LIETUVOS BANKAS

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

3rd Quarter of 2014

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 October 2014, 74 credit unions operated in Lithuania, with a total membership of over 147.2 thousand. As at the end of the previous quarter, 63 credit unions were members of the Lithuanian Central Credit Union (LCCU) and 11 were not members.

In the third quarter of 2014 credit union assets increased by 2 per cent (compared to 1 October 2013 data — decreased by 3.4 per cent) and on 1 October 2014 amounted to almost LTL 2 billion, or 2.5 per cent of the assets of the banking system (compared to 2.7% a year ago).

Dynamics of some performance indicators of the system of credit unions

Line No.	Indicator	Amount 01-10-2013, LTL million	Amount 01-07-2014, LTL million	Amount 01-10-2014, LTL million	Change Q3 2014, %	Change over a year, %
1.	**Assets**	**2,065.5**	**1,956.5**	**1,994.9**	**2.0**	**–3.4**
2.	Money	15.0	11.7	12.7	8.5	–15.3
3.	Funds with banks	28.7	22.6	19.0	–15.9	–33.8
4.	Funds with the LCCU	267.8	229.6	227.1	–1.1	–15.2
5.	Government securities (GS)	573.1	689.4	721.9	4.7	26.0
6.	**Loans granted**	**1,042.5**	**915.6**	**925.5**	**1.1**	**–11.2**
7.	Specific provisions for loans	39.6	35.8	40.6	13.4	2.5
8.	Ratio of specific provisions for loans to loans (%)	3.7	3.8	4.2	–	–
9.	Debt to the LCCU	65.2	81.3	80.1	–1.5	22.9
10.	**Deposits**	**1,799.6**	**1,665.8**	**1,698.6**	**2.0**	**–5.6**
10.1.	Of members and associated members of credit unions	1,787.6	1,656.3	1,688.6	**2.0**	–5.5
11.	**Share capital**	**203.6**	**173.4**	**174.8**	**0.8**	**–14.1**
12.	Profit (loss) for current year	–14.1	7.2	10.3	–	–

The change in the composition of credit union assets was insubstantial both in the reporting quarter and over the year. Loans granted to members represented the largest share (46.4%) of credit union assets. In the third quarter of 2014 the loan portfolio slightly increased and as of 1 October 2014 it amounted to LTL 925.5 million. In the reporting quarter housing loans grew the most, driving the increase in the loan portfolios of some credit unions or a smaller contraction. With the growth of the loan portfolio, in the reporting quarter loans issued to legal entities increased to LTL 220.9 million; however their share in the loan portfolio slightly decreased. On the reporting date these loans amounted to 23.9 per cent of all loans.

Credit unions, in accordance with the requirements of the Regulations of Credit Unions for the Assessment of Loans, started to assess more conservatively the loan portfolio quality and formed more specific provisions. Specific provisions for forming loans in the third quarter of 2014 increased by 13.4 per cent (compared to 1 October 2013 — 2.5%). It should be noted that the ratio of specific provisions to loans continued to increase. In addition, the number of unimpaired loans overdue for more than 60 days increased in the loan portfolio. This shows that debtors do not settle on time their debts with credit unions, while the size of the credit union losses, due to the loans not repaid on time, depends on the value of the assets pledged for these loans; therefore, **seeking to cover the possible loan impairment losses, credit unions are required to accumulate sufficient capital.**

Credit unions continued to invest in GS in the reporting period. Investment in GS rose to LTL 721.9 million and accounted for 36.2 per cent of credit union assets on 01 October 2014. As before, its major share (57%) consisted of the Republic of Lithuania GS portfolio; however, it should be noted that credit unions invest more in the GS of the European Union member states and EEE countries (especially long-term ones), which are currently very profitable, but very sensitive to changes in the interest rate. The aforementioned investments at the end of the third quarter of 2014 amounted to LTL 310.7 million, while their share in the whole GS portfolio increased by 2 p.p. (to 43%). **Evaluating that the credit unions could experience significant losses if, with the rise in interest rates in the market, they would have to sell these securities, investment in securities should not become the primary activity of credit unions.** Credit unions could invest in securities for liquidity management reasons or seeking to securely and reliably invest the funds temporarily unused for providing financial services. As credit unions kept increasing their investment in government securities and issuing new loans, their funds held at banks and the LCCU in the reporting quarter decreased and accounted for 12.3 per cent of the credit unions' total assets at the end of the reporting quarter.

Credit unions continued to cut their deposit rates in the reporting period, although slightly. According to the submitted reports, the 1.1–1.7 per cent rate on the most popular accepted deposits, i.e. deposits with a maturity of 12 months in national currency, prevailed (at the beginning of the year — 1.5–2.5%). Cutting of interest rates had an effect on sustainable growth of deposits at credit unions. According to the submitted reports, in the third quarter of 2014 the deposit portfolio increased by 2 per cent and stood at LTL 1.7 billion (5.6% less than a year ago). The deposits of natural persons accounted for the largest share of deposits (97%).

