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# Review of the Credit Union Sector

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**According to the data provided by credit unions on 1 October 2018, credit unions, which operated in line with the new rules of the reformed sector, complied with their prudential requirements, while the sector operated at a profit. Due to reorganisation by merger, the number of credit unions (members of the Lithuanian Central Credit Union (LCCU)) decreased.**

In the third quarter of 2018, the Bank of Lithuania granted permission for reorganisation of the following LCCU members: Kvėdarna credit union (merged with Šilutė credit union) and Varėna credit union (merged with Alytus credit union). As at 1 October 2018, three credit union groups operated within the credit union sector: the LCCU group, the United Central Credit Union (UCCU) group and credit unions restructuring into specialised banks. The LCCU group united 50, while the UCCU – 11 credit unions.

Credit unions that have chosen membership of the LCCU or the UCCU work with partners that share a common business vision and develop a uniform business model acceptable for all members. By complying with the agreed rules, members of central credit unions (CCUs) limit the risk assumed by the entire system of credit unions, thus strengthening supervision of their activities (the Bank of Lithuania supervises both individual credit unions and CCU groups at a consolidated level).

According to submitted reports, credit union market assets amounted to €694.3 million as at 1 October 2018. As can be seen in Chart 1, LCCU group assets, as before, accounted for the largest market share (56%), while the remaining share was comprised (almost equally) of the assets of the UCCU group and of credit unions under restructuring.

**Central credit unions.** After the end of the third quarter of 2018, reports of the LCCU, UCCU and both CCU groups were submitted.

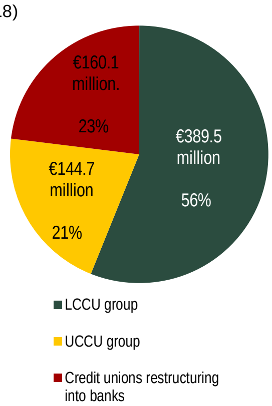
Having increased by €14.2 million in the third quarter of 2018, the common assets of the LCCU and the UCCU, most of which (86%) were those of the LCCU, amounted to €137.3 million as at 1 October 2018. Growth in assets was determined by deposits (mainly of credit unions that are LCCU and UCCU members), which rose by €12.3 million (to €102.2 million). The main reason behind such development was the fact that credit unions attracted more funds as members of credit unions started receiving money from agricultural output sold. As before, investments in debt securities comprised the main bulk of assets (49%). On the reporting date, the largest share of liabilities (85%) was comprised of CCU liabilities to credit institutions (credit union fixed-term deposits and funds in bank accounts).

During the period under review, the LCCU earned a €0.01 million profit, while the losses borne by the UCCU stood at €0.6 million. Both CCU groups met the capital adequacy ratio with a fair margin. As the Republic of Lithuania Government contributed a share of €8.88 million, thus increasing the LCCU's share capital, the overall capital adequacy ratio reached 45.75% (the requirement is 10.5%; see Table 1). The CCU liquidity coverage requirement was also met with a margin and stood at 111.6% (the requirement is 100%; see Table 2).

At the end of the third quarter of 2018, the LCCU and the UCCU's stabilisation fund amounted to €1.9 million and €0.35 million respectively. It should be noted that funds accumulated in the stabilisation fund for one of the main

**Chart 1. Market structure of Lithuanian credit unions by assets**

(1 October 2018)




Source: Bank of Lithuania.

**Table 1. Capital adequacy ratios for central credit unions**

| | Capital adequacy ratio, % 2018 Q2 | Capital adequacy ratio, % 2018 Q3 | Requirement, % |
|---|---|---|---|
| LCCU | 46.48 | 41.27 | 17.53 |
| UCCU | 85.63 | 88.28 | 10.5 |
| **Total** | **49.76** | **45.75** | – |
| LCCU group | 20.10 | 19.28 | 10.5 |
| UCCU group | 14.08 | 14.51 | 10.5 |
| **Total** | **18.02** | **17.67** | – |

Source: Bank of Lithuania.

