ACTIVITIES OF FINANCIAL MARKET PARTICIPANTS

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Review of the Activities of Credit Unions

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On 1 October 2017, financial and supervisory reports were presented to the Bank of Lithuania by 71 credit unions that united 164.5 thousand members. After initiation of bankruptcy proceedings to *Namų* and *Baltija* credit unions in October 2017 and revocation of the licence for *Vilniaus kreditas* credit union in November, 68 credit unions are currently in operation.

The processes taking place within the credit union sector, such as filing of applications for consent to be restructured into a specialised bank or reorganised through a merger with other credit unions, increase of sustainable capital, etc. show that credit unions are preparing for application in their activities of the provisions of the implementing laws for this sector's reform, to come into force as of 1 January 2018. It should be noted that six credit unions operating independently have applied to the Bank of Lithuania for consent to be restructured into a specialised bank, three of which (*Mano unija* credit union, LTL credit union, and *Saulėgrąža* credit union) have already been allowed to restructure. Others, having made up their mind to become members of a central credit union, have intensified work over their future membership. Moreover, the Bank of Lithuania has consented to reorganising the following credit unions members of the Lithuanian Central Credit Union (LCCU): Kvėdarna credit union, through a merger with Šilutė credit union; Varėna credit union, through a merger with Alytus credit union; Rokiškis credit union and Utena credit union, through a merger with Anykščiai credit union.

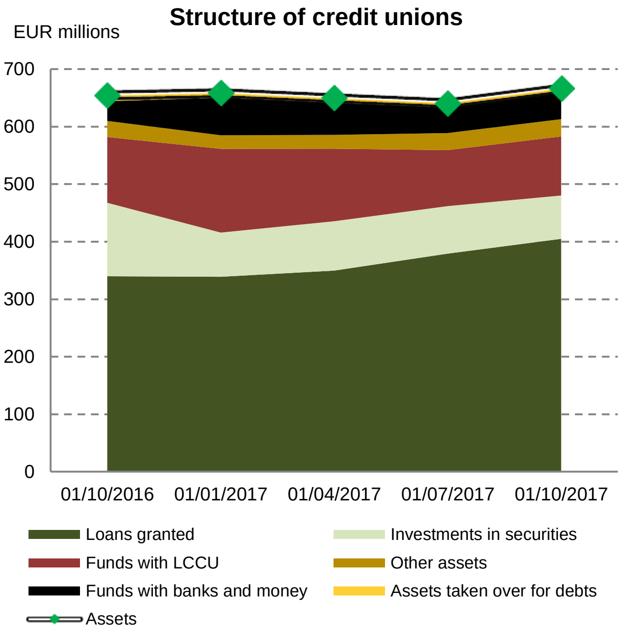
In Q3 2017, credit union assets grew by 4 per cent and, according to the reported data as at 1 October 2017, amounted to EUR 666.4 million[1], or 2.5 per cent of the banking system's assets (a year ago – 2.6%). The change in the credit union sector asset value resulted from growth in sight deposits with agricultural credit unions as members of the above-named credit unions started receiving funds from agricultural output sold.

As can be seen in the Chart, in Q3 2017 loans, which accounted for the largest asset share on the reporting data, and credit union funds with the LCCU grew the most, whereas investment in securities contracted.

At the end of the reporting period, credit unions had granted almost EUR 405 million in loans to their members. In Q3 2017, loans granted by credit unions increased by EUR 25.7 million, or 6.8 per cent (from the beginning of the year – 19.5%), while their credit union sector asset share – by 1.6 p.p. accordingly (from the beginning of the year – 9.3 p. p.), to over 60 per cent of the credit union sector assets according to the data as at 1 October 2017. Loans granted by credit unions to members-natural persons expanded by EUR 17.8 million over the reporting period, yet, as well as in the previous quarter, growth in such loans was somewhat weaker than that in loans to legal persons. The stronger rate of growth in loans to legal persons led to an increase in the loan portfolio share of loans to associated members (mainly legal entities) to 20.2 per cent.

