LIETUVOS BANKAS

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

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Credit unions. As of 1 July 2014, 74 credit unions operated in Lithuania, with their total membership of over 145.6 thousand. 63 credit unions were members of the Lithuanian Central Credit Union (LCCU), 11 were not its members.

On 30 April 2014 the Board of the Bank of Lithuania revoked the licence of the *Naftininkų investicijos* credit union. As a result, the number of credit unions decreased, but the membership of operating credit unions increased (surpassing the past year's membership).

After declining marginally in Q2 2014 (by 3.6% as compared to 1 July 2013 data), the assets of credit unions amounted to almost LTL 2 billion and accounted for 2.5 per cent of the assets of the system of operating banks on 1 July 2014 (2.7% a year ago).

Dynamics of some performance indicators of the system of credit unions

Seq. No	Indicator	Amount 01-07-2013, LTL million	Amount 01-04-2014, LTL million	Amount 01-07-2014, LTL million	Change Q2 2014, %	Change over a year, %
1.	**Assets**	**2,030.6**	**1,972.1**	**1,956.5**	**–0.8**	**–3.6**
2.	Money	13.3	14.7	11.7	–20.4	–12.0
3.	Funds with banks	34.7	23.2	22.6	–2.6	–34.9
4.	Funds with the LCCU	263.0	290.0	229.6	–20.8	–12.7
5.	Government securities (GS)	529.3	677.7	689.4	1.7	30.2
6.	**Loans granted**	**1,059.1**	**876.4**	**915.6**	**4.5**	**–13.5**
7.	Specific provisions for loans	29.8	33.7	35.8	6.2	20.1
8.	Ratio of specific provisions for loans to loans (%)	2.7	3.7	3.8	–	–
9.	Debt to the LCCU	63.4	64.8	81.3	25.5	28.2
10.	**Deposits**	**1,754.6**	**1,717.5**	**1,665.8**	**–3.0**	**–5,1**
10.1.	Of members and associated members of credit unions	1,741.7	1,707.7	1,656.3	–3.0	–4.9
11.	**Share capital**	**203.4**	**173.3**	**173.4**	**0.1**	**–14.7**
12.	Profit (loss) for current year	–7.3	–0.1	7.2	–	–

The change in the composition of credit union assets was insubstantial both in the reporting quarter and over the year. Loans granted to members represented the largest share (46.8%) of credit union assets. The loan portfolio increased by 4.5 per cent in Q2 2014 and amounted to LTL 915.6 million on 1 July 2014. The increase in the loan portfolio is to be related to the seasonality of agricultural works, as the loan portfolios of some credit unions whose members are engaged in agricultural activities expanded even up to 20 per cent. With growth in the loan portfolio there was an increase in loans granted to legal persons in the reporting period (up to LTL 219.2 million); however, their loan portfolio share remained unchanged, at 24 per cent of total loans, as at the beginning of the quarter.

Expansion of the loan portfolio share of non-performing loans (26.6% as of 1 July 2014) indicates a deterioration in loan quality. It is likely that credit unions, in accordance with the requirements of the Regulations for the Internal Control and Assessment (Management) of the Risk of Credit Unions, that came into effect in May 2014, identify their risks and, in accordance with the requirements of the Regulations of Credit Unions for the Assessment of Loans, started more conservatively assessing, and will continue to assess, their loan portfolio quality, and will form increasingly more specific provisions. **It should be noted that so far the credit unions' specific provisions formed are insufficient for covering likely losses on loan impairment.**

Credit unions continued to increase investment in GS in the reporting period. Investment in GS rose to LTL 689.4 million and accounted for 35.2 per cent of credit union assets on 1 July 2014. As before, its major share (59%) consisted of the Republic of Lithuania GS portfolio; however, investment in the GS of European Union Member States and EEE countries (especially long-term ones) grew stronger (to LTL 282.6 million), accounting for an increasingly larger share (41%). It should be noted that investment in GS should not become the key activity for credit unions as long-term debt securities (the credit unions' largest acquisition) are highly sensitive to interest rate changes. High sensitivity of the portfolio held to interest rate changes could result in significant losses if credit unions were to sell their securities because of a rise in market interest rates.