**Table 2. Liquidity coverage ratios for central credit unions**

| | Liquidity coverage ratio, % 2018 Q2 | Liquidity coverage ratio, % 2018 Q3 | Requirement, % |
|---|---|---|---|
| LCCU | 122.7 | 113.0 | 100 |
| UCCU | 113.2 | 105.5 | 100 |
| **Total** | **121.1** | **111.6** | – |
| LCCU group | 599.9 | 644.3 | 100 |
| UCCU group | 201.7 | 197.9 | 100 |
| **Total** | **415.5** | **416.5** | – |

Source: Bank of Lithuania.

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functions of CCUs – ensuring credit union solvency – are rather scarce (the requirement is to accumulate and hold at least 1% of the assets of the LCCU, UCCU, and their member credit unions). According to the data as at 1 October 2018, the stabilisation fund of the LCCU accounted for 0.49%, of the UCCU – 0.24% of the respective group's assets. Hence, in order to properly perform the assigned function, CCUs will have to increase their stabilisation funds to the required amount.

At the end of the quarter under review, funds accumulated by the LCCU in the liquidity support fund, which a CCU forms on a voluntary basis, amounted to €4.9 million, those accumulated by the UCCU – €1.3 million.

Assets of CCU groups amounted to €534.2 million at the end of the third quarter of 2018, a quarter-on-quarter increase of 5.9%. Their major share (69%) was comprised of loans, mainly granted by credit unions to their members. Almost a fifth of the assets was comprised of CCU groups' investments in debt securities, while the remaining share (10%) – of funds with the Bank of Lithuania, cash, funds with banks and other assets. Deposits remained the main financing source for CCU group assets, with 87% of these assets financed with them.

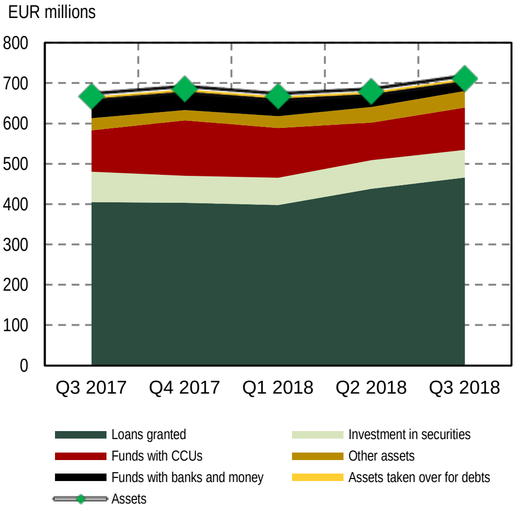
In the third quarter of 2018, both CCU groups operated at a profit. Over the nine months of this year, the LCCU group earned €1.9 million, the UCCU group – €0.4 million.

The CCU groups complied with the capital adequacy and liquidity coverage requirements with a fair margin: the overall capital adequacy ratio was 17.67% (the requirement is 10.5%; see Table 1), the liquidity coverage ratio – 416.5% (the requirement is 100%; see Table 2). Such high liquidity level, as in the previous quarter, was due to the liquid assets accumulated by the LCCU, UCCU and their member credit unions that almost exceeded the overall money outflow three times. As before, the CCU groups' liquid assets were comprised of very high quality and liquidity financial instruments: cash, funds with the Bank of Lithuania, and securities of the governments of EU countries.

**Credit unions.** As at 1 October 2018, 66 credit unions that united 160.2 thousand members presented their financial and supervisory reports to the Bank of Lithuania. As already mentioned, in the third quarter of this year, the Bank of Lithuania granted permission for reorganisation of the following LCCU members: Kvėdarna credit union (merged with Šilutė credit union) and Varėna credit union (merged with Alytus credit union). On 1 October 2018, the assets, rights and obligations of Kvėdarna credit union were transferred to Šilutė credit union which remained in operation after reorganisation. The reorganisation process of Kvėdarna and Šilutė credit unions was completed on 31 October 2018, while the reorganisation process of Varėna and Alytus credit unions is expected to be finished by the end of this year.

