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Review of the Activities of Credit Unions
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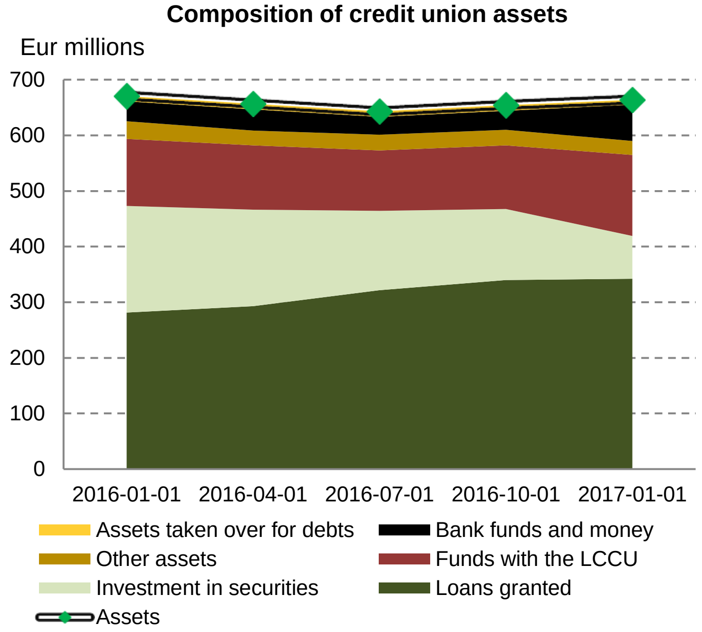
Upon withdrawal of the licence for *AMBER* credit union in the fourth quarter of 2016, 73 credit unions operated in Lithuania as of 1 January 2017. They united 163.1 thousand members. The Lithuanian Central Credit Union (LCCU) included 61 credit unions, 12 operated independently.

In 2016, credit union assets shrank by 1 per cent and, according to the data as of 1 January 2017, amounted to EUR 663.9 million[1], or 2.6 per cent of the banking system's assets (a year ago – 2.8%). The annual change in the credit unions sector assets was driven by the withdrawal of *AMBER* credit union from the market; it should be noted, however, that this change may be adjusted for the results of the credit union asset quality review, which was carried out by invoking audit undertakings. It should also be noted that the asset quality review results, which have already been submitted to credit unions, will reveal the actual value of the sector's assets and the business outlook for each credit union.

Composition of credit union assets



Source: Bank of Lithuania

The composition of credit union assets remained basically unchanged. As seen from the Chart, loans accounted for the major asset share on the reporting date. According to the data as of 1 January 2017, credit unions had granted EUR 342.2 million in loans to their members, which accounted for over 51 per cent of their assets. In the fourth quarter of 2016, credit union loans grew marginally, but their loan portfolio had expanded by EUR 60.7 million since the beginning of the year, an increase of one-fifth. Annual credit growth was driven by intensified crediting of natural persons: loans granted to these members had boosted by EUR 59.8 million since the beginning of the year (to legal persons – by EUR 0.9 million). In terms of crediting of natural persons, eleven credit unions were the most active in granting loans for consumption, housing, and agriculture, acquisition of immovable and movable property or refinancing of loans granted by other creditors. The loans granted by these credit unions to natural persons increased by EUR 39.5 million over the year, comprising accordingly a larger share of the loan portfolio, while the share of loans granted to associated members contracted, resulting in a 3.8 p.p. decline (to 19.6%) in the loan portfolio share of loans granted to the associated members.

With the expansion of the loan portfolio and a decline in specific provisions (for loan loss provisioning charges) by 15.5 per cent (to EUR 17.5 million), the ratio of specific provisions to loans decreased by 1.9 p.p. (to 4.9%) over the year. Growth in the loan portfolio also entails positive trends in the dynamics of other indicators[2] defining loan quality. While the relative values of these indicators decreased since the beginning of the year due to the expansion in the loan portfolio, the loans under which debt obligations were overdue for more than 60 consecutive days increased by EUR 2.2 million, compared to those at the end of 2015; non-performing loans – by EUR 4.2 million. This signals that members of credit unions default on more and more obligations. **The asset quality review conducted is likely to reveal the actual value of credit union loans, the size of losses incurred due to loan risk and their influence on the sustainable capital being formed by credit unions.**

[1] This Review does not evaluate the results of the credit union asset quality review conducted.

