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Review of the Activities of Credit Unions

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Gedimino pr. 6, LT-01103 Vilnius, Lithuania
Tel. +370 (5) 268 0029, fax +370 (5) 268 0038

www.lb.lt
info@lb.lt

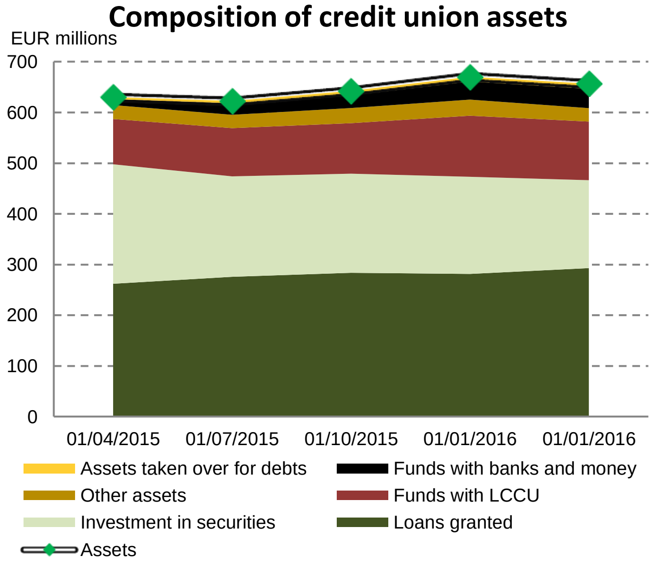
As of 1 April 2016, 74 credit unions were in operation. They united 158.9 thousand members (in Q1 2016, the membership increased by 1.8 thousand, whereas as of 1 April 2015 — by more than 7 thousand). Currently 61 credit unions are members of the Lithuanian Central Credit Union (LCCU), while 13 credit unions operate independently.

According to the decisions of the general members' meetings that took place in Q1 2016, credit unions whose operation in 2015 was profitable, used the profits earned to cover last year's losses and strengthen their capital base, while part of the credit unions that operated at a loss covered their losses with accumulated reserves or reserve capital. Credit unions whose reserve capital was insufficient for covering loss incurred transferred their uncovered loss to the beginning of 2016, hoping to use profits earned to cover them in the future.

In Q1 2016, credit unions decreased debt securities portfolios and used the funds received to repay deposits and cover other debts; hence, the assets of credit unions declined by almost EUR 14 million and, according to data as at 1 April 2016, amounted to EUR 656.8 million or 2.8 per cent of the assets of the banking system (same as a year ago).

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 April 2016, loans granted to members (EUR 293 million) accounted for 44.6 per cent of the assets. In Q1 2016, the loan portfolio of credit unions increased by EUR 11.5 million or 4.1 per cent. It should be noted that the growth of the loan portfolio was driven by consistently growing crediting of natural persons: loans granted to these members boosted by EUR 12.3 million over the year (to legal persons — by EUR 0.8 million). In terms of crediting of natural persons, 11 credit unions were the most active: they granted loans designated for consumption, housing, agriculture, acquisition of immovable and movable property or refinancing loans granted by other creditors. Changes in the composition of the loan portfolio of these credit unions also had a quite significant influence on certain changes in the composition of loans within the sector, i.e. on the contraction in the share of loans granted to associated members (mainly legal persons). The share of loans granted to associated members in the credit union sector's loan portfolio diminished by 1.1 p.p. in Q1 2016 — on 1 April 2016, these loans accounted for 22.3 per cent of total loans.

Composition of credit union assets



Source: Bank of Lithuania.

In Q1 2016, once credit unions wrote off loss-bearing loans totalling more than EUR 2 million and took over assets pledged for debts, specific provisions for covering likely losses on loan impairment decreased by 6.7 per cent — to EUR 19.3 million, while the ratio of specific provisions to loans reduced by 0.7 p.p. (to 6.2%) in the afore-mentioned period. However, other indicators defining loan quality deteriorated: the share of non-performing loans in the loan portfolio increased by 0.7 p.p. — to 22.2 per cent; the ratio of loans overdue for more than 60 days and the assets taken over for debts to loans increased as well (from 13.2% to 13.4%). **Given that assets taken over for debts are usually dedicated for sale, the expenses of their oversight and sale will worsen the financial situation of credit unions and negatively affect their capital in the future.**

According to the data as of 1 April 2016, slightly more than a fourth of credit union assets (EUR 173.4 million) consisted of investments in debt securities. In 2015, preparing to comply with the requirements of the Regulations on Credit Union Investment in Non-equity Securities (hereinafter 'Regulations'), credit unions reduced securities portfolios and changed their composition according to maturity over the reporting quarter. Since the beginning of the year, credit union investment in securities has dropped by EUR 18.2 million and, according to the data provided by credit unions, as at 1

April 2016 the securities portfolios of only two credit unions accounted for slightly more than 50 per cent of their on-balance-sheet assets. Both credit unions fulfilled the above-named requirement of the Regulations after the reporting date. After analysing the Investment in Non-equity Securities Reports, submitted for the first time on 1 April 2016, it was seen that credit unions found it harder to implement other requirements of the Regulations (due to the average modified financial duration of a securities portfolio, concentration of lower-rating government debt securities of EU countries and concentration on securities of a sole lower-rated issuer). Thus credit unions continue to take certain measures to satisfy requirements regarding the investment portfolio. As mentioned in previous reviews, as of 31 December 2016 the investment portfolio must 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 must not be longer than three years, and as of 31 December 2017 — no longer than two years. The Bank of Lithuania monitors changes in the composition of credit union assets and takes prudential measures if credit unions invest their funds received from securities sold in an insecure manner.

