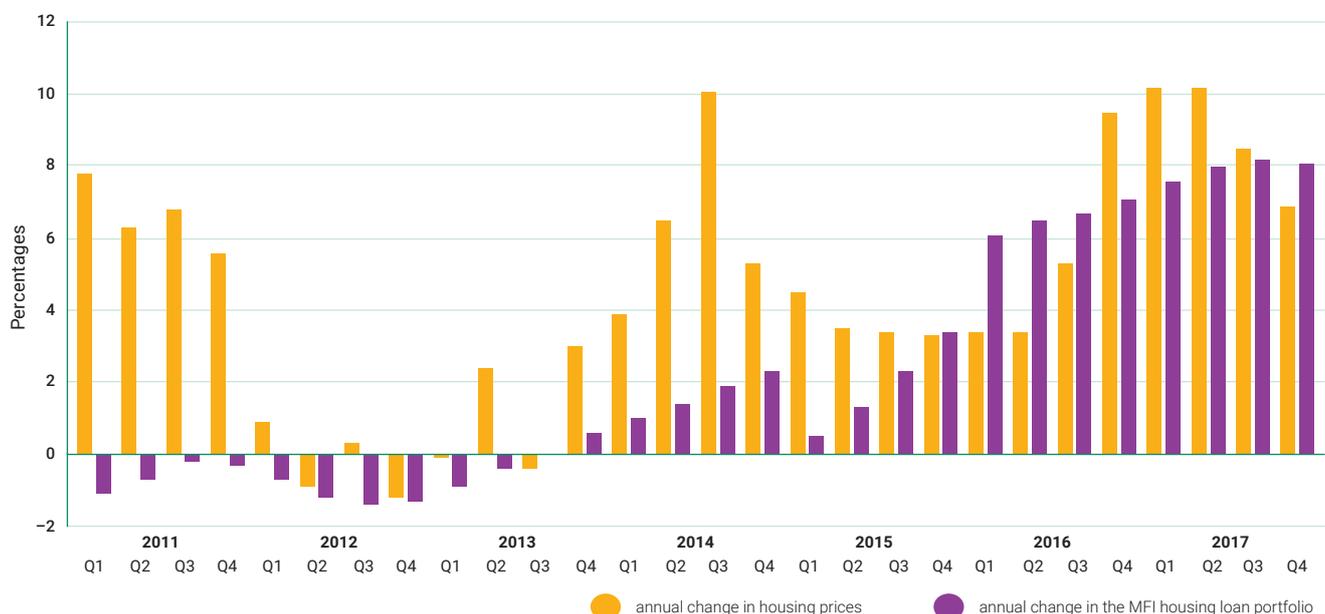
Market participants expect that in 2018 house prices will rise slower than last year.

**In 2017 crediting in Lithuania remained active.** Over the year the portfolio of loans issued to the private non-financial sector posted a 6.4% increase, to a similar extent stimulated by both loans to enterprises and households. The portfolio of loans to non-financial corporations expanded by 5.2% year on year. Lending to enterprises engaged in trade, professional and scientific as well as administrative and support activities registered the strongest growth. However, changes to the latter segments were markedly influenced by large-scale individual transactions. The housing loan portfolio was expanding rapidly as well: over the year it increased by 8.1%. This was mostly influenced by the historically-high activity in the RE market.

**In 2017 the number of housing transactions to a large extent remained unchanged (increased by 1%) and has been the highest over the last decade.** With activity continuing on an upward path, housing prices rose by almost a tenth – the strongest increase since 2008. However, in the second half of 2017, the first signs of a slowdown in the housing market were noticed: over the second and third quarter market participants concluded fewer transactions year on year, while prices rose at a slower pace. According to the surveys conducted by the Bank of Lithuania, banks and professional RE market participants expect that house prices in 2018 will increase at a slower rate than in 2017.

**The expanding domestic economy, still accelerating crediting and RE markets, as well as adequate bank profitability indicators show that now is the best time for accumulating an additional capital buffer, which would increase the resilience of the financial system to both potential cyclical risks and external economic shocks that may occur even when the financial situation in the country is sustainable.** As a result, at the end of 2017 the Bank of Lithuania took a decision to set a positive (0.5%) countercyclical capital buffer rate.

## Annual change in the MFI housing loan portfolio



# Macprudential policy

## Macprudential policy instruments



The countercyclical capital buffer rate was increased to 0.5%.



The Bank of Lithuania identified 4 systemically important institutions and set additional capital buffers for them.



The Responsible Lending Regulations started to be applied on an activity basis, i.e. not only for housing loans granted by credit institutions, but also other loans for house purchase granted by other credit providers or mortgage loans. The key principles set in the Responsible Lending Regulations remained unchanged.



The Bank of Lithuania adopted the framework for the mutual reciprocation of other Member States' macroprudential policy measures.

Having assessed the recent credit and RE market dynamics and seeking to prevent excessive credit growth, on 20 December 2017 the Bank of Lithuania decided to increase the countercyclical capital buffer rate<sup>1</sup>, which is revised on a quarterly basis, and set it at 0.5%. The countercyclical capital buffer requirement will come into effect on 31 December 2018. Applied for the first time in Lithuanian history, it will help strengthen financial system resilience to potential shocks. The application of the instrument is flexible: when faced with economic shocks or recession, the capital requirement might be relaxed, thus allowing credit institutions to maintain credit supply.

During the 2017 assessment, the Bank of Lithuania identified 4 systemically important institutions and set additional capital buffers for them. AB SEB bankas, Swedbank, AB, and Luminor Bank, AB, were set a 2% other systemically important institution capital buffer, AB Šiaulių bankas – a 0.5% capital buffer.

Since 1 July 2017, the Responsible Lending Regulations have been applied on the so-called activity basis, i.e. not only for housing loans granted by credit institutions, but also other loans for house purchase granted by other credit providers or mortgage loans.<sup>2</sup> In addition, now the Regulations also applied to credit-seeking natural persons who engaged in business activities (RE rental, exploitation or construction). The key lending principles and ratios set in the Responsible Lending Regulations remained unchanged.<sup>3</sup>

On 28 June 2017, the Bank of Lithuania adopted the framework for the mutual reciprocation of other Member States' macroprudential policy measures.<sup>4</sup> The Bank of Lithuania retains the right to decide not to reciprocate the recommended measure or use exceptions if deemed necessary. On 3 July 2017, banks operating in Lithuania were obligated to apply a 1% systemic risk buffer rate for all positions held in Estonia.<sup>5</sup>

## Macprudential policy measures implemented in Lithuania



1 <https://www.lb.lt/en/financial-stability-instruments-1#ex-1-2>.  
 2 Resolution No 03-22 of the Board of the Bank of Lithuania of 24 January 2017 on the amendment to Resolution No 03-144 of the Board of the Bank of Lithuania of 1 September 2011 on the Responsible Lending Regulations.  
 3 The 2017 Financial Stability Review of the Bank of Lithuania.  
 4 Resolution No 03-92 of the Board of the Bank of Lithuania of 28 June 2017 on the mutual recognition and reciprocation of macroprudential policy measures of EU Member States and the adoption of rules for the assessment of the cross-border impact of macroprudential policy measures applied by the Bank of Lithuania.  
 5 Recommendation ESRB/2016/4 of 24 June 2016.

# Management of financial assets

## Investment policy



Managing financial assets that are not related to monetary policy operations, the Bank of Lithuania seeks to ensure financial stability in Lithuania and the euro area, create conditions for smooth monetary policy implementation, ensure the financial independence of the Bank of Lithuania, and provide a buffer against economic and financial shocks as well as other extraordinary circumstances.

## Investment composition



The bulk of the Bank of Lithuania financial assets is invested in money market instruments and government debt securities in euro or other euro-hedged currencies.



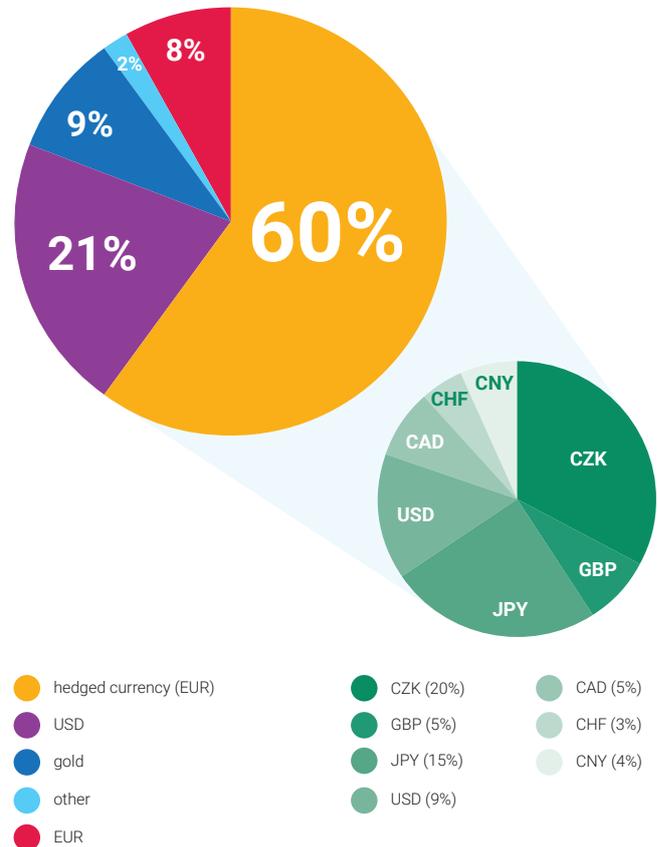
The Bank of Lithuania manages 5.8 tons of gold, which is stored at the Bank of England. Under favourable market conditions, gold is invested in gold deposits, thus earning interest, or through gold swaps, i.e. temporarily exchanging gold into other currencies and then investing them.

## Average composition of investments

Money market instruments	34.2
US government debt securities	23.1
China government debt securities	3.6
Debt securities of other governments	11.9
Debt securities of agencies, international organisations and municipalities	9.8
Corporate debt securities	12.0
Equity	5.4

Percentages

## Average composition of investments by currency



**The bulk of the Bank of Lithuania's investments was in euro or other currencies (US dollar, Japanese yen, Czech koruna, Chinese renminbi) with hedged currency risk.** Aiming at higher investment diversification, currency risk of part of investments (in 2017 – 22.6% on average) was not hedged. The majority of investments with unhedged currency risk were in US dollar.

**Security of financial assets is ensured through diversifying investment, concluding transactions only with investment-grade rating financial institutions that are of good repute, and investing only in debt securities with an investment grade rating.** The investment grade rating assigned to financial institutions and issuers of debt securities by international rating agencies indicates low probability of default on their liabilities. At the end of 2017, the average investment rating was AA, while 54% of investments were rated AAA (the highest rating).

**In terms of financial instruments, the majority of investments made in 2017 were in government debt securities and money market instruments.** The Bank of Lithuania invested in securities issued by more than 20 governments, government agencies, international organisations and municipalities. Money market instruments mainly consisted of deposits in other central banks and international organisations.

# Management of financial assets

## Investment goals



The Bank of Lithuania invests financial assets with the aim of diversifying risk and increasing expected return over a rolling 3-year investment horizon. Due to potentially higher returns in the medium term, the Bank of Lithuania tolerates the risk of short-term loss, the size of which, with high probability, should not exceed the risk budget predefined in the investment policy.

In 2017, the Bank of Lithuania's financial assets not related to monetary policy operations and liabilities amounted to, on average, €2,213 million, while return on these assets (non-adjusted for exchange rate and gold price changes) reached 1.45%. This was largely led by the depreciation of the US dollar. Return on financial assets excluding liabilities and adjusted for exchange rate changes was -1.14%.

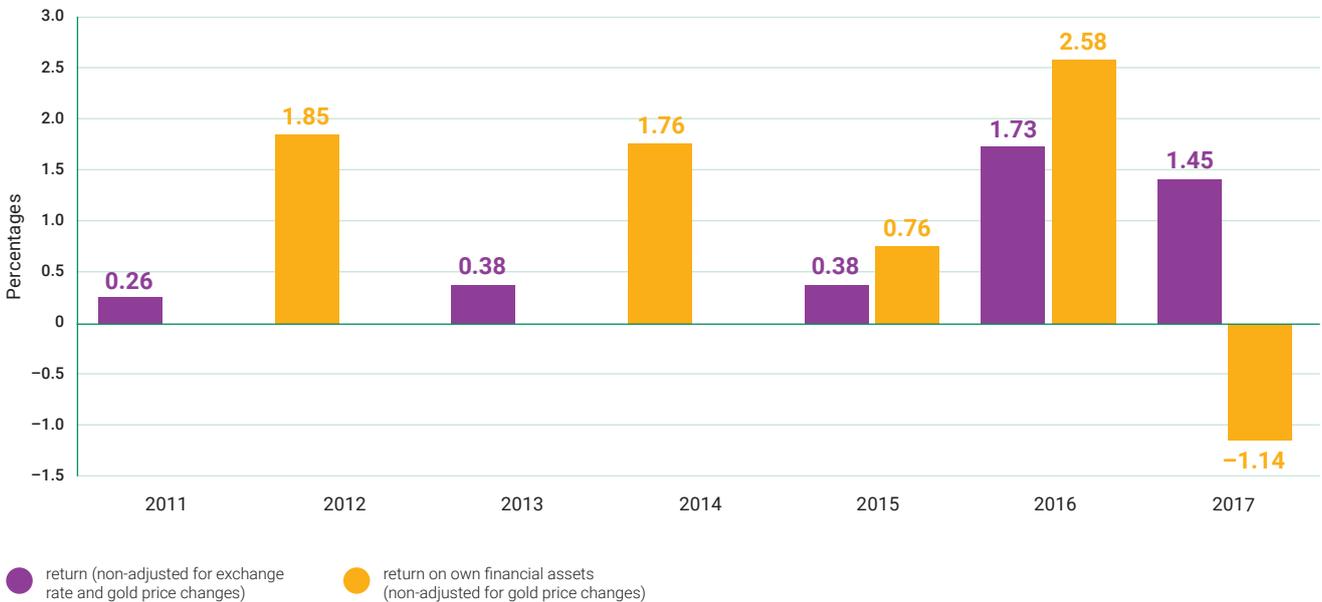
Market developments were rather favourable, i.e. all asset classes that the Bank of Lithuania invests in increased in value (excluding the cost for hedging currency risk). The global equity index (EUR) increased by 7%, European corporate bond price index - 2%, 1-10 year US government bonds - 1%. The only factors that had a negative effect on Bank of Lithuania investment results were the high price for hedging currency risk and the 12% depreciation of the US dollar against the euro.

## Investment results



The 3-year return on financial assets not related to monetary policy operations and liabilities was 2.18% or €54.5 million.

## Return on investment



# Payments

## Financial market infrastructure in Lithuania



The Bank of Lithuania manages two payment systems – TARGET2-LIETUVOS BANKAS and CENTROLink – and the access to the cash leg of the Eurosystem's new securities settlement infrastructure T2S.



Having implemented a long-term project, domestic financial institutions and the Bank of Lithuania joined T2S.



A new SSS was registered with the Bank of Lithuania; it is operated by the Latvian-based central securities depository Nasdaq CSD SE.



With a view to stable and efficient functioning of the payment systems, the Bank of Lithuania, together with other Eurosystem central banks, assessed the readiness of payment systems operating within the euro area to withstand cyber attacks and prepared recommendations on enhancing their resilience.

**The Bank of Lithuania created and manages CENTROLink, a payment system that executes SEPA payments** and has links with the international payment systems STEP2 and RT1. Payments within the system can be executed not only by credit institutions, but also by payment and e-money institutions.

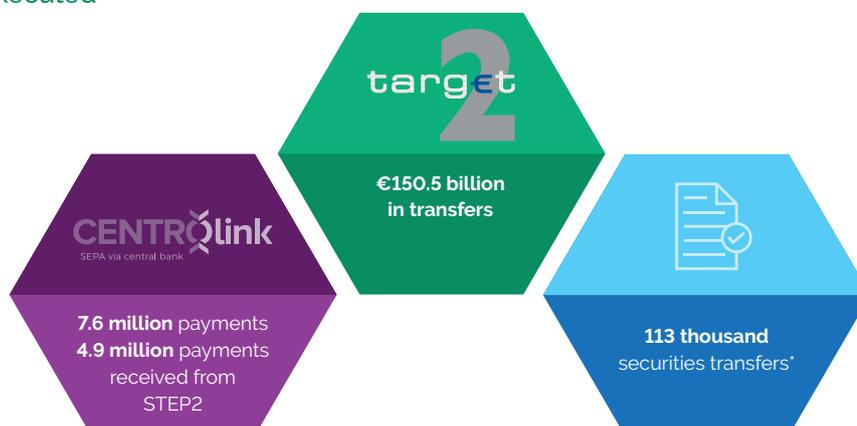
**In addition, the Bank of Lithuania is responsible for the component of TARGET2 – TARGET2-LIETUVOS BANKAS.** It is used for executing payments that implement Eurosystem monetary policy instruments and settling cash transactions between the Bank of Lithuania and credit institutions as well as urgent payments of bank clients.

**Having implemented a long-term project, domestic financial institutions, the Bank of Lithuania and Nasdaq CSD SE depository joined TARGET2-Securities (T2S).** The Bank of Lithuania was mandated to administer the access of Lithuanian credit institutions to the cash leg of T2S.

**A new SSS managed by Nasdaq CSD SE started functioning on 18 September 2017.** The depository was established in Latvia, with branches in Estonia and Lithuania. The licensing process of Nasdaq CSD SE was carried out in joint collaboration between the Bank of Lithuania and the Baltic supervisory and oversight authorities; Nasdaq CSD SE was the first central securities depository in the EU to be licensed in line with Regulation (EU) No 909/2014.

**The Bank of Lithuania has been devoting more attention to the cyber resilience of payment systems; together with other Eurosystem central banks, it assessed the readiness of payment systems operating within the euro area to withstand cyber attacks** and prepared recommendations on enhancing their resilience. The assessment was based on the CPMI-IOSCO guidance on cyber resilience for financial market infrastructures.

## Market infrastructure in Lithuania and transactions executed



\*Until 14 September 2017 securities transfers were carried out via a securities system operated by the Central Securities Depository of Lithuania.

