Executive summary of the public audit report

PERFORMANCE OF THE STATE UNDERTAKING DEPOSIT AND INVESTMENT INSURANCE

13 February 2014 No. VA-P-60-9-2

Full audit report in Lithuanian is available on the website of the National Audit Office: www.vkontrole.lt

DEFINITIONS

'**The insured**' means a bank, a foreign bank which has set up a branch in the Republic of Lithuania, a credit union or an undertaking or a foreign undertaking licensed to provide investment services, which pays, following the procedure established by the Law on Insurance and Liabilities to Investors, premiums to the Deposit Insurance Fund or the Fund of Insurance of Liabilities to the Investors administered by the state undertaking Deposit and Investment Insurance.

'**Insurance premium'** means a sum of money paid by the insured in accordance with the procedure laid down by the Law on Insurance and Liabilities to Investors into the Deposit Insurance Fund or the Fund of Insurance of Liabilities to the Investors administered by the state undertaking Deposit and Investment Insurance.

'Insurance compensation' means a sum of money prescribed by the Law on Insurance and Liabilities to Investors to which a depositor or an investor is entitled in the event of occurrence of an insured event.

'**Insured event'** means institution of bankruptcy proceedings against a credit union, bank or an undertaking or taking of a decision by a supervisory authority on the application of measures or suspension of the provision of investment services where a credit union or a bank/branch is not able to settle with creditors or when an undertaking/a subsidiary of an undertaking is not able to meet its liabilities to the investors.

'Financial brokerage firm' is a legal person whose regular business is the provision of one or more investment services to third parties and/or the performance of one or more types of investment activities on a professional basis. It shall be possible that the financial brokerage firms established in other states do not have the status of a legal person.

'Depositor' means a natural or legal person holding deposits with banks, branches and credit unions other than entities whose deposits under the Law on Insurance and Liabilities to Investors may not be covered by insurance.

'Investor' means a natural and legal person who has entrusted money or securities to the insured with the aim of availing himself of the investment services provided by the insurer.

'Management company' means any company the regular business of which is the management of investment funds or of investment companies and any company licensed to engage in pension accumulation activities.

EXECUTIVE SUMMARY

The state undertaking Deposit and Investment Insurance is the only company in Lithuania which insures deposits and liabilities to investors. Insurance premiums to this company are paid by[1]: 7 banks, 75 credit unions, 9 financial brokerage firms, and 11 management companies. As on 30 June 2013, the number of the depositors in the banks and credit unions was almost five million[2], potential insurance compensations would amount to LTL 29.66 billion.

There are a lot of reports in the public space about the insured failing to provide adequate information to depositors and investors that certificates of the deposits and bonds of the bank itself are not covered with the insurance of deposits and liabilities to investors[3].

It is obvious that because of their age, education, etc., not all people have and can have special investment knowledge to be able to independently evaluate whether the information provided by the insured about the insurance of deposits and liabilities to investors is clear and unambiguous, whether the right decisions on the investment of funds can be made and the risks of potential consequences can be understood. Therefore, proper provision of information to depositors and investors about the insurance of deposits and liabilities to investors has to be ensured.

It should be pointed out that it is the duty of the insured to inform depositors and investors. The state undertaking Deposit and Investment Insurance inspects how the insured inform depositors and investors about the insurance of deposits and liabilities to investors.

The objective of the audit was to assess whether the state undertaking Deposit and Investment Insurance has been efficiently performing the functions assigned thereto.

The audit assessed the performance of all eight functions assigned to the state undertaking Deposit and Investment Insurance in the Law on Insurance and Liabilities to Investors[4], namely:

- “to accumulate funds in the Deposit Insurance Fund and the Fund of Insurance of Liabilities to the Investors” – as on 30 June 2013, the deficit of the Deposit Insurance Fund stood at LTL (-)3,021 million, the amount of the Fund of Insurance of Liabilities to the Investors totalled LTL 6.87 million;
- “to calculate and pay compensations to the depositors and investors of the insured” – five insured events took place during six months from 2011 to 2013, the amount paid to 592,170 depositors totalled LTL 4,996.08 million;
- „to supervise compliance of the insured with the procedure of insurance laid down in the Law on Insurance and Liabilities to Investors“:

[1] Data of the state undertaking Deposit and Investment Insurance of 30 June 2013.

[2] One depositor can have several deposits with the same bank or credit union, so such depositor will be included in this number several times.

[3] “160 persons who had bonds and certificates of the deposits with Snoras bank filed a claim concerning payment of insurance compensations” (http://www.delfi.lt/verslas/snoras/160-asmenu-turejusiu-snoro-obligaciju-ir-indeliu-sertifikatus-kreipesi-su-pretenzija-del-draudimo-ismoku-mokejimo.d?id=53982375); „"The holders of bonds and certificates of the deposits with Snoras bank filed a claim concerning LTL 10 million” (http://vz.lt/?PublicationId=17dd8ff2-a828-4493-8eda-b142800e67f8).