In the reporting quarter, credit unions reduced cash in cash registers by transferring spare funds to accounts in banks and in the LCCU (these changes might have been triggered by the facts of irresponsible cash management identified during inspections and started pre-trial investigations concerning a shortage of cash in the cash registers of some credit unions); however, as credit unions increased investment in GS and granted new loans, their funds with the above-named credit institutions decreased as well. At the end of the reporting period the funds of credit unions held with banks and the LCCU accounted for 12.9 per cent of credit unions' total assets.

Credit unions continued to cut their deposit rates in the reporting period. According to the submitted reports, the 1.1–1.8 per cent rate on the most popular accepted deposits, i.e. those with a maturity of 12 months in national currency, prevailed (at the beginning of the year it was 1.5–2.5%). Cutting of interest rates, the seasonality of agricultural works-driven increase in financial requirements and withdrawal of a bankrupt credit union from the market had an impact on the decline in the volume of deposits with credit unions. According to the submitted reports, in Q2 2014 the deposit portfolio contracted by 3 per cent and stood at LTL 1.67 billion on the reporting date. The deposits of natural persons accounted for the largest share of deposits (97%).

The share capital of credit unions grew marginally in the reporting quarter and, as of 1 July 2014, amounted to LTL 173.4 million. The changes in the share capital were driven by credit unions' intensified borrowing to their members. **In view of the deteriorating quality of loans of credit unions, strengthening of the capital base remains a key task for them.** According to the financial reports, in the first half of 2014 credit unions earned 9.4 per cent more income and incurred 11.5 per cent less expenses year on year. Interest income, which represented more than 60 per cent of total income, was the main income source for credit unions. A significant proportion of income for credit unions came from securities transactions; however, this type of income is not stable, mainly one-off case. 42 credit unions, whose operations in the first half of 2014 were profitable, earned LTL 15.6 million of profit, however 32 of them operated at a loss and incurred LTL 8.4 million of losses, which reduced the profit of the system of credit unions to LTL 7.2 million (in the same period in 2013, credit unions incurred LTL 7.3 million of losses).

According to the data of submitted reports, as of 1 July 2014 the capital adequacy ratio of the system of credit unions was 22.77 per cent, the liquidity ratio — 65.75 per cent. All credit unions held liquid reserve assets sufficient to cover the net outflow of cash (high quality liquid assets amounted to LTL 446.3 million, while the net outflow of cash stood at LTL 13.6 million). Credit unions complied with the liquidity and the maximum open position in foreign currency ratios. One credit union failed to accumulate sufficient capital, necessary for ensuring compliance with the capital adequacy ratio (25%). Four credit unions did not comply with the maximum exposure to a single borrower ratio: two credit unions, in July 2014, submitted information to the Bank of Lithuania that they had taken action and ensured compliance with the maximum exposure to a single borrower ratio; for others, the deadlines for ensuring compliance with this ratio have been set.

In view of the changes taking place in the credit unions sector and aiming to improve the credit unions' regulatory and supervisory environment, the working group set up in the Bank of Lithuania has prepared a summary document (regarding a public consultation on the reform of the credit unions sector and further actions) in order to find measures that would help develop, together with financial market participants, a suitable system of credit unions operating on a cooperative basis.

The Seimas of the Republic of Lithuania, on 17 July 2014, adopted amendments to the Law on Credit Unions, which are aimed to ensure greater stability and soundness of credit union operations: credit unions will have to enhance their capital base and improve the management of their risk assumed. It is expected that the licensing procedure simplified by these amendments, the reinforced new ways of strengthening capital, the possibility to provide some financial services not only to members, and eased information disclosure requirements will help credit unions to earn more income, strengthen their capital, reduce operating risks, and will encourage sustainable development of credit unions.