The share capital of credit unions grew slightly in the reporting quarter and, as of 1 October 2014, amounted to LTL 174.8 million. Although the Amendment to the Law on Credit Unions cleared the linking of share contribution with the amount of money lent to the member, they enforced the new credit union share capital formation measures. **From now on credit unions will have the opportunity to lay down the share capital formation measures, because strengthening of the capital base continues to be one of the key tasks for credit unions.**

According to the financial reports, over the first nine months of 2014 credit unions earned 6.8 per cent more income and incurred 16.2 per cent less expenses year on year. Interest income, which represented more than 64 per cent of total income, was the main income source for credit unions. A significant portion of the income comprised of income of one-off nature, earned from securities operations. The result of the credit union operations in the nine months of 2014 — a profit of LTL 10.3 million (in 2013, in that same period, credit unions experienced a loss of LTL 14.1 million). 45 credit unions operated profitably, earning a profit of LTL 18.6 million, while 29 credit unions that operated unprofitably incurred a loss of LTL 8.3 million.

According to the data provided in the 1 October 2014 report, credit unions performed capital adequacy, liquidity and maximum open position in foreign currency ratios — the capital adequacy ratio amounted to 23.03 per cent, the liquidity ratio — 66.72 per cent. All credit unions held liquid reserve assets sufficient to cover the net outflow of cash (high quality liquid assets amounted to LTL 444.3 million, while the net outflow of cash stood at LTL 12.2 million). Two credit unions did not comply with the maximum exposure to a single borrower ratio: deadlines for ensuring compliance with this requirement have been set.

Seeking to identify the riskiest credit unions, the Supervision Service of the Bank of Lithuania approved a methodology according to which , using various indicators, the riskiness of credit unions is assessed. Using the results of this assessment and other information accessible to the Bank of Lithuania, credit unions are selected which strengthen prudential supervision.

The Seimas of the Republic of Lithuania on 17 July 2014 approved the amendments to the Law on Credit Unions. They aim to ensure greater operational reliability and security of credit unions — strengthen the capital base and improve the assumed risk management; however they do not solve this sector's systemic problems. For the operation of credit unions to be stable, the Bank of Lithuania, having summarised the results of public discussions on the future of credit unions, presented to the working group on structural reforms of the credit union sector, formed by the Seimas of the Republic of Lithuania, specific measures, which would help ensure stable and efficient activity of the credit union sector in the future.

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

Following a decrease of LTL 2.5 million in the reporting quarter, as of 01 October 2014 the assets of the LCCU amounted to LTL 313.1 million. The decrease in assets was driven by the share of the loan repaid to the creditor under contract. The major LCCU assets financing source — deposits (they finance 72% of the LCCU's assets) during the fourth quarter barely changed and at the end of the quarter amounted to LTL 225.5 million. The major share of the assets (53%) comprised of investment in debt securities. As of 01 October 2014, they amounted to LTL 165.5 million. The LCCU had mostly invested in the Republic of Lithuania's government securities — LTL 157.3

million (investment in GS of other countries amounted to the LTL 8.2 million). The LCCU's funds in banks during the aforementioned period decreased to LTL 1.9 million and continued to account for an insignificant asset share.

In the third quarter of 2014 the LCCU's loan portfolio slightly (2%) increased and on the reporting date amounted to LTL 90.5 million. Loans issued to credit unions during the reporting quarter declined from LTL 81 million to LTL 80 million (the subordinated loans issued to credit unions amounted to almost 31% of the LCCU's loan portfolio); however, loans to members of credit unions increased by almost a third — to LTL 10.2 million (11.3% of the loan portfolio). Loans to credit union members are mainly granted when credit unions are unable to grant a loan of the size required by a member without not complying with the maximum exposure to a single borrower ratio. The LCCU, in accordance with the procedure approved by the Board of the LCCU, conducts the assessment of the standing of credit union debtors who have applied to credit unions (LCCU members) for loans higher than LTL 300,000. According to the LCCU's submitted information, in the third quarter 2014 the standing of 37 debtors was assessed, of which the applications for a loan of 3 legal entities and 1 natural person have not been approved on account of the great risk falling on the credit union, while the applications of 6 debtors for a loan have only been approved on condition that they would comply with certain additional requirements.

According to the reports submitted, as of 1 October 2014, the quality of the loan portfolio was good: no specific provisions against loans were formed; there were no loans with their regular payments overdue for more than 60 days either. Under the agreement signed between the LCCU together with 57 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 on the reporting date were granted LTL 33.1 million in loans from the Entrepreneurship Promotion Fund for financing small businesses.

The LCCU's liquidity support reserves in the reporting quarter were almost unchanged and on 1 October 2014 amounted to LTL 14.3 million. **The stabilisation fund in the aforementioned period increased by LTL 0.5 million — to LTL 5.4 million; however it is still insufficient for solving larger credit union solvency issues.** The LCCU, seeking to ensure the execution of the function provided to it in the Law on the Central Credit Union — maintain the solvency of its members — should look for methods and means to strengthen the stabilisation fund.

In the reporting quarter the LCCU credit union members increased the LCCU's share capital with contribution supplements, which, even having returned to the Government of the Republic of Lithuania its acquired contribution of shares, over the reporting period increased by 4.8 per cent — to LTL 32.5 million.

The operating result of the LCCU over the nine months of 2014 — LTL 1.2 million in profit, although the activities of the reporting quarter experienced a loss (over 2013 in that same period LTL 1.3 million in profit was made). Interest income, received for investment in GS, drove the LCCU's operating result.

The LCCU continued to comply with the liquidity ratio holding a rather significant reserve. The LCCU's capital adequacy ratio also was well above the established minimum (8%) — on 1 October 2014 it amounted to 40.6 per cent.