Accepted deposits has remained the major funding source for credit unions — according to the data as of 1 April 2016, more than 88 per cent of credit union assets were financed with them. It should be noted that, in Q1 2016, the deposit portfolio contracted by slightly more than EUR 6 million or 1 per cent, amounting to EUR 580.8 million on the reporting date. As usual, farmers preparation for spring, which began at the beginning of the year, had a considerable impact on the decline of the deposit portfolio, as the most significant decrease in deposits was seen in credit unions uniting farmers. According to the data of the submitted reports, over the reporting quarter all credit unions were reducing interest rates on the most popular deposits with a maturity of 12 months in euro, thus at the end of the quarter interest rates of below 1 per cent on the afore-mentioned deposits were prominent in the credit union sector. It should be noted that decreasing interest did not have an effect of the habit of residents to choose time deposits of credit unions as a saving means — in individual credit unions the volumes of time deposits expanded, while their share in the credit union deposit portfolio increased somewhat. As usual, the deposits of natural persons accounted for the largest share of deposits (97%).

Even though the number of members of credit unions increased, the share capital contracted by EUR 0.3 million in Q1 2016, and according to the data of 1 April 2016, amounted to EUR 54.6 million. When the requirement of the Law on Credit Unions to link the loan granted with the amount of the share of that member was repealed, the share capital of some credit unions, in the context of an increase in loan portfolios, declined. With the decrease in share capital, credit unions strengthened their adjusted capital with subordinated loans granted by the LCCU. In the reporting quarter, the adjusted capital, which is crucial in ensuring compliance by the majority of credit unions with prudential ratios and other legislative requirements, grew somewhat (by 0.8%), amounting to EUR 55.5 million on the reporting date.

37 credit unions, whose operations in Q1 2016 were profitable, earned EUR 1.6 million in profit; however, a loss of EUR 1.4 million incurred by other 37 credit unions that operated at a loss reduced the profit of the sector to EUR 0.2 million (the same amount of profit was earned in Q1 2015 as well). Compared to the first quarter of the previous year, credit unions earned 43 per cent less income and incurred 25 per cent less expenses. According to the data as of 1 April 2016, the main share of the income of credit unions (70%) consisted of interest income, mainly — on loans granted to members. Compared to 1 April 2015, the share of such income in total income increased by 25 p.p., as, with the decline in securities, income received from securities operations dropped by more than five times, whereas their share in total income — by 33 p.p. Operating expenses accounted for the largest share of the sector's expenses in Q1 2016 (54%). Year on year, such expenses increased by 5.8 per cent (staff costs — by 6.2%), while their share in total expenditure increased by 16 p.p. **Therefore, it might be concluded that credit unions do not link staff costs with income earned.**

According to the data of reports as at 1 April 2016, the liquidity ratio of the credit unions system was 62.41 per cent (the required minimum is 30%[1]); however the liquidity ratio of one credit union was below that which was applied to it (60%).

As mentioned, the adjusted capital of credit unions grew, while the share of loans granted to associated members in the loan portfolio diminished, as credit unions had to comply with the capital adequacy ratio, calculated in line with the new Rules for Calculating Capital Adequacy Ratio of Credit Unions. On 1 April 2016, the capital adequacy ratio of the credit unions system was 17.56 per cent; however, the capital adequacy ratios of two independently operating credit unions (*Vilniaus kreditas* credit union and Šiauliai credit union) and *Pajūris* credit union, a member of the LCCU, were below the required minimum (13%). In addition, on the reporting date, the maximum exposure of five credit unions, including the above-named ones not complying with the capital adequacy ratio, accounted for more than 25 per cent of the adjusted capital of a credit union. **Thus, for these credit unions, strengthening their capital has remained a major task.**

After the reporting date, some credit unions provided information that they took measures to ensure compliance with the ratios and remedied the situation; for some credit unions, individual deadlines to ensure compliance with the ratios were set. For credit unions that are not in compliance with prudential ratios and do not take any measures to ensure compliance with them, the Bank of Lithuania applies the enforcement measures laid down in the Law on Credit Unions and gives relevant instructions in writing.

[1] For credit unions whose assets have been 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.