Strong growth in the loan portfolio and measures applied by credit unions, which contributed to reducing specific provisions (loan loss provisioning charges) by more than 2 per cent (to EUR 18.5 million), resulted in the improvement of loan quality indicators over the reporting period: the ratio of specific provisions to loans decreased by 0.4 p.p. (to 4.4%), while the loan portfolio share of non-performing loans[2] – by 1.8 p.p. (to 18.74%). While the above indicators improved

Structure of credit unions



Source: Bank of Lithuania

[1] In this Review, credit union sector data includes the data of *Namų* credit union, *Baltija* credit union and Vi*lniaus kreditas* credit union.
[2] Non-performing loans include unimpaired loans overdue for more than 60 days and total impaired loans.

with growth in the loan portfolio, the volume of bad loans written-off has remained (since 1 October 2016) almost unchanged for almost a year. **This shows that, in granting loans, credit unions did not adequately assess credit risk, incurring expenses due to their members' default on liabilities, which have not been repaid to date.**

Credit union investment in securities decreased gradually, to slightly more than half of the last year's portfolio at the end of the reporting period. With a contraction in credit union investment in securities by EUR 7.2 million (to EUR 75.4 million) in Q3 2017, their share in the growing assets of credit unions slimmed down by 1.6 per cent – to 11.3 per cent. The credit union sector securities portfolio is managed following the requirements laid down in the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations'). All credit unions complied with the Regulations' requirement regarding the share of the securities portfolio in the 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. Five credit unions failed to ensure compliance with other requirements of the Regulations: 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; four – for the average modified financial duration of a securities portfolio.

The main funding source for credit unions continues to be accepted deposits, with which they financed 86 per cent of their assets. As members of credit unions started receiving funds from agricultural output sold, their accepted deposits expanded by EUR 14 million (2.5%) in Q3 2017, to EUR 575.3 million on 1 October 2017. The overall growth in the deposit portfolio in the reporting period was due to a rise of EUR 13.3 million in sight deposits (to EUR 149.2 million). Fixed-term deposits, which, at the end of the reporting period, comprised almost three-fourths of total deposits with credit unions, grew marginally over the quarter. According to the data of submitted reports, some credit unions raised their interest rates in the reporting quarter, yet the interest rates of most credit unions on deposits with a maturity of 12 months were not higher than 0.8 per cent, like in previous periods. As usual, deposits of natural persons accounted for the largest share of the deposit portfolio (96.3%), since residents, driven by their long-term habit, choose deposits as a means of saving and investing.

Credit unions' share capital shrank by EUR 0.5 million in Q3 2017, to EUR 57.4 million. The change in their share capital was due to the transfer of one credit union member's additional share capital to reserve capital. It should be noted that, preparing to ensure compliance with the sector reform implementing requirements, credit unions seek to accumulate sustainable capital as large as possible. According to the data submitted, sustainable shares which are used to cover losses borne by a credit union have increased by more than three times since the beginning of the year, to EUR 28.7 million at the end of the reporting quarter, or more than half of the share capital.

According to submitted information, 47 credit unions that operated profitably have since the beginning of the year earned EUR 4.1 million in profits, while 24 credit unions that operated at a loss bore losses amounting to EUR 6.6 million that were due to the operating costs borne by the two above-named credit unions currently going bankrupt. **The activities of the credit union sector during the nine months of 2017 were loss bearing: the loss borne stood at EUR 2.5 million** (year on year – EUR 4.4 million).

This year's smaller loss was due to the fact that the decline in expenses borne by credit unions outpaced their income (year on year their expenses borne dropped by 13%, income received – by 7%). As usual, the largest share of credit unions' income (76%) was comprised of interest income, of which 95 per cent – on loans granted to members. Fee and commission income of credit unions (mainly on crediting liabilities) accounted for 14 per cent of total income. Growth in this income is likely to be associated with the expansion in credit volumes. Operating expenses accounted for the largest share (63.5%) of the credit union sector's expenses in the reporting period. The amount of expenses incurred by credit unions was almost the same as during the nine months of last year; however, their share increased by 8.2 p.p. in comparison with their slimming expenses, and it took 70.3 per cent of the income to cover them (an increase of 4.9 p.p. year on year). Over the nine months of 2017, the sector's interest expense incurred dropped by 8.7 per cent year on year; however, its total expense share increased by 1 p.p., to 20 per cent. **It should be noted that, given the significance of a positive operating result on the sustainability of capital, some credit unions should more objectively assess the impact of expense being incurred.**

