

LEGISLATION AND STRUCTURE OF LITHUANIAN CREDIT UNIONS SYSTEM

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ABSTRACT

The Law on Credit Unions was passed by the Parliament of Lithuania in the beginning of 1995 at the very start of the credit unions' movement. The first credit union was established at the end of 1995. Today the Lithuanian credit unions' movement has more than 107.000 members with accumulated savings of EUR 236,8 million and more than EUR 179 million of disbursed loans. These impressive growth results of credit unions in Lithuania would have not be possible without a favourable legal environment.

The structure of Lithuanian credit unions' system closely reflects Desjardins credit unions model (Quebec), because credit unions started their activities in 1994 with a financial support of Canadian International Development Agency, other donors and a strong know-how support of Desjardins credit unions' movement. Therefore initially the laws regulating credit unions activity in Lithuania, were drafted according to the practice of Desjardins credit unions. Only later, when Lithuania was preparing to join the European Union, laws were harmonised with the EU legal environment accordingly.

Over 15 years from the first piece of legislation on Credit Unions, several significant changes occurred in its legal environment. The first important amendments were passed in 2000, when a package of 4 laws was passed in the Parliament: amendments to the Law on Credit Unions, the Law on Deposits' Insurance and the Law on Legal Persons' Profit Tax and a new Law on Central Credit Union. The main function of the Central Credit Union is to ensure the liquidity of credit unions and to restore the impaired solvency of credit unions. A two-tier credit unions' system in Lithuania was established in 2002 when the Lithuanian Central Credit Union was licensed by the Central Bank of Lithuania. The other important achievement of Lithuanian credit unions was an exemption from EU credit institutions directive Nb. 2000/12/EB (2000) regarding the minimum capital requirement, which was agreed before entering the European Union. The third significant amendment of legal environment was made in 2008, when a new version of Law on Credit Unions was passed in order to harmonise it with the Civil Code, a Law on Financial Institutions and other laws.

The purpose of the paper is to analyse the structure of credit unions' system in Lithuania and to evaluate the attitudes of credit unions' leaders in regards to legal environment of credit unions in Lithuania.

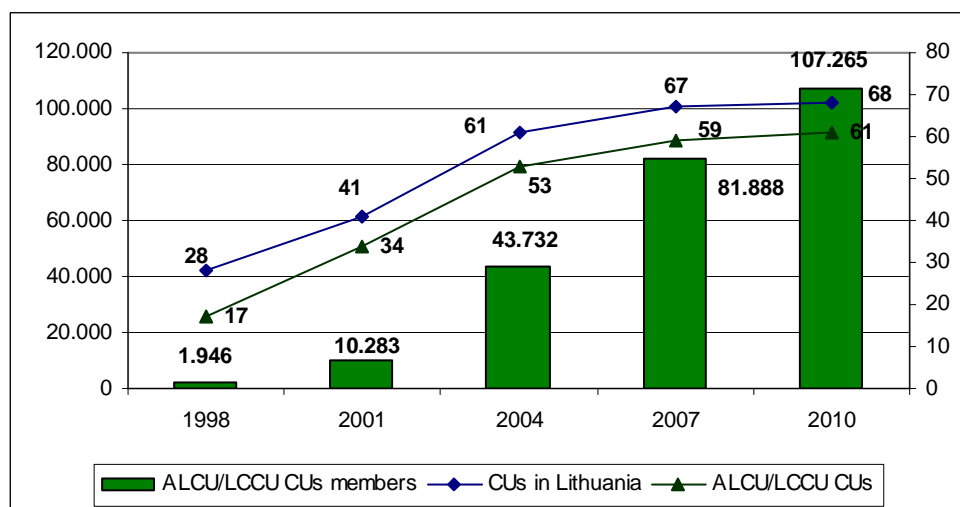
Key words: credit unions, Lithuanian Central Credit Union, legislation, structure

1. Structure of Lithuanian credit unions' network

The movement of credit unions in Lithuania started in 1995. Over 15 years this movement has developed and grown from scratch to a complex structure of financial cooperatives. Today the Lithuanian credit unions network has more than 107.000 members with accumulated savings of more than EUR 236,8 million and more than EUR 179 million of disbursed loans.

