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Review of the Credit Union Sector

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In 2017 credit unions had to prepare for the entry into force of legislation implementing this sector's reform, and 1 January 2018 marks the beginning of the period in which they will have to ensure the compliance with provisions of the new legislation.

With two central credit unions (CCUs) coming into operation, from 1 January 2018 a new structure have been put in place for the credit union sector. It consists of three credit union groups: the Lithuanian Central Credit Union (LCCU) group, the United Central Credit Union (UCCU) group and credit unions which are undergoing restructuring into specialised banks. The LCCU unites 51 credit unions, whilst membership of the UCCU was chosen by 11 credit unions.

CCUs not only provide financial services, they also have to maintain the liquidity and ensure the solvency of their members and also monitor and inspect any of their assumed risks. To add, the decision to become members of the CCU have opened up possibility for those credit unions to work with partners who share a common vision when it comes to their activities and to develop a common business model that is acceptable for all members. CCU groups have an opportunity to strengthen cooperative banking activities and enable the development of financial services for households and businesses.

According to the reported data, the marketable assets of credit unions amounted to €671.7 million as at 1 April 2018. As seen from Chart 1, the LCCU group's assets accounted for the largest share of the credit union market (56%), while the rest of it was almost equally shared by the assets of the UCCU and those credit unions which were undergoing restructuration.

Central credit unions. At the end of the first quarter of 2018, the Bank of Lithuania received the first UCCU reports as well as the first reports from the CCU groups.

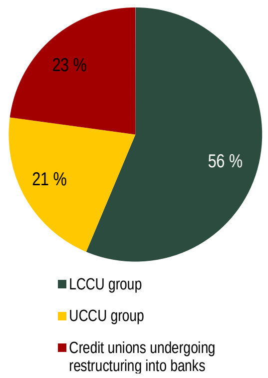
According to the reported data as at 1 April 2018, the total assets of both CCUs amounted to €153.2 million, with the LCCU's assets accounting for the largest share (80%) of it. CCU investments in securities accounted for the largest share of the assets (52%), funds held with the Bank of Lithuania – a smaller share (28%), while the rest were loans granted to credit unions and their members and other assets. The largest share of the liabilities (89%) on the reporting date consisted of CCU liabilities to credit institutions (involving fixed-term deposits and funds in bank accounts with credit unions).

Although CCUs operated at a loss in the first quarter of 2018 (the loss amounted to €0.3 million), the overall capital adequacy requirement was met with a fair margin. With the Republic of Lithuania share contribution (€8.88 million) increasing the LCCU's share capital, the total capital adequacy ratio amounted to 60.16% (the requirement is 10.5%) (see Table 1). The liquidity coverage requirement for CCUs was also met with a margin (133.8%, requirement – 100%) (see Table 2).

At the end of the first quarter of 2018, stabilisation funds of the LCCU and UCCU amounted to €1.1 million and €0.35 million respectively. It should be noted that this contains a fairly low amount of funds for one of the CCUs' main functions, namely ensuring the solvency of credit union members (no

Chart 1. Market structure of Lithuanian credit unions in terms of assets

(as of 1 April 2018)



Source: Bank of Lithuania.

Table 1. Capital adequacy ratios for Central Credit Unions

	Q1 2018	
	Capital adequacy ratio, %	REQUIREMENT, %
LCCU	59.79	17.53
UCCU	63.52	10.50
Total	**60.16**	–
LCCU group	20.60	10.50
UCCU group	14.89	10.50
Total	**18.65**	–

Source: Bank of Lithuania.

Table 2. Liquidity coverage ratios for Central Credit Unions

	Q1 2018	
	Liquidity coverage, %	REQUIREMENT, %
LCCU	145.80	100
UCCU	105.70	100
Total	**133.80**	–
LCCU group	1,016.70	100
UCCU group	372.2	100
Total	**707.50**	–

Source: Bank of Lithuania.

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less than 1% of a credit union's and its members assets should be accumulated and stored). According to the data as at 1 April 2018, the LCCU's stabilisation fund comprised 0.29% of its assets, while the UCCU's – 0.25%; therefore, the CCUs will have to increase their stabilisation fund to the required level so as to perform their assigned function accordingly.

At the end of the quarter, the LCCU's share in the liquidity support reserve (accumulated on a voluntary basis by CCUs) amounted to €4.9 million and the UCCU's – €1.3 million.

At the end of the first quarter of 2018, the assets of CCU groups amounted to €517.9 million. The largest share of this (61%) was made up of loans, mostly granted by credit unions to their members. Almost a quarter of the assets consisted of CCU groups' investments into securities, whilst the rest (15%) was made up of funds with the Bank of Lithuania, cash, funds in bank accounts, and other assets. The main financing source of assets of CCU groups was deposits, financing 89% of CCUs assets.

