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

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Credit unions. On 1 July 2015, 74 credit unions had operating licenses issued by the Bank of Lithuania. They united 153.5 thousand members (in Q2 2015 the number of members increased to 1.8 thousand, while as of 1 July 2014 — almost 8 thousand). At the reporting date, 63 credit unions were members of the Lithuanian Central Credit Union (LCCU); but in July, when one credit union withdrew, the number of LCCU members decreased and, respectively, the number of independently operating credit unions increased (to 12).

The assets of credit unions, with deposits decreasing in Q2 2015, dropped by 7.6 million and, according to data of 1 July 2015, amounted to EUR 622.8 million or 2.8 per cent of the banking system's assets (a year ago — 2.5%).

Development of major indicators of credit unions

Seq. No.	Indicator	Amount (EUR millions)			Change (%)	
		01/07/2014	01/04/2015	01/07/2015	Q2 2014	over a year
1	**Assets**	**566.6**	**630.4**	**622.8**	**–1.2**	**9.9**
2	Money	3.4	3.5	3.9	11.4	14.7
3	Funds with banks	6.5	8.1	18.5	2.3 t.	2.8 t.
4	Funds with the LCCU	66.5	89.4	95.1	6.4	43.0
5	Government securities (GS)	199.7	235.7	198.2	–15.9	–0.8
6	**Loans granted**	**265.2**	**262.1**	**275.8**	**5.2**	**4.0**
7	Specific provisions against loans	10.4	19.0	20.7	8.9	99.0
8	Ratio of specific provisions against loans to loans (%)	3.8	6.7	7.0	–	–
9	Debt to the LCCU	23.6	17.0	15.6	–8.2	–33.9
10	**Deposits**	**482.4**	**550.0**	**541.7**	**–1.5**	**12.3**
10.1	Of members and associated members of credit unions	479.7	547.4	538.1	-1.7	12.2
11	**Share capital**	**50.2**	**52.0**	**53.4**	**2.7**	**6.4**
12	Profit (loss) for current year	2.1	3.6	0.1	–	–

The structure of the credit union assets did not change — as during earlier reporting dates, so too on 1 July 2015 the major share of credit union assets (44.3%) was made up of loans granted to members (EUR 275.8 million). In the second quarter of 2015 the loan portfolio of credit unions increased by EUR 13.7 million. The greatest influence on the growth of the loan portfolio of the credit union sector in the aforementioned period was had by the increase in the loan portfolios of 11 credit unions, which had granted new loans for financing businesses, agriculture and housing. This change in credit union loan portfolios in large part resulted in the increase by EUR 6.4 million (up to EUR 72.5 million) of loans issued to associated members (mostly — legal entities) and the growth of the aforementioned loan share in the sector's loan portfolio (up to 26.3%).

It should be noted that the quality of the credit union loans in the reporting period worsened; therefore, more specific provisions were formed for covering any likely expenses from loan depreciation. The ratio of specific provisions formed by credit unions to loans increased by 0.3 p.p. — to 7 per cent, while non-performing loans, according to 1 July 2015 data, accounted for more than a fourth of total loans. **The worsening quality of the loan portfolio suggests that there is still the need for credit unions to accumulate capital, necessary for amortising likely losses on loan impairment and ensuring stability of operations.**

According to data of 1 July 2015, nearly a third of credit union assets amounted to investment in debt securities. In Q2 2015 they dropped by nearly 16 per cent — to EUR 198.2 million. In the aforementioned period, credit unions significantly decreased the existing short-term (up to 1 year) securities portfolio. At the same time there was also a decrease in long-term securities, amounting to 99 per cent of all the investment in the securities portfolio. Six credit unions, having long-term Greek securities, valued at EUR 0.7 million, due to the uncertain economic situation of the country, formed for them specific provisions. At the reporting date, the specific provisions formed for Greece's securities, amounted to EUR 0.3 million. It is likely that the decrease in investment in securities was a result of not only the increase in the need for more loans by members, but also preparation of credit unions to act in accordance with the requirements of the Regulations on Credit Union Investment in Non-equity Securities. According to the provisions of the aforementioned Regulations, as of 31 December 2015 the credit union investment portfolio should not amount to more than 50 per cent of the credit union's on-balance-sheet assets, while the average securities portfolio modified financial duration should not be longer than five years. From 31 December 2016 the investment portfolio should not amount to more than 35 per cent of the credit union's on-balance-sheet assets, while the securities portfolio's modified financial duration should not be longer than three years, and from 31 December 2017 — no longer than two years. It should be noted, that credit unions that invest fairly much in long-term securities and lower investment grade securities and assume the counterparty and market risks, are subject to individual supervisory measures by the Bank of Lithuania.

Deposits have remained the major financing source for credit unions. According to data of 1 July 2015, almost 87 per cent of credit union assets were financed with them. In Q2 2015, since deposits redeemable at notice in credit unions of farmers decreased due to the seasonality of agricultural work, the deposit portfolio decreased; however, compared to data of 1 July 2014, deposits increased by more than 12 per cent and on 1 July 2015 amounted to EUR 541.7 million. The deposits of natural persons continued to account for the largest share of deposits (97%).

With the increase in the number of credit union members, share capital in Q2 2015 increased by EUR 1.4 million and according to data of 1 July 2015, amounted to EUR 53.4 million; however, the adjusted capital of credit unions, which was important for ensuring the compliance with prudential requirements for the operation of credit unions and the requirements of other legal acts, decreased by 3.1 per cent (to EUR 57.1 million). The decrease in adjusted capital was a result of losses experienced by credit unions.