Supervision Service of the Bank of Lithuania. Contact person: Stanislava Kybartienė, telephone: (8 5) 2680 559, e-mail: skybartiene@lb.lt

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 sets of financial statements for 2015, verified by revision commissions (inspectors) or audit companies as well as the findings of the revision commissions (inspectors) on their websites or on websites of associations they belong to.**

Seeking to lay down legal preconditions for the implementation of the Conception for Sustainable Operation of Credit Unions, **the Republic of Lithuania draft laws, necessary for implementing the proposed systemic reform in the credit union sector, were submitted to the Seimas of the Republic of Lithuania**. The latest International Monetary Fund's (IMF) Lithuania evaluation report also focused mainly on credit unions. IMF experts proposed to strengthen the credit union sector and implement the structural reform in the sector by approving draft laws that are currently discussed at the Seimas of the Republic of Lithuania. One of them — **the draft Republic of Lithuania Law on Credit Unions** — lays down that a thorough, independent and standardised asset quality review (AQR) of operating credit unions should be conducted before the day of coming into force of this Law, by invoking audit companies, asset valuators or other persons with adequate qualifications. The aim of this review is to identify the financial situation of credit unions before the merger, remove existing problems from the new system of credit unions, and ensure the system's viability and credibility. The Bank of Lithuania is preparing to announce the public procurement of the credit union asset quality review services.

Financial services regulation initiatives of relevance to credit unions. The draft **Republic of Lithuania Law on Credit Relating to Real Property** is still being coordinated; it implements Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (Mortgage Credit Directive, MCD) as well as national proposals on the improvement of legal regulation in the field of granting residential loans. The draft law proposes to apply the MCD provisions to all credit agreements ensured not only by pledged residential property but by other types of real estate as well, implement the procedure for the provision of pre-contractual information to the borrower established in the MCD, set requirements for credit agreements, require to clearly disclose the composition of interest rates and conditions for changing interest rates, prohibit the selling of the mandatory financial product package with the credit agreement, limit the size of the tax rate on the anticipatory credit repayment, etc.

Soon the Seimas of the Republic of Lithuania should discuss the draft **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 (Payment Accounts Directive, PAD). The draft law proposes to supplement the above-named Law with provisions that would provide preconditions for reducing the price of the basket of operations usual for consumers down to that not higher than the region's average.

When amendments to the Law on Consumer Credits came into force on 1 February 2016, the List of persons, regarding whom requests to not allow them to conclude consumer credit agreements have been submitted (hereinafter 'List'), has been established. From 1 November 2016, every natural person will be able to add themselves to the List. In addition, persons who, by a court decision (pursuant to an application by the person's spouse, parents, children that are considered adults, a care (custody) establishment or a prosecutor), are forbidden to conclude consumer credit agreements will be added to the List for a period indicated in a court decision. Consumer credit lenders and peer-to-peer lending operators, in making the decision on the granting of a consumer credit, will have to check whether the person wishing to get a consumer loan is not on this List, since the consumer credit agreement concluded with a person included in the List will be deemed invalid.

The Bank of Lithuania has prepared a **proposal on improving personal warranty measures** and submitted it for public discussions (http://www.lb.lt/pasiulymas_del_asmeninio_uztikrinimo_priemoniu_reguliavimo_tobulinimo). The document proposes to ensure that credit institutions would not be able to require warranty from natural persons for the amount of loan, which exceeds the value of that person's unencumbered assets, i.e. natural persons would only warrant loans in an amount which is adequate to their financial situation. When a borrower is unable to repay a loan, it is also proposed to provide the possibility for the warrantor to pay contributions for the borrower from revenue being earned rather than repaying all credit from his/her assets in one go.

Settlement of disputes between consumers and credit unions. In the field of settlement of financial service disputes, disputes over shares still arise. The Bank of Lithuania receives applications requiring to oblige credit unions to credit additional contributions of shares in order to pay the last loan tranches.

Supervision Service of the Bank of Lithuania. Contact person: Stanislava Kybartienė, telephone: (8 5) 2680 559, e-mail: skybartiene@lb.lt

Annex: Dynamics of performance indicators of the credit unions sector

Seq. No	Indicator	Amount, EUR millions 01/04/2015	01/01/2016	01/04/2016	Change (%) Q1 2016	over the year
1	**Assets**	**630.4**	**670.5**	**656.8**	**–2.0**	**4.2**
2	Money	3.5	3.4	3.8	11.8	8.6
3	Funds with banks	8.1	32.3	34.2	5.9	4.2
4	Funds with the LCCU	89.4	120.5	115.6	–4.1	29.3
5	Government securities	235.7	191.7	173.4	–9.5	–26.4
6	**Loans granted**	**262.1**	**281.5**	**293.0**	**4.1**	**11.8**
7	Specific provisions against loans	19.0	20.7	19.3	–6.8	1.6
8	Ratio of specific provisions against loans to loans (%)	6.7	6.8	6.2	–	–
9	Debt to the LCCU	17.0	12.2	16.7	36.9	–1.8
10	**Deposits**	**550.0**	**586.8**	**580.8**	**–1.0**	**5.6**
10.1	Of members and associated members of credit unions	547.4	584.5	578.6	–1.0	5.7
11	**Share capital**	**52.0**	**54.9**	**54.6**	**–0.5**	**5.0**
12	Profit (loss) for current year	3.6	–3.6	0.2	–	–

Source: Bank of Lithuania.

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