LIETUVOS BANKAS

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

1st Quarter of 2013

ISSN 2335-8203 (ONLINE)

Gedimino pr. 6, LT-01103 Vilnius, Lithuania
Tel. +370 (5) 268 0029, fax +370 (5) 262 8124

www.lb.lt
info@lb.lt

Credit unions. As of 1 April 2013, 75 credit unions, uniting 144 thousand members, were operating in Lithuania. The Central Credit Union of Lithuania (CCUL) included 63 credit unions, 12 operated independently.

After the Board of the Bank of Lithuania revoked operating licences for two credit unions — the National Credit Union (*Nacionalinė kredito unija*) and *Švyturio taupomoji kasa* credit union — on 24 January 2013, the number of credit union members declined in the reporting period (for the first time since 1995), although their number increased by 10.8 thousand from 1 April 2012 to 1 April 2013.

At the beginning of the creation of the credit union sector the focus was that these specific credit institutions, operating on a cooperative basis, bringing together entities living in a certain location or engaged in similar activities, should satisfy first of all the economic and social needs of their members: accept deposits from some members and grant loans to others. The first credit unions were being established in regional centres. Their members were persons related to agricultural activity.

After embedding only the territorial membership principle in the Law on Credit Unions, recently credit unions are being established in cities and are characterised by exclusively strong growth rates. Offering the highest market interest rates on term deposits and applying various marketing programmes, these credit unions have deviated from the classical definition of a credit union. Expanding fast and attracting large numbers of participants, such credit unions are losing mutual confidence principles, although they are credit unions operating on merely a cooperative basis.

By decisions of the general meetings of members that took place in the first quarter of 2013, all credit unions whose activities were profitable in 2012 (51) enhanced their capital base with their profits earned, whereas part of the 26 ones that operated at a loss covered their losses with their reserve capital or reserve funds. **It should be noted that at some credit unions that have been operating at a loss for more than a year, uncovered loss has reached volumes of significance to these credit unions. Shareholders, as owners of a credit union, do not show initiative to contribute to the improvement of the credit union's financial standing.**

Revocation of the licences of the two credit unions mentioned above, which held over 5 per cent of the market, led to a shrinkage in the system of credit unions in the first quarter of 2013; however, as compared to the 1 April 2012 data, the assets of credit unions grew by 15.2 per cent and, according to the 1 April 2013 data, after having amounted to LTL 2 billion (as at the end of 2012), represented 2.6 per cent of the assets of the system of operating banks (2.3% a year ago).

Dynamics of some performance indicators of the system of credit unions

No.	Indicator	Amount 01-04-2012, LTL million	Amount 01-01-2013, LTL million	Amount 01-04-2013, LTL million	Change in Q1 2013, %	Change over year, %
1.	**Assets**	**1,762.0**	**2,055.8**	**2,029.6**	**–1.3**	**15.2**
2.	Funds with banks	79.0	80.6	48.6	–39.7	–38.5
3.	Funds with the CCUL	319.7	310.2	339.9	9.6	6.3
3.1.	Time deposits	127.8	158.9	180.7	13.7	41.4
4.	Government securities	309.7	412.4	456.5	10.7	47.4
5.	**Loans granted**	**954.3**	**1,122.9**	**1,050.4**	**–6.5**	**10.1**
6.	Specific provisions for loans	31.6	80..2	32.1	–2.5 times	1.6
7.	Ratio of specific provisions for loans to loans (%)	3.2	6.7	3.0	–	–
8.	Debt to the CCUL	45.9	53.1	54.3	2,3	18,3
9.	**Deposits**	**1,542.2**	**1,822.0**	**1,767.8**	**–2.3**	**14.6**
9.1.	Of members and associated members of credit unions	1,532.0	1,810.8	1,756.8	–3.0	14.7
10.	**Share capital**	**183.4**	**236.2**	**208.0**	**–11.9**	**13.4**
11.	Profit (loss) for current year	–5.5	–60.1	–11.8	–	–

According to the 1 April 2013 data, the assets of the 10 largest credit unions represented more than half of the assets of all credit unions. Credit union *Vilniaus taupomoji kasa* (with its assets accounting for 18.4% of the assets of all credit unions) remains the largest within the system of credit unions.

The change in the asset composition of credit unions was insubstantial both in the reporting period and over the year. Seeking to accumulate high quality liquid assets necessary to ensure compliance with the liquidity coverage ratio from 1 January 2013, credit unions increased their investments in government securities. After rising to LTL 456.5 million, credit union investments in government securities accounted for 22.5 per cent of credit union assets on 1 April 2013. As was previously the case, the bulk of them (nearly 71%) consisted of the Republic of Lithuania government securities portfolio, which increased by 1.8 per cent in the first quarter of 2013 — to LTL 322.9 million; investments in the securities of the European Union countries and the European Economic Area (LTL 133.6 million) accounted for 29 per cent of the government securities portfolio.

