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

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Credit unions. As of 1 April 2015, 74 credit unions operated in Lithuania (63 credit unions were members of the Lithuanian Central Credit Union, LCCU), with a total membership of 151.7 thousand (almost 2 thousand more than at the beginning of the year).

By the decisions of the general members' meetings that took place in Q1 2015, all credit unions (53), the operations of which in 2014 were profitable, have strengthened their capital base with profits earned, while part of the credit unions that operated at a loss covered their losses with accumulated reserves or reserve capital. Credit unions whose reserves and reserve capital were insufficient for covering the loss incurred transferred their uncovered loss to the beginning of 2015. **It should be noted that at some credit unions, which have been operating at a loss for more than a year, the uncovered loss reduced the equity capital of these credit unions to such an extent that it became less than ½ of their share capital (a breach of the requirement of the Republic of Lithuania Law on Credit Unions (hereinafter — the Law) for the size of equity capital); however, the shareholders of none of them made the decision to cover the loss with additional contributions.** Credit unions choose other ways of addressing this issue, including the increase of share and reserve capital.

The assets of credit unions, according to 1 April 2015 data, amounted to EUR 630.4 million, or 2.8 per cent of the assets of the system of operating banks (2.5% a year ago).

Dynamics of some performance indicators of the system of credit unions

Seq. No	Indicator	Amount (EUR millions)			Change (%)	
		01/04/2014	01/01/2015	01/04/2015	Q1 2015	over a year
1.	**Assets**	**571.2**	**617.2**	**630.4**	**2.1**	**10.4**
2.	Money	4.3	5.2	3.5	–32.7	–18.6
3.	Funds with banks	6.7	12.2	8.1	–33.6	21.0
4.	Funds with the LCCU	84.0	86.2	89.4	3.7	6.4
5.	Government securities (GS)	196.3	221.3	235.7	6.5	20.1
6.	**Loans granted**	**253.8**	**263.5**	**262.1**	**–0.5**	**3.3**
7.	Specific provisions for loans	9.8	17.3	19.0	9.8	93.9
8.	Ratio of specific provisions for loans to loans (%)	3.7	6.2	6.7	–	–
9.	Debt to the LCCU	18.8	18.6	17.0	**–8.6**	–9.**6**
10.	**Deposits**	**497.4**	**535.0**	**550.0**	**2.8**	**10.6**
10.1.	Of members and associated members of credit unions	494.6	532.2	547.4	2.9	10.7
11.	**Share capital**	**50.2**	**51.4**	**52.0**	**1.2**	**3.6**
12.	Profit (loss) for current year	–0.04	0.6	3.6	–	–

Loans granted to members (EUR 262.1 million) represented the largest share of the assets of credit unions (41.6%). While loans granted increased by EUR 8.3 million, or 3.3 per cent year on year, the credit unions' portfolio did contract in the reporting quarter. The contraction of the loan portfolio was due to an increase in specific provisions in Q1 2015, as credit unions, by assessing loan portfolios more conservatively, identified the loans of problem debtors and revealed a more realistic quality of loans granted. Although the loan portfolio contracted, according to the data of submitted reports, in Q1 2015 credit unions granted new loans, financing housing acquisitions and business. As a result, the loans granted to legal persons in the above-named period grew by EUR 1.1 million, while their portfolio share, after expanding for the second consecutive quarter, in this quarter increased by 0.6 p.p. and accounted for 25.2 per cent of total loans as of 1 April 2015.

As was already mentioned, in the reporting period, credit unions recorded the deteriorating quality of loans and increased their specific provisions to cover possible costs of loan impairment. The ratio of specific provisions formed by credit unions to loans increased by 0.5 p.p. — to 6.7 per cent, while non-performing loans, according to 1 April 2015 data, accounted for more than a fourth of total loans. **This suggests that credit unions must accumulate capital necessary for amortising likely losses on loan impairment and ensuring stability of operations.**

