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As of 1 April 2017, 72 credit unions operated in Lithuania, with a total membership of 162.8 thousand. In March 2017, the licence of *Pajūrio* credit union was revoked. 71 credit unions currently operate in Lithuania, as in April bankruptcy proceedings were initiated against *Žemaitijos iždas* credit union.

As was mentioned in previous reviews, credit unions are preparing for systemic restructuring in compliance with passed laws for the implementation of the credit union sector reform. General meetings of the shareholders of credit unions take decisions on their restructuring into specialised banks, joining or leaving the Lithuanian Central Credit Union (LCCU), signing an agreement on the establishment of a new central credit union. The Bank of Lithuania has already given consent for one credit union to be restructured into a specialised bank; one more credit union, intending restructuring, submitted appropriate documents for consent. In April 2017, 13 credit unions established a new, United Central Credit Union, which carries on preparations and has submitted appropriate documents to the Bank of Lithuania to be granted a licence.

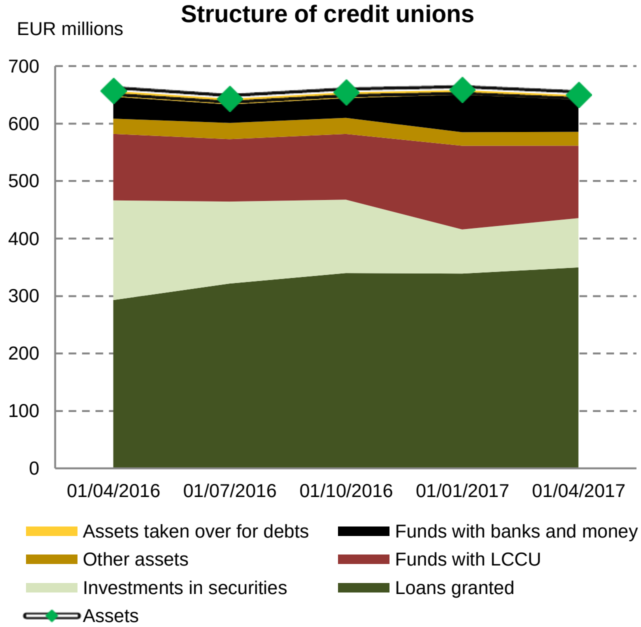
General meetings of shareholders, which took place in the first quarter of 2017, approved the audited annual financial statements of credit unions, as well as their performance for 2016 reflecting the influence of an asset quality review. It should be noted that, considering the credit union asset quality, the sector's operating result was worse, compared to the reported data for the fourth quarter of 2016 – the audited losses stood at EUR 6.1 million (an increase of more than EUR 6 million). By decisions of general meetings of the shareholders, credit unions which operated profitably in 2016 used their profits earned to cover the last year's losses and to increase their sustainable capital, while part of credit unions which operated at a loss covered their losses from the accumulated reserves or reserve capital. Credit unions, the reserve capital of which was insufficient to cover incurred loss, transferred their uncovered loss to the beginning of 2016, hoping to use profits earned to cover them in the future.

In 2017, credit union assets shrank by 1.4 per cent and, according to the reported data as of 1 April 2017, amounted to EUR 649.5 million, or 2.5 per cent of the banking system's assets (a year ago – 2.8%). This change in the credit union sector asset volume was driven by a decline in the deposits of credit unions uniting agricultural workers due to the approaching agricultural season.

As can be seen in the Chart, in the first quarter of 2017 credit union funds with the LCCU, with banks, and their money declined, while granted loans, which, on the reporting date, accounted for the largest asset share, as well as investment in securities, were on the rise.

At the end of the reporting period, credit unions had granted to their members EUR 349.8 million in loans. In the first quarter of 2017, loans granted by credit unions increased by 3.2 per cent, while their share in the credit union sector assets – by 2.4 p.p., to more than half of the credit union sector assets (54%). Credit unions continued to be more active in crediting natural persons: loans granted to these members have grown by EUR 8.5 million since the beginning of the year (to legal persons – EUR 2.3 million); however, the share of loans granted to natural persons in the sector's loan portfolio has declined somewhat. As a result, the loan portfolio share of loans granted to associate members (mainly legal persons) remained unchanged in the reporting period, standing at 19.4 per cent at the end of the period.

Structure of credit unions



Source: Bank of Lithuania

With the expansion of the loan portfolio and a decline in specific provisions (for possible loan loss provisioning charges) of 4.3 per cent (to EUR 19.8 million), the ratio of specific provisions to loans decreased by 0.5 p.p. (to 5.3%). Growth in the loan portfolio entailed a decline in the loan portfolio share of non-performing loans. However, loans, the discharge of the debt obligations of which is overdue for more than 60 consecutive days, have increased by EUR 5.8 million since the beginning of the year, while the ratio of the

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above-named loans and assets taken over for debts to total loans increased by 1.2 p.p., to 12.1 per cent at the end of the quarter. **This indicates that members of credit unions default on more and more obligations and therefore, in the future, should loans impair, credit unions may bear related costs.** Moreover, according to the most recent data, the processes of the recognition of 20 credit unions' asset quality review results have not been completed because of the recognition of the results of the assessment of loans (or including loans), and may have an impact on the change in specific provisions and related expenses.