The credit union sector faced no significant changes over the third quarter of 2018. As mentioned before, three credit union groups operated as at 1 October 2018: the LCCU group uniting 50 credit unions, the UCCU group uniting 11 credit unions, and 5 credit unions undergoing restructuring into specialised banks. It should be noted that following the assessment and proposal of the Bank of Lithuania, the European Central Bank granted a specialised banking licence to the credit union Mano unija, making it the first specialised bank in the country – AB Mano bankas.

**Chart 2. Composition of credit union assets**
(1 October 2017–1 October 2018)




Source: Bank of Lithuania.

**In the third quarter of 2018, credit union assets grew by 4.8% and, according to the data reported on 1 October 2018, amounted to €710.8 million, or 2.6% of the banking system's assets** (a year ago – 2.5%). This was driven by growth in sight deposits with credit unions uniting farmers after members of credit unions started receiving funds from agricultural output sold, and by the rise in time deposits with credit unions operating in the country's largest cities.

As can be seen in Chart 2, in the third quarter of 2018, growth in loans – which accounted for the largest asset share on the reporting date – and in credit union funds with CCUs was the most buoyant, whereas investment in securities contracted.

As at 1 October 2018, loans granted to members (€466.0 million), as in previous periods, represented the largest share of credit union assets (65.6%).[1] In the third quarter of 2018, loans granted by credit unions increased by €27.9 million or 6.4% (17.2% since the start of the year). Loans granted by credit unions to members that are natural persons increased by €18.7 million over the reporting period (to legal persons – €9.2 million), yet, as in the previous quarter, growth in such loans was weaker than that in loans to legal persons. As a result, the loan portfolio share of loans

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

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granted to associated members (mainly legal persons) continued expanding, accounting for more than a fifth of the loan portfolio at the end of the period (21.3%).

Specific provisions formed by credit unions (for covering potential losses on loan impairment) kept declining. As in the previous quarter, they dropped by 1.4% (to €13.7 million), leading to a decrease in the ratio of specific provisions to loans of 0.2 percentage point (to 2.9%). While growth in the loan portfolio and decreasing specific provisions have had a positive impact on other indicators defining the quality of loans within the credit union sector[2], the share of loans, whose debt obligations are overdue for more than 60 consecutive days, in the loan portfolio of some credit unions increased. **Therefore, looking ahead these credit unions may incur losses related to loan value impairment, which will have a negative impact on their capital.**

**Following last quarter's increase, credit union investment in securities dropped by 3.4% in the third quarter of 2018** (to €68.5 million), accounting for slightly less than a tenth of credit union assets. According to submitted reports, all credit unions complied with the requirement established by the Regulations on Credit Union Investment in Non-equity Securities (hereinafter – Regulations) for the amount of the securities portfolio share in the on-balance-sheet assets: at the end of the quarter, securities constituted no more than 35% of their on-balance-sheet assets. Three credit unions failed to comply with other requirements of the Regulations: one of them – for concentration on securities of a sole lower-rated issuer and the average modified financial duration of the securities portfolio, the other two – for concentration on securities of a sole lower-rated issuer.

**Accepted deposits remained the main funding source for credit unions, with which they financed 86% of their assets.** As members of credit unions started receiving funds from agricultural output sold, in the third quarter of 2018 their accepted deposits expanded by €25.8 million (4.4%) and amounted to €608.4 million on 1 October 2018. It should be noted that during the reporting period growth was recorded in both fixed-term and sight deposits. Having increased by €15.1 million or 10.7%, sight deposits, as in previous periods, made up about a fourth (€157 million) of all deposits accepted, while fixed-term deposits, accounting for almost three-fourths of all deposits accepted by credit unions at the end of the period (451.4 million), grew by €10.7 million or 2.4% over the quarter. According to submitted reports, some credit unions raised their interest rates in the reporting quarter, yet the interest rates of most credit unions on deposits with a maturity of 12 months were higher than 0.9%. As usual, deposits of natural persons accounted for the largest share of the deposit portfolio (96.4%) since residents, driven by their long-term habit, choose deposits as a means of saving and investing.

