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Review of the Activities of Credit Unions 2017

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On 1 January 2018, financial and supervisory reports were presented to the Bank of Lithuania by 68 credit unions that united 160.9 thousand members.

In the beginning of 2018, *Neris* credit union was issued a license. Over the same period two credit unions (*Centro taupomoji kasa* credit union and *Taupkasė* credit union) were deemed insolvent. By resolution of the Board of the Bank of Lithuania these two credit unions were permanently revoked their licences and an application to the court regarding initiation of bankruptcy proceedings was made (bankruptcy proceedings for *Centro taupomoji kasa* credit union were initiated in February).

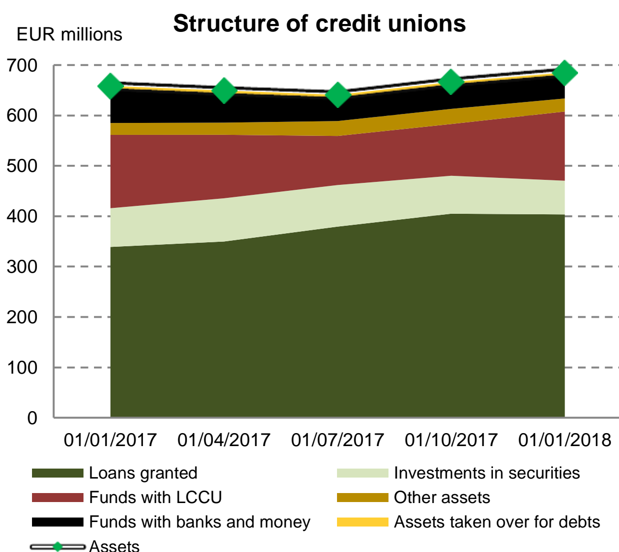
2017 marked the year for credit unions to prepare for the reform of the credit union sector that began with an asset quality review. Two central credit unions (CCUs) started operating in Lithuania; they took action to ensure the solvency of their members and were able to control the level of their risk assumed. All credit unions had to take a decision whether to choose the restructuring-into-a-bank-procedure or continue operating as members of one of the CCU (either Lithuanian Central Credit Union or United Central Credit Union) until 1 January 2018. The decision to remain members of CCUs opened up a possibility for those credit unions (61 credit union) to work with partners that share a common vision regarding their activities and to develop an acceptable business model common for all members. CCU groups have an opportunity to strengthen cooperative banking activities and enable expansion of financial services for households and businesses.

Five credit unions (*Mano unija* credit union, LTL credit union, *Taupa* credit union, *Ratas* credit union and *Saulėgrąža* credit union) that decided to develop their activities according to a bank model, received permission from the Bank of Lithuania to restructure. To obtain a specialised bank licence, they will have to reorganise their activities within a five-year-transitional period so as to meet all requirements set for banks and be able to engage in traditional banking activities. Credit unions that failed to obtain a bank licence within the period specified, will be able use the possibility to become members of the CCU and continue operating as part of the CCU, while activities of those that did not become members of the CCU will be terminated as the Bank of Lithuania will have to revoke their credit union licences.

In 2017 credit union assets grew by more than 4 per cent and, according to unaudited data as at 1 January 2018, amounted to EUR 685.2 million, or 2.5 per cent of the banking system's assets (a year ago – 2.6%). The annual change in the credit union sector asset value was driven by growth of time deposits as some credit unions increased their interest rate on these deposits.

As can be seen in the Chart, in 2017 credit unions loans[1] grew and at the end of the year they accounted for the largest asset share, while other asset positions, notably security investments, decreased.

At the end of 2017, credit unions had granted to their members EUR 403.5 million in loans. In 2017, loans granted by credit unions increased by EUR 64.5 million, or 19 per cent, while their credit union sector asset share – by 7.4 p.p. accordingly. Loans comprised more than a half (almost 59%) of the credit union sector assets according to the data as at 1 January 2018. Loans granted by credit unions to members that are natural persons expanded by EUR 48.9 million over the reporting period, yet the total growth of such loans was slower than that of loans to legal persons. The stronger rate of growth in loans to legal



Source: Bank of Lithuania.

[1] *The financial statements present loan value, which is calculated by adding up the balances of loans and interest accrued and subtracting specific provisions formed.*

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persons led to an increase in the loan portfolio share of loans to associated members (mainly legal entities) to 20.2 per cent.

