ACTIVITIES OF FINANCIAL MARKET PARTICIPANTS

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

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Credit unions. The number of credit unions that in Q3 2015 had operating licenses issued by the Bank of Lithuania remained unchanged — on the reporting date, 74 credit unions were operating. They united 155.5 thousand members (in Q3 2015 the number of members increased to 2 thousand, whereas as of 1 October 2014 — more than 8 thousand). At the start of the quarter, 63 credit unions were members of the Lithuanian Central Credit Union (LCCU), but in July, when one credit union left, the number of LCCU members decreased to 62 and respectively the number of independently operating credit unions increased (to 12).

In Q3 2015, while the deposit portfolio was growing due to continuously paid attractive interest rates (since banks offered very low or even zero-interest rates, some credit unions paid interest no less than 1.5 per cent in euro on deposits with a 12 month maturity), the assets of credit unions grew by EUR 20 million and, according to data as of 1 October 2015, amounted to EUR 642.8 million, or 2.8 per cent of the assets of the banking system (down from 2.5% a year ago).

Development of performance indicators of the credit unions sector

Seq. No	Indicator	Amount, EUR millions			Change (%)	
		01/10/2014	01/07/2015	01/10/2015	Q3 2015	over a year
1	**Assets**	**577.8**	**622.8**	**642.8**	**3.2**	**11.3**
2	Money	3.7	3.9	3.5	–10.3	–5.4
3	Funds with banks	5.5	18.5	21.5	16.2	3.9 t.
4	Funds with the LCCU	65.8	95.1	99.6	4.7	51.4
5	Government securities (GS)	209.1	198.2	195.6	–1.3	–6.4
6	**Loans granted**	**268.1**	**275.8**	**283.7**	**2.9**	**5.8**
7	Specific provisions against loans	11.8	20.7	20.4	–1.4	72.9
8	Ratio of specific provisions against loans to loans (%)	4.2	7.0	6.7	–	–
9	Debt to the LCCU	23.2	15.6	15.2	–2.6	–34.5
10	**Deposits**	**492.0**	**541.7**	**559.5**	**3.3**	**13.7**
10.1	Of members and associated members of credit unions	489.1	538.1	556.9	3.5	13.9
11	**Share capital**	**50.6**	**53.4**	**54.2**	**1.5**	**7.1**
12	Profit (loss) for current year	3.0	0.1	1.7	–	–

The structure of the credit union assets remained unchanged: as during earlier reporting dates, so too on 1 October 2015 the major share of credit union assets (44.1%) was made up of loans granted to members (EUR 283.7 million). Even though in Q3 2015 the loan portfolios of credit unions grew much more slowly than in the previous quarter, the loans granted by credit unions boosted by EUR 7.9 million. It should be noted that the growth of the loan portfolio was due to more active crediting of natural persons over the aforementioned period, especially of eight credit unions whose credit to natural persons, designated for consumption, housing, acquisition of real estate or refinancing loans issued by other creditors, rose significantly. This change in credit union loan portfolios resulted largely in specific changes in the composition of loans in the sector — the share of loans to associated members (mostly to legal persons) decreased by 1 p.p. (up to 25.3%).

It should be noted that the quality of the credit union loans, which was deteriorating for a long time, improved somewhat over the reporting quarter, hence credit unions formed less specific provisions against likely expenses on loan depreciation. Indicators defining the quality of loans improved as well: the ratio of specific provisions formed by credit unions to loans increased by 0.3 p.p. (up to 6.7%), while the share of non-performing loans in the loan portfolio — by 1.6 p.p. (up to 23.7%). It is likely that these changes were determined by a more conservative crediting practice and the improving financial condition of borrowers (there were less loans with payments overdue for more than 60 days). However, it should be noted that the improvement of the loan portfolios of some credit unions was determined by the takeover of assets pledged for loans into the credit union's ownership. These assets often are just a short-term improvement of the financial standing of a credit union, as their supervision or development (in order to improve their attractiveness) and sale are related to additional expenses. **In this context, strengthening of the capital remains one of the most important tasks of the credit unions sector.**