Given the expansion in the deposit portfolio during the reporting period, the need to borrow from CCUs weakened. Credit unions' indebtedness to the LCCU and UCCU – loans for working capital and subordinated loans – grew by only €2.8 million over the third quarter (over the second quarter – €12.3 million). Credit unions' peer-to-peer lending decreased as well.

As the membership of credit unions increased and members of credit unions, especially those who credited the most actively, brought in additional shares, the share capital boosted by 2.7% (to €48.8 million) during the reporting period. The increase in the share capital was also driven by growth in the share capital of some credit unions restructuring into specialised banks. According to reported data, sustainable shares of credit unions, which are used for covering losses incurred by a credit union, rose by 5.5% during the reporting period (to €43.0 million), to account for nearly 88% of the share capital. Unsustainable additional shares, which comprised the remaining portion of share capital and as of 1 January 2018 are not included in a credit union's adjusted capital used for the calculation of capital-related prudential requirements, can be returned to members that applied for their return. **Growth in sustainable shares suggests that credit unions are actively working towards ensuring compliance with the laws implementing the credit union sector reform, which came into force at the beginning of the year.**

**According to submitted reports, the credit union sector's operating result for the nine months of 2018 was a €3.3 million profit (the loss incurred in the same period last year stood at €2.5 million).** 50 credit unions that operated at a profit earned €4.1 million, while 16 credit unions incurred a €0.8 million loss.

Profitability of credit union activities was driven by growth in net interest income, which was underpinned by stronger lending activity, and operating costs (rental and advertising, as well as marketing), which on a year-on-year basis significantly decreased. Over the nine months of 2018, credit unions earned €12.4 million in net interest income (compared to €11.9 million earned over the nine months of 2017) and incurred €11.7 million, or 25%, less operating expenses (compared to €15.6 million incurred over the nine months of 2017). Another significant contributor to such profitability was the recovered credit union loan value that amounted to €1.4 million. As usual, in the period under review the largest share of credit unions' income (80%) was comprised of interest income, of which 97% were on loans granted to members. Operating expenses accounted for the largest share of credit unions' expenses (61%), which took 52% of their income to cover them (a year-on-year decrease of 18 percentage points).

[2] Indicators defining loan quality – the share of non-performing loans in the loan portfolio and the ratio of loans overdue for more than 60 days to assets taken over for debts to total loans.

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According to the data reported on 1 October 2018, the capital adequacy ratio of the credit union system stood at 13.67% (in 2018 the required minimum for LCCU and UCCU members was 5.25%, for credit unions undergoing restructuring into a specialised bank – 7.30%); the liquidity ratio – 39.56% (the required minimum – 30%). All credit unions complied with the abovementioned ratios.

A capital adequacy ratio of 10.5% has been established for LCCU and UCCU members. These credit unions will have to ensure compliance with this ratio starting from no later than 1 January 2028. A capital adequacy ratio of 14.5% has been set for credit unions restructuring into specialised banks; its implementation will have to be ensured within a shorter time-frame – by the end of 2023.

Over the period under review, credit unions complied with other capital-related prudential requirements as well: the maximum exposure for a single borrower requirement (the amount of loans to a single borrower may not exceed 25% of a credit union's adjusted capital) and the maximum open position in foreign currency (the ratio of the overall open position to a credit union's adjusted capital may not exceed 25% and the ratio of the open position in a single currency to a credit union's adjusted capital may not exceed 15% of the credit union's adjusted capital).