After two years of decline, credit union investment in securities increased by more than a tenth in the first quarter of 2017, to account for only half of the last year's portfolio. In the first quarter of 2017, credit union investment in securities grew by EUR 9 million (to EUR 85.8 million), to 13.2 per cent of credit union assets. According to the reported data, credit unions managed securities portfolios in compliance with the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations') requirement for the securities portfolio's average modified financial duration of three years. All credit unions also complied with the Regulation's requirement for the size of the securities portfolio share in on-balance-sheet assets: at the end of the quarter, securities did not account for more than 35 per cent of their on-balance-sheet assets. Four credit unions failed to comply with other requirements: one – for the average modified financial duration of a securities portfolio, concentration of lower-rated government securities of EU countries, and concentration in securities of a sole lower-rated issuer; while three credit unions – for the average modified financial duration of a securities portfolio. **The securities portfolios of some credit unions have been inadequately diversified by duration; as a result, after selling part of their holdings of securities, these credit unions may encounter difficulties (due to a limited supply of short-term securities) related to compliance with the requirement for the average modified financial duration** (as of 31 December 2017, the average modified financial duration of a securities portfolio will not be longer than two years). In order to ensure compliance with the above-named requirement, they may have to restructure their total securities portfolio held.

The main funding source for credit unions continues to be accepted deposits, with which they financed almost 90 per cent of their assets. As mentioned above, deposits accepted by credit unions have declined by EUR 9.9 million (1.7%) since the beginning of the year, to EUR 580.8 million as of 1 April 2017. This change in the deposit portfolio resulted from increased financial requirements of credit unions uniting agricultural workers, related to the approaching agricultural season. The overall decline in the deposit portfolio in the reporting period was due to a decline of EUR 14 million in sight deposits (to EUR 158.4 million), while fixed-term deposits, which, at the end of the period, accounted for almost three-fourths of the total deposits accepted by credit unions, have increased by EUR 4.1 million since the beginning of the year. According to the reported data, like at the beginning of the year, annual interest rates on deposits with a maturity of 12 months not above 0.8 per cent prevailed in the credit union sector; however, some credit unions, aiming to accumulate funds for crediting or acquisition of securities, raised their interest rates on deposits – mainly on those with a longer maturity. As usual, deposits of natural persons accounted for the largest share of the deposit portfolio (96.9%), since, as is the long-term habit, residents choose deposits as a means of saving and investing.

In the first quarter of 2017, the share capital of credit unions contracted by 1.9 per cent, to EUR 57.2 million at the end of the quarter. This change in the share capital was due to the revocation of the licence for *Pajūris* credit union and this credit union leaving the market. According to the data reported by credit unions, sustainable shares, with which the losses incurred by a credit union are covered, accounted for 23.2 per cent of a credit union's share capital, an increase of 11.6 p.p. from 1 January 2017 (as of 1 May 2017 – 28.4%). An increase in the share of sustainable shares in share capital suggests that credit unions take measures to ensure the growth of sustainable capital, including attraction of new additional shares (all additional shares accepted in 2017 are in compliance with sustainable capital requirements). **It should be noted that credit unions, in preparation for the coming into force of all laws for the implementation of the credit union sector reform as of 1 January 2018, will have to further strengthen their holding of capital by enlarging the share of sustainable capital.**

According to the reported data, in the first quarter of 2017, 43 credit unions earned EUR 1.8 million in profits; however, the loss of EUR 1.5 million, incurred by 29 credit unions which operated at a loss, reduced the sector's profit to EUR 0.3 million (in the first quarter of 2016, credit unions earned EUR 0.2 million in profits). The better operating result for the first quarter of 2017 was due to the fact that growth in the expenses borne by credit unions outpaced that in income (year on year expenses borne dropped by 16%, while income received – by 14%). As usually, the largest share of credit unions' income (80%) was comprised of interest income, of which 94 per cent – on loans granted to members. Operating expenses accounted for the largest share (63%) of the credit union sector's expenses in the reporting period. Year on year these expenses dropped by 15 per cent, but their share in total expenditure expanded. Moreover, with a decrease in income, an increasingly larger share of income is used to cover operating expenses (compared to the first quarter of 2016, this share increased by 8 p.p., to 60%). As most credit unions cut their interest rates on deposits last year, in the first quarter of 2017 the sector bore 18 per cent less interest cost year on year; however, like a year ago, this cost accounted for one-fourth of total cost. **As income declines, credit unions should assess the soundness of their expenses borne, especially operating expenses, which comprise the largest share, and seek a positive operating result, which is necessary for the increasing of sustainable capital.**