According to data of 1 October 2015, nearly a third of credit union assets (EUR195.6 million) consisted of investment in debt securities. In Q3 2015, having prepared to act in accordance with requirements of the Regulations on Credit Union Investment in Non-equity Securities (so that as of 31 December 2015 their investment portfolio would not amount to more than 50 per cent of the their on-balance-sheet assets, while the average securities portfolio's modified financial duration would not be longer than five years), credit unions decreased security portfolios and changed their composition according to term. Nonetheless, in order to fulfil the above-mentioned requirements, some credit unions will have to take additional measures. As of 31 December 2016 even stricter requirements for investment in securities will be laid down — the investment portfolio shall 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 shall not be longer than three years, and as of 31 December 2017 — no longer than two years. It should be noted that the Bank of Lithuania is monitoring actions of credit unions, which invest fairly much in long-term securities and lower investment grade securities and assume the counterparty and market risks, related to ensuring compliance with the requirements of the above-mentioned Regulations.

Deposits have remained the major financing source for credit unions. According to data of 1 October 2015, 87 per cent of credit union assets were financed with them. In Q3 2015, the deposit portfolio expanded by only 3.3 per cent, whereas, compared to data of 1 October 2014, deposits grew by almost 14 per cent and amounted to EUR 559.5 million as of 1 October 2015. The deposits of natural persons continued to account for the largest share of deposits (97%). Even though, as mentioned before, deposits grew while credit unions paid attractive interest rates, their growth could be higher according to representatives of credit unions of farmers. So far, farmers are not selling their harvest of 2015; they are waiting for the increase in prices.

With the increase in the number of members of credit unions, the share capital increased by EUR 0.8 million in the third quarter, and according to data of 1 October 2015, amounted to EUR 54.2 million. Over the aforementioned period, the adjusted capital of credit unions, which is crucial in ensuring compliance by the majority of credit unions with prudential ratios and the requirements of other legal acts, grew by 3.3 per cent (up to EUR 59 million) as well. The growth of the adjusted capital was determined by the operations of credit unions over the recent quarter.

In Q3 2015, credit unions earned EUR 1.6 million in profit, whereas since the beginning of the year — EUR 1.7 million in profit (in nine months of 2014, EUR 3 million was earned in profit). It should be noted that in nine months of 2015 credit unions incurred 1.4 per cent more expenses year on year; however, they earned 3.4 pre cent less income. The largest part of the credit unions' assets (63.4%) was made up by interest income; however, it should be noted that, as of 1 October 2015, one-off and volatile income, received from sales of securities, made up almost a third of all income. Operating (42%) and interest (26%) expenses accounted for the largest share of the sector's expenses. According to data of 1 October 2015, 47 credit unions, the operations of which since the start of the year were profitable, earned EUR 3.9 million in profit; 29 credit unions operated at a loss, incurring EUR 2.2 million in losses.

As mentioned before, in the reporting quarter the share of loans to associated members in the credit union sector's loan portfolio decreased, while the adjusted capital increased. It is likely that credit unions sought to ensure the implementation of the capital adequacy ratio, calculated in line with the requirements of the Rules for Calculating the Capital Adequacy Ratio of Credit Unions, which came into effect as of 30 September 2015. According to the requirements of these Rules, the need for larger capital is calculated for more risky assets, i.e. for loans issued to associated members, depending on their share in the risk portfolio.