# Payments

## Revision of the price and composition of the basic payment account service

 Lithuanian residents were ensured the right to use the basic payment account service and, in turn, the possibility to use basic payment services for a reasonable price.

 The Bank of Lithuania left the current price (€1.5 or €0.75 for residents receiving social aid) and composition of the payment service basket unchanged for 2018.

 With banks offering various types of service packages, already half of residents have started using payment service baskets.

## Choice of pricing for payment services in Lithuania



Source: Survey of residents conducted on behalf of the Bank of Lithuania.

## Implementation of the Payment Services Directive

 Legal acts transposing the Payment Services Directive were drafted.

 The new framework will ensure better consumer protection in case of unauthorised payment transactions, stricter payment security requirements and more favourable conditions for closing a payment account.

 Innovative services (payment initiation and account information) are to emerge in the market, contributing to the increase in market competition.

 The API Standard Working Group prepared recommendations on the standardisation of the payment initiation and account information services.

## Regulatory benefits



**From February 2017 banks and credit unions must offer consumers the basic payment account service**, the composition and price cap of which is set by the Bank of Lithuania. By the end of 2017, the basic payment account service was used by more than 42 thousand residents. Banks have been also providing consumers with payment service baskets of their own, which have replaced the previous pricing when a fee was charged for each transaction or service.

**Upon the revision of the price cap for the basic payment account, the Bank of Lithuania left its monthly price unchanged (€1.5 or €0.75 for residents receiving financial social aid).** The composition of the payment service basket has also remained unchanged. The payment service basket has been set at a regulated price quite recently; therefore, before initiating any changes, regulatory effects should be monitored for a longer period of time.

**In 2017 the Bank of Lithuania, together with the Ministry of Finance, prepared draft legal acts transposing the Payment Services Directive.** The new regulatory framework will ensure better consumer protection in many situations, for example, in cases of unauthorised payments. The new services, i.e. payment initiation and account information, are expected to have the most significant effect. The providers of these services will usher in innovation by offering consumer-friendly payment products, more convenient payment acceptance when purchasing on e-shops, and a possibility to analyse data from all accounts in one place.

**The market-initiated API Standard Working Group prepared a report containing recommendations** on how to ensure that the API required for payment initiation and account information services is safe and, in turn, contributes to the development of the payments market in Lithuania.

# Supervision

## Financial market



In carrying out the supervision of financial market participants, the Bank of Lithuania aims to ensure reliable and effective functioning of the financial market as well as its sustainable development, responsible behaviour of market participants and rational financial decision-making by consumers.



Information on market participants and their operating results as well as reviews on the activities of market participants are published on the Bank of Lithuania [website](#).



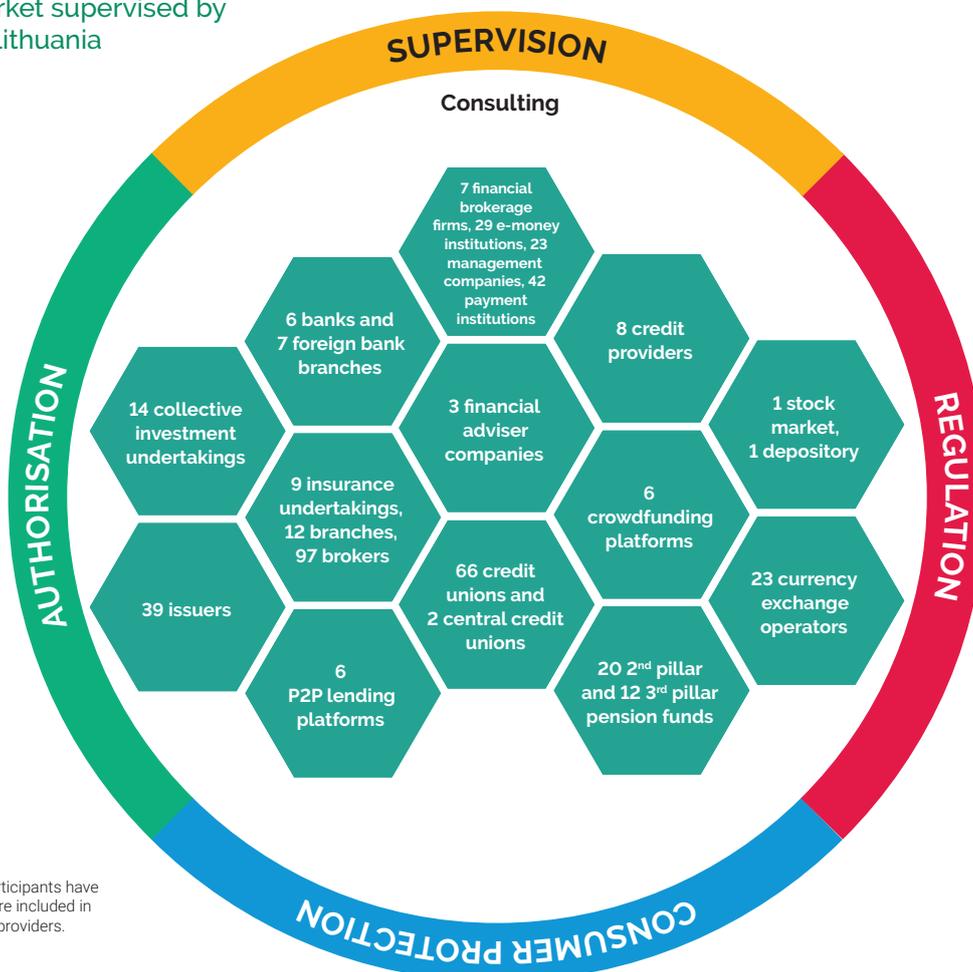
The Bank of Lithuania supervises more than 450 market participants whose assets exceed €36.7 billion.

**The banking sector undergone considerable consolidation in 2017:** the largest banks in the country continued to optimise their functions, distributing them among the centres of excellence within the group. The merger between AB DNB and Nordea Bank, AB, was completed: the new bank called Luminor started its operation on 1 October 2017. It is the third largest bank in Lithuania with a market share of 16% in deposits and 23% in lending, and a wide customer base of around 1.3 million.

**Having opened the doors for establishing specialised banks, the Bank of Lithuania received numerous applications for such licences** (including the world famous startup Revolut). It should be noted, however, that the last banking licence in Lithuania was issued in 2007 to AB bankas Finasta. Some credit unions also started restructuring into specialised banks; hence, they will add to the range of financial services available to consumers and increase market competition.

**The year 2017 saw a growing interest in licences required for payment service provision.** Those keen on obtaining such licences were mostly foreign FinTech businesses (companies from the UK and other EU countries, Israel, Asia) as they granted authorisation to provide services across the EU.

## Financial market supervised by the Bank of Lithuania



Note: Some market participants have 2 or more licences or are included in several lists of service providers.

# Supervision

## Prudential supervision



The Bank of Lithuania continued to carry out ongoing supervision of market participants, mainly focusing on areas exposed to highest risk.



It inspected 2 banks, 2 insurance undertakings, 7 credit unions, 1 management company, 1 e-money institution, 1 financial brokerage firm, 1 payment institution; conducted 2 investigations; revoked 5 credit union and 1 insurance brokerage firm licence.



To assess risks assumed by banks and the adequacy of their management as well as set individual requirements, it carried out the annual Supervisory Review and Evaluation Process (SREP).



For the first time since the entry into force of the Solvency II Directive, the Bank of Lithuania conducted a comprehensive risk assessment of insurance undertakings.

### Banks continued to operate in a stable manner, while their business models remained unchanged:

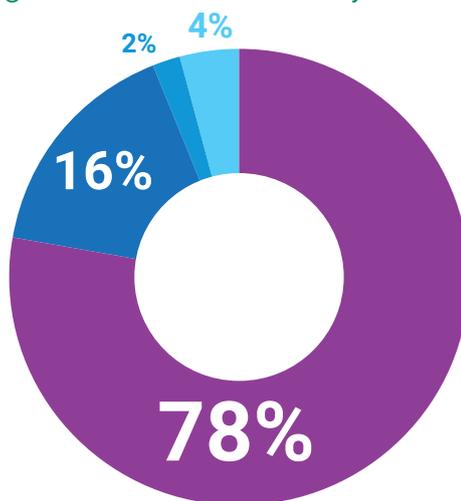
as before, the main share of their assets was comprised of loans, while deposits accounted for the bulk of their liabilities. Housing loans have posted strong growth within the loan segment in recent years. The level of non-performing loans remained broadly unchanged and continues to be well below the EU average. Deposits with banks have recently been growing on account of corporate funds. The banking sector's capital continued on a sustainable path, whereas its liquidity level was still high.

**The insurance market maintained momentum;** its volumes reached €0.8 billion. Market growth was driven by a 21% increase in the non-life insurance sector, whereas the life assurance sector ended the year with a decline of 6%. Claims paid under insured events grew at a rather fast pace. Insurance undertakings earned more than €31 million in profit. The bulk of profits within the entire market was earned by life assurance undertakings. All insurance undertakings were solvent and complied with the solvency capital ratio. The operations of insurance brokerage firms were profitable, earning them €4.3 million.

### The credit union sector reform, which was implemented throughout 2017, was successfully completed.

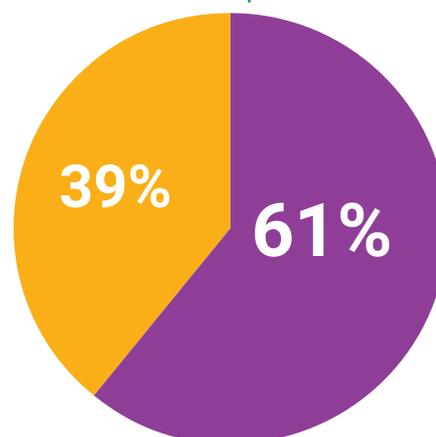
Since the beginning of 2018, 2 central credit unions have been in operation: the Lithuanian Central Credit Union, whose membership includes 50 credit unions and the Government of the Republic of Lithuania, and the newly-established United Central Credit Union, comprising 11 credit unions. Having incurred a loss of €6.1 million a year earlier, in 2017 the credit union sector earned €2.2 million in unaudited profits. The capital adequacy and liquidity ratios within the credit union sector stood above the established requirements; however, 7 credit unions did not meet certain prudential requirements. In 2017 the Bank of Lithuania completed the valuation of the quality of credit union assets.

### Banking and credit union market by assets



- banks
- foreign bank branches
- credit unions
- central credit unions

### Insurance market under supervision



- life assurance undertakings
- non-life insurance undertakings

# Supervision

## Licensing



The Bank of Lithuania authorised 24 e-money and payment institutions, 4 insurance brokerage firms, 1 central credit union, 11 management companies and investment undertakings.



7 companies were included in the public lists of operators of crowdfunding and P2P lending platforms.



The ECB did not oppose the acquisition of AB DNB bankas.



By proposal from the Bank of Lithuania, the ECB issued a credit institution licence to the United Central Credit Union.



The LCCU was recognised as complying with the new Law on Central Credit Unions.



5 credit unions were permitted to restructure into specialised banks.



The Bank of Lithuania received 3 applications for a specialised bank licence

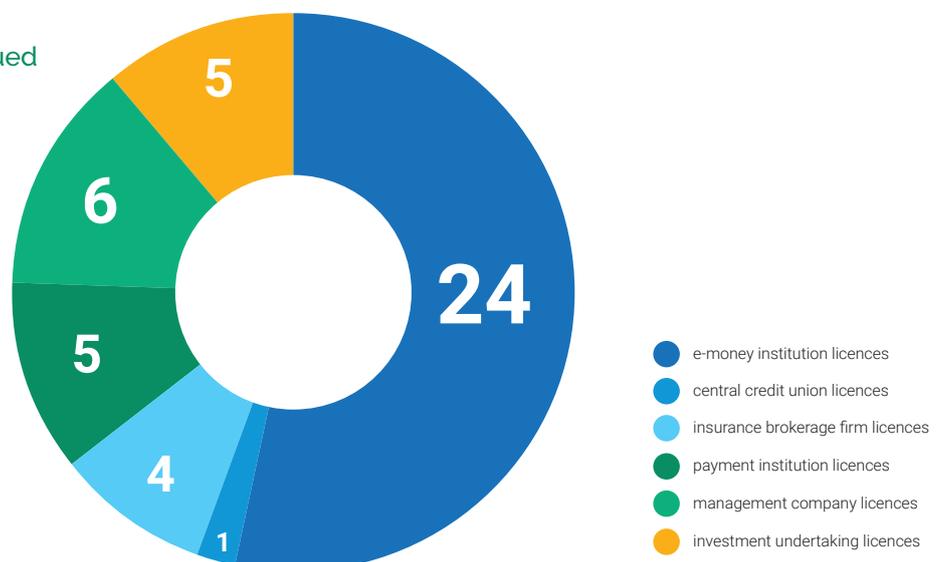
**In 2017 the Bank of Lithuania received 3 applications for a specialised bank licence.** According to the most recent data, in addition to the 3 already submitted applications, market participants intend to submit another 19 in 2018. These include applications from 5 credit unions that have been authorised to restructure into a specialised bank. It is important to note that licences for specialised banks, like others, are issued by the ECB.

**In 2017 FinTech companies were issued 29 licences** – nearly twice as many as in 2016 (17 licences granted). Having met with more than 100 companies to discuss the possibilities to set up in Lithuania, currently the Bank of Lithuania is investigating nearly 20 applications.

**With a view to making Lithuania an international hub for payment services and encouraging innovation in the domestic payments market, the Bank of Lithuania has already developed a one-stop shop, set up a dedicated email for all queries on setting up in Lithuania, allowed foreign citizens to submit documents necessary for obtaining a licence in English, and updated the Lithuanian and English versions of its Licensing Guide.** As of September 2017, the Bank of Lithuania website has a section dubbed the Newcomer Programme. In a concise and clear manner, it presents key information for new market participants under establishment. Since its launch, the section has been viewed more than 1,300 times. The Bank of Lithuania has also been creating a regulatory sandbox that will allow companies developing innovative financial products to test their business solutions in a controlled environment, with no regulatory sanctions.

**In 2018 the Bank of Lithuania is also planning to launch an electronic licensing facility** – all companies will be able to get the necessary paperwork done electronically, thus saving time and resources.

Licences issued



# Supervision

## Supervision of financial services



The Bank of Lithuania investigated more than 700 complaints from natural and legal persons and inquiries regarding financial service providers' compliance with legislative requirements.



It carried out 24 inspections and investigations regarding financial service providers' compliance with legislative requirements (most of which were related to consumer credit provision).



It imposed 19 enforcement measures for the violation of legal acts regulating financial services.



The number of collective investment undertakings for informed investors increased as 16 of them were established in 2017.



A Lithuanian company launched the first ever IPO of corporate green bonds.

**Most complaints and inquiries received by the Bank of Lithuania were related to consumer credit provision. Last year the central bank also saw a rise in the number of complaints and inquiries regarding the provision of payment and insurance services.**

**The Bank of Lithuania imposed 6 fines and 3 warnings on consumer credit providers and operators of P2P lending platforms** for the violations of the provisions of the Law on Consumer Credit. Fewer cases of essential violations in creditworthiness assessment have been noted.

**In monitoring the financial services market, the Bank of Lithuania took notice of the credit union Taupkasė and its service Indėlis PLIUS.** One of its requisite conditions was to transfer part (30, 50 or 70%) of the amount designated for saving as additional share into the credit union's capital. The supervisor concluded that Taupkasė provided inadequate information to its clients: offering a fixed-term deposit PLIUS with the possibility to acquire additional share, the company did not disclose all of the inherent risks and consequently received a fine.

**The Bank of Lithuania publicly warned insurers** that it would treat such insurer actions when vehicle owners are offered exceptionally high compulsory MTPL insurance premiums as avoidance to conclude insurance contracts and will apply statutory sanctions.

**Following the initiation of amendments to the Law on Companies by the Bank of Lithuania and the Government of the Republic of Lithuania, private limited liability companies were allowed to issue bonds publicly.** Having issued €300 million worth of green bonds, Lietuvos energija, UAB, has listed them on the Luxembourg and Nasdaq Vilnius stock markets.

Financial service supervision is aimed at drawing a fair balance between financial market participant and consumer interests



# Supervision

## Supervision of financial services



The Law on Real Estate Related Credit, aimed at strengthening legal protection of borrowers, has come into force.



To encourage capital market development, the prepared amendments to the laws regulating the activities of collective investment undertakings were submitted to the Ministry of Finance.



The Bank of Lithuania took action within the payment services provision market, recommending banks to give up debt accumulation practises with regard to clients owning inactive accounts.



Virtual currencies gained popularity.

**The Bank of Lithuania announced its position regarding banks and their clients' inactive accounts.** Credit institutions were urged to take active measures to close dormant yet cost-bearing accounts. In addition, credit institutions were advised not to impose any charges on accounts that are empty and have shown no activity within a 12-month period. If there are still funds on the inactive account, credit institutions should notify clients of their dormant account, disclose any applicable fees and offer the possibility to transfer funds or close the account altogether. The Bank of Lithuania has been actively monitoring the market situation and banks' actions vis-à-vis clients who have dormant accounts. As at 31 December 2017, dormant accounts accounted for a quarter (1.1 million) of all payment accounts with banks – since 31 May 2017 their number has declined by more than 423 thousand.

**The Bank of Lithuania announced its position on virtual currencies and ICO.** Given that virtual currencies have become more popular, the Bank of Lithuania warned the public of the risks involved, urging them to be more cautious. In its position intended towards market participants, the Bank of Lithuania stated that the supervised financial market participants should not engage in activities related to virtual currencies. In addition, the Bank of Lithuania has also provided its assessment on ICO, a method for attracting capital that has been rapidly gaining traction. Despite the fact that this activity is unregulated, in its nature, it constitutes collection of money from investors; therefore, in certain cases, such offerings should be subject to the requirements and restrictions of investment-related laws. The Bank of Lithuania has already received a multitude of queries regarding business models and compliance of ICO with the established requirements.