[2] Indicators defining loan quality include the share of non-performing loans in the loan portfolio and the ratio of loans overdue for more than 60 days and the assets taken over for debts to total loans.

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Credit union investment in securities declined by almost two-thirds in 2016. In 2016, securities shrank by almost EUR 118 million and, according to the data as of 1 January 2017, amounted to EUR 77.7 million, or 11.7 per cent of credit union assets. Implementing the requirements of the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations'), credit unions reduced their securities portfolios and changed their composition according to maturity. According to submitted data, all credit unions complied with the Regulations' requirement for the size of the securities portfolio share in on-balance-sheet assets: at the end of the year, securities did not account for more than 35 per cent of their on-balance-sheet assets; however, after analysing the reports on investment in non-equity securities provided by credit unions, it turned out that it five credit unions had failed to ensure compliance with other requirements (for the average modified financial duration of a securities portfolio, concentration of lower-rated government debt securities of EU countries and concentration on securities of a sole lower-rated issuer). **Given that, as of 31 December 2017, the average modified financial duration of a securities portfolio will not have to exceed two years, some credit unions will have to change the composition of their securities portfolio to comply with investment portfolio requirements.**

Accepted deposits remained the major funding source for credit unions – nearly 90 per cent of credit union assets were financed with them. In 2016, the deposit portfolio expanded by EUR 3.9 million (0.7%), to EUR 590.7 million as of 1 January 2017. The contribution to this change in the deposit portfolio stemmed from recognition of *AMBER* credit union as insolvent. As was mentioned in the Review of the Activities of Credit Unions for Q3 2016, upon occurrence of an insured event and entitlement of *AMBER* credit union depositors to insurance claims (of about EUR 17 million), these deposits were eliminated from the credit union system's deposit portfolio; therefore, fixed-term deposits declined over the year. General annual growth in the deposit portfolio was driven by an increase in sight deposits, which grew by some EUR 20.3 million since the beginning of the year, to almost 30 per cent of total deposits as of 1 January 2017. According to the data of submitted reports, most credit unions cut their deposits rates in 2016; however, individual credit unions raised their interest rates to accumulate funds for crediting. Towards the end of the year, interest rates on deposits in euro with a maturity of 12 months of up to 0.8 per cent prevailed in the credit unions sector. Most of deposits (96.5%), as usual, were of natural persons, who continued to opt for deposits as a means of secure saving, despite the changes in credit union interest rates.

As the membership of credit unions increased and members of credit unions, especially those who credited the most actively, brought in additional shares, the share capital boosted by 6.1 per cent in 2016 – to EUR 58.3 million, while the adjusted capital, which is important for ensuring compliance with most of prudential and other legal requirements, – by 8.1 per cent (to EUR 59.6 million). **According to the data as of 1 January 2017 submitted by credit unions, the shares that satisfied sustainable capital requirements, accounted for 11.7 per cent of the share capital, an increase of 1.4 per cent from 1 October 2016**. The bulk of the share capital (90%) was comprised of additional shares, only a small share of which (1.3%) is sustainable – they can be used to cover a loss incurred by credit unions (all additional shares brought in after 1 January 2017 satisfy sustainable capital requirements). **Therefore, credit unions will have to take action to increase the share of their capital satisfying sustainable capital requirements, including attraction of new additional shares.**