According to the data of submitted reports, as of 1 October 2015 the capital adequacy ratio of the system of credit unions was 18.50 per cent (minimum requirement is 13%). The liquidity ratio of the system of credit unions stood at 63.08 per cent (the required minimum is 30%[1]). At the reporting date the prudential ratios were not complied with by four credit unions. One credit union was not in compliance with the capital adequacy ratio, the maximum open

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

position in foreign currency ratio and the maximum exposure for a single borrower ratio; two credit unions — with the maximum exposure for a single borrower ratio, while one credit union — with the liquidity ratio. In addition, two credit unions, whose major share of the loan portfolio was made up of loans to associated members, did not comply with the capital adequacy ratio, calculated according to the aforementioned requirements of the new Rules. The capital adequacy ratios, calculated according to the requirements of the previously applicable rules, were complied with (according to the currently effective rules, all credit unions shall comply with this ratio as of 31 March 2016 at the latest). For some credit unions that are not in compliance with the prudential ratios, but are eliminating the violations of legal acts identified during the inspection and deficiencies in their activities, individual deadlines are defined, until which they must ensure compliance with the ratios. In October 2015 some credit unions presented information that they took measures with which they ensured compliance with prudential ratios. For credit unions that are not in compliance with the prudential ratios, the Bank of Lithuania applies the enforcement measures provided in the Law on Credit Unions and provides relevant written orders.

It should be noted that credit unions, which did not accumulate sufficient capital, did not comply with the aforementioned prudential ratios, except the liquidity ratio. **Given that compliance with the majority of prudential ratios and the requirements of other legal acts, which depends on the capital base of credit unions, is the main indicator for the ability of these credit unions to operate in a stable and reliable manner, credit unions must accumulate a stable capital using all measures.**

Seeking to set legal preconditions for the implementation of the Conception for Sustainable Operation of Credit Unions, which was approved by the Republic of Lithuania Seimas Committee on Budget and Finance, draft legal acts of the Republic of Lithuania necessary for implementing the credit union sector's systemic reform are currently being provided to the aforementioned committee.

The Lithuanian Central Credit Union.[2] As of 1 July 2015, the LCCU united 63 credit unions; however, in July, when Šiauliai credit union left, the number of LCCU members decreased.

The assets of the LCCU in the second quarter of 2015 increased by EUR 2 million — to EUR 117.6 million. Increase in assets was due to the growth in deposits by 4.8 per cent (up to LTL 93.3 million), which continued to be the main LCCU assets financing source (79% of the LCCU's assets are financed with them).

The largest share of the LCCU's assets (47%) consisted of investments in debt securities, which in the reporting quarter decreased by EUR 2.7 million and, according to data of 1 July 2015, amounted to EUR 55.8 million. The GS of the Republic of Lithuania comprised the major part of these investments (91%), another part was comprised of debt securities of other European Union countries' (Latvia, Croatia, Hungary, Romania and Bulgaria) governments and of debt securities of one Estonian enterprise.

As debt securities and loan portfolios contracted, the LCCU held more funds with the Bank of Lithuania. In the period under review these funds increased by 15.6 per cent (to LTL 40.1 million) and, as of 1 July 2015, accounted for 34 per cent of the LCCU's assets, whereas the LCCU's funds in banks (EUR 0.8 million) that remained unchanged over the quarter amounted to an insignificant share of the assets.

As mentioned before, in Q2 2015 the loan portfolio contracted. Loans granted by credit unions over the aforementioned period decreased by EUR 1.2 million and as of 1 July 2015 amounted to EUR 18.8 million. Loans issued to credit union members of the LCCU amounted to EUR 15.7 million, whereas other loans (for more than EUR 3 million) were granted to members of credit unions.

With the increase in deposits at credit unions, the LCCU's liquidity support reserve increased by EUR 0.3 million and as of 1 July 2015 amounted to EUR 5 million. Funds in the stabilisation fund, for restoring the solvency of the credit unions (LCCU members), having aided one credit union, decreased to EUR 1 million, even though the majority of the LCCU's members (credit unions) paid in advance the 2015–2017 contributions.

As of 1 July 2015, the LCCU's share capital, as in the beginning of the quarter, amounted to EUR 9.4 million. The net operating income earned by the LCCU in the first quarter of 2015 did not cover the administration and depreciation expenses; therefore there was a loss of EUR 0.1 million (over the same period in 2014, EUR 0.4 million in profit was made).

2 Due to the later date of presenting the LCCU's reports, the review of the activities for Q2 2015 is provided.