### Law on Real Estate Related Credit



Uniform offers



30-day consideration period



Right to refuse additional financial products



Mandatory specification of contractual terms



Ceiling for early credit repayment



Payment deferral for up to 3 months

# Settlement of disputes between consumers and financial market participants

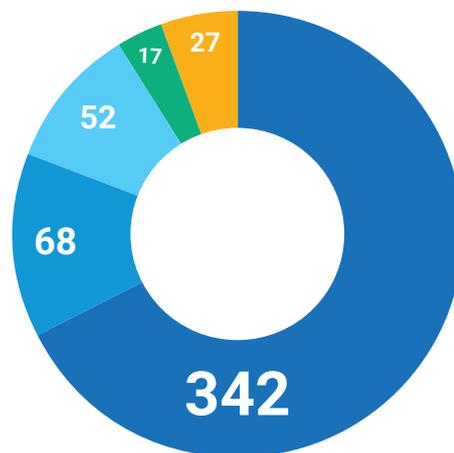


The Bank of Lithuania settled 506 disputes over financial services provision agreements, took decisions regarding the subject matter of 215 disputes.



Even though the increase in the number of disputes settled in 2017 was marginal compared to 2016, the number of disputes with insurance undertakings grew significantly.

Disputes by type of financial service



- non-life insurance
- crediting
- payment services
- life assurance
- other services

**In 2017, as many as 71% of all disputes settled at the Bank of Lithuania involved insurance undertakings, disputes with banks accounted for 20%, while 9% of total disputes were with other financial market participants.** Disputes with insurers over non-life insurance contracts have been on an upward climb. Compared to 2016, the number of such disputes increased by 33%; they accounted for 94% of all disputes with insurance undertakings. In total, the market recorded 110 disputes over compulsory MTPL insurance, 99 – over property insurance, and 58 – over land vehicles (other than railway rolling stock) insurance (CASCO). In addition, quite many disputes with financial market participants arose over crediting (68) and payment services (52).

**In settling disputes, the Bank of Lithuania always aims at ensuring that the parties to the dispute reach a peaceful agreement.** With the total number of disputes settled having grown 10%, peaceful agreements saw similar growth (9%) – during the reporting year 76 disputes were settled by reaching a peaceful agreement.

**During the reporting period, a total of 36% of Bank of Lithuania decisions was made in favour of consumers, while financial market participants implemented 83% of Bank of Lithuania recommendations.** Despite the year-on-year increase in the number of disputes settled in favour of consumers (75% of the recommendations were implemented), financial market participants were more keen on implementing the decisions taken by the Bank of Lithuania. The list of impersonal decisions of the Bank of Lithuania regarding the subject matter of a dispute and financial market participants that have not implemented the above-named recommendations is published on the Bank of Lithuania website.

Disputes by financial market participant



# Bank resolution



The prepared resolution plans cover 3/4 of Lithuania's banking market.



Preparations for the 2019 Nordic-Baltic crisis management exercise were started.



€6.95 million collected from banks operating in Lithuania was transferred to the Single Resolution Fund.



The Bank of Lithuania formed a position on the most important provisions of the amendments to the Bank Recovery and Resolution Directive and presented it at the Council of Europe.

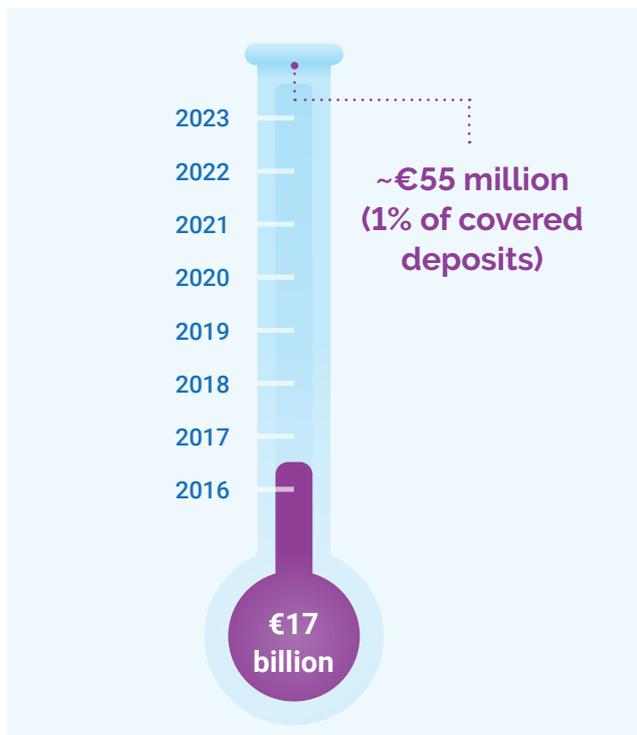
In 2017 the Bank of Lithuania carried out its functions as the national resolution authority in close cooperation with the Single Resolution Board, which is the central resolution authority within the banking union aiming at ensuring orderly resolution of banks in the euro area member states. Participating in the resolution colleges of Swedish, Danish and Latvian banking groups, the Bank of Lithuania helped to prepare resolution plans, mainly focusing on determining bank functions that are of particular importance for the real economy and analysing possible resolution financing sources.

With a view to further enhancing its institutional capacities in crisis management, the Bank of Lithuania joined the common regional project of the Nordic and Baltic countries, coordinated by Sweden's Riksbank. Over the course of the project, counterparties plan to carry out a cross-border crisis management exercise as well as assess the respective institutions' readiness to manage crises. The exercise will take place in 2019.

In 2017, banks operating in Lithuania paid €6.95 million in ex-ante contributions, which were transferred to the Single Resolution Fund. In 2015–2017 Lithuanian banks paid, in total, €24.5 million in ex-ante contributions (all credit institutions within the banking union – €17 billion).

In 2017 the Bank of Lithuania took an active part in the review of the legal basis of the EU resolution framework – the Bank Recovery and Resolution Directive. At the Council of Europe it also presented its position regarding the Commission's proposal of November 2016 on the implementation of risk mitigating measures in the banking sector. Most attention was devoted to such issues as distinction of the powers of resolution authorities of international banking groups, imposition of a moratorium, and the introduction of a safety margin for absorbing losses and recapitalising subsidiary banks.

## Single Resolution Fund at the end of 2017



# Cash



The Bank of Lithuania completed the Reform of Cash Circulation, which allowed optimising domestic cash management processes.



The total value of euro cash issued into circulation by the Bank of Lithuania amounted to €3,056.7 million on 31 December 2017, a year-on-year increase of 17.4%.



The Bank of Lithuania exchanged into euro nearly LTL 20.1 million; the total value of litas in circulation decreased to LTL 450.8 million.



It issued into circulation 7 collector euro coins and 1 commemorative euro coin.



The Bank of Lithuania approved its Coin Creation Strategy.



2,680 counterfeit euro banknotes and coins were withdrawn from circulation.



As of 1 July 2017, the Bank of Lithuania took over the majority of authenticity examinations of suspicious euro banknotes from the Lithuanian Police Forensic Science Centre.

## Net currency issue

EUR millions

	Q1	Q2	Q3	Q4
2015	1,618.94	1,823.00	1,956.22	2,160.72
2016	2,204.31	2,354.07	2,444.08	2,604.27
2017	2,670.53	2,773.98	2,854.00	3,056.71

**In 2017 the Reform of Cash Circulation was concluded.** This allowed for optimising domestic cash management processes, reducing cash management and transport costs as well as costs related to cash cycle management incurred by the Bank of Lithuania. **Financial gain related to the reform totalled €1.1 million.**

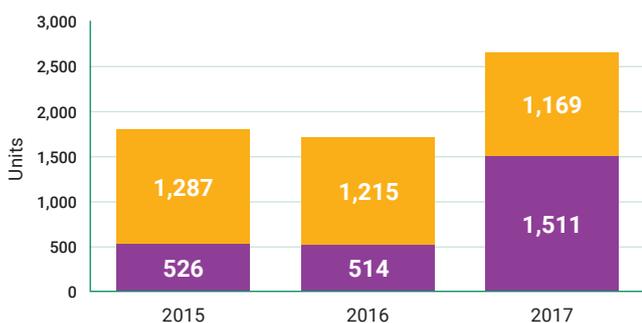
**On 31 December 2017, year on year, the total value of euro banknotes and coins issued into circulation by the Bank of Lithuania increased by 17.4%, to stand at €3,056.7 million (including numismatic items).** In 2017, the total value of litas banknotes and coins in circulation decreased by 4.8% – to LTL 450.8 million.

**In 2017 the Bank of Lithuania issued into circulation 7 collector euro coins, 5 of which were minted in silver (Ag 925), 2 – from a copper-nickel alloy.** It also issued a €2 commemorative coin with the Lithuanian national side. More information is available [here](#).

**In 2017 the Bank of Lithuania prepared its Coin Creation Strategy,** which sets out the coin creation model, specific tasks and implementing measures aimed at expanding the scope of themes, increasing the involvement of the public in coin issue, and ensuring a high artistic level of coins issued as well as appropriate representation of the Bank of Lithuania.

**2,435 counterfeit euro banknotes, 245 counterfeit euro coins and 48 counterfeit litas banknotes were withdrawn from circulation.** The majority of counterfeit notes (85%) were €50 banknotes. The new €50 banknotes from the Europa series, containing enhanced security features, entered into circulation on 4 April 2017.

## Counterfeit euro cash withdrawn from circulation in Lithuania



- examined at the Lithuanian Police Forensic Science Centre and the Forensic Science Centre of Lithuania
- examined at the Bank of Lithuania

Source: Bank of Lithuania.

**As of 1 July 2017, the Bank of Lithuania took over the majority of authenticity examinations of suspicious euro banknotes that the Lithuanian Police Forensic Science Centre had previously performed, in turn establishing itself as a centre of excellence.** The Bank of Lithuania conducted 56.4% of total authenticity examinations (2.9 times more than in 2016). In 2017, the Bank of Lithuania received 3,692 applications (1.6 times more than in 2016) from natural and legal persons to exchange worn or damaged currency.

# Handling of statistics



The Bank of Lithuania improved statistics dissemination to meet user needs.



Bank of Lithuania statistics were integrated into the OECD framework for statistics.



The Bank of Lithuania developed new financial statistics.

**In 2017, the statistics page on the Bank of Lithuania website was tailored to meet target user needs.** Statistical data is now presented in brief and predefined tables as well as comprehensive databases. The data is easily accessible on mobile devices and via social media networks. The new website facilities allow users to download data in different formats or visualise them in charts. The upgraded page provides information on metadata, quality policy, data confidentiality and revisions, information for data providers, etc.

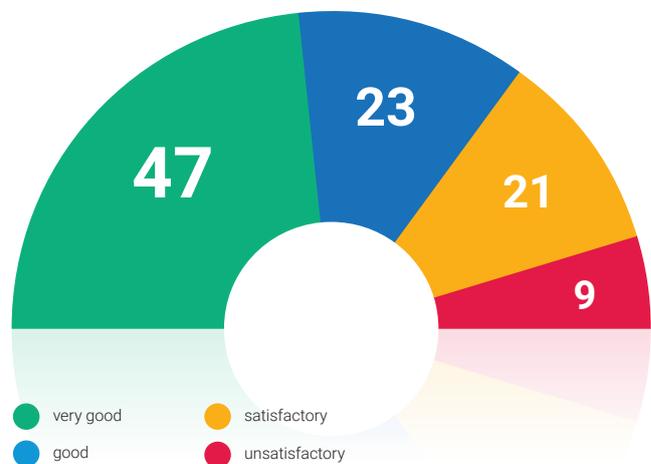
**Implementing OECD requirements,** the Bank of Lithuania compiled and submitted statistics on institutional investors, financial accounts, the balance of payments, and foreign direct investment. It also improved data consistency across statistical domains, which was recognised by the OECD experts.

## The central bank continued to develop new financial statistics:

- » statistics on the balance sheet of Lithuanian insurance corporations (other than their branches abroad) and of foreign branches established in Lithuania, covering data on life insurance and non-life insurance corporations;
- » more detailed data on export and import of services by type and country;
- » data on direct investment income by country and activity;
- » more detailed MFI balance sheet statistics on collective investment units holdings by currency and MFI holdings of own securities issued by themselves;
- » more detailed payments statistics.

**The Bank of Lithuania introduced a new format of statistical releases.** They now became shorter, highlighting major events and including more visual information.

## User assessment of the new Bank of Lithuania statistics dissemination



# Treasury agent

## Administration of the accounts of the State Treasury and other institutions

 The Bank of Lithuania administered euro and foreign currency accounts of the Ministry of Finance, European Commission and World Bank Group.

 It executed 473 thousand credit transfer instructions of the Ministry of Finance and other clients, amounting to €17.5 billion.

 At the end of 2017, the Bank of Lithuania and the Ministry of Finance created a joint working group to assess the optimisation of payment processes related to the state treasury management.

accordance with the procedure set forth by the State Treasury Law of the Republic of Lithuania and other legal acts. In addition, the Bank of Lithuania managed euro accounts of EU institutions and international financial institutions (hereinafter – other institutions). Monetary resources in the State Treasury accounts managed by the Ministry of Finance made up the largest share of funds held in all accounts.

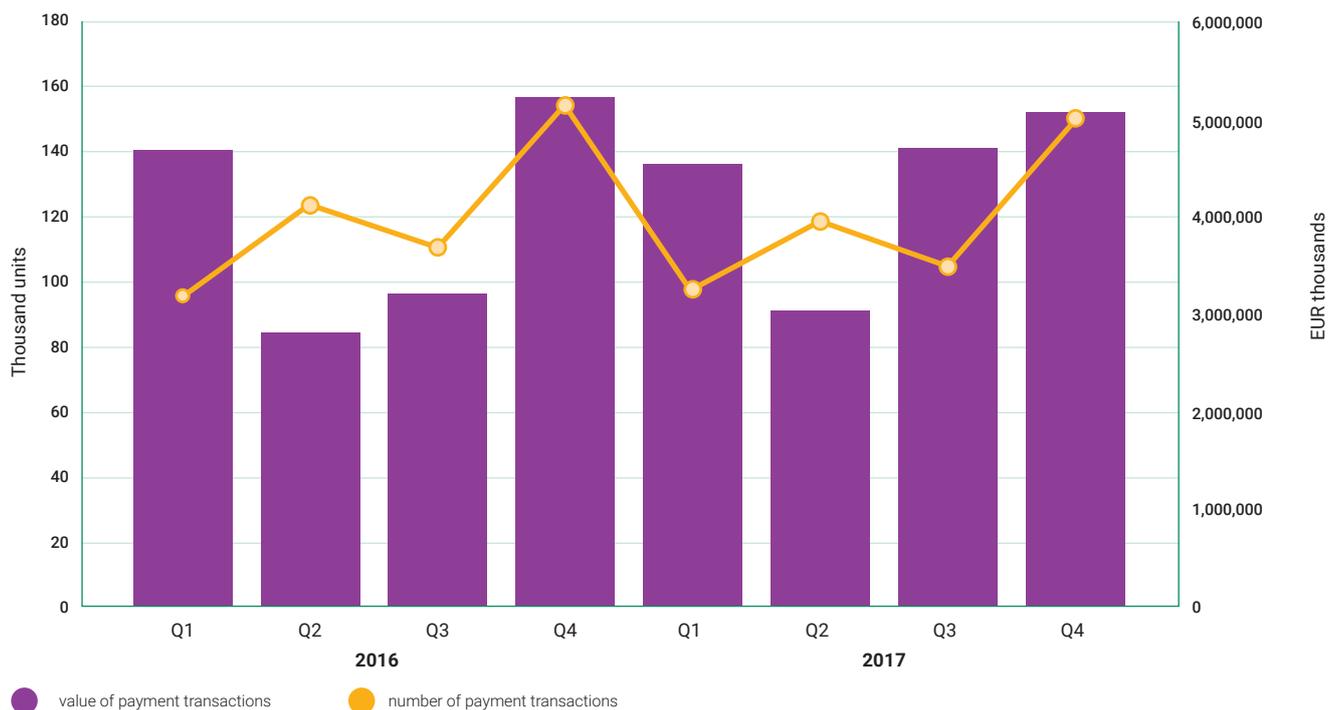
**As at 31 December 2017, 65 accounts of the State Treasury and other institutions were administered by the Bank of Lithuania** (as at 31 December 2016 – 68). These accounts were opened and administered at the Bank of Lithuania in accordance with the legal acts of the Republic of Lithuania, the Bank of Lithuania and the ECB.

**The following banking services are offered to the State Treasury and other institutions: payment services, foreign exchange transactions, account statements and other reporting services.** In 2017, the Bank of Lithuania executed 473 thousand credit transfer instructions of the Ministry of Finance and other institutions; their total value amounted to €17.5 billion.

Acting as a state treasury agent under the Law on the Bank of Lithuania, **in 2017 the Bank of Lithuania administered euro and foreign currency accounts of the State Treasury.** The state monetary resources held in these accounts are managed by the Ministry of Finance. The resources are accumulated and used in

**On 22 November 2017, at the initiative of the Bank of Lithuania, the Ministry of Finance and the Bank of Lithuania set up a joint working group,** which is to assess the strategies for optimising payment processes related to the state treasury management and, accordingly, prepare an action plan by 10 May 2018.

## Execution of credit transfer instructions of the Ministry of Finance and other institutions



# Organisation of activities

## Staff and working environment



The employees of the Bank of Lithuania are specialists that have suitable professional and academic qualification as well as excellent analytical skills.



On 31 December 2017, the number of actual staff positions at the Bank of Lithuania stood at 591\*.



The Bank of Lithuania devotes much attention to professional development of its staff and fosters a knowledge-sharing culture.



With the aim to optimise activities, the Bank of Lithuania restructured its Security Department, while the Public Procurement Division was declared autonomous.



**The employees that already have experience working in the organisation can further develop their careers climbing the career ladder.** In 2017, 10.45% of the Bank of Lithuania staff members took the opportunity to advance their career internally. The data also covers those employees that were promoted following a positive performance evaluation, as well as employees that took up managerial positions via internal recruitment.