By resolution of the Board of the Seimas of the RL, a working group was set up on 16 May 2014 to draft a Sustainable Concept of Credit Unions. The working group, which includes representatives of the Seimas of the RL, Ministry of Finance of the RL, Bank of Lithuania, associations uniting credit unions and their members, LCCU and credit unions, was assigned with drafting the concept by 24 September 2014 and submitting it to the Budget and Finance Committee for discussing.

The Lithuanian Central Credit Union. As of 1 July 2014, the LCCU united 63 credit unions.

Following a decrease of LTL 59 million in Q2 2014, as of 1 July 2014 the assets of the LCCU amounted to LTL 315.6 million. The main reason for the decrease in the assets was an almost one-fifth decline (to LTL 225.5 million) in credit union deposits, which continued to be the main source of financing of LCCU assets (71% of LCCU assets are financed with them). The largest share of the LCCU's assets (58%) consisted of investments in Republic of Lithuania GS (doesn't have GS of other countries), which declined in the reporting quarter and, as of 1 July 2014, amounted to LTL 182.3 million. While, in the aforementioned period, the LCCU's funds with banks grew by 27.1 per cent (to LTL 6.2 million), they continued to account for an insignificant asset share.

The LCCU's loan portfolio expanded by 23.7 per cent and, as of 1 July 2014, amounted to LTL 88.7 million. The loans granted to credit unions by the LCCU amounted to LTL 81 million (the subordinated loans granted to credit unions accounted for almost 34% of the LCCU's loan portfolio). The LCCU continued to grant loans to members of credit unions — on the reporting date, they have been granted LTL 7.7 million (8.7% of the loan portfolio). Loans to credit union members are mainly granted when credit unions are unable to grant a loan of the size required by a member without not complying with the maximum exposure to a single borrower ratio. The entire contribution of shares necessary for being issued a loan is transferred to a credit union participating in syndicating the loan, thereby enhancing the credit union's capital base. It should be noted that the LCCU, in accordance with the procedure approved by the Board of the LCCU, conducts the assessment of the standing of credit union debtors who have applied to credit unions (LCCU members) for loans higher than LTL 300,000. According to the LCCU’s submitted information, in Q2 2014 the standing of 55 debtors was assessed, of which the applications for a loan of 1 legal person and 1 natural person have not been approved on account of the great risk falling on the credit union, while the applications of 13 debtors for a loan have only been approved on condition that they would comply with certain additional requirements.

According to the submitted reports, as of 1 July 2014, the loan portfolio quality was good: no specific provisions for loans were formed; there were no loans with regular payments overdue for more than 60 days either. Under the agreement signed between the LCCU, together with 57 credit unions, and 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 37.1 million in loans from the Entrepreneurship Promotion Fund for financing small businesses.

The LCCU’s liquidity maintenance reserve contracted by LTL 2.7 million — to LTL 14.5 million in Q2 2014.`**The stabilisation fund, even after granting support to one credit union, boosted to LTL 4.9 million in the aforementioned period, continuing to be insufficient for addressing any greater solvency issues of credit unions though. It should be noted that, holding the fund of this size, the LCCU can only provide aid to single credit unions; therefore, in order to carry out its statutory function — to maintain the solvency of its members — should look for measures and ways to strengthen the stabilisation fund.**

The share capital of the LCCU, after the repayment to the Government of the Republic of Lithuania of LTL 0.6 million of its acquired contribution of shares, contracted by 2 per cent in the reporting period and, as of 1 July 2014, amounted to LTL 31 million.

The LCCU’s operating result for the first half of 2014 is LTL 1.3 million of profit, with the greatest contribution to it having stemmed from the interest income received from investment in government securities (in the same period in 2013, the profit earned amounted to LTL 1 million).

The LCCU continued to comply with the liquidity ratio holding a rather significant reserve. The LCCU's capital adequacy ratio also was well above the established minimum (8%), at 34 per cent as of 1 April 2014*.

*Due to the deferred time limits for the submission of the report, the capital adequacy ratio is presented as at 1 April 2014.