[4] Law on the Republic of Lithuania on Insurance of Deposits and Liabilities to Investors, 20 June 2002, No. IX-975, Art. 18.

  - to inspect whether the insured have correctly determined the insurance cover, the basis for calculating insurance premiums and whether they have correctly calculated the insurance premium and paid it in due time – 4,921 reports of the insured were checked, 89 erroneous reports were identified, which were later correctly. Also, during the first half of the year from 2010 to 2013:
    - ✓ an excess insurance premium in the amount of LTL 10,000 was calculated for one insured;
    - ✓ insurance premiums in the amount of LTL 3,240 were not paid in due time by four insured;
    - ✓ default interest in the amount of LTL 1,498 was calculated for 27 insured;
  - to inspect whether the insured are ready to supply the undertaking with data required for calculating insurance compensations – 39 such checks were carried out during ten months from 2010 to 2013; irregularities were identified during 20 checks (54 per cent);
  - to inspect whether the insured provide adequate information to depositors and investors about the insurance of deposits and liabilities to investors – 52 checks were carried out during ten months from 2010 to 2013;
- "to invest the funds administered and the equity capital resources of the insurance undertaking into the securities of central banks and governments of the states approved by the Council of the insurance undertaking and into the deposits with the Bank of Lithuania" – as on 30 June 2013, the book value of the bonds of the Republic of Lithuania purchased by the undertaking was LTL 41.15 million, their maturity date 10 February 2016.

The assessment of the performance of eight functions assigned to the state undertaking Deposit and Investment Insurance (the findings are given in Annex 2 of the Report) revealed problems in relation to the function "to supervise compliance of the insured with the procedure of insurance laid down in the Law on Insurance and Liabilities to Investors".

The cost-benefit analysis of the state undertaking Deposit and Investment Insurance is provided in Annex 3 of the Report.

The audit was conducted at the Ministry of Finance of the Republic of Lithuania and the state undertaking Deposit and Investment Insurance. The problems identified and possible solutions were discussed with representatives of the Bank of Lithuania, the Ministry of Finance, and the Association of Lithuanian Banks.

The audit covered the period 2010–2013, first half of the year. The analysis of changes also used the data from the second half of 2013 and later periods.

The following public audit conclusions and recommendations were drawn upon the assessment of the audit findings

CONCLUSIONS

1. Legislation does not govern the ways, form and measures to be used by the insured for informing depositors and investors about the insurance of deposits and liabilities to investors:

   1.1. This prevents the provision of clear and understandable information to depositors and investors, as required by the Law on Insurance and Liabilities to Investors.

1.2. The Rules of Inspection of the Insured of the state undertaking Deposit and Investment Insurance cannot always be used to determine how the insured inform depositors and investors about the insurance of deposits and liabilities to investors.

1.3. Conclusions provided in the reports of inspections carried out by the state undertaking Deposit and Investment Insurance may contain signs of subjectivity.

2. The Ministry of Finance, as the authority exercising the rights and duties of the owner of the state undertaking Deposit and Investment Insurance, for twelve years has been failing to take any steps to ensure legal regulation of the ways, measures and form to be used by the insured for informing depositors and investors about the insurance of deposits and liabilities to investors.

RECOMMENDATIONS

To the Ministry of Finance:

In view of the fact that one of the key elements of the protection of depositors and investors is provision of information thereto about the insurance of deposits and liabilities to investors and in order to ensure clearer and more detailed information, the Ministry of Finance should:

1. Initiate amendment of the Law on Insurance and Liabilities to Investors specifying the ways, form and measures for providing information (for example, what information shall be provided against receipt, what information shall be available on the websites of the insured, etc.) to depositors and investors about the insurance of deposits and liabilities to investors by the insured.

To the state undertaking Deposit and Investment Insurance:

1. Following the adoption of the amendment of the Law on Insurance and Liabilities to Investors, the Rules of Inspection of the Insured[5] approved by order of the Director of the state undertaking Deposit and Investment Insurance should be amended specifying the information provision ways and measures to be checked by the undertaking staff during inspections of the insured.

2. Following the information provided in Chapter 1 of the Report about the insured[6] who did not provide correct and detailed information about the insurance of deposits and liabilities to investors, inspections of these insured should be carried out.

[5] Approved by Order No. V-72 of the Director the state undertaking Deposit and Investment Insurance of 16 July 2013.

[6] The list of the insured is given in the letter addressed to the state undertaking Deposit and Investment Insurance.