The growth in the loan portfolio and measures applied by credit unions, which contributed to reducing specific provisions (for covering likely losses on loan impairment) by a fifth (to EUR 16.4 million), resulted in annual improvement of loan quality indicators: the ratio of specific provisions to loans over the year decreased by 1.9 p.p. (to 3.9%), while share of non-performing loans[2] in the loan portfolio – by 4.7 p.p. (to 18%).

While the abovementioned indicators improved with the growth in the loan portfolio, the volume of total written-off loans decreased over the year only by the share of written-off loans from bankrupt credit unions that withdrew from the market. **This shows that credit unions currently in operation were not able to recover expenses incurred due to inadequately assessed credit risk up to now.**

Credit union investment in securities continued to decrease gradually in 2017. From the beginning of the year credit union investment in securities contracted by nearly EUR 10 million (to EUR 67 million), while their share in the growing assets of credit unions slimmed down by 1.9 p.p. – to 9.8 per cent. The largest share of the securities portfolio (92.2%) was comprised of Lithuanian Government securities, it posted an increase of 5.8 p.p. year on year. The remaining share was comprised of government securities of Latvia, Slovenia, Romania, Bulgaria and Greece. The credit union sector securities portfolio is managed following the requirements laid down in the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations'). All credit unions complied with the Regulations' requirement regarding the share of the securities portfolio in the on-balance-sheet assets: at the end of the quarter, securities did not account for more than 35 per cent of their on-balance-sheet assets. Three credit unions still failed to comply with other requirements of the Regulations: one – for the average modified financial duration of a securities portfolio, concentration of lower-rated government securities of EU countries, and concentration in securities of a sole lower-rated issuer; two – for the average modified financial duration of a securities portfolio.

The main funding source for credit unions continues to be accepted deposits with which they financed 89 per cent of their assets. Deposits accepted by credit unions have expanded by nearly EUR 21 million (3.5%) in 2017 and stood at EUR 611.4 million as of 1 January 2018. The annual growth in the deposit portfolio was driven by an EUR 16.1 million (to EUR 434.3 million) increase in time deposits of credit unions, aiming to restructure into specialised banks, and of some members of the CCU that increased their deposit interest rates. According to the reported data, 29 credit unions raised their interest rates on deposits with a maturity of 12 months since the beginning of the year; however interest paid for these deposits were lower than 1 per cent. Due to acceptance of more expensive deposits the profitability of some credit unions diminished. Having nowhere to safely invest them, some credit unions held their funds with the Bank of Lithuania, banks or the LCCU, receiving almost no income. Sight deposits, which at the end of the period comprised slightly more than a fourth of total deposits with credit unions, grew by only EUR 4.6 million year on year. With resident saving habits remaining the same, deposits of natural persons accounted for the largest share of the deposit portfolio (96.2%).

Credit unions' share capital shrank by EUR 3.5 million in 2017, to EUR 54.8 million. The change in their share capital was due to the withdrawal from the market of credit unions currently going bankrupt. Preparing to ensure compliance with the sector reform implementing requirements, credit unions accumulated sustainable capital. According to the reported data, sustainable shares which are used to cover losses born by a credit union comprised EUR 37.8 million at the end of the year, or more than two thirds of the share capital.

In 2017, the credit union sector's result of activities amounted to EUR 2.2 million of unaudited profit. 48 credit unions whose operations were profitable from the beginning of the year earned a profit of EUR 4.1 million, while 20 credit unions which operated at a loss sustained a loss of EUR 1.9 million. In 2016 credit unions bore a loss of EUR 6.1 million. Were it not for the losses sustained by two credit unions (EUR 1 million) that had their licences revoked in 2018, credit union sector's unaudited profit would have amounted to EUR 3.2 million.

Profitability of credit union sector activities was due to the fact that the decline in expenses borne by credit unions outweighed their income received (year on year their income received dropped by 7%, and expenses borne – by 28.5%). As usual, the largest share of credit union income (78%) was comprised of interest income, of which 95 per cent – on loans granted to members. Fee and commission income of credit unions (mainly on crediting liabilities) accounted for 14.5 per cent of total income. Growth in this income is likely to be associated with the expansion in credit volumes. The diminishing specific provisions necessary for amortising likely losses on the credit union asset value led to a year-on-year decrease in this sector's expenses by more than a fourth. Operating expenses accounted for the largest share of credit unions' expenses (64%), and it took 58.4 per cent of the income, or 0.5 p.p more than in 2016, to cover them. It should be noted that the share of income needed to cover operating expenses has been increasing for several consecutive years (form 2014 it increased by 25 p.p.). Credit unions' expenses for interest accounted for one-fourth of total expenses. **Given the significance of profitable activities on capital sustainability, credit unions, in taking decisions on their busi-**

[2] *Non-performing loans include unimpaired loans overdue for more than 60 days and total impaired loans.*

ness model, should concentrate more on the analysis of the generated income and expenses incurred, notably operating expenses.