Over the first quarter of 2018, the LCCU group earned €1.1 million profit; however the loss suffered by the UCCU reduced the total profit by €0.04 million to €1.06 million.

The total capital adequacy ratio for the CCU groups was 18.65% (requirement – 10.5%, see Table 1), the liquidity coverage ratio – 707.5% (requirement – 100%, see Table 2). Such a high liquidity level was conditioned by liquid assets that had been accumulated by CCUs and their credit union members, which exceeded cash outflows more than four times. The liquid assets for CCU groups consisted of very high quality and liquidity financial instruments: cash, funds with the Bank of Lithuania, and government securities of EU countries.

Credit unions. As of 1 April 2018, a total of 67 credit unions operated in Lithuania, with a membership of 158,100. In the first quarter of 2018, a credit union licence was issued to Neris credit union and two credit unions (Centro taupomoji kasa and Taupkasė) were permanently revoked their licences.

As mentioned, 62 credit unions were members of CCUs, whilst five (Mano unija, LTL, Taupa, Rato kredito unija and Saulėgrąža) which decided to develop their operations along the banking model received permission from the Bank of Lithuania to restructure. They have to reorganise their activities within a five-year-period so as meet all the requirements set to banks. Only having obtained a specialised banking licence, they will be able to operate as banks.

In the first quarter of 2018, general meetings of the credit union shareholders confirmed financial statements and performance results of the credit unions for 2017 audited by independent companies. After working at a loss for two consecutive years, credit union sector produced €1.7 million of audited profit in 2017 (in 2016, it suffered a loss of €6.1 million). Following decisions reached in the shareholder general meetings, those credit unions which operated profitably in 2017 used their profits to cover the previous year's losses and to increase their sustainable capital, while some credit unions which operated at a loss covered their losses from accumulated reserves or reserve capital. Credit unions which had reserve capital that was insufficient to cover their incurred losses were able to transfer their uncovered losses to the beginning of 2018, hoping to use profits earned to cover them in the future.

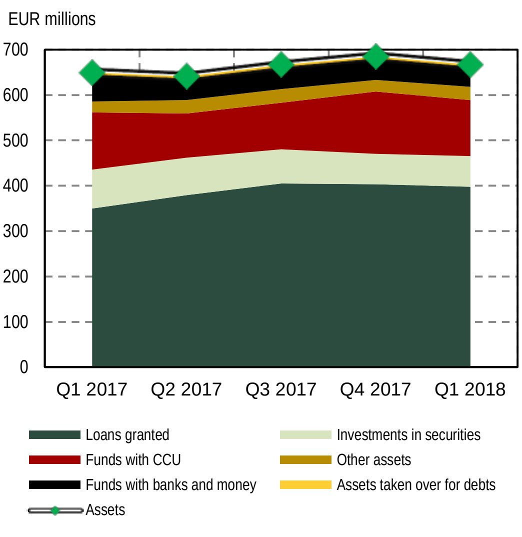
Credit union assets contracted by 2.6% in the period under review, but they remained higher than on 1 April 2017 and amounted to €667.1 million, or 2.6% of the banking system's assets according to the reported data as of 1 April 2018 (a year ago it was 2.5%). This change in the volume of the credit union sector's assets was driven by a decline in deposits from credit unions uniting agricultural workers due to the approaching agricultural season and the withdrawal from the market of two credit unions which had gone bankrupt.

In the first quarter of 2018, all asset positions of credit unions went down except for investments in securities and other assets (see Chart 2).

On 1 April 2018, loans which had been granted to members (amounting to €397.7 million)[1] represented the largest share of credit unions' assets (60%). Since the beginning of the year, the loan portfolio of credit unions shrank by 1.4%, but the share of loans increased by 0.7 percentage point when compared to the more rapidly decreasing assets in the credit union sector. The loan portfolio decrease was determined by a reduction in loans granted to natural persons; since the beginning of the year loans granted to such members contracted by €5.4 million (to legal persons – by €0.2 million). As a result, the

Chart 2. Composition of credit union assets

(1 April 2017–1 April 2018)



Source: Bank of Lithuania.

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

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share of loans granted to associated members, mostly legal entities, further increased during the period under review and made up more than a fifth of the entire loan portfolio at the end of the period.