**The Bank of Lithuania employees improved their competences in the field of central banking, as well as cooperated, exchanged**

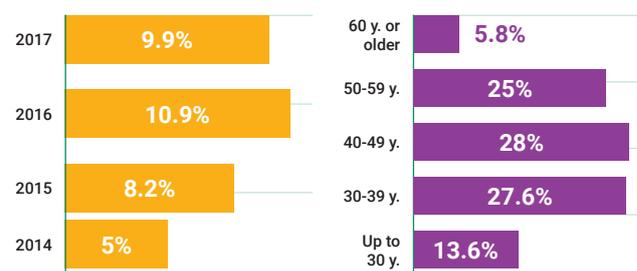


**ideas and shared best practices with ECB experts.** In 2017, 8 Bank of Lithuania employees had a unique opportunity to work at the ECB under fixed-term contracts. 2 Bank of Lithuania employees took part in the ECB's newly-launched Schuman Programme, which is aimed at encouraging short-term (6–9 months) mobility among the European central banks, gaining international experience and contributing to the activities of other European central banks.

**In 2017 the Bank of Lithuania continued to strengthen its staff management and leadership skills and launched a new initiative – the Talent Programme.** In order to implement its strategic directions that aim to maintain dialogue with financial market participants and attract new ones, build strong relationships of trust with external markets, and move towards a service-oriented approach in terms of external clients, the Bank of Lithuania introduced courses on attracting and retaining domestic and external payment service providers.

**The organisational structure of the Bank of Lithuania remained largely unchanged.** The Bank of Lithuania has 4 services, namely the Banking Service, the Economics and Financial Stability Service, the Supervision Service, and the Organization Service. Expanding research capacities in both applied and basic research falls under the domain of the Centre for Excellence in Finance and Economic Research. There are 4 autonomous divisions (the Public Procurement Division became autonomous in 2017, prior to this it was part of the Organization Service) and 4 autonomous departments. Having restructured the Security Department, part of security services was outsourced.

## Staff turnover (left-hand side) and distribution by age (right-hand side)



\*The number does not include 15 staff members who were on maternity/paternity leave and 9 staff members who were on unpaid leave during their work at other institutions.

# Research activities



Economic research at the Bank of Lithuania is primarily conducted at the Applied Macroeconomic Research Division (TMTS) and the Center for Excellence in Finance and Economic Research (CEFER).



Research carried out at TMTS plays a notable role in the decision-making process of the central bank.



Having signed a cooperation agreement with Kaunas University of Technology (KTU) in 2017, CEFER, established jointly with Vilnius University (VU), seeks to become a hub of economic and financial sciences in the Baltic region, raise the quality of economic and financial research, and encourage quality discussions on relevant economic and financial issues.



Main fields of expertise at CEFER:

- » International finance and macrofinance
- » Impact of debt on the economy and households
- » Labour economics, reform modelling and assessment
- » Experimental economics
- » Dynamic Stochastic General Equilibrium models
- » Household consumption and income inequality

**Top-tier international publications.** In 2017, CEFER and TMTS (including visiting researchers) prepared 14 working papers and 8 publications, some of which were published in internationally-acclaimed journals such as *Journal of Finance*, *Journal of International Money and Finance*, *Contemporary Economic Policy*, and *Labour Economics*.

**High-level conferences, seminars, workshops and research clusters across the Baltics.** A perfect example is the annual Lithuanian economics conference, which this year will also be the inaugural Baltic Economic Conference, held in Vilnius on June 2018. It will host, among others, the keynote speaker Prof. M. Hashem Pesaran from the Universities of Cambridge and Southern California, one of the leading experts in macroeconomics and

econometrics. Organising a biennial conference as well as joint exchange programmes and discussions with researchers from the Baltic central banks, the Bank of Lithuania has also been developing close links with the Central Bank Research Association and the National Bank of Poland.

**Promotion of quality economic and financial thought.** To this end, the employees of the central bank welcome visiting researchers, give presentations and hold seminars open to the general public, central bank staff, as well as external researchers and experts. To encourage high-quality research, the Bank of Lithuania grants two awards for scientific activities: the Vladas Jurgutis Award (€10 thousand) and the Bank of Lithuania Award for Dissertation in the Field of Economics (€5 thousand).

**Education, lectures and updated study programmes.** In cooperation with TMTS and VU, CEFER created a bachelor's programme in Quantitative Economics that offers a unique blend of contemporary economics, mathematics, statistics, and data science. The English-taught programme led by CEFER and TMTS researchers as well as VU lecturers is expected to promote education transcending national borders, allow talented youth to stay in Lithuania, and prepare a new generation of analysts able to combine economic intuition, data analytics, and mathematical and computer modelling. This will add to the pool of highly-skilled workers. In addition, CEFER proposed to develop a joint VU and KTU PhD programme in Economics that would be on a par with those taught at top universities, helping to save the already scarce human resources and raise the bar in terms of quality, thus contributing to the education of the new generation of scholars. CEFER also took the initiative and organised various seminars and workshops aimed at increasing the competence of researchers working at universities.



# Other important events during the reporting period



The Bank of Lithuania organised several high-level conferences: the international Macroprudential Policy Conference, two Real Estate Conferences, and the Economics Conference on income inequality in Lithuania.



At the end of 2017 the Deutsche Bundesbank, Narodowy Bank Polski and Lietuvos bankas signed a consortium agreement for the implementation of the EU Twinning Project 'Strengthening the National Bank of Belarus'.



On 24 April 2017, the Bank of Lithuania launched its new website (4.62 million views by 31 December), which took the award for Central Banking's Website of the Year.



It increased the use of social media for communications purposes (reach: Facebook – 1.2 million users, LinkedIn – 0.5 million users, Twitter – 75 thousand users).



Tomas Garbaravičius, Member of the Board of the Bank of Lithuania, at the Central Banking Awards in London

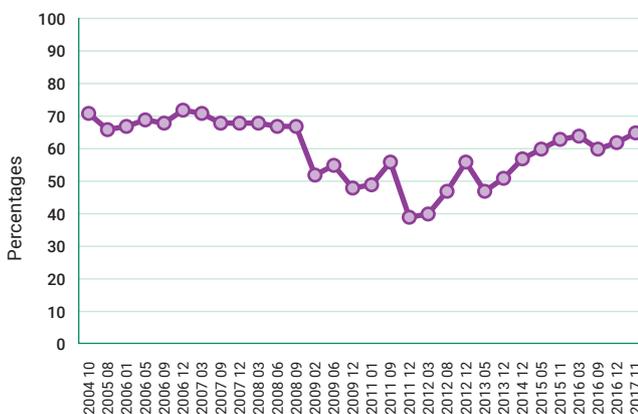
One of the most prominent international events organised by the Bank of Lithuania in 2017 was the high-level conference on macroprudential policy issues titled 'Should macroprudential policy target real estate prices?' Featuring keynote speeches by Stefan Ingves, Governor of Sveriges Riksbank, and Jon Danielsson, Director of the Systemic Risk Centre at the London School of Economics, the conference provided a unique opportunity for key stakeholders to share best practices in identifying RE price bubbles as well as views on macroprudential tools used to prevent them. It brought together high-level policymakers from the Bank of Lithuania, ECB, IMF, and the central banks of Poland, France, Sweden, Germany and other countries, as well as researchers and experts from leading financial and academic institutions (more than 40 representatives from around the world).

Seeking to gather policy advisers and academics from Lithuania and abroad to discuss risks posed by income inequality as well as possible ways to tackle the issue, **the Bank of Lithuania organised the international Economics Conference on income inequality in Lithuania.**

In September 2017, the proposal for the EU Twinning Project 'Strengthening the National Bank of Belarus', submitted by a consortium of national central banks of Germany, Lithuania and Poland, was selected and a Consortium Agreement was signed later in the year, on 22 December. **With a budget of €1.15 million, the project aims to enhance the capacity of the National Bank of Belarus to effectively pursue its core responsibilities in the field of financial stability, banking supervision, payment systems, financial consumer protection, and communication policy.** Set to run for 18 months, the project counts on the expertise of the Bundesbank as the main partner and the central banks of Poland and Lithuania as junior partners.

**The website of the Bank of Lithuania took the award for Central Banking's Website of the Year.** According to the international publisher, the key factors behind the website's success were its user-friendly information architecture, designed to make the most relevant information as accessible as possible, as well as the visually-appealing take on content presentation (e.g. short videos showcasing the key functions of the central bank).

## Level of public confidence in the Bank of Lithuania





**LIETUVOS BANKAS**  
EUROSISTEMA

# Annual Financial Statements of the Bank of Lithuania

**2017**

# CONTENTS

<b>INDEPENDENT AUDITOR'S REPORT TO THE SEIMAS OF THE REPUBLIC OF LITHUANIA</b>	<b>38</b>
<b>BALANCE SHEET OF THE BANK OF LITHUANIA</b>	<b>40</b>
<b>PROFIT AND LOSS ACCOUNT OF THE BANK OF LITHUANIA</b>	<b>42</b>
<b>EXPLANATORY NOTES</b>	<b>43</b>
1. Basis for preparation and presentation of the Annual Financial Statements	<b>43</b>
2. Accounting policy	<b>43</b>
3. Financial risk and its management	<b>48</b>
4. Financial accounting principles on operations related to participation in the Eurosystem	<b>49</b>
5. Notes on the Balance Sheet	<b>53</b>
6. Notes on the Profit and Loss Account	<b>63</b>
7. Other notes	<b>67</b>



## Independent auditor's report

To the Seimas of the Republic of Lithuania

### Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank of Lithuania ("the Bank") as at 31 December 2017 and its financial performance for the year then ended in accordance with Guideline (EU) 2016/2249 of the European Central Bank (ECB) on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), adopted by the Governing Council of the ECB, the Law on the Bank of Lithuania and the Accounting Policy approved by the Board of the Bank of Lithuania.

#### *What we have audited*

The Bank's financial statements comprise:

- the balance sheet as at 31 December 2017;
- the profit and loss account for the year then ended;
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Independence*

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the Law of the Republic of Lithuania on the Audit of Financial Statements that are relevant to our audit of the financial statements in Republic of Lithuania. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the Law of the Republic of Lithuania on the Audit of Financial Statements.

### Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Guideline (EU) 2016/2249 of the European Central Bank (ECB) on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), adopted by the Governing Council of the ECB, the Law on the Bank of Lithuania and the Accounting Policy approved by the Board of the Bank of Lithuania, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

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## **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

On behalf of PricewaterhouseCoopers UAB

A handwritten signature in blue ink, appearing to read 'Rimvydas Jogėla', is written over a circular blue stamp or seal.

Rimvydas Jogėla  
Partner  
Auditor's Certificate No.000457

Vilnius, Republic of Lithuania  
3 April 2018

# Balance Sheet of the Bank of Lithuania

EUR thousands

	Notes	31 December 2017	31 December 2016
<b>ASSETS</b>			
<b>1. Gold and gold receivables</b>	<b>1</b>	<b>202,484</b>	<b>205,508</b>
<b>2. Claims on non-euro area residents denominated in foreign currency</b>		<b>4,003,379</b>	<b>2,735,714</b>
Receivables from the IMF	2	163,092	175,044
Balances with banks and security investments, external loans and other external assets	3	3,840,288	2,560,670
<b>3. Claims on euro area residents denominated in foreign currency</b>	<b>4</b>	<b>9</b>	<b>137,272</b>
<b>4. Claims on non-euro area residents denominated in euro</b>	<b>5</b>	<b>8,934</b>	<b>71,439</b>
<b>5. Lending to euro area credit institutions related to monetary policy operations denominated in euro</b>	<b>6</b>	<b>303,000</b>	<b>303,000</b>
Main refinancing operations		-	-
Longer-term refinancing operations		303,000	303,000
Fine-tuning reverse operations		-	-
Structural reverse operations		-	-
Marginal lending facility		-	-
Credits related to margin calls		-	-
<b>6. Other claims on euro area credit institutions denominated in euro</b>	<b>7</b>	<b>12,077</b>	<b>365</b>
<b>7. Securities of euro area residents denominated in euro</b>		<b>10,265,899</b>	<b>6,836,895</b>
Securities held for monetary policy purposes	8	9,699,423	6,339,625
Other securities	9	566,476	497,270
<b>8. General government debt denominated in euro</b>		<b>-</b>	<b>-</b>
<b>9. Intra-Eurosystem claims</b>		<b>3,803,146</b>	<b>4,003,096</b>
Participating interest in the ECB	10	207,183	207,183
Claims equivalent to the transfer of foreign reserves	11	239,454	239,454
Net claims related to the allocation of euro banknotes within the Eurosystem	12	3,356,508	3,556,459
Other claims within the Eurosystem (net)		-	-
<b>10. Items in course of settlement</b>		<b>-</b>	<b>-</b>
<b>11. Other assets</b>		<b>179,639</b>	<b>117,010</b>
Tangible and intangible fixed assets	13	30,781	30,034
Other financial assets	14	3,355	3,355
Off-balance-sheet instruments revaluation differences	15	71,336	32,578
Accruals and prepaid expenses	16	71,466	50,108
Sundry	17	2,702	936
<b>TOTAL ASSETS</b>		<b>18,778,567</b>	<b>14,410,300</b>

# Balance Sheet of the Bank of Lithuania

EUR thousands

	Notes	31 December 2017	31 December 2016
<b>LIABILITIES</b>			
<b>1. Banknotes in circulation</b>	<b>18</b>	<b>6,321,866</b>	<b>6,081,566</b>
<b>2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro</b>	<b>19</b>	<b>5,077,380</b>	<b>2,481,461</b>
Current accounts (covering the minimum reserve system)		5,077,380	2,481,461
Deposit facility		-	-
Fixed-term deposits		-	-
Fine-tuning reverse operations		-	-
Deposits related to margin calls		-	-
<b>3. Other liabilities to euro area credit institutions denominated in euro</b>	<b>20</b>	<b>1,200</b>	<b>-</b>
<b>4. Debt certificates issued</b>		<b>-</b>	<b>-</b>
<b>5. Liabilities to other euro area residents denominated in euro</b>	<b>21</b>	<b>1,868,929</b>	<b>691,063</b>
General government		1,840,777	689,958
Other liabilities		28,153	1,105
<b>6. Liabilities to non-euro area residents denominated in euro</b>	<b>22</b>	<b>11,400</b>	<b>21,362</b>
<b>7. Liabilities to euro area residents denominated in foreign currency</b>	<b>23</b>	<b>224,770</b>	<b>372,947</b>
<b>8. Liabilities to non-euro area residents denominated in foreign currency</b>	<b>24</b>	<b>31,936</b>	<b>45,815</b>
<b>9. Counterpart of special drawing rights allocated by the IMF</b>	<b>25</b>	<b>162,985</b>	<b>174,924</b>
<b>10. Intra-Eurosystem liabilities</b>		<b>3,985,282</b>	<b>3,536,746</b>
Net liabilities related to the allocation of euro banknotes within the Eurosystem		-	-
Other liabilities within the Eurosystem (net)	<b>26</b>	3,985,282	3,536,746
<b>11. Items in course of settlement</b>	<b>27</b>	<b>21,469</b>	<b>1,300</b>
<b>12. Other liabilities</b>		<b>270,813</b>	<b>217,826</b>
Off-balance-sheet instruments revaluation differences	<b>15</b>	47,626	5,023
Accruals and income collected in advance	<b>28</b>	9,025	4,190
Sundry	<b>29</b>	214,162	208,613
<b>13. Provisions</b>	<b>30</b>	<b>106,895</b>	<b>105,728</b>
<b>14. Revaluation accounts</b>	<b>31</b>	<b>217,327</b>	<b>223,661</b>
<b>15. Capital</b>	<b>32</b>	<b>444,389</b>	<b>428,896</b>
Authorised capital		60,000	60,000
Reserve capital		384,389	368,896
<b>16. Profit for the year</b>	<b>43</b>	<b>31,926</b>	<b>27,004</b>
<b>TOTAL LIABILITIES</b>		<b>18,778,567</b>	<b>14,410,300</b>

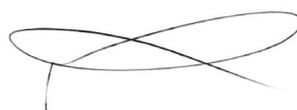
# Profit and Loss Account of the Bank of Lithuania

EUR thousands

	Notes	2017	2016
Interest income		64,810	34,240
Interest expense		(6,504)	(3,664)
<b>1. Net interest income</b>	<b>33</b>	<b>58,306</b>	<b>30,576</b>
Realised gains (losses) arising from financial operations		6,125	28,557
Write-downs on financial assets and positions		(50,406)	(6,390)
Transfer to provisions for risks		-	(56,500)
<b>2. Net result of financial operations, write-downs and risk provisions</b>	<b>34</b>	<b>(44,281)</b>	<b>(34,334)</b>
Fees and commissions income		7,091	6,028
Fees and commissions expense		(1,852)	(1,282)
<b>3. Net income from fees and commissions</b>	<b>35</b>	<b>5,239</b>	<b>4,747</b>
<b>4. Income from equity shares and participating interests</b>	<b>36</b>	<b>10,900</b>	<b>13,190</b>
<b>5. Net result of pooling of monetary income</b>	<b>37</b>	<b>34,670</b>	<b>47,924</b>
<b>6. Other income</b>	<b>38</b>	<b>1,216</b>	<b>1,207</b>
<b>TOTAL NET INCOME</b>		<b>66,050</b>	<b>63,310</b>
<b>7. Staff costs</b>	<b>39</b>	<b>(16,317)</b>	<b>(14,771)</b>
<b>8. Administrative expenses</b>	<b>40</b>	<b>(8,449)</b>	<b>(8,348)</b>
<b>9. Depreciation of tangible and intangible fixed assets</b>	<b>13</b>	<b>(2,997)</b>	<b>(2,102)</b>
<b>10. Banknote production services</b>	<b>41</b>	<b>(2,307)</b>	<b>(9,344)</b>
<b>11. Other expenses</b>	<b>42</b>	<b>(4,054)</b>	<b>(1,740)</b>
<b>PROFIT FOR THE YEAR</b>	<b>43</b>	<b>31,926</b>	<b>27,004</b>

The Annual Financial Statements 2017 of the Bank of Lithuania were approved on 29 March 2018 by Resolution No 03-50 of the Board of the Bank of Lithuania.

Chairman of the Board



Vitas Vasiliauskas

Director of the Accounting Department  
Organization Service



Lina Našlėnienė

# Explanatory notes

## 1. BASIS FOR PREPARATION AND PRESENTATION OF THE ANNUAL FINANCIAL STATEMENTS

As of 1 January 2015, Lithuania is a member of the euro area.