To ensure compliance with the maximum exposure requirement, some credit unions directed their funds from banks to the CCUL; therefore, as the last quarter of 2012, in the first quarter of 2013 credit unions recorded growth in their deposits with the CCUL and an increase in their asset share (as of 1 April 2013, credit union deposits with the CCUL accounted for 16.7% of total assets).

Loans represented the largest share (51.8%) of credit union assets. Since 1 April 2012 the loan portfolio has expanded by 10.1 per cent; however, loans granted by credit unions in the reporting period contracted by 6.5 per cent and amounted to less than LTL 1.1 billion on 1 April 2013. It should be noted that the contraction in the loan portfolio in the recent quarter was not only driven by the suspension of the operation of the National Credit Union and *Švyturio taupomoji kasa* credit union, but also credit unions' formed specific provisions for loans due to increasing loan risk, and limitation on credit for some credit unions. According to reporting data, the amount of loans to natural persons decreased, while the amount of loans to associated members legal persons continued to increase. These riskier loans, meant mainly for financing business, following elimination of the data of the National Credit Union and *Švyturio taupomoji kasa* credit union, rose by LTL 9.3 million during the reporting period and as of 1 April 2013 represented nearly a third of total loans. A considerable share of business loans goes to credit unions in operation in Vilnius region.

After withdrawal from the credit union market of two credit unions in bankruptcy (National Credit Union and *Švyturio taupomoji kasa* credit union), the ratio of specific provisions for loans and loans dropped from 6.7 per cent to 3 per cent in the reporting period, and the share of non-performing loans from 17.6 per cent to 15.3 per cent of the loan portfolio. **While the indicators characterising the loan portfolio quality are better in the credit union sector than in the banking system, in analysing the activities of individual credit unions though, it should be noted that the possibilities for the repayment of loans granted are assessed with insufficient conservativeness.** The specific provisions formed by credit unions are insufficient to amortise losses on loan impairment, thus the Bank of Lithuania, seeking a more conservative approach of credit unions to the risks assumed, prepares new documents and updates the existing ones for the regulation of loan assessment and risk management.

With limited possibilities to expand the range of their services, yet offering higher interest rates on deposits than banks, credit unions are attractive to the population. According to the data of submitted reports, as of 1 April 2013 the interest rates of 2 to 3 per cent on the most popular deposits in national currency with a maturity of 12 months dominated credit unions (some of them offered higher interest rates), thus the volumes of credit union deposits continued to expand. Since 1 April 2012 the volumes of credit union deposits have expanded by 14.6 per cent; in the first quarter of 2013, however, deposits with credit unions (after termination of activities of two credit unions) contracted by 2.3 per cent and were below LTL 1.8 billion on 1 April 2013. Deposits of natural persons accounted for 97.2 per cent of total deposits. Each depositor of a credit union, being at the same time that credit union's member shareholder, should take a more active part in the credit union's activities when taking financial and other decisions; however, in a context of favourable deposit insurance terms and conditions, depositors of the credit union don't even endeavour to assess the risks themselves, as in the event of bankruptcy of the credit union they suffer the least (losing only their share, where their deposit does not exceed the amount insured).

The decline in the number of credit union members and in their loan portfolio had a negative influence on the share capital of credit unions. After a decline of nearly 12 per cent in the first quarter of 2013, it amounted to LTL 208 million on 1 April 2013. It should be noted that share capital accumulated by crediting own members is unstable, because, after repayment of a loan or part of it, such share contributions often are repaid. Moreover, when facing difficulties, credit union members, who are also the owners of a credit union, are not willing to pay extra contributions to capital and to assume the responsibility for the operating performance of the credit union.

According to the data of submitted reports, in the first quarter of 2013, 40 credit unions earned a profit of LTL 3.3 million, but 35 credit unions operated at a loss, which amounted to LTL 15.1 million and led to loss incurring activities of credit unions with their losses amounting to LTL 11.8 million (in the same period a year ago, the losses were half as low).

The cause for credit union activities at a loss in the reporting period was loan impairment costs (LTL 16.3 million). Due to them, the costs rose 26 per cent year on year. The loss was reduced by net interest income received (LTL 14.6 million) and, as a result of expansion in the government securities portfolio, profit earned from securities transactions, which totalled LTL 1.1 million (2.6 times as large as in the first quarter last year).