Although the loan portfolio shrank, specific provisions (for covering likely losses on loan impairment) decreased at a higher rate. During the reporting quarter they decreased by almost a third (to €14.1 million) and this conditioned a reduction in the ratio of specific provisions to loans by 0.6 percentage point (to 3.4%). Due to a significant reduction in specific provisions, the other credit union sector's loan quality indicators also improved[2], but it should be noted that the contracting loan portfolios of some credit unions contained an increased number of loans with debt obligations overdue for more than 60 consecutive days. **Therefore in the future such credit unions may bear expenses related to loan impairment which will negatively affect their capital.**

Credit union investments in securities, which went down last year, in the first quarter of 2018 increased by 1.0% (to €67.7 million) and amounted to a tenth of credit union assets. According to the reported data, all credit unions fulfilled the requirement of the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations') regarding the share of the securities portfolio in the on-balance sheet assets: at the end of the quarter, securities did not amount to more than 35% of their on-balance sheet assets. Most credit unions also fulfilled other requirements which were outlined in the Regulations; however, 11 credit unions had difficulties which were related to the requirement of the Regulations for compliance with the average modified financial duration of a securities portfolio (it was longer than two years). Ten credit unions now comply with a requirement which was included in the latest version of the Regulations which states that the average modified financial duration of a security portfolio must not exceed 3.5 years (this entered into force on 1 May 2018), but the average modified financial duration of a securities portfolio of one credit union exceeds even this extended period. This credit union does not fulfil the requirements regarding the concentration of lower-rated government securities of EU countries and the securities of a sole lower-rated issuer.

Accepted deposits have remained the main funding source for credit unions. At the end of the period under review, deposits were used for financing almost 90% of assets. As mentioned, financial requirements of credit unions uniting agricultural workers which were related to the forthcoming agricultural season and the withdrawal from the market of two credit unions going bankrupt resulted in the reduction in the deposit portfolio. Deposits accepted by credit unions have declined by €18.5 million (3%) since the beginning of the year and amounted to €592.9 million as of 1 April 2018. The total change in a deposit portfolio for the period under review was driven by a decrease of €10.5 million in sight deposits (to €166.6 million) and €8 million – in fixed-term deposits (to €426.3 million), which accounted for three quarters of all deposits accepted by credit unions at the end of the period. According to the reported data, in the first quarter of 2018, interest rates offered by credit unions for deposits with a maturity of 12 months remained almost unchanged: in the credit union sector interest rates not exceeding 0.8% prevailed, the same as at the beginning of the year. Deposits of natural persons who still choose them as a means for saving and investment accounted for the largest share of the deposit portfolio (96.1%).

Credit union share capital contracted by a sixth in the first quarter of 2018 and at the end of the quarter amounted to €46.3 million. The change in share capital was due to the revocation of licences for Centro taupomoji kasa and Taupkasė and their withdrawal from the market. According to the reported data, sustainable shares of credit unions with which incurred losses (€38 million) are covered amounted to almost 82% of share capital, or 13 percentage points more than at the beginning of the period under review. The remaining part of share capital consisted of non-sustainable shares. Since 1 January 2018, these shares are not included in the recalculated capital, used for the calculation of capital-related requirements, and may be reimbursed to members who have applied for such a reimbursement.

The increase in the share of sustainable shares suggests that credit unions aim to ensure compliance with the laws implementing credit union sector reform, which entered into force at the beginning of the year.

According to the reported data, in the first quarter of 2018 the credit union sector's operational result amounted to €1.8 million. A total of 46 credit unions operated profitably, earning €2.2 million, while 21 credit unions which operated unprofitably incurred a loss of €0.4 million. In the first quarter of 2017, credit unions earned €0.3 million in profits.

Higher profits of the first quarter of this year, when compared to the same period in 2017, were driven by the recovery of loan values. The credit union value recovery amounted to €1.3 million, thereby accounting for a significant share of profits. The sector's profits were boosted as a result of credit unions managing to reduce their operational expenses (in terms of rents, advertising, and marketing). In addition, credit union lending activities brought about improvements in the main items of revenue and expenses – with both net interest income and net fee and commission income picking up. As usual, the largest share of credit union income (80%) was comprised of interest income, of which 96% – on loans granted to members. Operational expenses incurred by credit unions recorded a year-on-year decrease of 6% and accounted for the largest share of expenses (75%).

According to the reported data as of 1 April 2018, the capital adequacy ratio of credit unions stood at 13.03% (in 2018, the minimum requirement for credit unions within the membership of the CCU is 5.25%, and for those undergoing restructur-

[2] Indicators which serve to define loan quality include the share of non-performing loans in the loan portfolio and the ratio of loans which have been overdue for more than sixty days and assets which have been taken for debts to total loans.

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ing – 7.30%), the liquidity ratio – at 45.08% (the minimum requirement is 30%). All credit unions fulfilled the requirements mentioned.