The financial accounting of the Bank of Lithuania is managed and the Annual Financial Statements are prepared in accordance with Guideline (EU) 2016/2249 of the European Central Bank (hereinafter 'ECB') on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), adopted by the Governing Council of the ECB (hereinafter 'Accounting Guideline'), the Law on the Bank of Lithuania and the Accounting Policy approved by the Board of the Bank of Lithuania. If a specific accounting treatment is not laid down in the Accounting Guideline and the Accounting Policy of the Bank of Lithuania and in the absence of decisions and instructions to the contrary by the ECB, the Bank of Lithuania shall follow the principles of the international accounting and financial reporting standards as adopted by the European Union.

Due to rounding, the totals included in the Balance Sheet, Profit and Loss Account and Notes of the Bank of Lithuania may not equal the sum of the individual figures.

## 2. ACCOUNTING POLICY

### 2.1. GENERAL PRINCIPLES

In managing financial accounting, the Bank of Lithuania follows the following basic accounting assumptions: going concern basis, accruals principle, post-balance sheet events.

The qualitative characteristics in drawing up the financial statements of the Bank of Lithuania are as follow: economic reality and transparency, prudence, materiality, consistency and comparability.

Gold, marketable securities and other on-balance-sheet and off-balance-sheet assets and liabilities that comprise financial assets (hereinafter 'financial items') in financial accounting are recorded at acquisition cost (transaction price), and in the Annual Financial Statements are presented at market price (except for securities valued at amortised cost). Results arising from revaluation of marketable debt and equity securities (on a code-by-code basis) and derivatives (on an item-by-item basis) at market prices are accounted for separately.

In the Annual Financial Statements, financial items denominated in foreign currency are presented in euro at market rates.<sup>1</sup> Results arising from revaluation of gold and foreign currency (on a currency-by-currency basis) at market rates are accounted for separately.

Unrealised revaluation loss arising at the end of the financial year from revaluation of a separate financial item at market price or market rate and exceeding previous unrealised revaluation gain registered in a corresponding revaluation account is recognised as the expense of the reporting financial year. Unrealised loss taken to Profit and Loss Account cannot be reversed in subsequent years against new revaluation gain of the same financial item resulting from changes in market price and market rate or offset by the revaluation gain of another type of financial item.

Unrealised revaluation gain arising at the end of the financial year from the revaluation of a separate financial item at market price and market rate is presented in revaluation accounts.

The average rate and average price method is used in order to compute the acquisition costs for gold, securities and foreign currency. Such acquisition costs are used for the purpose of calculating the realised and unrealised results.

Income and expense are recognised in the accounting period in which they are earned or incurred and not in the period in which they are received or paid. Income and expense in foreign currency are recognised in euro at market rates prevailing on the day of their recognition in accounting; they influence a respective foreign currency position on that date.

<sup>1</sup> Market rate – euro and foreign currency reference rate, based on the daily concertation procedure between central banks within and outside the ESCB, published by the ECB.

## 2.2. FOREIGN CURRENCY

### The market rates of the euro and foreign currency with which the Bank of Lithuania holds material positions

Foreign currency per euro

Currency	Code	31 December 2017	31 December 2016	Change (%)
Swiss franc	CHF	1.17020	1.07390	9.0
US dollar	USD	1.19930	1.05410	13.8
Japanese yen	JPY	135.010	123.400	9.4
Special drawing rights (SDR)	XDR	0.84203	0.78456	7.3
Chinese yuan	CNY	7.80440	7.32020	6.6
Canadian dollar	CAD	1.50390	1.41880	6.0
British pound	GBP	0.88723	0.85618	3.6

The average rate of foreign currency is recalculated on a daily basis in case of an increase of a respective foreign currency position. When the foreign currency position decreases – the realised result is calculated.

In the event of the recognition of unrealised revaluation loss on a separate foreign currency at year-end, the average rate of that currency is correspondingly adjusted to the market rate on the last business day of the financial year.

## 2.3. GOLD

In the Annual Financial Statements, gold is presented in euro at the market price of one Troy ounce, prevailing on the last business day of the financial year.

In the event of the recognition of unrealised revaluation loss on gold at year-end, the average cost of gold is correspondingly adjusted to the gold market price prevailing on the last business day of the financial year.

Transactions related to gold swaps are accounted for in the same way as repurchase agreements.

## 2.4. MARKETABLE SECURITIES

Marketable debt and equity securities are recorded in on-balance-sheet accounts at acquisition cost on the settlement date.

Securities held for monetary policy purposes, as well as debt securities classified as held-to-maturity, are presented in the Balance Sheet at amortised cost subject to impairment. Other marketable securities are presented in the Balance Sheet either at the mid-market prices or on the basis of the relevant yield curve prevailing on the balance sheet date. Revaluation results of securities related with changes of the market price of securities and the market rate of the foreign currency are presented in separate revaluation accounts.

The average price of each issue of securities is recalculated at the end of the business day in consideration of all purchases of the same issue of securities made during the day and their average acquisition costs. Realised gain (loss) for the same day sales of these securities is calculated according to this new average cost.

A coupon purchased together with debt securities is presented in a separate Balance Sheet item as other assets and is not included in the acquisition cost of the securities.

Dividends, bought together with equity securities, are included in the acquisition cost of the securities. Dividends bought in the period when the dividend receivable is announced are presented in a separate Balance Sheet item as other assets.

The difference between the debt security acquisition cost and its par value – discount or premium – is recognised as income or expense according to the straight-line method on a daily basis from the purchase settlement date to the maturity date or sale settlement date. The nominal value of inflation-linked securities is indexed to the inflation index on a daily basis from the settlement date of the purchase transaction to the maturity date or settlement date of the sale transaction. The nominal value change is recognised as interest income or expense.

Discount on non-coupon bearing debt securities is amortised according to the internal rate of return (IRR), and discount or premium on coupon bearing debt securities is amortised according to the straight-line method.

If at the end of the financial year unrealised revaluation loss on valuation of a separate issue of securities is recognised as expense, the average cost of such issue of securities is adjusted according to its market price prevailing on the last business day of the financial year.

## 2.5. NON-MARKETABLE EQUITY INSTRUMENTS

Non-marketable equity instruments are long-term investments in equity instruments held for the specific purposes of the Bank of Lithuania in order to participate in the activities of a specific enterprise whose equity instruments are non-marketable and their price is not quoted in the market. They are recorded at acquisition cost subject to impairment.

## 2.6. INCOME AND EXPENSE

In the Profit and Loss Account, interest on a separate financial item or instrument is presented on a net basis (interest income is netted against interest expense on the same financial item or instrument).

Realised income and expense related to sold foreign currency, gold and securities are recognised in the income and expense accounts. Such income and expense are calculated considering the average rate or average price of the corresponding financial item.

Unrealised revaluation gain of financial items is not recognised as income and is presented in revaluation accounts. Unrealised revaluation loss, exceeding previous revaluation gain related to the corresponding financial item, is recognised as expense at the year-end.

Impairment losses are recognised as expense and are not reversed in subsequent years unless the impairment decreases and this decrease can be related to an observable event that occurred after the impairment was first recorded.

Dividends of marketable equity securities are booked upon their announcement, while dividends of non-marketable equity instruments are booked upon having been settled or having received a notification on their distribution.

## 2.7. REVERSE TRANSACTIONS

Reverse transactions are operations whereby the Bank of Lithuania buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

Repurchase agreements are presented as collateralised deposits of the counterparty on the liabilities side of the Balance Sheet, while the financial asset that has been given as collateral (sold and repurchased under these agreements) remains on the asset side of the Balance Sheet for the period of transactions.

Reverse repurchase agreements are presented as collateralised loans on the asset side of the Balance Sheet. The collateral acquired (bought with a subsequent sale under these agreements) is not reported in the Balance Sheet and is not revalued during the transaction period. Collateral provided in the form of cash is presented on the liabilities side of the Balance Sheet.

The difference between the purchase and repurchase price of the collateral acquired under reverse repurchase and repurchase agreements is recognised on a daily basis as interest income or expense over the remaining duration of the transaction.

## 2.8. FOREIGN EXCHANGE TRANSACTIONS

Foreign currency to be received or paid, under foreign exchange spot, forward and swap transactions, influences a respective foreign currency's position on the trade date and is recorded in off-balance-sheet accounts from the trade date to the settlement date.

The difference in the value at the spot and forward rates of the foreign exchange forward and swap transactions is recognised as interest income or expense and is accrued on a daily basis over the remaining duration of the transaction.

Non-deliverable foreign exchange forwards are recorded at notional amount calculated based on the forward exchange rate in the off-balance-sheet accounts from the trade date to the maturity date. In the Balance Sheet, the value of these transactions is presented at market prices prevailing on the last business day of the financial year. Unrealised loss recognised as expense at the end of the financial year is presented as off-balance-sheet instruments revaluation difference on the Balance Sheet liabilities side. The difference between the forward rate and the spot rate at the settlement date of the transaction, taking into account any accumulated impairment losses, is recognised as realised income or expense.

## 2.9. FORWARD TRANSACTIONS IN SECURITIES

Forward purchases or sales of securities are recognised in off-balance-sheet accounts from the trade date to the settlement date at the forward price of the transaction. In the Balance Sheet, the value of these transactions is presented at the forward market price prevailing on the last business day of the financial year.

On the settlement date of forward transactions in securities, the purchases or sales of the securities are recorded on the on-balance-sheet accounts at the actual market price, and the difference between this price and the forward price of the transaction is recognised as realised income or expense.

## 2.10. INTEREST RATE TRANSACTIONS

Interest rate futures are recorded in off-balance-sheet accounts at the nominal value of contracts from the trade date to the closing or maturity date. Daily changes in the variation margin of these contracts are recognised as realised income or expense.

Interest rate swaps are recorded in off-balance-sheet accounts at notional amount from the trade date to the closing or maturity date. In the Balance Sheet, the value of these transactions is presented at market prices, prevailing on the last business day of the financial year. Unrealised loss recognised as expense at the end of financial year is presented as off-balance-sheet instruments revaluation difference on the Balance Sheet liabilities side and is subject to straight-line amortisation till the maturity date of the transaction. Interest income and interest expense is accrued on a daily basis over the remaining duration of the transaction.

## 2.11. TANGIBLE AND INTANGIBLE FIXED ASSETS

Tangible fixed assets include such tangible assets whose useful life is longer than one year and whose acquisition cost (including VAT) is no less than EUR 2,000. Intangible fixed assets include items without physical substance whose useful life is no less than one year and whose acquisition cost is no less than EUR 2,000. Tangible and intangible fixed assets are recorded in the Balance Sheet at cost less accumulated depreciation (amortisation). Internally generated tangible and intangible assets are recorded as fixed assets if they comply with the recognition criteria. The initial cost of such assets consists of the direct staff cost, the cost of assets and services acquired or depreciated (amortised) in order to develop the assets. The fixed assets under construction, pieces of art, museum stocks and tangible assets included in the list of cultural valuables (excluding buildings) are not depreciated (amortised). Depreciation (amortisation) of other fixed assets is calculated on a straight-line basis over the expected useful life of the assets. The residual depreciation (amortisation) period is reviewed having assessed that the useful life of the fixed assets has changed significantly.

### Useful lives of tangible and intangible fixed assets

Fixed assets	Years
Tangible assets	
Buildings	33–59
Cash processing equipment	7–12
Computer equipment	3–7
Other inventories (furniture, office equipment and other)	5–30
Intangible assets	3–10

If there are indications that the value of real estate has declined significantly, at the end of the financial year, the acquisition cost of such assets is reduced by the amount of impairment loss.

When fixed assets are sold, the difference between the value of sale and the value presented in the Balance Sheet is recognised as income or expense.

Maintenance and repair costs of fixed assets are recognised as an expense at the time they are incurred.

## 2.12. BANKNOTES AND COINS IN CIRCULATION

The euro area NCBs and the ECB, which together comprise the Eurosystem, issue euro banknotes.<sup>2</sup> The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last business day of each month in accordance with the banknote allocation key.<sup>3</sup>

The ECB is allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% is allocated to NCBs according to the Eurosystem capital key. The share of banknotes allocated to each NCB is disclosed in their Balance Sheet under liability item 'Banknotes in circulation'.

The difference between the value of euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of euro banknotes that it actually puts into circulation is presented as remunerated intra-Eurosystem balance.<sup>4</sup> The remuneration of this balance is calculated at the latest available marginal interest rate used by the Eurosystem in its tenders for the main refinancing operations<sup>5</sup>.

The interest income or expense on this balance is disclosed in the Profit and Loss Account item 1 'Net interest income' (see Note 33).

Seeking to avoid fluctuations in monetary income after new members join the Eurosystem, the net intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted by the compensatory amount, which is applied for the new entrants from the cash changeover year and gradually reduced over the following five years. For the Bank of Lithuania, the period for which the above-mentioned adjustments are applicable will terminate on 31 December 2020. As of 1 January 2021, the interest income will be calculated on the whole position of the net claims related to the allocation of euro banknotes.

The nominal value of euro circulation coins issued into circulation by the Bank of Lithuania is presented in the Balance Sheet item 12 'Other liabilities'.

The nominal value of litas<sup>6</sup> banknotes and litas circulation coins issued into circulation by the Bank of Lithuania and not returned from circulation after the euro adoption is presented in the Balance Sheet item 12 'Other liabilities'. Having reliably assessed using the statistical methods of forecasting that the value of the liability to accept litas banknotes and coins differs significantly from those presented in the Balance Sheet, the value of this liability is derecognised from the Balance Sheet and provisions shall be formed for the assessed value of probable return. The difference between the nominal value derecognised and the provisions formed shall be recognised as income. Provisions for the exchange of litas banknotes and coins can be adjusted after updating forecasts for litas returns according to actual data.

The sale price (excluding VAT) of collector euro coins and other numismatic valuables is recognised as income.

The cost of printing banknotes and minting coins, as well as other expenses associated with the issue of banknotes and coins into circulation, are recorded as expenses when incurred, irrespective of when the coins and banknotes were put into circulation.

## 2.13. PROVISIONS FOR COVERING FINANCIAL RISKS AND LIABILITIES

Provisions for expected foreign exchange rate, interest rate, gold price and credit risks (hereinafter 'provisions for risks') are formed by the Board of the Bank of Lithuania, in order that the Bank of Lithuania would have sufficient financial resources to offset the negative change in value arising from the financial assets, including the financial assets acquired in connection with monetary policy operations of the Eurosystem, as well as the financial liabilities related to the management of these assets, and in such way safeguard the Bank of Lithuania's capital and the real value of financial assets.

These provisions are formed according to the rules established by the Board of the Bank of Lithuania. The aim of these provisions is to cover the assessed level of risk, which is set in accordance with the risk assessment methodology approved by the Governing Council of the ECB. The expected shortfall at a 99% confidence level (ES99%) is used to define the target amount of risk provisions. Provisions for risks may be used for the coverage of all or part of the net expenses related to financial assets operations (realised result, unrealised revaluation loss and impairment of the financial assets). Provisions for termination benefits, payable for staff who will qualify for the state social insurance pension while working at the Bank of Lithuania, are assessed using actuary calculations. Their value is determined as termination benefits earned by the employee upon retirement and calculated based on the employee change dynamics and wage growth preconditions, discounted at using the long-term lending interest rates in the Republic of Lithuania.

Other provisions for liabilities, such as provisions for wages and salaries payable for annual leave, provisions for termination benefits or provisions related to the exchange of litas banknotes and coins, are not discounted due to the relatively short period from the formation of these provisions to their use.

Provisions for risks and liabilities are formed as at year-end and recognised as expense.

<sup>2</sup> ECB Decision of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L 35, 9.2.2011, p. 26, as amended.

<sup>3</sup> Banknote allocation key means the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in such total.

<sup>4</sup> ECB Decision of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast) (ECB/2016/36), OJ L 347, 20.12.2016, p. 26.

<sup>5</sup> The marginal interest rate used by the Eurosystem in its tenders for the main refinancing operations was 0% over 2017.

<sup>6</sup> The national currency used as legal tender until the adoption of the euro.

### 3. FINANCIAL RISK AND ITS MANAGEMENT

#### 3.1. MANAGEMENT OF FINANCIAL RISK RELATED TO MONETARY POLICY OPERATIONS

The risk related to monetary policy operations is managed within the Eurosystem on an integral basis. The Bank of Lithuania takes part in this risk management process by representation in the Risk Management Committee of the ECB, which is responsible for the management of financial risk related to monetary policy operations and to investment of foreign reserves of the Eurosystem.

Monetary policy operations are exposed to counterparty credit risk. For management of this risk, credibility requirements for counterparties, with which these operations can be executed, are established. Monetary policy operations are conducted only against collateral. Collateral should match the established requirements for suitability and other risk control instruments.

To mitigate the risk of securities purchase operations, requirements for securities, which can be acquired by the Eurosystem under adopted securities purchase programmes, and limits on acquisition are set.

The Bank of Lithuania ensures, that financial institutions registered in Lithuania and participating in monetary policy operations as well as collateral provided under monetary policy operations would match established requirements, and controls fulfilment of established risk limits.

#### 3.2. MANAGEMENT OF FINANCIAL RISK RELATED TO THE INVESTMENT OF THE BANK OF LITHUANIA

Investments made by the Bank of Lithuania, not related to monetary policy operations, are exposed to market, credit, liquidity and settlement risks.

Value-at-risk is the basic tool for the evaluation and management of market risk of investment portfolio which is the largest part of financial assets, not related to monetary policy operations. It is calculated for one year period at 95% confidence level and cannot exceed EUR 150 million. The application of the risk budget ensures integral management of market risk, more flexible use of various investment strategies as well as one indicator for the overall assessment of both equity and debt securities risk. The model used for the calculation of value-at-risk considers past patterns and forecasted macroeconomic environment. As at 31 December 2017 the risk value amounted to EUR 101 million (as at 31 December 2016 – EUR 66 million).

In pursuit of a credible risk management system, other market risk management instruments are combined with the risk budget instrument.

For managing foreign exchange rate risk related to financial assets which do not correspond to liabilities in foreign currencies, limits for open currency positions are established. Exchange rate risk related to financial assets corresponding to liabilities in foreign currencies is eliminated by investing in the currency of liabilities.

