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 April 2014, 75 credit unions operated in Lithuania, with total membership of over 144.4 thousand. The membership of the Lithuanian Central Credit Union (LCCU) included 62 credit unions, 12 were not members.

Following the revocation by the Board of the Bank of Lithuania of the operating licence of Vilniaus *taupomoji kasa* credit union on 17 January 2014, the number of credit unions in the reporting period declined to that on 1 April 2013. The Board of the Bank of Lithuania on 30 April 2014 revoked the operating licence of *Naftininkų investicijos* credit union, therefore membership of credit unions decreased still more.

By decisions of the general members' meetings that took place in Q1 2014, all credit unions the operations of which in 2013 were profitable (49) have strengthened their capital base with profits earned, while part of the 26 credit unions that operated at a loss covered their loss with accumulated reserves or reserve capital. It should be noted that for some credit unions that have operated for a number of years at a loss the volume of uncovered loss has become significant; however, the shareholders of none of them have adopted the decision to cover the loss with additional member share contributions.

After declining by 8 per cent in Q1 2014 and 2.8 per cent compared to the data as of 1 April 2013, the assets of credit unions stood below LTL 2 billion and on 1 April 2014 accounted for 2.5 per cent of the assets of the system of operating banks (2.6% a year ago).

Dynamics of some performance indicators of the system of credit unions

Seq. No.	Indicator	Amount 01-04-2013, LTL million	Amount 01-01-2014, LTL million	Amount 01-04-2014, LTL million	Change Q1 2014, %	Change over a year, %
1.	**Assets**	**2,029.6**	**2,144.2**	**1,972.1**	**–8.0**	**–2.8**
2.	Funds with banks	48.6	30.4	23.2	–23.8	–52.4
3.	Funds with the LCCU	339.9	292.2	290.0	–0.8	–14.7
4.	Government securities (GS)	456.5	646.1	677.7	4.9	48.5
5.	**Loans granted**	**1,050.4**	**1,027.6**	**876.4**	**–14.7**	**–16.6**
6.	Specific provisions for loans	32.1	63.0	33.7	–46.5	5.0
7.	Ratio of specific provisions for loans to loans (%)	3.0	5.8	3.7	–	–
8.	Debt to the LCCU	54.3	62.6	64.8	3.8	19.3
9.	**Deposits**	**1,767.8**	**1,868.1**	**1, 717.5**	**–8.1**	**–2.8**
9.1.	Of members and associated members of credit unions	1,756.8	1,855.8	1,707.7	–8.0	–2.8
10.	**Share capital**	**208.0**	**208.7**	**173.3**	**–17.0**	**–16.7**
11.	Profit (loss) for current year	–11.8	–39.4	–0.1	–	–

The change in the composition of credit union assets was insubstantial both in the reporting quarter and over the year. They continued to increase investment in government securities (GS). After rising to LTL 677.7 million in the reporting period, as of 1 April 2014 these investments accounted for 34.4 per cent of credit union assets. As was previously the case, the bulk of them (61%) consisted of the Republic of Lithuania GS portfolio. Investment in European Union Member State and European Economic Area GS (LTL 263.5 million) accounted for 39 per cent of the GS portfolio. As credit unions kept increasing their investment in GS, the holdings of funds with banks and the LCCU decreased and accounted for 15.9 per cent of the credit unions' total assets at the end of the reporting quarter. It should be noted that investment in GS should not become the credit unions' major activity, as long-term GS (the credit unions' largest acquisition) are highly sensitive to interest rate changes. The high sensitivity of the held portfolio to interest rate changes could lead to substantial losses, if credit unions were to sell securities due to market interest rate increases.

On the reporting date, cash in credit unions' cash registers (LTL 14.7 million) accounted for a small asset share (0.7%); however, after analysing the reports submitted by individual credit unions, once can see that the asset cash share of some of them is much higher than the average of the entire system (of nineteen credit unions — 1–3%, of three of them — 6–7%, of one — above 15%). It should also be noted that large cash balances in the credit unions' cash registers have a negative impact on the credit unions' profitability and threaten both the security of the money and the security and credibility of credit union activities. Moreover, the recently conducted target inspections revealed that not all of the credit unions manage their cash responsibly. Due to the shortage of cash in the cash registers of some credit unions, pre-trial investigations have been initiated against them.

