LIETUVOS BANKAS

Review of the Activities of Credit Unions and the Central Credit Union of Lithuania of 2013

ISSN 2335-8203 (ONLINE)

Gedimino pr. 6, LT-01103 Vilnius, Lithuania
Tel. +370 (5) 268 0029, fax +370 (5) 268 0038

www.lb.lt
info@lb.lt

Credit unions. As of 1 January 2014, there were 76 credit unions operating in Lithuania, uniting over 150.5 thousand members (in Q4 2013 the number of members increased by 2.9 thousand and from the beginning of the year — by 4.9 thousand). In 2013, licenses were issued to two credit unions (the credit union *Saulėgrąža* and *Šeimos kredito unija*), while the licenses of three credit unions were permanently withdrawn (*Nacionalinė kredito unija* and the credit unions *Švyturio taupomoji kasa* and *Laikinosios sostinės kreditas*). On 17 January 2014 the Board of the Bank of Lithuania permanently withdrew the license of the credit union *Vilniaus taupomoji kasa*. Out of 76 currently operating credit unions, 62 are members of the Lithuanian Central Credit Union of (LCCU) and 13 do not belong to the LCCU.

Analysis of the operating credit unions reveals that the activities of a number of credit unions remain grounded on a cooperative basis, i.e. its members pool their money and, by providing loans, the credit unions fulfil the economic and social needs of their members. However, some credit unions (mostly in large cities), having chosen an aggressive strategy, are moving away from the classic cooperation-based credit union model. These credit unions, in applying various marketing programs and offering large interest on deposits, draw in new members who are interested in the personal benefits they can receive from the credit union; however, they barely care about the credit union’s successful operation (they do not participate in the management process, or contribute to the improvement of the financial position of those operating at a loss). Rapid expansion of such credit unions, without an adequate capital reserve, sustainable and capable of absorbing losses, inadequate competence of some credit union heads and an irresponsible attitude are the main reasons for the problems arising in the credit union sector, which led to the application of urgent supervisory measures for credit unions.

The Bank of Lithuania, in early 2013, implemented stricter prudential requirements for the operations of credit unions and for some certain credit unions the operational restrictions led to more sustainable growth, i.e. slower growth in deposits and assets. In addition, some changes were observed in the structure of the loan portfolio — decrease in the share of riskier loans granted to associated members as well as a concentration of large loans.

In the fourth quarter of 2013 credit union’s assets increased by 3.8 per cent, over the year — by 4.3 per cent, and according to 1 January 2014 data amounted to LTL 2.1 billion, or 2.8 per cent of the assets of the banking system (compared to 2.6% a year ago).

Dynamics of some performance indicators of the system of credit unions

Line No.	Indicator	Amount 01-01-2013, LTL million	Amount 01-10-2013, LTL million	Amount 01-01-14 LTL million	Change Q4 2013, %	Change over year, %
1.	**Assets**	**2,055.8**	**2,065.5**	**2,144.2**	**3.8**	**4.3**
2.	Funds with banks	80.6	28.7	30.4	5.9	–62.3
3.	Funds with the LCCU	310.2	267.8	292.2	9.1	–5.8
3.1.	Time deposits	158.9	132.0	142.2	7.7	–10.5
4.	Government securities (GS)	412.4	573.1	645.7	12.7	56.6
5.	**Loans granted**	**1,122.9**	**1,042.5**	**1,028.0**	**–1.4**	**–8.5**

Line No.	Indicator	Amount 01-01-2013, LTL million	Amount 01-10-2013, LTL million	Amount 01-01-14 LTL million	Change Q4 2013, %	Change over year, %
6.	Specific provisions for loans	80.2	39.6	62.7	58.3	–21.8
7.	Ratio of specific provisions to the loan portfolio (%)	6.7	3.7	5.8	–	–
8.	Debt to the LCCU	53.1	65.2	62.6	–4.0	17.9
9.	**Deposits**	**1,822.0**	**1,799.6**	**1,868.1**	**3.8**	**2.5**
9.1.	Members and associated members of credit unions	1,810.8	1,787.6	1,855.8	3.8	2.5
10.	**Share capital**	**236.2**	**203.6**	**208.7**	**2.5**	**-11.6**
11.	Profit (loss) for current year	–60.1	–14.1	–38.3	–	–

The change in the composition of credit unions assets was insubstantial both in the reporting quarter and over the year. Their investment into government securities (GS) intensified. After rising to LTL 645.7 million in 2013, these investments accounted for 30.1 per cent of credit union assets on 1 January 2014. As in previous years, the bulk of investment (61%) consisted of the Republic of Lithuania's GS portfolio. Over the year the investments in European Union member states and European Economic Area GS grew by 2.6 times (to LTL 251.5 million) and amounted to 39 per cent of the government securities portfolio. As credit unions kept increasing their investment in GS, the holdings of funds with banks and the LCCU continued to decrease and accounted for 15 per cent of credit unions' total assets at the end of the year.