Credit risk is managed by dealing only with investment grade financial institutions, investing only in investment grade financial instruments. Taking into account the credibility of counterparty or issuer, limits on the liabilities to the Bank of Lithuania by issuers, counterparties and their groups are established. These limits help to diversify concentration of credit risk.

Liquidity risk is managed by combining the duration of liabilities and corresponding investments.

Various account management instruments are applied to diminish settlement risks: the delivery-versus-payment principle, matching of debt and credit turnovers, ISDA Master Agreement.

Appropriate investment allocation plays an important role in financial risk management seeking to reduce the concentration of investment. In 2017, the Bank of Lithuania ensured diversification of investments by investing in debt securities of nine countries and more than twenty issuers. The Bank of Lithuania also invests in exchange traded funds (ETFs) linked to well-diversified equity and debt securities market indexes.

For managing foreign exchange rate and interest rate risks, the Bank of Lithuania widely uses financial derivatives. All financial derivatives are included in the measurement of the market and credit risk of the Bank of Lithuania's financial assets investment.

## 4. FINANCIAL ACCOUNTING PRINCIPLES ON OPERATIONS RELATED TO PARTICIPATION IN THE EUROSISTEM

This chapter covers the accounting principles of claims and liabilities as well as income, and expenses arising from operations related to participation in the Eurosystem.

### 4.1. PARTICIPATING INTEREST IN ECB CAPITAL

Shares of the national central banks in the subscribed capital of the ECB depend on the established key for ECB capital subscription, which is adjusted, in accordance with the provisions of the Statute of the European System of Central Banks (hereinafter 'ESCB') and of the ECB, every five years and every time when a new Member State joins the EU, on the basis of population and GDP data provided by the European Commission.

#### Participating interest of NCBs of the EU Member States in the ECB capital<sup>7</sup>

Central bank	Capital key as at 31 December 2017, %	Paid-up capital as at 31 December 2017, EUR	Eurosystem capital key as at 31 December 2017, %
Nationale Bank van België / Banque Nationale de Belgique	2.4778	268,222,025	3.52003
Deutsche Bundesbank	17.9973	1,948,208,997	25.56743
Eesti Pank	0.1928	20,870,614	0.27390
Banc Ceannais na hÉireann / Central Bank of Ireland	1.1607	125,645,857	1.64892
Bank of Greece	2.0332	220,094,044	2.88842
Banco de España	8.8409	957,028,050	12.55961
Banque de France	14.1792	1,534,899,402	20.14334
Banca d'Italia	12.3108	1,332,644,970	17.48904
Central Bank of Cyprus	0.1513	16,378,236	0.21494
Latvijas Banka	0.2821	30,537,345	0.40076
Lietuvos bankas	0.4132	44,728,929	0.58700
Banque centrale du Luxembourg	0.2030	21,974,764	0.28839
Bank Ċentrali ta'Malta / Central Bank of Malta	0.0648	7,014,605	0.09206
De Nederlandsche Bank	4.0035	433,379,158	5.68748
Oesterreichische Nationalbank	1.9631	212,505,714	2.78883
Banco de Portugal	1.7434	188,723,173	2.47672
Banka Slovenije	0.3455	37,400,399	0.49083
Národná banka Slovenska	0.7725	83,623,180	1.09743
Suomen Pankki – Finlands Bank	1.2564	136,005,389	1.78487
<b>Total (euro area central banks)</b>	<b>70.3915</b>	<b>7,619,884,851</b>	<b>100.00000</b>
Българска народна банка (Bulgarian national bank)	0.8590	3,487,005	-
Česká národní banka	1.6075	6,525,450	-
Danmarks Nationalbank	1.4873	6,037,512	-
Hrvatska narodna banka	0.6023	2,444,963	-
Magyar Nemzeti Bank	1.3798	5,601,129	-

<sup>7</sup> From 1 January 2014, the capital key remains unchanged.

Central bank	Capital key as at 31 December 2017, %	Paid-up capital as at 31 December 2017, EUR	Eurosystem capital key as at 31 December 2017, %
Narodowy Bank Polski	5.1230	20,796,192	-
Banca Națională a României	2.6024	10,564,124	-
Sveriges Riksbank	2.2729	9,226,559	-
Bank of England	13.6743	55,509,148	-
<b>Total (non-euro area central banks)</b>	<b>29.6085</b>	<b>120,192,083</b>	<b>-</b>
<b>Total</b>	<b>100.0000</b>	<b>7,740,076,935</b>	<b>100.0000</b>

The contribution of the Bank of Lithuania to ECB capital is presented in Note 10 'Participating interest in the ECB'.

#### 4.2. FOREIGN RESERVES TRANSFERRED TO THE ECB

Pursuant to Article 48 and Article 30 of the Statute of the ESCB and of the ECB, the NCBs, when joining the Eurosystem, transfer their share of foreign reserves to the ECB, applying the ratio of the number of shares subscribed by the NCB concerned and the number of shares already paid up by the other NCBs.

The ECB's liabilities to the euro area, equivalent to the transfer of foreign reserves by the NCBs, comprised the amount of EUR 40,792,608 thousand. The share of foreign reserve assets, transferred to the ECB by the Bank of Lithuania, is reported under 'Claims equivalent to the transfer of foreign reserves' (see Note 11).

The remuneration of foreign reserves transferred to the ECB is calculated daily, at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations<sup>8</sup>.

#### 4.3. LENDING TO EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

**Main refinancing operations.** Main refinancing operations are executed through liquidity providing reverse transactions with a weekly frequency and a maturity of one week, normally by means of standard tenders. These operations play a key role in achieving the aims of the steering interest rate, managing market liquidity and signalling the monetary policy stance.

**Longer-term refinancing operations.** These operations aim to provide counterparties with additional longer-term refinancing. In 2017, operations with maturity of 3 months were conducted. Additionally, in 2016 the Governing Council of the ECB introduced a series of four targeted longer-term refinancing operations. These operations have a four-year maturity, with a possibility of full or partial repayment after two years. The applicable interest rate for these targeted longer-term refinancing operations depends on the individual lending benchmark of the respective counterparty between the date of allotment and January 2018. The actual rate will be set in 2018 and will range between the main refinancing operations rate and the deposit facility rate at the time of the allotment. Since the actual rate will only be known in 2018 and a reliable estimate is not possible at this juncture, the deposit facility rate has been used for calculating the interest rate for these targeted longer-term refinancing operations for 2017, as this is deemed a prudent approach.

**Fine-tuning reverse operations.** Fine-tuning reverse operations aim to regulate the market liquidity situation and steer interest rates, particularly to smooth the effects on interest rates caused by unexpected market fluctuations. Owing to their nature, they are executed on an ad hoc basis.

**Structural reverse operations.** These are reverse open-market transactions through standard tenders to enable the Eurosystem to adjust its structural liquidity position vis-à-vis the financial sector.

**Marginal lending facility.** The marginal lending facility is a standing facility provided by the Eurosystem, which may be used by counterparties to obtain overnight liquidity from national central banks at a pre-specified interest rate against eligible assets.

**Credits related to margin calls.** They refer to cash paid to counterparties in those instances where the market value of the collateral exceeds an established trigger point implying an excess of collateral with respect to outstanding monetary policy operations.

As at 31 December 2017, the total Eurosystem NCB's holding of monetary policy assets amounted to EUR 764,310 million (as at 31 December 2016 – EUR 595,873 million), of which the Bank of Lithuania held EUR 303 million (see Note 6).

Losses can only materialise if both the counterparty fails and the recovery of funds received from the resolution of the collateral provided by the counterparty is not sufficient. For specific collateral, which can be accepted by the NCBs at their own discretion, risk sharing has been excluded by the Governing Council of the ECB.

<sup>8</sup> The marginal interest rate used by the Eurosystem in its tenders for the main refinancing operations was 0% over 2017.

#### 4.4. SECURITIES HELD FOR MONETARY POLICY PURPOSES

As at 31 December 2017, the securities held by the ECB and NCBs amounted to EUR 2,386,012 million (as at 31 December 2016 – EUR 1,654,026 million); they were acquired within the scope of three covered bond purchase programmes, the Securities Markets Programme, the asset-backed securities purchase programme, the public sector asset purchase programme<sup>9</sup> and the corporate sector purchase programme. As at 31 December 2017, the Bank of Lithuania's share of securities purchased for monetary policy purposes amounted to EUR 9,699 million (see Note 8).

In 2017, the Eurosystem continued its securities purchases under the expanded asset purchase programme<sup>10</sup>. This programme includes the third covered bond purchase programme, the asset-backed securities purchase programme, the public sector asset purchase programme and the corporate sector purchase programme.

The monthly pace of combined net asset purchase programme purchases by the NCBs and the ECB was EUR 80 billion on average until March 2017 and EUR 60 billion from April 2017 until the end of the year. Based on the decision taken by the Governing Council of the ECB in October 2017, these purchases are intended to continue at a monthly pace of EUR 30 billion from January until September 2018 or beyond, if necessary, and in any case until the Governing Council of the ECB sees a sustained adjustment in the path of inflation that is consistent with its inflation aim. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the asset purchase programme.

Securities purchased under all of these programmes are valued on an amortised cost basis subject to impairment. In accordance with Article 32.4 of the Statute of the ESCB and of the ECB, losses from holdings of securities purchased under the Securities Markets Programme, the third covered bond purchase programme and the corporate sector purchase programme as well as securities of supranational organisations purchased under the public sector asset purchase programme (totalling EUR 638 970 million as at 31 December 2017), if they were to be materialised, are shared in full by the Eurosystem NCBs, in proportion to the prevailing Eurosystem capital key.

The Governing Council of the ECB assesses on a regular basis the financial risks associated with the securities held under all these programmes. Annual impairment tests are conducted on the basis of the estimated recoverable amounts as at the year-end. Upon assessing that the value of a security is impaired, in accordance with the prudence principle, a provision against losses in monetary policy operations is established. Impairment losses materialising from securities held for monetary policy purposes, which are proportionally shared in full by all the Eurosystem NCBs, are recognised as part of net result of monetary income's pooling.

The value of securities holdings of the Bank of Lithuania is presented in Note 8 'Securities held for monetary policy purposes'.

#### 4.5. LIABILITIES TO EURO AREA CREDIT INSTITUTIONS, RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

**Deposit facility.** Deposit facility is a liquidity absorbing standing facility provided by the Eurosystem, which counterparties can use to make overnight deposits with NCBs at the pre-specified rate.

**Fixed-term deposits.** These liabilities relate to liquidity-absorbing fine-tuning operations for a fixed term and with a fixed rate of interest.

**Fine-tuning reverse operations.** Fine-tuning reverse operations are liquidity-absorbing reverse operations used to offset high liquidity imbalances.

**Deposits related to margin calls.** They refer to cash received from counterparties in those instances where the market value of the collateral has fallen below an established trigger point implying a shortfall of collateral to cover the outstanding monetary policy operations.

<sup>9</sup> Decision ECB/2015/10 of 4 March 2015 on a secondary markets public sector asset purchase programme, OJ L 121, 14.5.2015, p. 20.

<sup>10</sup> Further information on the asset purchase programme is available on the ECB's website.

#### 4.6. PARTICIPATION IN TARGET2

Cross-border payments in the EU settled in TARGET2<sup>11</sup> give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis only the ECB. Intra-Eurosystem balances of the Bank of Lithuania vis-à-vis the ECB arising from TARGET2 are disclosed under the Balance Sheet items 'Other claims within the Eurosystem (net)' or 'Other liabilities within the Eurosystem (net)'.

#### 4.7. ALLOCATION OF MONETARY INCOME

Monetary income of the Eurosystem, accruing to the NCBs in the performance of the ESCB's monetary policy functions, is calculated and allocated among the NCBs at the end of each financial year in proportion to their Eurosystem capital key in accordance with Article 32 of the ESCB and of the ECB.

The amount of the NCBs' monetary income is determined by measuring actual income, which it derives from the earmarkable assets held against its liability base.

The earmarkable assets consist mainly of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; securities held for monetary policy purposes; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET2 transactions; net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; accrued interest on monetary policy liabilities, the maturity of which is one year or longer; a limited amount of each NCBs' gold holdings in proportion to each NCBs' capital key share. Gold is considered to generate no income. Securities held for monetary policy purposes under both Decision ECB/2009/16 on the implementation of the covered bond purchase programme and Decision ECB/2011/17 on the implementation of the second covered bond purchase programme, as well as government securities under Decision ECB/2015/10 on the implementation of a secondary markets public sector asset purchase programme are considered to generate income at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations.

The liability base consists mainly of the following items: banknotes in circulation; liabilities to euro area credit institutions related to monetary policy operations denominated in euro; net intra-Eurosystem liabilities resulting from TARGET2 transactions; net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The difference between the NCBs' earmarkable assets value and its liability base value shall be offset by applying to the difference the latest available marginal rate for the Eurosystem's main refinancing operations<sup>12</sup>.

After pooling of the annual monetary income of the Eurosystem and reallocation to NCBs in proportion to their subscribed capital keys, the differences between the NCBs' pooled monetary income and allocated in proportion to the Eurosystem capital key are settled among the NCBs' via TARGET2. The net result arising from the reallocation of monetary income for the Bank of Lithuania is disclosed in Note 37.

#### 4.8. MANAGEMENT OF NET FINANCIAL ASSETS

The Agreement on Net Financial Assets is an agreement between the Eurosystem NCBs and the ECB which sets the maximum amount of net financial assets of each NCB and the ECB held for non-monetary policy purposes and its management. The net financial assets covered by the agreement are mainly formed using liability base funds received from monetary policy operations that are temporarily free from performing monetary policy operations at that time (see section 4.7 of the Accounting Policy). Such assets are usually comprised of gold and foreign currency reserves, investments in euro.

The Bank of Lithuania became party to the Agreement on Net Financial Assets on 1 January 2015. The Bank of Lithuania determines the amount of financial assets, taking into consideration market conditions as well as investment opportunities and restrictions; however, the average amount of financial assets cannot be above the maximum amount of net financial assets set in accordance with the agreement, i.e. EUR 5,856 million.

<sup>11</sup> The Trans-European Automated Real-time Gross settlement Express Transfer system.

<sup>12</sup> The marginal interest rate used by the Eurosystem in its tenders for main refinancing operations was 0% over 2017.

#### 4.9. DISTRIBUTION OF THE ECB PROFIT

The net profit of the ECB is distributed pursuant to Article 33 of the Statute of the ESCB and of the ECB. The Governing Council of the ECB may decide to make transfers to the provision for foreign exchange rate, interest rate, credit and gold price risks. The remaining net profit is distributed to the shareholders of the ECB in proportion to the Eurosystem capital key.

Unless otherwise decided by the Governing Council of the ECB, the ECB distributes seigniorage income, which arises from the 8% share of euro banknotes allocated to the ECB, as well as the income arising from the securities acquired under securities programmes (the securities markets programme, the third covered bond purchase programme, the asset-backed securities purchase programme and the public sector asset purchase programme), by means of an interim distribution of profit in January of the following year.<sup>13</sup> The result from ECB interim profit distribution is recorded by the Bank of Lithuania as income of the financial year when this income was accrued, not received.

After approval by the Governing Council of the ECB annual accounts, the ECB distributes the remaining part of the ECB profit (after interim profit distribution and transfer to the provision). The result from the ECB final profit distribution is recorded by the NCBs as income of the financial year when this income was received.

The received distribution of the ECB profit is disclosed in the Profit and Loss Account item 4 'Income from equity shares and participating interests' (see Note 36).

## 5. NOTES ON THE BALANCE SHEET

### Note 1. Gold and gold receivables

	31 December 2017	31 December 2016
Gold holdings in:		
Troy ounces	187,159	187,158
Kilograms	5,821	5,821
Price per one Troy ounce, EUR	1,081.881	1,098.046
<b>Value of gold, EUR thousands</b>	<b>202,484</b>	<b>205,508</b>

The gold held by the Bank of Lithuania as at 31 December 2017, the same as at 31 December 2016, was invested in gold swaps.

### Note 2. Receivables from the IMF

EUR thousands

	31 December 2017	31 December 2016
Balance in the Special Drawing Rights account with the IMF	163,051	175,000
Reserve tranche position in the IMF	41	44
<b>Total</b>	<b>163,092</b>	<b>175,044</b>

The major part of the SDR balance in the SDR account with the IMF, managed by the Republic of Lithuania, is comprised of SDR 137,239 thousand (EUR 162,985 thousand), allocated by the IMF in 2009, which is disclosed under the Balance Sheet of the Bank of Lithuania liability item 9 'Counterpart of special drawing rights allocated by the IMF'. The Bank of Lithuania receives interest on balance in the SDR account with the IMF and pays interest on SDR allocated by the IMF.

The decrease in the euro equivalent value of the SDR balance in the SDR account with the IMF was due to the appreciation of the euro against the SDR in 2017.

<sup>13</sup> Decision ECB/2014/57 of 15 December 2014 on the interim distribution of the income of the European Central Bank (recast), OJ L 53, 25.2.2015, p. 24, as amended.

## Reserve tranche position in the IMF

SDR thousands

	31 December 2017	31 December 2016
Lithuania's quota in the IMF	441,600	441,600
Promissory notes of the government of the Republic of Lithuania	(465,246)	(429,238)
Cash funds in the IMF account with the Bank of Lithuania	(1,195)	(1,113)
Valuation adjustment	24,876	(11,215)
<b>Reserve tranche position in the IMF</b>	<b>34</b>	<b>34</b>

The reserve tranche position in the IMF is the difference between (a) Lithuania's quota in the IMF, and (b) non-interest-bearing promissory notes issued for the benefit of the IMF by the government of the Republic of Lithuania and the balance in the IMF account with the Bank of Lithuania for financial operations with the IMF. The difference incurred due to the change in the euro value against SDR is presented as the valuation adjustment.

Lithuania's quota in the IMF belongs to the Republic of Lithuania and reflects its voting power within the IMF, as well as determines the financial commitments of Lithuania to the IMF and how much it could borrow from the Fund. 99.75% of Lithuania's quota was paid in non-interest-bearing promissory notes of the government of Republic of Lithuania denominated in euro.