Loans granted to members represented the largest share (44.4%) of credit union assets. The loan portfolio decreased by 14.7 per cent in Q1 2014 and amounted to LTL 876.4 million on 1 April 2014. The decrease in the loan portfolio is related to the termination of activities of *Vilniaus taupomoji kasa* credit union and formation of specific provisions for loans.

The aforementioned factors and the application of a tighter capital adequacy ratio had an impact on a decrease in loans to legal persons. These loans decreased by LTL 90 million in Q1 2014 and amounted to LTL 207.8 million on 1 April 2014 (their loan portfolio share contracted from 30 to 24% over a year). A considerable share of business loans continues to go to credit unions in operation in Vilnius area.

Following the withdrawal from the credit union market of the bankrupt *Vilniaus taikomoji kasa* credit union, the ratio of specific provisions against loans to loans decreased in the reporting period and as of 1 April 2014 was 3.7 cent, while the share of non-performing loans in the loan portfolio continued to expand (increasing from 22.2 to 27.1%). The increase in this ratio is likely to be related to loan portfolio quality assessment according to the requirements of the Regulations for the Assessment of Credit Union Loans that came into effect in January 2014. However, the inspections carried out show that not all credit unions conservatively assess their loan portfolios and form adequate specific provisions, thus the loan portfolio quality may actually be poorer. The Regulations for the Internal Control and Assessment (Management) of the Risk of Credit Unions that came into effect in May 2014, setting forth more detailed procedures and requirements adapted to the specific activities of credit unions, should help credit unions identify not only credit risk, but also other risks inherent in their activities, and manage them more efficiently.

Credit unions reduced their deposit rates in the reporting period. According to the submitted reports, the 1.5–2 per cent rate on the most popular accepted deposits, i.e. deposits 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 and the withdrawal of the largest credit union from the market had an impact on the decline in deposits with credit unions. According to the submitted reports, in Q1 2014 the deposit portfolio contracted by 8.1 per cent and stood at LTL 1.7 billion on the reporting date. The deposits of natural persons accounted for the largest share of deposits (97%).

The share capital of credit unions contracted by 17 per cent in the reference period and, as of 1 April 2014, amounted to LTL 173.3 million. The changes in share capital were driven by the decreasing membership of credit unions, but major contribution to the decrease in share capital stemmed from the shrinkage of the loan portfolio , in repaying a loan or part of it, these share contributions in most cases are repaid. This supports the statement that the share capital accumulated from contributions of shares through granting loans is unstable.

In Q1 2014, the profits earned by 34 credit unions amounted to LTL 7.9 million; however 41 credit unions operated at a loss and incurred losses amounting to LTL 8 million. They accounted for the loss-incurring operations of the system of credit unions — the losses incurred totalled LTL 0.1 million (in the same period in 2013, the losses amounted to LTL 11.8 million). The greatest losses (LTL 3.2 million) due to loan impairment were incurred by Panevėžys credit union. Loan impairment was the main reason behind the loss-incurring activities of most credit unions; however, the expenses to third countries for their services (consultancy, financial intermediation, legal services, advertising) accounted for a relatively large portion of some of the credit unions. After analysing the financial statements of the credit unions and their submitted information about the services they purchase one can see that, in many cases, the efficiency of the services purchased is doubtful, while their purchasing-related expenditure — economically ungrounded. Such expenditure, which does not yield economic benefit, worsens the credit unions' performance and weakens their capital.