Credit unions which had membership within the CCU were set a 10.5% capital adequacy ratio. The credit unions mentioned will have to ensure the compliance with this requirement no later than from 1 January 2028. Credit unions which are undergoing restructuring into specialised banks were set a 14.5% capital adequacy ratio, and they will have to ensure its fulfilment in a shorter period, by the end of 2023. It should be noted that four credit unions had difficulties in complying with the maximum exposure for a single borrower requirement, but in the second quarter of 2018 some of them submitted information that they had remedied the situation and are now in compliance with the requirement, whilst one of those undergoing restructuring intend to fulfil all of the prudential requirements after the reorganisation process is completed.

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

Taking into account the requirements of applicable legal acts as regards the reform of credit unions, the Bank of Lithuania confirmed new **Regulations on Credit Union Investment in Non-equity Securities** in March 2018. They set policy-making and supervisory requirements for credit union investments into non-equity securities for CCU members, as well as investment risk management requirements for CCU members and credit unions which obtained a permission from the Bank of Lithuania to carry out their restructuring. As mentioned, the new regulations came into force as of 1 May 2018.

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Annex. Key performance indicators of the credit union sector

Table 1. Main items of the balance sheet statement of Central Credit Unions and central credit union groups (data as at 31 March 2018)

Seq. No	Indicator	Amount, EUR millions					
		LCCU	UCCU	Total:	LCCU group	UCCU group	Total:
1.	**Assets**	**123.1**	**30.1**	**153.2**	**378.2**	**139.7**	**517.9**
1.1.	Debt securities	69.3	10.8	80.1	100.2	23.7	123.9
1.2.	Equity securities	1.1	–	1.1	1.0	–	1.0
1.3.	Cash	–	–	–	2.3	0.8	3.1
1.4.	Funds with central banks	25.4	18.2	43.6	25.4	18.2	43.6
1.5.	Funds with credit institutions	17.5	1.0	18.5	9,3	5.6	14.9
1.6.	Loans granted to customers	8.2	–	8.2	225.6	89.0	314.6
1.6.1.	Non-financial undertakings	4.3	–	4.3	38.8	10.9	49.7
1.6.2	Households	3.9	–	3.9	186.8	78.2	265.0
1.6.2.1	of which: loans for house purchase	0.5	–	0.5	52,9	27.7	80,6
1.7.	Other asset positions	1.6	0.1	1.7	14.3	2.4	16,7
2.	**Liabilities and equity**	**123.1**	**30.1**	**153.2**	**378.2**	**139.7**	**517,9**
2.1.	Liabilities to credit institutions	93.4	28.1	121.5	3.7	–	3.7
2.2.	Deposits	1.5	–	1.5	330.1	125.5	455.6
2.2.1.	Other financial institutions	0.5	–	0.5	0.5	–	0.5
2.2.2	Non-financial undertakings	1.0	–	1.0	12.3	7.3	19.6
2.2.3.	Households	–	–	–	317.2	118.2	435.4
2.3.	Other positions of liabilities	13.5	0.4	13.9	8.5	2.5	11.0
2.4.	Total equity	14.7	1.6	16.3	35,9	11.7	47,6
2.4.1	Profit (loss) for current year	–0.08	–0.2	–0.3	1.1	–0.04	1.06
3.	**Number of credit unions (CCU members)**	**–**	**–**	**–**	**51**	**11**	**62**

Source: Bank of Lithuania.

Table 2. Dynamics of performance indicators of the credit union sector

Seq. No	Indicator	Amount, EUR millions			Change (%)	
		01/04/2017	01/01/2018	01/04/2018	Q1 2018	over the year
1	**Assets**	**649.5**	**684.8**	**667.1**	–2.6	2.7
2	Money	3.8	3.4	3.5	2.9	–7.9
3	Funds with banks	51.9	41.3	39.6	–4.1	–23.7
4	Funds with the CCU	126.0	137.3	123.4	–10.1	–2.1
5	Government securities	85.8	67.0	67.7	1.0	–21.1
6	**Loans granted**	**349.8**	**403.3**	**397.7**	**–1.4**	**13.7**
7	Specific provisions against loans	19.8	16.6	14.1	–15.1	–28.8
8	Ratio of specific provisions against loans to loans (%)	5.3	4.0	3.4	–	–
9	Debt to the CCU	10.4	13.5	14.4	6.7	38.5
10	**Deposits**	**580.8**	**611.4**	**592.9**	**–3.0**	**2.1**
10.1	Of members and associated members of credit unions	577.8	608.2	589.4	–3.1	**2.0**
11	**Share capital**	**57.2**	**54.8**	**46.3**	**–15.5**	**–19.1**
12	Profit (loss) for current year	0.3	1.7	1.8	–	–

Source: Bank of Lithuania.

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