Until the end of 2017, the Bank of Lithuania performed the function of the depository of IMF funds. In the beginning of 2018, the Bank of Lithuania took over also the functions of the fiscal agency of the IMF from the Ministry of Finance of the Republic of Lithuania.

## Note 3. Balances with banks and security investments, external loans and other external assets denominated in foreign currency

This Balance Sheet item consists of the Bank of Lithuania's balances with credit institutions, investments in securities and reverse repurchase agreements of non-euro area residents denominated in foreign currency.

EUR thousands

	USD	CHF	JPY	CZK	CAD	Other	Total
<b>31/12/2017</b>							
Balances in current accounts	1,810	835,528	580,517	502,696	253	2,261	<b>1,923,064</b>
Debt securities	1,231,790	-	-	-	196,244	241,286	<b>1,669,321</b>
Marketable equity securities	247,152	-	-	-	-	-	<b>247,152</b>
Reverse repurchase agreements	750	-	-	-	-	-	<b>750</b>
<b>Total</b>	<b>1,481,503</b>	<b>835,528</b>	<b>580,517</b>	<b>502,696</b>	<b>196,497</b>	<b>243,547</b>	<b>3,840,288</b>
<b>31/12/2016</b>							
Balances in current accounts	7,300	775,839	709,277	476,848	82	1,170	<b>1,970,515</b>
Debt securities	326,138	-	-	-	87,549	176,183	<b>589,870</b>
Reverse repurchase agreements	285	-	-	-	-	-	<b>285</b>
<b>Total</b>	<b>333,723</b>	<b>775,839</b>	<b>709,277</b>	<b>476,848</b>	<b>87,631</b>	<b>177,353</b>	<b>2,560,670</b>

The Bank of Lithuania manages financial investments using funds temporarily free from performing the single monetary policy (see Accounting Policy, section 4.8). Aiming at maximum diversification of financial assets investment risk and increase of the expected return over the medium term, in 2017 the Bank of Lithuania upgraded its strategic investment allocation by including new types of securities and increasing the investment portfolio. Additionally, the Bank of Lithuania created a separate reserve portfolio of USD 1 billion consisting of safe investments in US government securities denominated in US dollars. Currency risk of the reserve portfolio is not hedged and, therefore, substantial fluctuations of the portfolio's value in euros are possible.

### Breakdown of balances with banks and security investments, external loans and other external assets by the economic area of residence of the issuer and counterparty

EUR thousands

	31 December 2017	31 December 2016
USA	1,434,638	179,337
Switzerland	835,528	775,839
Non-euro area EU Member States	633,819	595,391
Japan	601,885	728,247
Canada	229,227	96,975
China	85,456	89,479
International financial institutions	11,115	65,657
Other countries	8,619	29,745
<b>Total</b>	<b>3,840,288</b>	<b>2,560,670</b>

### Note 4. Claims on euro area residents denominated in foreign currency

EUR thousands

	USD	CHF	Other	Total
<b>31/12/2017</b>				
Balances in current accounts	9	0	0	9
<b>Total</b>	<b>9</b>	<b>0</b>	<b>0</b>	<b>9</b>
<b>31/12/2016</b>				
Balances in current accounts	127	0	0	127
Debt securities	137,145	-	-	137,145
<b>Total</b>	<b>137,272</b>	<b>0</b>	<b>0</b>	<b>137,272</b>

### Note 5. Claims on non-euro area residents denominated in euro

This Balance Sheet item consists of the Bank of Lithuania's balances in current accounts and investments in securities of non-euro area residents denominated in euro.

EUR thousands

	31 December 2017	31 December 2016
Balances in current accounts	8,934	386
Debt securities	-	71,052
<b>Total</b>	<b>8,934</b>	<b>71,439</b>

In 2017 the part of balances in current accounts that amounted to EUR 6,700 thousand was provided as collateral to the counterparty in the form of cash to ensure the discharge of the Bank of Lithuania obligations under transactions outstanding.

### Breakdown of claims on non-euro area residents denominated in euro by the economic area of residence of the issuer and counterparty

EUR thousands

	31 December 2017	31 December 2016
Non-euro area EU Member States	8,934	64,499
Japan	-	6,937
International financial institutions	-	3
<b>Total</b>	<b>8,934</b>	<b>71,439</b>

**Note 6. Lending to euro area credit institutions related to monetary policy operations denominated in euro**

EUR thousands

	31 December 2017	Conducted in 2017	31 December 2016
Main refinancing operations	-	6,000	-
Longer-term refinancing operations	303,000	-	303,000
<b>Total</b>	<b>303,000</b>	<b>6,000</b>	<b>303,000</b>

Descriptions of these operations are presented in section 4.3 of the Explanatory Notes 'Lending to euro area credit institutions denominated in euro'.

In 2017 no impairment losses from these monetary policy operations were incurred by the Bank of Lithuania.

**Note 7. Other claims on euro area credit institutions denominated in euro**

This item consists of the Bank of Lithuania's balances with credit institutions which do not relate to monetary policy operations. As at 31 December 2017, the balances in current accounts amounted to EUR 12,077 thousand (as at 31 December 2016 – EUR 365 thousand).

**Note 8. Securities held for monetary policy purposes**

This item consists of the Republic of Lithuania government and supranational securities acquired by the Bank of Lithuania within the scope of the public sector purchase programme (see Explanatory Notes section 4.4).

EUR thousands

	31 December 2017		31 December 2016	
	Amortised cost	Market value	Amortised cost	Market value
Republic of Lithuania government securities	1,720,641	1,743,946	1,530,440	1,547,227
Supranational securities	7,978,782	7,994,057	4,809,185	4,786,705
<b>Public sector purchase programme total</b>	<b>9,699,423</b>	<b>9,738,003</b>	<b>6,339,625</b>	<b>6,333,932</b>

The market value of the securities presented in the table is not recorded on the Balance Sheet or in the Profit and Loss Account but is provided for presentation purposes only.

As a result of an impairment test conducted as at 31 December 2017 on securities purchased under the public sector purchase programme, the Governing Council of the ECB decided that all future cash flows on these securities were expected to be received, therefore no impairment losses from securities held by the Bank of Lithuania were incurred in 2017.

**Note 9. Other securities**

This item presents the Bank of Lithuania's investments in debt and marketable equity securities by euro area residents.

EUR thousands

	31 December 2017	31 December 2016
Debt securities, excl. classified as held-to-maturity	22,871	153,417
Marketable equity securities	543,605	343,854
<b>Total</b>	<b>566,476</b>	<b>497,270</b>

Marketable equity instruments are investments in exchange traded fund units, replicating corporate debt or equity securities indexes. As at the end of 2017, the market value of investments, which replicate the equity securities index, amounted to EUR 141,239 thousand (as at 31 December 2016 – EUR 128,309 thousand).

## Note 10. Participating interest in the ECB

EUR thousands

	31 December 2017	31 December 2016
Contribution of the Bank of Lithuania to the ECB capital	44,729	44,729
Contribution of the Bank of Lithuania to the reserves of the ECB and to provisions, equivalent to reserves	162,454	162,454
<b>Total</b>	<b>207,183</b>	<b>207,183</b>

With effect from 1 January 2014, the share of the Bank of Lithuania in the subscribed and paid-up capital of the ECB comprises 0.4132% or EUR 44,729 thousand.

The Bank of Lithuania, pursuant to Article 48.2 of the Statute of the ESCB and of the ECB, has contributed to the reserves of the ECB and to provisions, equivalent to reserves, EUR 162,454 thousand.

## Note 11. Claims equivalent to the transfer of foreign reserves

Upon joining the Eurosystem, the Bank of Lithuania, pursuant to Article 48.1 of the Statute of the ESCB and of the ECB, transferred its share of foreign reserves to the ECB.

Claims equivalent to the transfer of foreign reserves of the Bank of Lithuania, shown in this Balance Sheet item, comprise EUR 239,454 thousand. These claims were determined by multiplying the amount of the foreign reserves already transferred to the ECB at historical exchange rates (31 December 1998) by the ratio between the number of shares subscribed by the NCB concerned and the number of shares already paid up by the other NCBs.

## Note 12. Net claims related to the allocation of euro banknotes within the Eurosystem

This item presents the claim of the Bank of Lithuania to the Eurosystem, related to the allocation of euro banknotes within the Eurosystem (see the Explanatory Note, section 2.12 and Note 18). In 31 December 2017 these net claims of the Bank of Lithuania decreased by EUR 199,951 thousand or 6% year on year due to a higher increase in nominal value of the banknotes put into circulation by the Bank of Lithuania (17%) compared to the rise in nominal value of banknotes in circulation in the entire Eurosystem (4%).

## Note 13. Tangible and intangible fixed assets

EUR thousands

	Tangible assets				Intangible assets (including assets under construction)	Total
	Buildings and construction in progress	Cash processing equipment (including assets under construction)	Computer equipment (including assets under construction)	Other tangible assets (including assets under construction)		
Acquisition cost as at 31 December 2016	36,313	5,919	10,800	8,170	7,129	<b>68,331</b>
Additions in 2017	–	105	903	73	2,664	<b>3,745</b>
Disposals in 2017	–	(195)	(170)	(344)	(45)	<b>(753)</b>
Acquisition cost as at 31 December 2017	36,313	5,829	11,533	7,899	9,749	<b>71,322</b>
Accumulated depreciation as at 31 December 2016	(13,811)	(4,941)	(8,680)	(6,537)	(4,328)	<b>(38,297)</b>
Depreciation in 2017	(1,415)	(198)	(691)	(104)	(589)	<b>(2,997)</b>
Depreciation of disposed assets in 2017	–	195	170	344	45	<b>753</b>
Accumulated depreciation as at 31 December 2017	(15,226)	(4,944)	(9,201)	(6,297)	(4,872)	<b>(40,541)</b>
<b>Net carrying amount as at 31 December 2017</b>	<b>21,086</b>	<b>885</b>	<b>2,332</b>	<b>1,602</b>	<b>4,877</b>	<b>30,781</b>
<b>Net carrying amount as at 31 December 2016</b>	<b>22,501</b>	<b>978</b>	<b>2,120</b>	<b>1,633</b>	<b>2,802</b>	<b>30,034</b>

The significant impact on the increase of intangible fixed assets in 2017 had the recognition of three items of internally generated intangible assets as the fixed assets that amounted to EUR 1,216 thousand.

In 2017, The Board of the Bank of Lithuania made a decision to implement the renovation project of the Bank of Lithuania's premises situated in Vilnius, Žirmūnų g. 151. During the implementation of this project, part of the premises will be dismantled at the beginning of 2019. The useful life of the part of the premises to be dismantled was reduced to the date of derecognition (31 December 2018), thus the depreciation of this building increased by EUR 547 thousand in 2017.

The Bank of Lithuania has not concluded any transactions with the mortgage of tangible assets of the Bank of Lithuania.

## Note 14. Other financial assets

EUR thousands

	31 December 2017	31 December 2016
Bank for International Settlements shares	3,334	3,334
SWIFT shares	21	21
<b>Total</b>	<b>3,355</b>	<b>3,355</b>

The Bank of Lithuania is a member of the Bank for International Settlements (BIS), with 1,070 shares, the acquisition cost of which is EUR 3,334 thousand and the nominal value per share is SDR 5,000. The Bank of Lithuania received EUR 394 thousand in dividends for these BIS shares in 2017 (EUR 290 thousand in 2016).

The Bank of Lithuania holds seven SWIFT shares with the acquisition cost of EUR 20,741. Dividends are not paid for these shares.

## Note 15. Off-balance-sheet instruments revaluation differences

Off-balance-sheet instruments revaluation differences represent the revaluation of off-balance-sheet accounted foreign exchange payables and receivables due to changes in the market rates and the revaluation of non-deliverable foreign exchange forward transactions, interest rate swaps and forward transactions in securities due to market price movements.

EUR thousands

	31 December 2017		31 December 2016	
	Positive differences	Negative differences	Positive differences	Negative differences
Foreign exchange transactions	62,888	30,461	25,688	4,374
Non-deliverable foreign exchange forwards	6,122	16,170	6,178	649
Interest rate swaps	2,325	996	713	-
<b>Total</b>	<b>71,336</b>	<b>47,626</b>	<b>32,578</b>	<b>5,023</b>

## Note 16. Accruals and prepaid expenses

EUR thousands

	31 December 2017	31 December 2016
Accrued interest income	64,439	44,335
On securities held for monetary policy purposes	49,428	34,506
On financial derivatives	8,569	3,692
On other securities	5,258	5,453
On accounts and deposits	1,183	663
Other accrued interest	-	22
Debt securities coupon payment purchased	5,837	4,918
Prepaid expenses	1,191	856
<b>Total</b>	<b>71,466</b>	<b>50,108</b>

## Note 17. Sundry

EUR thousands

	31 December 2017	31 December 2016
Advances and other receivables	1,279	91
Dividends receivable	540	-
Short-term assets	466	353
Loans to the staff of the Bank of Lithuania	416	492
<b>Total</b>	<b>2,702</b>	<b>936</b>

The largest share of advances and other receivables was the advance payment of EUR 1,221 thousand for minting of collector coins.

Dividends receivable are dividends of marketable equity securities that are recognised as income on their announcement day but not received yet.

Pursuant to a resolution of the Board of the Bank of Lithuania, loans to the Bank of Lithuania's employees are no longer issued as of 2009.

### Note 18. Banknotes in circulation

EUR thousands

	31 December 2017	31 December 2016
Euro banknotes issued by the Bank of Lithuania	2,965,358	2,525,107
Adjustment for banknote allocation in the Eurosystem	3,906,279	4,085,333
The ECB's share of euro banknotes in circulation	(549,771)	(528,873)
<b>Total</b>	<b>6,321,866</b>	<b>6,081,566</b>

This item consists of the Bank of Lithuania's share of total euro banknotes in circulation according to the banknote allocation key (see the Explanatory Notes, section 2.12). As at 31 December 2017, the banknote allocation key was 0.5400%. The nominal value of euro banknotes actually issued by the Bank of Lithuania in 2017 increased by 17%. As this was less than the allocated amount, the difference of EUR 3,356,508 thousand (compared to EUR 3,556,459 thousand as at 31 December 2016) is shown under the asset sub-item 'Net claims related to the allocation of euro banknotes within the Eurosystem' (see Note 12).

### Note 19. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

This item contains the balances on the current accounts of credit institutions with the Bank of Lithuania that are required to hold minimum reserves. Bank minimum reserve balances have been remunerated at the latest available marginal interest rate used by the Eurosystem in its tenders for main refinancing operations<sup>14</sup>. The reserves held in excess of the minimum requirements are remunerated at a lower rate of either zero per cent or the deposit facility rate.

EUR thousands

	31 December 2017	Conducted in 2017	31 December 2016
Current accounts (covering the minimum reserve system)	5,077,380	-	2,481,461
Deposits related to margin calls	-	25,000	-
<b>Total</b>	<b>5,077,380</b>	<b>25,000</b>	<b>2,481,461</b>

The reserves of credit institutions held in excess of the minimum requirements rose due to structural monetary policy operations executed by the Eurosystem.

Descriptions of other liquidity absorbing monetary policy operations are presented in the Explanatory Notes, section 4.5 'Liabilities to euro area credit institutions related to monetary policy operations denominated in euro'.

### Note 20. Other liabilities to euro area credit institutions denominated in euro

As at 31 December 2017, this item presented collateral in the form of cash whereby the counterparty ensured the discharge of its obligations towards the Bank of Lithuania under transactions outstanding (EUR 1,200 thousand). As at 31 December 2016, the Bank of Lithuania had no such liabilities.

### Note 21. Liabilities to other euro area residents denominated in euro

This item contains the balances on the current accounts of euro area residents with the Bank of Lithuania denominated in euro.

<sup>14</sup> The marginal interest rate used by the Eurosystem in its tenders for the main refinancing operations was 0% over 2017.

EUR thousands

	31 December 2017	31 December 2016
Liabilities to the general government	1,840,777	689,958
Other liabilities	28,153	1,105
<b>Total</b>	<b>1,868,929</b>	<b>691,063</b>

The increase of other liabilities is related to the rise in the number of the non-bank sector's participants (i.e. payment, e-money and other institutions) of the payment system operated by the Bank of Lithuania.

### Note 22. Liabilities to non-euro area residents denominated in euro

This item presents balances in current accounts of international and other non-euro area institutions with the Bank of Lithuania denominated in euro, with a total value of EUR 11,400 thousand as at 31 December 2017. As at 31 December 2016, this item contained balances in current accounts of international institutions in euros (EUR 18,262 thousand) and other liabilities to non-euro area residents (EUR 3,100 thousand).

### Note 23. Liabilities to euro area residents denominated in foreign currency

This item shows repurchase agreements and gold swaps in foreign currency concluded by the Bank of Lithuania with euro area financial sector residents, as well as liabilities to the general government, the main part of which consists of balances in current accounts of government institutions in foreign currency.

EUR thousands

	USD	CAD	CHF	XDR	Total
<b>31/12/2017</b>					
Liabilities to the financial sector	171,080	28,007	25,445	-	<b>224,531</b>
Repurchase agreements	-	28,007	-	-	<b>28,007</b>
Gold swaps	171,080	-	25,445	-	<b>196,525</b>
Liabilities to the general government	198	-	-	41	<b>238</b>
<b>Total</b>	<b>171,277</b>	<b>28,007</b>	<b>25,445</b>	<b>41</b>	<b>224,770</b>
<b>31/12/2016</b>					
Liabilities to the financial sector	372,720	-	-	-	<b>372,720</b>
Repurchase agreements	151,279	-	-	-	<b>151,279</b>
Gold swaps	221,441	-	-	-	<b>221,441</b>
Liabilities to the general government	184	-	-	44	<b>227</b>
<b>Total</b>	<b>372,903</b>	<b>-</b>	<b>-</b>	<b>44</b>	<b>372,947</b>

### Note 24. Liabilities to non-euro area residents denominated in foreign currency

This item presents repurchase agreements concluded by the Bank of Lithuania with non-euro area residents and other liabilities in US dollar with a total value of EUR 31,936 thousand as at 31 December 2017 (compared to EUR 45,815 thousand as at 31 December 2016).