In Q2 2015 credit unions experienced EUR 3.5 million in losses, which decreased the half-year's profit to EUR 0.1 million (in 2014 in the same period, credit unions earned EUR 2.1 million in profit). During the reporting period, the main reason for unprofitable activities — losses, experienced due to securities revaluation (EUR 4.1 million), which exceeded by almost two times the one-off profit earned from securities revaluation in the first quarter of 2015. Credit unions in the first half year of 2015 earned less income than in the same period last year and experienced 8.6 per cent larger expenditure than in the aforementioned period. The largest share of expenses (38%) was made up of operating costs and interest, as well as value, impairment expenses (23% each), while the largest share of income (59%) went to interest income. In the first half year of 2015, 44 credit unions operated profitably, earning a profit of EUR 2.8 million, while 30 credit unions that operated unprofitably incurred a loss of EUR 2.7 million.

As was mentioned, in the reporting quarter the share of loans to associated members in the credit union sector's loan portfolio increased, while adjusted bank capital, due to experienced losses, decreased. It should be noted that the aforementioned changes can have a rather significant influence on some credit unions in the future, ensuring the implementation of the capital adequacy requirement, since, with the Bank of Lithuania, adjusting the size of the capital adequacy requirement (as of 30 September 2015 all credit unions will be under identical (13%) capital adequacy requirements), the Rules for Calculating Capital Adequacy were changed. According to the requirements for these rules, the need for larger capital is calculated as being more risky for assets, i.e. loans issued to associated members, depending on their share in the loan portfolio. Taking into account the fact that a major share of some credit union loan portfolios (even up to 80%) are made up of loans issued to associated members, **strengthening of the capital remains one of the most important tasks of the credit unions sector. Therefore, credit unions, seeking to ensure compliance with prudential requirements and other legal acts, using all measures, are required to form a stable capital, which is necessary for seeking to ensure the security and reliability of the provision of financial services.**

According to the data of submitted reports, as of 1 July 2015 the liquidity ratio of the system of credit unions was 63.71 per cent (the required minimum is 30%[1]). The capital adequacy ratio of credit unions stood at 22.14 per cent. (the required minimum is 13%[2]). At the reporting date the prudential requirements were not complied with by 9 credit unions. One credit union was not in compliance with the capital adequacy, maximum open position in foreign currency and maximum exposure for a single borrower; three credit unions — capital adequacy and maximum

[1] For credit unions, with assets above EUR 4.34 million and their annual growth rate of deposits exceeding sustainable growth rates, the liquidity ratio of 40, 50 or 60 per cent, respectively, is applicable.

[2] For credit unions, with a significant share of their loan portfolio made up of loans granted to associated members, this ratio must not be below 18 or 25 per cent.

exposure for a single borrower requirements, while five credit unions were not in compliance with one requirement — maximum exposure for a single borrower. For some credit unions, not in compliance with the aforementioned requirements, but eliminating the violations of legal acts and deficiencies in their activities as identified during the inspection, individual deadlines are defined until which the requirements must be complied with. Some credit unions in July 2015 submitted information that they took measures with which they ensured compliance with prudential requirements. For credit unions not in compliance with the prudential requirements, the Bank of Lithuania applies the enforcement measures provided in the Law on Credit Unions and provides relevant written orders.

The Republic of Lithuania Seimas Committee on Budget and Finance has already approved the Conception for Sustainable Operation of Credit Unions, which provides the tasks for restructuring the system of credit unions. Seeking to lay down the legal preconditions for the implementation of the Conception for Sustainable Operation of Credit Unions, currently the Republic of Lithuania's legal acts are being prepared, necessary for implementing the credit union sector's systemic reform.

The Lithuanian Central Credit Union.[3] As of 1 April 2015, the LCCU united 63 credit unions. The assets of the LCCU, with deposits growing, in the first quarter of 2015 increased by EUR 4.2 million — to EUR 115.6 million. Deposits, which have increased by EUR 2.9 million (to EUR 89 million), were the LCCU's financing source (they are used to finance 76% of the LCCU's assets). The largest share of the LCCU's assets (51%) consisted of investments in securities, which in the reporting period increased by EUR 8.3 million and, according to data of 1 April 2015, reached EUR 58.5 million. The LCCU's investment in the Republic of Lithuania's government securities (EUR 53.4 thousand) made up 91 per cent of all investment in government securities; the remaining part was made up of the European Union country (Latvia, Croatia, Hungary, Romania and Bulgaria) government securities.

With the LCCU increasing investment in securities, the loan portfolio contracted. In the reporting period, loans decreased by EUR 1.8 million and on 1 April 2015 amounted to EUR 20 million. The loans issued to credit union members of the LCCU amounted to EUR 16.6 million. The LCCU's liquidity support reserve, with the growth in deposits at credit unions, increased by EUR 0.5 million and on 1 April 2015 amounted to EUR 4.7 million. Funds in the stabilisation fund, for restoring the solvency of the credit unions (LCCU members), increased (to EUR 1.7 million), because the LCCU member credit unions made advance payments to this fund. **Since most credit unions paid the 2015–2017 contributions in advance, in the future the LCCU could encounter difficulties in dealing with issues of credit union solvency.**

The LCCU's share capital did not change — as in the beginning of the quarter, on the reporting date it amounted to EUR 9.4 million. In the first quarter of 2015 the net operating income earned by the LCCU did not cover the administration and depreciation expenses, therefore a loss of EUR 24 thousand (in 2014 in the same period — EUR 65 thousand in profit) was experienced.

In the reporting quarter, the Board of the Bank of Lithuania discussed the results of the targeted inspection of the LCCU, performed in the second quarter of 2014. Because of violations of legal acts and operating deficiencies, the LCCU was warned and obligated to terminate them by 30 June 2015.

[3] Due to the later date of presenting the LCCU's reports, the review of the activities for Q1 2015 is provided.