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According to the reported data as of 1 April 2017, the capital adequacy ratio of the system of credit unions stood at 16.03 per cent (the requirement is 13%), liquidity ratio – at 51.14 per cent (the required minimum is 30%). On the reporting date, 13 credit unions did not comply with prudential ratios:

- *Palanga* credit union, *Moterų taupa* credit union, *Namų* credit union (formerly *Šešiagrašis*), *Vilniaus kreditas* credit union, *Centro taupomoji kasa* credit union, *Baltija* credit union and *Žemaitijos iždas* credit union, against which bankruptcy proceedings were initiated in April 2017, did not comply with the capital adequacy and the maximum exposure for a single borrower requirements;
- *Kėdainių kraštas* credit union, *Pareigūnų* credit union, *Vievio taupa* credit union, *Trakai* credit union, *Klausučiai* credit union and *Varėna* credit union – the maximum exposure for a single borrower requirement.

The above-named credit unions did not comply with prudential requirements due to a shortage of capital, which built up (or increased) after a credit union asset quality review. It should be noted that part of credit unions recognised their asset quality review results, while for some of them this process is still going on. **Therefore, considering that the asset quality review process is not completed in all credit unions and, once it is completed, they would have to adjust their asset value because of related expenses borne, strengthening of capital for part of credit unions remains one of the major strategic aims.**

In the second quarter of 2017, *Kėdainių kraštas* credit union, *Vievio taupa* credit union, *Pareigūnų* credit union and *Trakai* credit union reported that they had remedied the situation and are now in compliance with the maximum exposure for a single borrower requirement; *Namų* credit union and *Moterų taupa* credit union – in compliance with the capital adequacy requirement. Credit unions not in compliance with prudential requirements and which have not taken action to ensure compliance are subject by the Bank of Lithuania to the enforcement measures provided for in the Republic of Lithuania Law on Credit Unions.

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).

2017 is the period during which credit unions must prepare for the coming into force of laws for the implementation of credit union sector reform as of 1 January 2018. One of the major steps in pushing through the credit union sector reform approved by the Seimas of the Republic of Lithuania, the major purpose of which is to ensure the sector's long-term sustainable development, was an asset quality review of all credit unions. Essential weaknesses identified during this process confirmed the necessity of the sector's reform which is underway. In April 2017, after receiving consent from 69 credit unions out of 72, including the LCCU, the asset quality review results will be made public. The asset quality review results for each credit union, information about the capital adequacy ratio which was reported by credit unions (the most recent – on 1 April 2017) and about the asset quality review process status is available on the Bank of Lithuania website (http://www.lb.lt/uploads/documents/files/musu-veikla/Finansinis-stabilumas/Kredito%20unijų%20reforma/KU-turto-kokybes-vertinimas-kapitalo-pakankamumo-rodiklis.pdf).

Considering that the implementation of the reform envisaged by the new laws mitigates the risks arising within this sector, the Bank of Lithuania approved amendments to the Rules for Calculating the Capital Adequacy Ratio of Credit Unions in April 2017.

As of 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 the illegal use of personal data, so that, in case of losing their personal documents or losing them otherwise, other persons cannot take out consumer credits in their name. As mentioned in the previous review, a **List of Persons Regarding whom Requests to not Allow Them to Conclude Consumer Credit Agreements have been Submitted** 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 notarised authorisation, etc.) has the possibility to be put on it free of charge. Information on the procedure for submitting a request and entering on the List (or removing from it) is available at (http://www.lb.lt/lt/stop-vartojimo-kreditams).

Prior to granting consumer credit to a person, credit unions must 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.

Annex. Dynamics of performance indicators of the credit union sector

Seq No	Indicator	Amount, EUR millions			Change (%)	
		01/04/2016	01/01/2017	01/04/2017	2017 Q1	over the year
1	**Assets**	656.8	658.5	649.5	–1.4	–1.1
2	Money	3.8	3.4	3.8	11.8	–
3	Funds with banks	34.3	61.7	51.9	–15.9	51.3
4	Funds with the LCCU	115.6	145.6	126.0	–13.5	9.0
5	Government securities	173.4	76.8	85.8	11.7	–50.5
6	**Loans granted**	293.0	339.0	349.8	3.2	19.4
7	Specific provisions against loans	19.3	20.7	19.8	–4.3	2.6
8	Ratio of specific provisions against loans to loans (%)	6.2	5.6	5.3	–	–
9	Debt to the LCCU	16.7	11.8	10.4	–11.9	–37.7
10	**Deposits**	580.8	590.7	580.8	–1.7	–
10.1	Of members and associated members of credit unions	578.6	587.9	577.8	–1.7	–0.1
11	**Share capital**	54.6	58.3	57.2	–1.9	4.8
12	Profit (loss) for current year	0.2	–6.1	0.3	–	–

Source: Bank of Lithuania.

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