According to the data of submitted reports for 1 April 2013, the capital adequacy ratio of the system of credit unions was 19.7 per cent (the ratio being 13%), the liquidity ratio — 52.54 per cent (the ratio being 30%). Credit unions held a sufficient reserve of high quality liquid assets to cover the net outflow of cash. According to reports, high quality liquid assets stood at LTL 415.8 million, and the net outflow of cash at LTL 15.2 million, i.e. credit unions' accumulated liquid assets were 27.4 times in excess of minimum requirement, although the liquidity coverage ratio of two credit unions was below the established 100 per cent. A requirement of the Law on Credit Unions for all credit unions to comply with the maximum exposure requirement and a new wording of the concept of "loan" became effective as of 1 January 2013. According to it, funds with credit institutions, among other things, are attributed to loans, except for funds held with the CCUL, and from 1 February additional limitation on the maximum exposure requirement shall be LTL 500 thousand. On the reporting date, **15 credit unions did not ensure compliance with the maximum exposure requirement.** Some credit unions took action to ensure compliance with ratios and provided the Bank of Lithuania with information on being already in compliance with prudential requirements in April 2013. To credit unions that did not ensure compliance with prudential requirements the enforcement measures established in this Law will be applied. It should be noted that, in order to prevent occurrence of more severe problems in the future and reduce risks, a tighter capital adequacy ratio to credit unions with a large share of loans issued to associated members (legal persons) and a liquidity ratio for credit unions with their deposit growth rates outpacing sustainable growth rates became effective on 1 April 2013. Credit unions will provide the Bank of Lithuania with information on compliance with these ratios, as well as other ratios in their 1 July 2013 reports.

In observance of a resolution of the Board of the Bank of Lithuania, credit unions for the first time published on the their own websites, and the websites of the associations they belong to, the sets of financial statements for 2012 verified by controllers' commissions (controllers) and auditors along with the findings of the controllers' commissions and the auditors. Having by now only provided summarized data of the whole of the banking and credit union sector, the Bank of Lithuania also decided to publish quarterly information on each credit union's key performance indicators and compliance with prudential requirements.

With the aim that credit unions have a more conservative approach to the risk they assume, the Bank of Lithuania prepares documents for the regulation of risk assessment. Minimum Loan Assessment Requirements for Credit Unions regulating loan assessment and the formation of specific provisions are being cardinally updated; working out of provisions covering the processes of the organisation of internal control and risk assessment (management) at credit unions, the observance of which will ensure identification of risks involved in the activities of credit unions and their more effective management, is close to completion.
In addition, a set-up working group (comprising representatives from the Ministry of Finance, the Bank of Lithuania, associations uniting credit unions and the CCUL) has been preparing draft laws for the regulation of credit union activities with the aim of ensuring their safe and sound operation, establishing an adequate balance between the development of credit unions and their possibilities to amortise risk assumption-related losses.

Central Credit Union of Lithuania. As of 1 April 213, the CCUL united 63 credit unions.

Following an increase of 31.5 million litas in the first quarter of 2013, on 1 January 2013 the CCUL's assets amounted to LTL 402.3 million. The main reason behind the increase was an expansion in the deposit portfolio of credit union members of the CCUL. In the reporting period, credit union deposits grew by nearly 10 per cent — to LTL 325.6 million. They remained the major source of financing of the CCUL's assets (81% of the CCUL's assets are financed with them). The biggest share of the CCUL's assets (61.7%) consisted of investments in the Republic of Lithuania government securities (it does not have government securities of other countries). As of 1 April 2013, they totalled LTL 248.4 million. The CCUL's funds with banks, after declining by nearly a fourth since the beginning of the year (to LTL 16.5 million), represented an inconsiderable share of the assets (4.1%).

The portfolio of loans granted to CCUL members expanded in the reporting period and stood above LTL 54 million on 1 April 2013. Subordinated loans granted to credit unions represented a significant proportion of the CCUL's loan portfolio (48%). According to the reports submitted on 1 April 2013, the quality of the loan portfolio remained good: no specific provisions for loans were formed, and there were no loans with regular payments overdue for more than 60 days. Under the agreement signed between the CCUL together with 57 credit unions with the manager of the Entrepreneurship Promotion Fund (INVEGA) on the management of an LTL 50 million worth micro crediting project, credit unions were granted LTL 19.1 million of loans from the Entrepreneurship Promotion Fund for the financing of small business.

The CCUL's Liquidity Maintenance Reserve (formed from contributions of CCUL members) increased to LTL 14.3 million in the first quarter of 2013, while the Stabilisation Fund, after provision of financial aid to Palanga Credit Union, contracted by 27.3 per cent — to LTL 5.2 million. As mentioned in the previous reviews, **the volume of funds accumulated in the Stabilisation Fund is rather low** for implementing the CCUL's main functions — to ensure liquidity and solvency of its members (credit unions) and maintain stability within the credit union system against a background of impairment of the quality of loans granted by credit unions and increasing related losses. Apart from the functions mentioned above, the CCUL must monitor the activities of credit unions that belong to it, carry out their inspections, and provide recommendations for their operation. The CCUL informed the Bank of Lithuania, which is responsible for the supervision of credit unions, in the first quarter of 2013 about significant deficiencies and violations identified in the operation of one credit union.

In the reporting quarter, the CCUL's share capital, after repayment to the Government of the Republic of Lithuania part of its supplementary share acquired at the end of 2011, shrank by LTL 1 million and amounted to LTL 30.2 million on 1 April 2013.

In the first quarter of 2013 the CCUL earned a profit of LTL 598 thousand (LTL 336 thousand in the same period of 2012). Major contribution to the CCUL's operating performance came from interest income received from investment in government securities.

The CCUL continued to comply with the liquidity and capital adequacy ratios holding a significant reserve.