Credit unions further invested in debt securities (GS) using the funds of attracted deposits for their acquisition. In Q1 2015 credit union investment in GS boosted by 6.5 per cent — to EUR 235.7 million and accounted for 37.4 per cent of credit union assets as of 1 April 2015. It should be noted that after investing more in long-term GS (with the maturity of over one year) for several consecutive years, in Q1 2015 credit unions invested more actively in short-term (up to one year) GS of European Union Member States and European Economic Area countries. It is likely that, in investing temporarily spare funds, credit unions have already taken into account some of the requirements of the draft Regulations on Credit Union Investment in Non-equity Securities for the investment portfolio, which are under preparation by the Bank of Lithuania. While, in Q1 2015, the GS portfolio share of long-term GS contracted by almost 8 p.p., it further remained significant (89%). Six credit unions held EUR 0.7 million of Greece's long-term GS, for which, due to the uncertainty surrounding the country's economic situation, specific provisions are formed. Credit unions that invest fairly much in long-term GS and lower investment grade GS 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. 87 per cent of credit union assets were financed with them. According to the data of submitted reports, in Q1 2015 deposits grew by 2.8 per cent, while from 1 April 2014 — by almost 11 per cent and amounted to EUR 550 million as of 1 April 2015. 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 the share capital in Q1 2015 increased and, according to 1 April 2015 data, amounted to EUR 52 million. The adopted amendments to the Law provided credit unions with the possibility to increase their capital through the acquisition of privileged shares by their members; however, credit unions almost have not used this possibility thus far.

As mentioned, some credit unions that operated at a loss did not comply with the requirement for the size of equity capital contained in the Law. These credit unions have been taking action to ensure that their equity capital were not less than ½ of their share capital: one credit union increased its share capital with contributions of shares, others intend to do so in the future, while still others are looking for the possibilities to increase their reserve capital. Given that the strengthening of capital continues to be a major task for the credit unions sector, **credit unions, seeking to ensure compliance with the requirement of the Law and form sustainable capital, necessary for the safe and sound provision of financial services, must undertake every measure.**

47 credit unions, whose operations in Q1 2015 were profitable, earned EUR 3.9 million of profit; 27 credit unions operated at a loss, however, incurring EUR 0.3 million of losses, which reduced the credit unions sector's profit to EUR 3.6 million (in Q1 2014 the operations of credit unions were loss-incurring, with EUR 37.2 thousand of losses incurred). Having eliminated impairment expenses, the profits of credit unions earned in this quarter would be higher by EUR 2.3 million. In the reporting period, credit unions, after incurring expenses of nearly the same amount as in Q1 of the last year, earned 38 per cent more income as compared to this period. Although, as credit unions increased their GS portfolios, one-off income, received from GS operations, represented the major share of income (50%), interest income continued to account for a significant share — 45 per cent of total income.

According to the data of submitted reports, as of 1 April 2015 the liquidity ratio of the system of credit unions was 70.14 per cent (the required minimum is 30%[1]). The capital adequacy ratio of credit unions was 23.87 per cent (the required minimum is 13%[2]); however, the capital adequacy ratio of one credit union was below the requirement (18%).In April 2015 this credit union provided information that, with the decrease in the loan portfolio share of loans granted to associated members, since Q2 it has been subject to a lower capital adequacy ratio that this credit union already breaches no more. The maximum exposure to a single borrower ratio was not complied with by two credit unions, which have been removing the deficiencies identified during the inspection, and two credit unions which held funds with a bank the balances of which exceeded 25 per cent of their recalculated capital. The latter two credit unions in April 2015 provided the Bank of Lithuania with the information that they had taken action and complied with the maximum exposure to a single borrower ratio.

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

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

It should be noted that information on each credit union's major performance indicators for the year and each quarter as well as on their compliance with prudential ratios is published on the website of the Bank of Lithuania. In addition, credit unions, following the resolution of the Board of the Bank of Lithuania, published the sets of financial statements for 2014, verified by revision commissions (auditors) or audit companies as well as the findings of the revision commissions (auditors) on their websites or on those of the associations they belong to.

The Republic of Lithuania Seimas' Committee on Budget and Finance has approved the conception of sustainable operation of credit unions presented by the Working Group for the Preparation of a Draft Conception for Sustainable Operation of Credit Unions. Legal acts, necessary for the implementation of the systemic reform of the credit unions sector laid down in this conception are currently being drafted.

The Review of the Activities of the Central Credit Union of Lithuania for Q1 2015, due to changes in the time limits for the submission of financial statements, will be published together with the Review of the Activities of Credit Unions for Q2 2015.