According to the data of submitted unaudited reports, in 2016, 48 credit unions earned EUR 3.8 million in profits; however, 25 credit unions that operated at a loss bore a somewhat higher loss, which determined loss-bearing operation of the credit unions sector – the loss amounted to EUR 38.8 thousand (in 2015, the audited loss amounted to EUR 3.6 million). It should be noted that the sector's performance for 2016 may be adjusted for the results of the asset quality review conducted. A lower loss for 2016 was due to a decline in the credit union costs incurred (the costs incurred declined by 25.5% and the income received was lower by 18%, as against the figures for 2015). At the end of 2016, the majority of credit union income (70%) was comprised of interest income (mainly – for loans granted to members); however, its amount declined by a tenth from 2015. A decline of two-thirds in the income received from securities (as credit unions reduced their securities portfolio) weighed significantly on the decline in interest income. Moreover, with the contraction of securities portfolios, the income earned on securities transactions halved. Operating expenses accounted for the largest share (57%) of the credit unions sector's expenses in 2016. Compared to 2015, these expenses declined by 7 per cent, but 57 per cent of total income received was used to cover them, an increase of 7 p.p. from 2015. As most credit unions cut their deposit rates, the sector's interest expenses declined by 27 per cent from 2015, although the share of these expenses in total expenditure contracted marginally (from 22.6% to 21.9%). Impairment costs, which were the reason behind an increase in the operating loss for some credit unions or their loss-bearing operation, decreased by nine times, compared to 2015, to account for an insignificant share of the sector's total expenses (2%) in 2016; it is likely, however, that the impairment will be identified after an evaluation of the results of the asset quality review carried out. **In the formation of sustainable capital, in an environment of decreasing income, credit unions should therefore also reduce expenses, particularly operating expenses, which account for the largest share, and seek a positive operating result.**

According to the data of submitted reports as of 1 January 2017, the capital adequacy ratio of the system of credit unions was 17.48 per cent (the requirement is 13%), the liquidity ratio – 53.79 per cent (as of 31 December 2016, the minimum requirement **for all credit unions** is 30%). On the reporting date, seven credit unions did not comply with prudential ratios:

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- *Centro taupomoji kasa* credit union, *Pajūrio* credit union (for them, individual time limits for ensuring compliance with the requirements have been set), and *Palanga* credit union did not comply with the capital adequacy and maximum exposure for a single borrower requirement requirements;
- *Baltija* credit union – the capital adequacy requirement;
- *Vilniaus kreditas* credit union, for which an individual time limit has been set to ensure compliance with the requirement, *Moterų taupa* credit union and *LTL* credit union – the maximum exposure for a single borrower requirement.

Given that a lack of capital determined non-compliance by the above-named credit unions with prudential requirements and, as stated above, sustainable capital only accounts for 11.7 per cent of the share capital of credit unions, accumulation of sustainable capital is one of the major strategic goals in credit union activities.

In January 2017, *Moterų taupa* credit union, *LTL* credit union, *Baltija* credit union and *Palanga* credit union submitted information that they have remedied the situation and already comply with the prudential requirements.

It should be noted that information on each credit union's key 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 (http://www.lb.lt/pagrindiniai_kredito_uniju_sektoriaus_veiklos_rodikliai).

After the Seimas of the Republic of Lithuania passed a new Law on Credit Unions, **the Bank of Lithuania approved legal acts related to the credit union reform and establishment of central credit unions and specialised banks.** Having introduced in the Law on Credit Unions the possibility to reorganise a credit union into a bank operating under an authorisation issued by the Bank of Lithuania, the credit union subject to restructuring will have to get permission from the supervisory authority to restructure it. In view of the above, the Board of the Bank of Lithuania approved **the Regulations on Granting an Authorisation to Carry out Restructuring of a Credit Union.** This document lays down the procedure for filing applications to the Bank of Lithuania to grant an authorisation to carry out restructuring of a credit union, cases of refusal to grant such an authorisation, what documents are to be submitted to the Bank of Lithuania to get an authorisation. Along with an application to grant an authorisation, the decision of a general meeting of members on the restructuring of the credit union will have to be submitted to the Bank of Lithuania (if such has been taken), a plan for the restructuring, approved by the bodies of the credit union, etc. This package will have to contain information on the protection of the members of the credit union and of the interests of its creditors during the credit union's restructuring. Credit unions not willing to operate according to cooperation principles and join a safer system of cooperative banking, will be able to develop activities under a commercial bank model with some restrictions on their activities. **Credit unions opting for restructuring in 2017 should prepare and approve plans for the restructuring of their activities.**