According to the reported data as at 1 October 2017, the capital adequacy ratio of the system of credit unions stood at 17.12 per cent (the requirement is 13%) and the liquidity ratio – at 42.88 per cent (the required minimum is 30%). On the reporting date, seven credit unions did not comply with prudential ratios:

- *Namų* credit union, *Baltija* credit union, *Vilniaus kreditas* credit union and *Centro taupomoji kasa* credit union did not comply with the capital adequacy and the maximum exposure to a single borrower requirements;
- *Klausučiai* credit union, *Moterų taupa* credit union and Rokiškis credit union – the maximum exposure to a single borrower requirement.

Non-compliance by the above-named credit unions with prudential requirements was a result of a lack of capital, which happened (or increased) due to significant expenses incurred (in some cases – due to expenses related to asset quality).

In Q4 2017, three credit unions that did not comply with one, maximum exposure for a single borrower requirement, submitted information that they had remedied the situation and are now in compliance with all prudential requirements.

Three credit unions that did not comply with the capital adequacy and the maximum exposure to a single borrower requirements, and took no measures to ensure compliance with them, were subject to an enforcement measure provided for in the Republic of Lithuania Law on Credit Unions – revocation of the licence of a credit union for good and application to the court regarding initiation of bankruptcy proceedings (for *Namų* credit union and *Baltija* credit union bankruptcy proceedings have already been initiated). The issue of application of an enforcement measure to the fourth credit union, which did not meet the above-named requirements, is to be addressed in the near future.

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 Bank of Lithuania website (https://www.lb.lt/en/key-performance-indicators-of-the-credit-unions-sector).

As mentioned in previous reviews, one of the main steps in carrying out the credit union sector reform approved by the Seimas of the Republic of Lithuania was assessment of the asset quality of all credit unions, the results of which were recognised by the credit union sector, except for two credit unions, and recorded in their financial statements. The asset quality review results for each credit union, information about the capital adequacy ratio for 1 April 2017, reported by credit unions, and the status of the asset quality review process are 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).

Taking into account that the implementation of the reform provided for by new laws adopted mitigates risks arising within this sector, the Bank of Lithuania, at the end of the first half of 2017, adopted a resolution on approval of prudential requirements for credit unions, set the terms for the implementation of this resolution, and approved Regulations of Credit Unions for the Calculation of the Maximum Exposure to a Single Borrower Requirement. New Regulations for the Calculation of Capital Adequacy of Credit Unions and credit union supervisory report forms were approved in July 2017. The new requirements will come into force on 1 January 2018.

Annex. Dynamics of performance indicators of the credit union sector

Seq. No	Indicator	Amount, EUR millions			Change (%)	
		01/10/2016	01/07/2017	01/10/2017	2017 Q3	over the year
1	**Assets**	**654.4**	**641.0**	**666.4**	**4.0**	**1.8**
2	Money	3.9	3.7	3.4	–8.1	–12.8
3	Funds with banks	30.2	40.7	42.5	4.4	40.7
4	Funds with the LCCU	114.4	97.4	102.6	5.3	–10.3
5	Government securities	127.7	82.6	75.4	–8.7	–41.0
6	**Loans granted**	**339.9**	**379.3**	**405.0**	**6.8**	**19.1**
7	Specific provisions for loans	18.4	18.9	18.5	–2.1	0.5
8	Ratio of specific provisions for loans to loans (%)	5.1	4.8	4.4	–	–
9	Debt to the LCCU	17.6	18.4	19.6	6.5	11.4
10	**Deposits**	**558.0**	**561.3**	**575.3**	**2.5**	**3.1**
10.1	Of which members and associated members of credit unions	555.3	557.8	572.1	2.6	3.0
11	**Share capital**	**58.9**	**57.9**	**57.4**	**–0.9**	**–2.6**
12	Profit (loss) for the current year	–4.4	0.5	–2.5	–	–

Source: Bank of Lithuania.