### Note 25. Counterpart of special drawing rights allocated by the IMF

This item presents liabilities to the IMF related to the allocation of SDR to all Member States carried out by the IMF in 2009. According to this allocation, SDR 137,239 thousand was allocated to Lithuania (see Note 2).

### Note 26. Other liabilities within the Eurosystem (net)

EUR thousands

	31 December 2017	31 December 2016
Balance in TARGET2 account	4,026,154	3,590,341
Distribution of monetary income	(35,074)	(47,924)
Interim distribution of the ECB profit	(5,798)	(5,672)
<b>Total</b>	<b>3,985,282</b>	<b>3,536,746</b>

Other liabilities within the Eurosystem include (a) Intra-Eurosystem balance (net) of the Bank of Lithuania vis-à-vis the ECB in respect of the transfers through TARGET2 by the ESCB national central banks and the ECB; (b) the position vis-à-vis the ECB in respect of monetary income redistribution's amount receivable; (c) the Bank of Lithuania's position vis-à-vis the ECB in respect of any amounts receivable or refundable, including the amount due to the Bank of Lithuania in respect of the ECB's interim profit distribution.

Claim on the ECB in connection with the reallocation of monetary income comes from the difference between the amounts pooled and allocated by Eurosystem NCBs (see Note 37).

Following a decision of the Governing Council of the ECB, the amount due to the euro area NCBs in 2017, with respect to the ECB's interim profit distribution, was EUR 987,730 thousand (see section 4.8 of the Explanatory Notes). The amount due to the Bank of Lithuania amounted to EUR 5,798 thousand and was recognised as income of 2017 (see Note 36).

To improve the comparability between the Bank of Lithuania and the other euro area NCBs' financial accounting data, in the Annual Financial Statements of 2017, the Balance Sheet sub-items 'Other claims within the Eurosystem (net)' and 'Other liabilities within the Eurosystem (net)' were presented as a single liabilities sub-item. Accordingly, the comparative information for 2016 was reclassified.

EUR thousands

	31 December 2016 balance as published in 2016	Adjustment owing to reclassification	31 December 2016 balance as published in 2017
Other claims within the Eurosystem (net)	53,596	(53,596)	-
Other liabilities within the Eurosystem (net)	3,590,341	(53,596)	3,536,746

### Note 27. Items in course of settlement

As at 31 December 2017, the balance of this item consists of the marketable equity securities' purchase transactions (EUR 11,869 thousand) and cash management operations with commercial banks in the course of settlement (EUR 9,600 thousand). As at 31 December 2016, this item consisted only of cash management operations with commercial banks in the course of settlement.

### Note 28. Accruals and income collected in advance

EUR thousands

	31 December 2017	31 December 2016
Accrued interest expenses	7,754	2,466
On financial derivatives	5,865	1,782
On monetary policy operations	1,852	623
Other accrued interest expenses	37	62
Other accrued expenses	1,226	1,678
Income collected in advance	45	46
<b>Total</b>	<b>9,025</b>	<b>4,190</b>

### Note 29. Sundry

EUR thousands

	31 December 2017	31 December 2016
Litas banknotes in circulation	91,190	97,508
Euro coins in circulation	90,092	78,181
Litas coins in circulation	32,182	32,341
Sundry	697	582
<b>Total</b>	<b>214,162</b>	<b>208,613</b>

## Note 30. Provisions

EUR thousands

	31 December 2017	31 December 2016
Provisions for risks (see the Explanatory Notes, section 2.13)	102,420	102,420
Provisions for unrealised impairment loss of monetary policy operations established by the ECB	404	–
Provisions for liabilities related to	4,070	3,307
Termination benefits, payable to staff who will qualify for the state social insurance pension while working at the Bank of Lithuania	1,814	1,426
Wages and salaries payable for annual leave	1,675	1,263
Termination benefits to the members of the Board as provided in the Law on the Bank of Lithuania	158	121
Termination benefits by agreements payable to the staff in the subsequent financial year	7	13
Provisions for exchanging derecognised litas banknotes and coins	417	484
<b>Total</b>	<b>106,895</b>	<b>105,728</b>

In 2017 no additional provisions for risks were formed.

As a result of the impairment test conducted on its securities held under the corporate sector purchase programme, the Governing Council of the ECB has deemed it appropriate to establish a provision of EUR 68,871 thousand against losses in monetary policy operations, in relation to a security held by an NCB of the Eurosystem. The size of this provision has been calculated taking into account the information regarding the security sale in January 2018. This is in line with the provisions of the Accounting Guideline for post-balance sheet events<sup>15</sup>. As a result, a provision of EUR 404 thousand equal to the Eurosystem capital key of the Bank of Lithuania, i.e. 0.5870% of the total provision, was created. This provision was recognised as part of the result of monetary income pooling (see Note 37).

Provisions for termination benefits, payable to staff who will qualify for the state social insurance pension while working at the Bank of Lithuania, increased mainly due to the weaker employee change dynamics, the growth in the number of staff and wages and salaries. Provisions for wages and salaries payable for annual leave increased mainly due to the increase in the number of unused annual leave days. The change in these provisions is presented as expenses in Note 39 'Staff costs'.

Provisions for the exchange of derecognised litas banknotes and coins are the provisions, formed in 2014, for covering the nominal value of derecognised litas banknotes and coins, which may be returned to the Bank of Lithuania for exchange into euro. EUR 67 thousand of these provisions were used in 2017 (compared to EUR 34 thousand in 2016).

## Note 31. Revaluation accounts

Revaluation accounts present unrealised revaluation gains of foreign currency, debt and marketable equity securities, as well as off-balance-sheet financial instruments. Unrealised revaluation gains of financial items, which built up before joining the euro area, are shown separately from other revaluation gains.

EUR thousands

	31 December 2017	31 December 2016
Revaluation accounts		
Pre-system unrealised gains	164,456	164,456
Equity securities	21,641	14,585
Gold	20,332	23,357
Financial derivatives	8,447	6,890
Debt securities	2,449	2,994
Foreign currency	2	11,378
<b>Total</b>	<b>217,327</b>	<b>223,661</b>

Unrealised revaluation losses, recognised as expenses at the end of 2017 are presented in Note 34 'Net result of financial operations, write-down and risk provisions'.

<sup>15</sup> Article 4(3) of the Guideline on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34).

## Note 32. Capital

Statement of changes in equity for 2017

EUR thousands

	31 December 2017	2016 profit distribution	31 December 2016
Capital			
Authorised capital	60,000	-	60,000
Reserve capital	384,389	15,494	368,896
<b>Total</b>	<b>444,389</b>	<b>15,494</b>	<b>428,896</b>

The authorised capital of the Bank of Lithuania amounts to EUR 60,000 thousand and is fully formed.

Pursuant to the Law on the Bank of Lithuania, the Bank of Lithuania's reserve capital must not be lower than five amounts of its authorised capital and can be increased from the Bank of Lithuania's profit by an independent decision of the Board of the Bank of Lithuania, adopted taking into account risks and their likely impact. Reserve capital is used for the Bank of Lithuania's loss absorption.

In 2015, the Board of the Bank of Lithuania made a decision to increase the reserve capital up to a specified amount, providing that the annual rate of increase shall be proportionally close to the Bank of Lithuania's projected Republic of Lithuania GDP in the medium-term (calculated in comparative prices) annual average growth.

## 6. NOTES ON THE PROFIT AND LOSS ACCOUNT

### Note 33. Net interest income

EUR thousands

	2017		2016	
	Interest income	Interest expense	Interest income	Interest expense
Monetary policy operations	37,028	(1,229)	17,091	(537)
Securities held for monetary policy purposes	26,782	-	10,791	-
Current accounts (covering the minimum reserve system)	10,244	-	6,296	-
Deposits related to margin calls	2	-	4	-
Main refinancing operations	-	-	0	-
Marginal lending facility	-	-	0	-
Longer-term refinancing operations	-	(1,229)	-	(537)
Debt securities	19,428	-	11,029	-
Balances in current accounts with the Bank of Lithuania	6,885	-	2,895	-
Foreign exchange transactions	1,349	-	2,829	-
Intra-Eurosystem claims/liabilities	-	-	265	-
Claims related to the allocation of euro banknotes within the Eurosystem	-	-	192	-
TARGET2 balances	-	-	51	-
Foreign reserves transferred to the ECB	-	-	21	-
The Bank of Lithuania's balances in current accounts	-	(352)	-	(284)
Interest rate swaps	-	(502)	-	(179)
Gold swaps	-	(2,178)	-	(994)
Repurchase agreements	-	(2,243)	-	(1,671)
Other	120	-	130	-
<b>Total interest income (expense)</b>	<b>64,810</b>	<b>(6,504)</b>	<b>34,240</b>	<b>(3,664)</b>
<b>Net interest income</b>	<b>58,306</b>		<b>30,576</b>	

In 2017, the net interest income increased by EUR 27,730 thousand, compared to 2016, mainly due to the growth in net interest income from monetary policy operations. This growth was related to purchase of securities under the public sector asset purchase programme (see Note 8) and still negative deposit facility rate (-0.4%).

### Note 34. Net result of financial operations, write-downs and risk provisions

This item includes (a) net income (expense) related to the sale transactions of financial instruments, gold and foreign currency; (b) write-downs of financial items, which consists of unrealised revaluation loss as a result of the decline in market prices and rates on 31 December 2017 as compared to the average prices and rates of these items; and (c) additional provisions for foreign exchange rate, interest rate, gold price and credit risks, formed, by a decision of the Board of the Bank of Lithuania, based on the assessment of the level of accounting risk assumed.

EUR thousands

	2017	2016
<b>Net realised gains (losses) arising from:</b>	<b>6,125</b>	<b>28,557</b>
Interest rate derivatives	3,798	(24,421)
Transactions in securities	3,215	46,200
Other transactions in gold and foreign currency	(888)	6,778
<b>Write-downs on financial items</b>	<b>(50,406)</b>	<b>(6,390)</b>
Foreign currency	(24,048)	(37)
Financial derivatives	(17,166)	(649)
Securities	(9,192)	(5,705)
<b>Transfers to provisions for risks</b>	<b>-</b>	<b>(56,500)</b>
<b>Net result of financial operations, write-downs and risk provisions</b>	<b>(44,281)</b>	<b>(34,334)</b>

The write-down of foreign currency was mainly due to the depreciation of the US dollar against the euro.

The write-down of financial derivatives was mainly due to the decrease in the market value of non-deliverable foreign exchange forwards.

### Note 35. Net income from fees and commissions

EUR thousands

	2017	2016
Fees and commissions income	7,091	6,028
Contributions of supervised financial market participants	5,554	5,035
Settlement services	617	511
Security lending	559	304
Other services	362	178
Fees and commissions expense	(1,852)	(1,282)
Financial instruments	(1,552)	(1,037)
Other	(300)	(245)
<b>Net income from fees and commissions</b>	<b>5,239</b>	<b>4,747</b>

Pursuant to the Law on the Bank of Lithuania, the costs of financial market supervision are funded by the contributions of supervised financial market participants and own funds of the Bank of Lithuania. In 2017, the Bank of Lithuania collected contributions amounting to EUR 5,260 thousand to cover the costs of financial market supervision (in 2016 – EUR 4,781 thousand).

In 2015, the Bank of Lithuania was assigned the function of financial institutions resolution. In 2017, the Bank of Lithuania collected the contributions of financial market participants amounting to EUR 293 thousand to finance the activity of the financial sector resolution authority (in 2016 – EUR 254 thousand).

Fees and commissions expense grew mainly due to more fees paid for the Bank of Lithuania's accounts management and the external management of the financial assets portfolio in 2017.

**Note 36. Income from equity shares and participating interests**

EUR thousands

	2017	2016
Income from distribution of the ECB profit	7,130	7,255
Dividend income from marketable equity securities	3,377	5,646
Dividend income from non-marketable equity securities	394	290
<b>Total</b>	<b>10,900</b>	<b>13,190</b>

**Note 37. Net result of pooling of monetary income**

EUR thousands

	2017	2016
Net monetary income pooled by the Bank of Lithuania	(28,240)	(10,233)
Net monetary income reallocated to the Bank of Lithuania	63,332	58,159
Adjustment for the monetary income of previous years	(18)	(2)
The Bank of Lithuania's share in the provision against losses in monetary policy operations (see Note 30)	(404)	-
<b>Net result of pooling of monetary income</b>	<b>34,670</b>	<b>47,924</b>

**Note 38. Other income**

EUR thousands

	2017	2016
Income from sale of collector coins and other numismatic items	899	801
Income from coin rolling services	161	59
Other miscellaneous income	156	347
<b>Total</b>	<b>1,216</b>	<b>1,207</b>

**Note 39. Staff costs**

EUR thousands

	2017	2016
Expenses on wages and salaries:	11,461	11,097
to the members of the Board	351	380
to the heads of structural divisions	904	763
to other staff of the Bank of Lithuania	10,206	9,954
Other emoluments	402	525
Contributions to the State Social Insurance Fund	3,623	3,578
Expenses on (income from) provisions related to liabilities to the staff	830	(429)
<b>Total</b>	<b>16,317</b>	<b>14,771</b>

Pursuant to the Law on the Bank of Lithuania, the Board of the Bank of Lithuania consists of: the Chair, two Deputy Chairs, and two Members.

As at 31 December 2017, four Services, four autonomous Departments and four autonomous Divisions operated in the Bank of Lithuania. As at 31 December 2017, the Bank of Lithuania employed 591 staff members (at the end of 2016 – 588) of which 38 (at the end of 2016 – 19) worked under a fixed-term labour contract. In addition, 24 employees were on parental leave or unpaid leave for the term of their contracts with the ECB and the IMF (at the end of 2016 – 13).

In 2017, an increase in expenses on wages and salaries was caused by the increased average number of staff and the growth of wages and salaries.

In 2017, the part of staff costs that amounted to EUR 460 thousand were included in the initial costs of the internally generated intangible assets items (see section 2.11 of the Explanatory Notes and Note 13) and are not presented in this item.

## Note 40. Administrative expenses

EUR thousands

	2017	2016
Administrative expenses		
Tangible assets maintenance	3,024	3,305
Information systems maintenance and information acquisition	1,346	1,414
Participation in international organisations fees	1,196	1,123
Business trips	802	760
Equipment and office supply	431	423
Training of the staff	378	347
Communication	299	236
Mail and telecommunication	264	222
Other	710	518
<b>Total</b>	<b>8,449</b>	<b>8,348</b>

## Note 41. Banknote production services

The Bank of Lithuania participates in the production of euro banknotes together with other NCBs of the euro area. The Governing Council of the ECB sets the denominations of euro banknotes and their quantities that must be produced each year from euro area NCB funds. In 2017, the Bank of Lithuania incurred EUR 2,307 thousand of euro banknote production expenses that were necessary to supplement the Eurosystem's strategic reserve (in 2016 – EUR 9,344 thousand).

## Note 42. Other expenses

EUR thousands

	2017	2016
Euro circulation coin minting expenses	3,434	447
Collector and commemorative coin minting expenses	579	593
Cash circulation expenses	41	56
Other miscellaneous expenses	0	644
<b>Total</b>	<b>4,054</b>	<b>1,740</b>

In 2017 the number of euro circulation coins minted increased due to the increased demand for euro circulation coins.

## Note 43. Distribution of the profit

Pursuant to Article 23 of the Law on the Bank of Lithuania, profit (loss) is distributable (coverable) as follows:

- 1) net distributable profit (loss), which consists of the profit (loss) for the last financial year and undistributed profit (if any) carried over from the previous financial periods, is distributed (covered) after the end of the financial year;
- 2) net distributable loss shall be covered from the reserve capital of the Bank of Lithuania. When the reserve capital is not sufficient to cover the net distributable loss, the remaining uncovered losses are carried forward to be covered by the distributable profit of the succeeding financial years;
- 3) net distributable profit shall be allocated in the following sequence:
  - » to cover the uncovered loss carried forward;
  - » for the authorised capital up to the amount specified in the Law on the Bank of Lithuania;
  - » for the reserve capital up to the amount independently established by the decision of the Board of the Bank of Lithuania, taking into account the potential impact of risks; however, this capital shall not be less than five amounts of the authorised capital of the Bank of Lithuania;
  - » to the State Budget as the profit contribution of the Bank of Lithuania. This contribution shall not exceed the amount corresponding to 70% of the calculated average of the profit (loss) of the Bank of Lithuania of the last three financial years.

The surplus of the distributable profit after allocation shall be carried forward as undistributed profit and shall be distributed in subsequent financial years.

## Profit distribution

EUR thousands

	2017	2016	2015
Profit distribution			
Allocation to the reserve capital of the Bank of Lithuania	20,757,026	15,493,621	11,334,686
Transfer to the state budget	11,169,059	11,510,168	10,444,643
<b>Total</b>	<b>31,926,085</b>	<b>27,003,790</b>	<b>21,779,329</b>

## 7. OTHER NOTES

### Note 44. Derivatives

As at 31 December 2017, the Bank of Lithuania had outstanding foreign exchange swaps, foreign exchange forwards, non-deliverable foreign exchange forwards, interest rate futures and interest rate swaps. All these transactions were conducted in the context of the management of the Bank of Lithuania's financial assets (excluding monetary policy operations).

### Foreign exchange swaps and foreign exchange forwards

EUR thousands

	31 December 2017	31 December 2016
Claims	6,549,820	4,625,327
Liabilities	6,549,820	4,625,327

### Non-deliverable foreign exchange forwards

EUR thousands

	31 December 2017	31 December 2016
Notional claims	519,879	184,298
Notional liabilities	530,287	181,131

### Interest rate futures

EUR thousands

	31 December 2017	31 December 2016
Notional claims	2,254,127	1,590,705
Notional liabilities	4,429,584	320,300

### Interest rate swaps

The notional value of interest rate swap transactions as at 31 December 2017 amounted to EUR 680,187 thousand (as at 31 December 2016 – EUR 4,743 thousand).

## Resolutions adopted by the Board of the Bank of Lithuania in 2017

- » The Bank of Lithuania took active legislative actions, adopting regulatory Bank of Lithuania legal acts.
- » The Board of the Bank of Lithuania adopted 92 resolutions regulating activities of banks and other financial market participants; they are made publicly available on the [Register of Legal Acts](#).