One of the major elements of the structural reform is abandoning the attitude that there can only be one central credit union in Lithuania. From now on, no less than five credit unions will be able to establish a central credit union by common agreement. As a result, credit unions applying an agreed business strategy will be able in 2017 to agree and to reach an agreement on further common work, while on reaching such an agreement, each credit union will define the business strategy of their members. This will address the existing sector fragmentation issue, when operation is based on different rules – part of credit unions are united under the Lithuanian Central Credit Union, the other part operates on a single basis.

Some signs of preparations for the reform have also been observed in the credit unions sector. At general meetings of members, some credit unions have been discussing, *inter alia,* the issues of changing the address of their registered office, restructuring into a specialised bank, joining or leaving the Lithuanian Central Credit Union and signing an agreement on the establishment of a new central credit union.

Financial services regulation initiatives of relevance to credit unions. Upon adoption of the **Law on Amendments to the Law on Payments**, implementing Directive 2014/92/EU on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features, as of 1 February 2017 residents will be able to use a limited-price basket of basic payment services. At banks and credit unions, residents are free to choose the basic payment account service for a limited price. Its fundamental goal is increasing of the availability and spread of payment services.

Upon ordering a limited-price basket, residents will be provided the following services at no additional cost: opening of an account and administration service, electronic banking service, unlimited crediting of received funds, payment card and payment card operations, at least ten electronic transfers in euro, unlimited depositing of cash, withdrawal of at least EUR 550 in cash. The monthly price for this package of services will not exceed EUR 1.5, while for those with low income, half the price will be applied – no more than EUR 0.75. Banks and credit unions providing the payment account service must offer their clients a basket of payment services established by the Bank of Lithuania, but residents do not necessarily need to accept this offer; they are free to choose from alternatives offered by other banks or credit unions.

The **Republic of Lithuania Law on Credit Related to Real Property**, adopted in 2016, implements Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (hereinafter – Directive). The Law also regulates other uncertainties that arose in the area of granting household credits, finding a balance between the interests of the two parties to a transaction – creditor and consumer who receives the credit. The requirements of the Law, to come into force as of 1 July 2017, will be applied to all credit agreements secured by real estate property concluded by the consumer. Moreover, this Law, *inter alia*:

- facilitates the possibility for the consumer to compare several credit proposals and choose the most beneficial for them. With this end in view, creditors or intermediaries will have to provide to the consumer information on the credit terms and conditions, prepared in a standardised form;
- the list of mandatory terms and conditions of credit agreements provided therein is likely to facilitate negotiations between the credit taking party and the creditor – many terms and conditions of agreements that the consumers had to negotiate prior to this Law coming into force have already been laid down in the list of mandatory terms and conditions of credit agreements;
- disclosure to the consumer of the composition of the interest rate and of the conditions for changing the interest rate is simplified and standardised;
- credit institutions are prohibited from pairing, i.e. practice requiring the consumer to conclude a credit agreement involving other financial products or services (life assurance, investment products, payment services) that are virtually unnecessary or dispensable for the borrower, except for some exemptions relating to insurance of the housing to be purchased or opening of a free account for collecting credit contributions.
- the consumer is provided a 30-day ‘consideration’ period prior to signing an agreement, during which the credit taking party will be able to closely compare, weigh and assess the credit proposals, as well as their capabilities.
- the consumer is also provided a withdrawal period, which means that the credit taking party may, within 14 days of conclusion of the agreement, withdraw from the credit agreement already concluded.
- legal acts set the maximum charge for early credit repayment – 3 per cent of the credit amount being repaid before maturity. It is expected that this provision will encourage to create more favourable possibilities for early repayment of housing loans and refinancing;
- the amount of penalty for the default on liabilities that can be applied to the consumer is also regulated. It will not exceed 0.05 per cent of the amount overdue for each day of delay.
- consumers facing financial difficulties for important reasons are provided a three-month ‘credit holiday’.