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



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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 groups of central credit unions (data as at 30 September 2018)**

| No. | Indicator | Amount, EUR millions | | | | | |
|---|---|---|---|---|---|---|---|
| | | LCCU | UCCU | Total | LCCU group | UCCU group | Total |
| **1.** | **Assets** | **118.5** | **18.8** | **137.3** | **389.5** | **144.7** | **534.2** |
| 1.1. | Debt securities | 57.2 | 9.7 | 66.9 | 83.3 | 24.2 | 107.5 |
| 1.2. | Equity securities | 1.9 | – | 1.9 | 1.9 | – | 1.9 |
| 1.3. | Cash | – | – | – | 2.3 | 0.8 | 3.1 |
| 1.4. | Funds with central banks | 14.9 | 5.2 | 20.1 | 14.9 | 5.7 | 20.6 |
| 1.5. | Funds with credit institutions | 31.9 | 1.5 | 33.4 | 6.2 | 6.8 | 13.0 |
| 1.6. | Loans to customers | 10.7 | 2.2 | 12.9 | 266.1 | 104.7 | 370.8 |
| 1.6.1. | Non-financial undertakings | 6.4 | 0.7 | 7.1 | 47.9 | 13.8 | 61.7 |
| 1.6.2. | Households | 4.3 | 1.5 | 5.8 | 218.2 | 90.9 | 309.1 |
| 1.6.2.1 | o/w loans for house purchase | 0.9 | 0.1 | 1 | 79.3 | 29.8 | 109.1 |
| 1.7. | Other asset positions | 1.9 | 0.2 | 2.1 | 14.8 | 2.5 | 17.3 |
| **2.** | **Liabilities and equity** | **118.5** | **18.8** | **137.3** | **389.5** | **144.7** | **534.2** |
| 2.1. | Liabilities to credit institutions | 85.3 | 15.6 | 100.9 | 2.2 | – | 2.21 |
| 2.2. | Deposits | 1.3 | – | 1.3 | 338.9 | 126.3 | 465.2 |
| 2.2.1. | Other financial undertakings | 0.7 | – | 0.7 | 0.8 | – | 0.8 |
| 2.2.2. | Non-financial undertakings | 0.6 | – | 0.6 | 12.5 | 4.9 | 17.4 |
| 2.2.3. | Households | – | – | – | 325.6 | 121.4 | 447.0 |
| 2.3. | Other positions of liabilities | 16.8 | 0.04 | 16.8 | 10.8 | 6.0 | 16.8 |
| 2.4. | Total equity | 15.1 | 3.2 | 18.3 | 37.6 | 12.4 | 50.0 |
| 2.4.1. | Profit (loss) for the current year | 0.01 | -0.6 | -0.6 | 1.9 | 0.4 | 2.3 |
| **3.** | **Number of credit unions (CCU members)** | **–** | **–** | **–** | **50** | **11** | **61** |

Source: Bank of Lithuania.

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

| No. | Indicator | Amount, EUR millions | | | Change (%) | |
|---|---|---|---|---|---|---|
| | | 01/10/2017 | 01/07/2018 | 01/10/2018 | 2018 Q3 | Annual |
| **1.** | **Assets** | **666.4** | **678.5** | **710.8** | **4.8** | **6.7** |
| 2. | Money | 3.4 | 3.5 | 3.3 | -5.7 | -2.9 |
| 3. | Funds with banks | 42.5 | 28.1 | 20.6 | -26.7 | -51.5 |
| 4. | Funds with the CCU | 102.6 | 93.1 | 104.9 | 12.7 | 2.2 |
| 5. | Government securities | 75.4 | 70.9 | 68.5 | -3.4 | -9.2 |
| **6.** | **Loans granted** | **405.0** | **438.1** | **466.0** | **6.4** | **15.1** |
| 7. | Specific provisions against loans | 18.5 | 13.9 | 13.7 | -1.4 | -25.9 |
| 8. | Ratio of specific provisions against loans to loans (%) | 4.4 | 3.1 | 2.9 | – | – |
| 9. | Debt to the CCU | 19.6 | 26.7 | 29.5 | 10.5 | 50.5 |
| **10.** | **Deposits** | **575.3** | **582.6** | **608.4** | 4.4 | 5.8 |
| 10.1. | of members and associated members of credit unions | 572.1 | 579.1 | 604.9 | 4.5 | 5.7 |
| **11.** | **Share capital** | **57.4** | **47.5** | **48.8** | 2.7 | **-15.0** |
| 12. | Profit (loss) for the current year | -2.5 | 2.3 | 3.3 | – | – |

Source: Bank of Lithuania.

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