Loans granted to members represented the largest share (47.9%) of credit union assets. The loan portfolio, which in 2013 decreased by 8.5 per cent, on 1 January 2014 amounted to LTL 1 billion. The decrease in the loan portfolio was related to the limited maximum exposure to a single borrower (LTL 500 thousand), restricted lending for some credit unions and increasing of loans with specific provisions. The aforementioned factors and the application of stricter capital adequacy requirements had an impact on the decrease of loans to legal entities. These loans of higher risk, mostly granted to financing businesses, in 2013 decreased by LTL 85.5 million and amounted to an increasingly smaller share of the loan portfolio (on 1 January 2014 — 29% of the loan portfolio). Loans to legal entities could have also decreased because the LCCU performs a secondary status assessment of debtors who have filed applications for credit union (LCCU member) loans, larger than LTL 300 thousand. According to the LCCU's information, until 1 January 2014, the status of 104 debtors was assessed. Due to the high risk for the credit union it has been decided not to grant loans to 20 debtors, 7 of which were legal entities (LTL 6.6 million). A considerable share of loans to businesses remains in credit unions operating in Vilnius area.

After credit unions began to more conservatively assess the credit risk, in the reporting quarter the ratio of specific provisions to the loan portfolio increased, as well as the share of non-performing loans in the loan portfolio. On 1 January 2014, the ratio of specific provisions to the loan portfolio reached 5.8 per cent, while non-performing loans amounted to 22.3 per cent of total loan portfolio. However, taking into account that not all credit unions conservatively assessed loan portfolios and made up the necessary specific provisions, the loan portfolio quality could be much lower. The Bank of Lithuania, seeking to ensure appropriate credit risk management in credit unions, approved the Credit Union Loan Assessment Rules, which came into effect in January 2014. Credit unions will be required to review loan portfolios and, having assessed them in accordance to the requirements provided in the aforementioned rules and having calculated the specific provisions, will have to re-assess the quality of the portfolio and assumed risk.

The deteriorating indicators of the quality of credit unions loan portfolio as well as on-site inspection results raises concerns regarding the possibility of some credit unions to recover loans, and also reveals both irresponsible lending performance results in previous years and insufficient consideration to loan risk assessment at the initial stage. With the aim of ensuring identification of the risks involved in credit union operations and their more effective management, the Bank of Lithuania approved the Regulations of Credit Unions Internal Control and Risk Assessment (Management), which provide for detailed risk management procedures and requirements adjusted to the specifics of the credit union activities.

Having limited opportunities to expand the spectrum of offered services, but paying higher interest rates on deposits than banks, credit unions are attractive to the population. As of 1 January 2014 the interest rates of 1.5–2.5 per cent on the most popular deposits in national currency with a maturity of 12 months dominated in credit unions (some of them offered even higher interest rates). Although credit unions decreased deposit rates and, compared to the previous year, deposits grew significantly slower; in 2013, deposits attracted by credit unions increased by 2.5 per cent (LTL 46 million) and on 1 January 2014 amounted to LTL 1.9 billion. Deposits of natural persons accounted for the largest share of total deposits (97%). It should be noted that credit union depositors, mostly interested in higher interest rates, are not interested in the credibility of credit unions, as, under favourable terms and conditions of deposit insurance, in the case of bankruptcy of the credit union, they suffer the least (losing only the share contribution when the deposit does not exceed the insured amount (EUR 100 thousand (LTL 345 thousand)).

The slower growth in the number of credit union members and the decreasing loan portfolio led to changes in the share capital of credit unions, since the share capital accumulated from contributions of shares through granting loans is unstable. In repaying a loan or part of it, these share contributions in most cases are repaid; therefore, in 2013, with the decrease in loans, share capital decreased by 11.6 per cent to LTL 208.7 million. Moreover, when in a difficult situation, the members of a credit union (owners), of which many are basically depositors, are not willing to pay extra contributions to the capital and assume the responsibility for the performance of the credit union. It should be noted that the largest share of risk related to the activities of credit unions goes to members who borrow from credit unions. In credit unions there are less such members than depositors, however in the case of a credit union's insolvency they would suffer the most, i.e. they would lose their shares contribution, which amounts to no less than one tenth of the loan amount.

In 2013, based on the unaudited data, 49 credit unions earned a profit of LTL 7.7 million, but 26 of them operated at a loss, which amounted to LTL 46 million and led to loss incurring activities of the system of credit unions — LTL 38.3 million (in 2012 — LTL 60.1 million). The largest loss (LTL 32.4 million) was incurred by the credit union *Vilniaus taupomoji kasa*, the operating license of which, as was already mentioned before, was withdrawn by the Bank of Lithuania in January 2014.