On 1 November 2016, the Bank of Lithuania began providing a new service, *STOP: Consumer Credits*, the purpose of which is to help individuals to secure themselves against excessive and irresponsible borrowing, also against illegal use of personal data, so that in the case of losing their personal documents or losing them otherwise, other persons could not take out consumer credits in their name. As a result, a **List of Persons Regarding whom Requests to not Allow Them to Conclude Consumer Credit Agreements have been Submitted** (hereinafter ‘List’), has been drawn up by the Bank of Lithuania; each natural person who is not wishing to get consumer credit or their representative holding a valid proxy (e.g. a notarial authorisation, etc.) has the possibility to be put on it free of charge. If family members (spouse, parents, adult children) do not have such an authorisation, but see the person’s uncontrollable borrowing, they can apply to court, asking for banning such a person from concluding consumer credit agreements; once the court makes such a ruling, the Bank of Lithuania will put that person on the List. A person can be entered on this List for a period specified in their request or for a period specified in the court ruling, while if the person does not specify any term in the request – for two years. Information on the procedure for submitting a request and entering on the List (removing from it) is available at http://www.lb.lt/sarasas. As of 1 November, about 350 persons of a different age, not wishing to get consumer credit for a specified period (some of them for 30–40 years and more), have already been put on the List.

Credit unions must, prior to granting consumer credit to a person, check whether that person is not on the List, because it is prohibited to grant consumer credit to persons put on this List, while the consumer credit agreements concluded with them are deemed invalid. It should be noted that, in meeting this obligation, consumer credit issuers, including credit unions, submit enquiries about persons wishing to get consumer credit.

Settlement of disputes between consumers and credit unions. In 2016, the Bank of Lithuania received 16 applications regarding disputes that arose between credit unions and consumers. The Bank of Lithuania made one decision regarding the subject matter of a dispute (reversed a consumer’s claim), one dispute ended by reaching a peaceful agreement between the consumer and the credit union. The subject matter of most claims was the return of credit union shares. The Supervision Service of the Bank of Lithuania receives applicant requests to oblige credit unions to credit additional contributions of shares in order to pay the last loan tranches. The Bank of Lithuania, considering the arising double legal relationship between applicants and credit unions in such cases – consumer loans and participation in the capital of the credit union – refuses to settle disputes of this nature as, in order to settle a dispute of an applicant, as a consumer, over the fulfilment of a loan agreement materially, the issue of the applicant’s membership in the credit union and the use of a share, as a security, proving the person’s participation in the capital of the credit union, should first be resolved, whereas such disputes are only settled in courts of general jurisdiction.

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Annex. Dynamics of performance indicators of the credit unions sector

Seq. No	Indicator	Amount, EUR millions			Change (%)	
		01/01/2016	01/10/2016	01/01/2017	2016 Q4	over the year
1	**Assets**	**670.5**	**654.4**	**663.9**	1.5	–1.0
2	Money	3.4	3.9	3.4	–12.8	–
3	Funds with banks	32.3	30.2	61.7	**2 times**	91.0
4	Funds with the LCCU	120.5	114.4	145.6	**27.3**	20.8
5	Government securities	195.6	127.7	77.7	–39.2	–60.3
6	**Loans granted**	**281.5**	**339.9**	**342.2**	**0.7**	**21.6**
7	Specific provisions against loans	20.7	18.4	17.5	–4.9	–15.5
8	Ratio of specific provisions against loans to loans (%)	6.8	5.1	4.9	–	–
9	Debt to the LCCU	12.2	17.6	11.8	–33.0	–3.3
10	**Deposits**	**586.8**	**558.0**	**590.7**	**5.9**	**0.7**
10.1	Of members and associated members of credit unions	584.5	555.3	587.9	**5.9**	**0.6**
11	**Share capital**	**54.9**	**58.9**	**58.3**	–1.0	**6.2**
12	Profit (loss) for current year	–3.6	–4.4	–0.04	–	–

Source: Bank of Lithuania.

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