According to unaudited data as at 1 January 2018, the capital adequacy ratio of the credit unions stood at 18.64 per cent (the requirement is 13%); however, the capital adequacy ratio of individual credit unions differed considerably – the three largest stood at 30.76, 29.7, and 29.06 per cent, while the three smallest – at 1.12, 5.97, and 13.07 per cent (two were below the minimum requirement).

The liquidity ratio of the credit union sector stood at 45.7 per cent (the required minimum is 30%) as at 1 January 2018. All credit unions complied with the liquidity ratio, however the liquidity ratio of individual credit unions' differed considerably – from 35.67 per cent to 73.95 per cent (three largest stood at 73.95%, 73.31% and 68.75%, while three smallest – at 35.67%, 35.85% and 35.99%).

On the reporting date, seven credit unions did not comply with prudential ratios:

- *Centro taupomoji kasa* credit union and *Taupkasė* credit union – the capital adequacy and the maximum exposure to a single borrower requirements;
- Varėna credit union and Kvėdarna credit union, Utena credit union, Kelmė credit union and *Taupa* credit union – the maximum exposure to a single borrower requirement.

Non-compliance by the above-named credit unions with prudential requirements was a result of a lack of capital, which happened (or increased) due to significant expenses incurred (in some cases – due to expenses related to asset quality).

In the beginning of 2018, some credit unions that did not comply with one requirement – maximum exposure for a single borrower – submitted information that they had remedied the situation and are now in compliance with prudential requirements, while Varėna credit union that started the reorganisation process will comply with the requirements once it is merged with Alytus credit union. *Centro taupomoji kasa* credit union and *Taupkasė* credit union that failed to observe the capital adequacy and the maximum exposure to a single borrower requirements were subject to an enforcement measure provided for in the Republic of Lithuania Law on Credit Unions. As mentioned above, the Bank of Lithuania decided to permanently revoke the licences of these two credit unions and applied to the court regarding the initiation of bankruptcy proceedings (bankruptcy proceedings were initiated for *Centro taupomoji kasa* credit union).

It should be noted that information on each credit union's key performance indicators for the year and each quarter as well as on their compliance with prudential ratios is published on the Bank of Lithuania website.

As mentioned in previous reviews, one of the main steps in carrying out the credit union sector reform approved by the Seimas of the Republic of Lithuania was the asset quality review of all credit unions, the results of which were recognised by the credit union sector, except for *Taupkasė* credit union, and recorded in their financial statements. The asset quality review results for each credit union, information about the capital adequacy ratio for 1 April 2017, reported by credit unions, and the status of the asset quality review process are available on the Bank of Lithuania website.

Annex. Dynamics of performance indicators of the credit union sector

Seq. No	Indicator	Amount, EUR millions			Change (%)	
		01/01/2017	01/10/2017	01/01/2018	2017 Q4	over the year
1	**Assets**	**658.5**	**666.4**	**685.2**	**2.8**	**4.1**
2	Money	3.4	3.4	3.4	–	–
3	Funds with banks	61.7	42.5	41.3	–2.8	–33.1
4	Funds with the LCCU	145.6	102.6	137.3	33.8	-5.7
5	Government securities	76.8	75.4	67.0	–11.1	–12.8
6	**Loans granted**	**339.0**	**405.0**	**403.5**	**–0.4**	**19.0**
7	Specific provisions for loans	20.7	18.5	16.4	–11.4	–20.8
8	Ratio of specific provisions for loans to loans (%)	5.8	4.4	3.9	–	–
9	Debt to the LCCU	11.8	19.6	13.5	–31.1	14.4
10	**Deposits**	**590.7**	**575.3**	**611.4**	**6.3**	**3.5**
10.1	Of which members and associated members of credit unions	587.7	572.1	608.2	6.3	3.5
11	**Share capital**	**58.3**	**57.4**	**54.8**	**–4.5**	**–6.0**
12	Profit (loss) for current year	-6.1	-2.5	2.2	–	–

Source: Bank of Lithuania.

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