According to 1 January 2014 data, the capital adequacy ratio of the credit unions system was 18.44 per cent and the liquidity ratio — 58.46 per cent. All credit unions had sufficient reserve of liquid assets to cover net cash outflow (high quality liquid assets amounted to LTL 418.1 million, while the net cash outflow stood at LTL 96.7 million). Although credit unions restructure their activities to comply with stricter prudential requirements, seven credit unions were unable to do so — the credit union *Vilniaus taupomoji kasa* did not perform all of the prudential requirements, while **six more credit unions** at the reporting date did not ensure compliance with the maximum exposure for a single borrower requirement. Three credit unions took measures and informed the Bank of Lithuania that in January 2014 they are already complying with prudential requirements, while several were given time until which they were obligated to ensure compliance with the requirements. The credit union *Naftininkų investicijos*, which until the specified date did not ensure compliance with the maximum exposure for a single borrower requirement, was fined. It should be noted that the information on each credit union's main performance indicators for the year and each quarter, as well as on their compliance with prudential requirements, is published on the website of the Bank of Lithuania.

A working group (comprised of representatives from the Ministry of Finance, the Bank of Lithuania, associations uniting credit unions and the LCCU) has prepared draft laws for the regulation of the activities of credit unions with the aim of dealing with urgent issues of capital increase, establishing an adequate balance between the development of credit unions and their possibilities to amortise risk assumption-related losses, and was approved by the Government of the Republic of Lithuania. In addition, taking into account the changes occurred in the credit union sector and seeking to improve the credit union regulated and supervised environment, a working group was formed at the Bank of Lithuania, the goal of which was to perform an analysis of credit union activities and submit proposals for the sector's structural reform options and methods, which would strengthen the credit unions and ensure stable and long-term activity of the sector in the future. Based on the data of the analysis and the International Monetary Fund's technical assistance recommendations, material is being prepared for a public discussion on the options for credit union reform.

The Lithuanian Central Credit Union. As of 1 January 2014, the LCCU united 63 credit unions.

The LCCU's assets, which in 2013 had slightly decreased, on 1 January 2014 amounted to LTL 366.7 million. The main reason for this asset decrease was 7 per cent (up to LTL 275 million) drop in credit union deposits, which continued to be the main source of financing of LCCU assets (75% of LCCU assets are financed with them). The largest share of the LCCU's assets (62%) was comprised of investments in the Republic of Lithuania's GS (LCCU doesn't have the GS of other countries), which according to 1 January 2014 data amounted to LTL 227.4 million. After decreasing by 10 times from the beginning of the year (to LTL 2 million), the LCCU's funds with banks represented an insignificant share of its assets.

The portfolio of loans granted to LCCU members expanded, amounting to more than LTL 68 million as of 1 January 2014. Loans granted to credit unions by the LCCU amounted to LTL 62.4 million. Subordinated loans granted to credit unions continued to represent a significant proportion of the LCCU's loan portfolio (45%). In Q4 2013, the LCCU continued to provide loans to members of credit unions. These are syndicated loans with credit unions, which require share contributions paid to a respective credit union, thus strengthening its capital bases. As of the reporting date such loans amounted to LTL 5.4 million (8% of the loan portfolio).

According to the reports submitted on 1 January 2014, the quality of the loan portfolio remained good: no specific provisions for loans were formed; there were no loans with regular payments overdue for more than 60 days either. Under the agreement signed between the LCCU and credit unions and the manager of the Entrepreneurship Promotion Fund (INVEGA) on the management of an LTL 50 million worth micro-crediting project, credit unions were granted LTL 33.2 million in loans from the Entrepreneurship Promotion Fund for financing small businesses.

The LCCU's Liquidity Maintenance Reserve (formed from contributions of LCCU members) increased to LTL 17.2 million on 1 January 2014. The stabilisation fund in the aforementioned period increased by LTL 0.9 million, up to LTL 7.6 million. The case of the credit union *Vilniaus taupomoji kasa* showed **that having a fund of that size, the LCCU is unable to solve larger solvency problems of credit unions.** The LCCU, in seeking to ensure the fulfilment of its functions provided in the Law — maintain the solvency of its members — should look for methods and means to strengthen the stabilisation fund.

On 1 January 2014 the LCCU's share capital amounted to LTL 32.3 million. Credit union members of the LCCU in 2013 contributed LTL 3.4 million; therefore, over the reported period, having returned to the Government of the Republic of Lithuania LTL 2.3 million in acquired share contributions, the LCCU's share capital increased by 3.5 per cent.

Based on the unaudited reports, the LCCU's performance in 2013 was LTL 0.9 million profit mainly due to interest income received from investment in GS (in 2012 the profits earned amounted to LTL 0.3 million).

The LCCU's liquidity and capital adequacy ratios continued to be met with a significant reserve.