According to the data of submitted reports, as of 1 April 2014 the liquidity ratio of the system of credit unions was 67.84 per cent. All credit unions held liquid reserve assets sufficient to cover the net outflow of cash (high quality liquid assets amounted to LTL 458.4 million, while the net outflow of cash stood at LTL 13.8 million). The capital adequacy ratio of credit unions stood at 21.14 per cent. While credit unions have been further modifying their operations so as to comply with the tightened prudential requirements, five credit unions failed in doing so — on the reporting date, the capital adequacy ratio of two credit unions was below the requirement, four credit unions did not comply with the maximum exposure for one borrower requirement (*Naftininkų investicijos* credit union, whose licence has been revoked, did not comply with the two aforementioned prudential requirements, and as of 30 April 2014 — all of them, except for the liquidity requirement). One credit union in April 2014 submitted information to the Bank of Lithuania that it had taken action and ensured compliance with the maximum exposure for one borrower requirement; for others, the deadlines for ensuring compliance with this requirement have been set. To credit unions that have not ensured compliance with prudential requirements, the enforcement measures established in the Law on Credit Unions can be applied. 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 requirements is published on the website of the Bank of Lithuania. In addition, credit unions, following the decision of the Board of the Bank of Lithuania, published the sets of financial statements for 2013, verified by revision commissions (reviser) or external audit companies as well as the findings of the revision commissions (reviser) or external audit companies on their websites or on those of the associations they belong to.

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 and submitted for public discussion a document which addresses the surfacing issues within the credit unions sector and submits proposals on the sector' strengthening both on the level of individual credit unions and the system as a whole, in order to find the best solution. Together with financial market participants, it is expected to find measures that would help creating an adequate system of credit unions functioning on a cooperative basis.

Amendment to the Law on Credit Unions have currently been discussed at the Seimas of the Republic of Lithuania, the adoption of which would not only strengthen the capital base and improve the management of the risk assumed, but would simplify the credit union licensing procedure, ease the information disclosure requirements, and the administration burden falling on credit unions at the same time. Moreover, the adoption of the amendments to the Law would create a possibility to generate more income by providing some financial services such as money transfer or cash exchange not only to own members.

The Lithuanian Central Credit Union As of 1 April 2014, the LCCU united 62 credit unions.

Following an increase of LTL 8 million in Q1 2014, as of 1 April 2014 the assets of the LCCU amounted to LTL 374.6 million. The main reason for asset growth — an increase of 2.7 per cent (up to LTL 282.5 million) in credit union deposits, which continued to be the main source of financing of LCCU assets (75% of LCCU assets are financed with them). The largest share of the LCCU's assets (69%) consisted of investments in the Republic of Lithuania's GS (doesn't have GS of other countries), which, as of 1 April 2014, amounted to LTL 259.8 million. While, since the beginning of the year, the LCCU's funds with banks have grown by 35.5 per cent (to LTL 2.8 million), they continued to account for an insignificant asset share.

The LCCU's loan portfolio expanded by 5.9 per cent and as of 1 April 2014 amounted to almost LTL 72 million. The loans granted to credit unions by the LCCU amounted to LTL 64.5 million (the subordinated loans granted to credit unions accounted for almost 45% of the LCCU's loan portfolio). The LCCU continued to grant loans to credit union members — on the reporting date, they have been granted LTL 7.2 million (11% of the loan portfolio). These were loans syndicated with credit unions, obtaining which requires share contributions to be paid to a respective credit union, thereby strengthening its capital bases. 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 Q1 2014 the standing of 35 debtors was assessed, of which the application for a loan of 1 legal person has not been approved on account of the great risk falling on the credit union.

According to the reports submitted, as of 1 April 2014 the quality of the loan portfolio was good: no specific provisions for loans were formed; there were no loans with their 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 (formed from contributions of LCCUL members) increased by LTL 0.6 million — to LTL 17.2 million in Q1 2014. The stabilisation fund, after support to one credit union, contracted to LTL 3.5 million in the aforementioned period. It should be noted that, holding the fund of this size, the LCCU can only provide aid to single credit unions, but is not in a position to address the solvency issues of larger credit unions. The LCCU, in seeking to ensure the execution of the function provided to it in the Law — maintain the solvency of its members, should look for methods and means to strengthen the stabilisation fund.

The share capital of LCCU, after the repayment to the Government of the Republic of Lithuania of LTL 0.6 million of its acquired share contribution, contracted by 1.8 per cent in the reporting period and as of 1 April 2014 amounted to LTL 31.7 million.

The LCCU's operating result for Q1 is a profit of LTL 244 thousand; the greatest contribution to it stemmed from the interest income received from investment in government securities (in the same period in 2013, the profits earned amounted to LTL 598 thousand).

The LCCU continued to comply with the liquidity ratio holding a significant reserve.