In the Chart 1 we can see credit unions and their membership growth from 1998 until the mid of 2010. As of 1st of July there were 68 credit unions operating in Lithuania and out of them 61 credit unions were members of the Lithuanian Central Credit Union and the Association of Lithuanian Credit Unions.

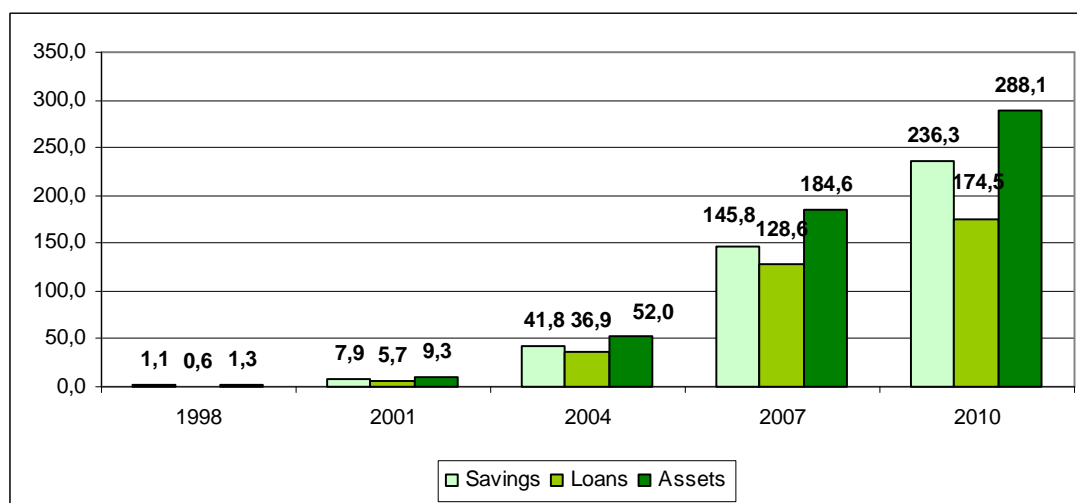
Chart 1. Credit unions and their members in Lithuania, 1998-2010



Source: Central Bank of Lithuania, LCCU, 2010

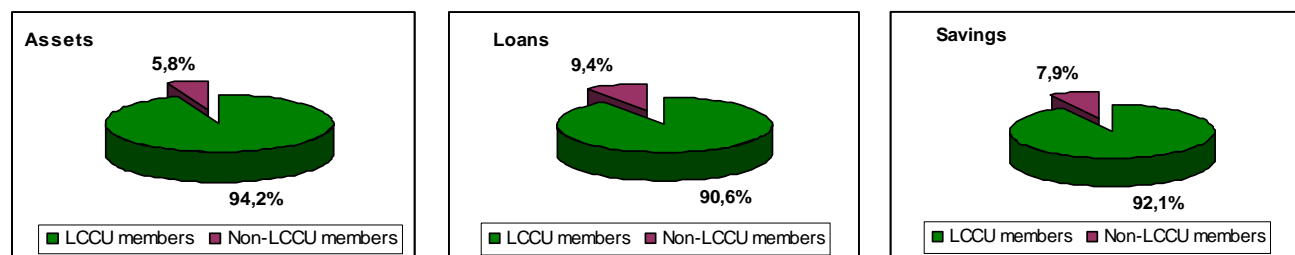
The Chart 1 demonstrates that the number of credit unions was growing fast until 2004. After 2004 the growth of new credit unions slowed down, but assets, savings and loans are still growing.

Chart 2. Assets, savings and loans growth of CUs belonging to LCCU/ ALCU network, 1998-2010



Source: LCCU, 2010

Chart 3. Assets, savings and loans' share of CUs belonging to LCCU/ALCU and non-members, 1st of July, 2010



Source: Central Bank of Lithuania, LCCU, 2010

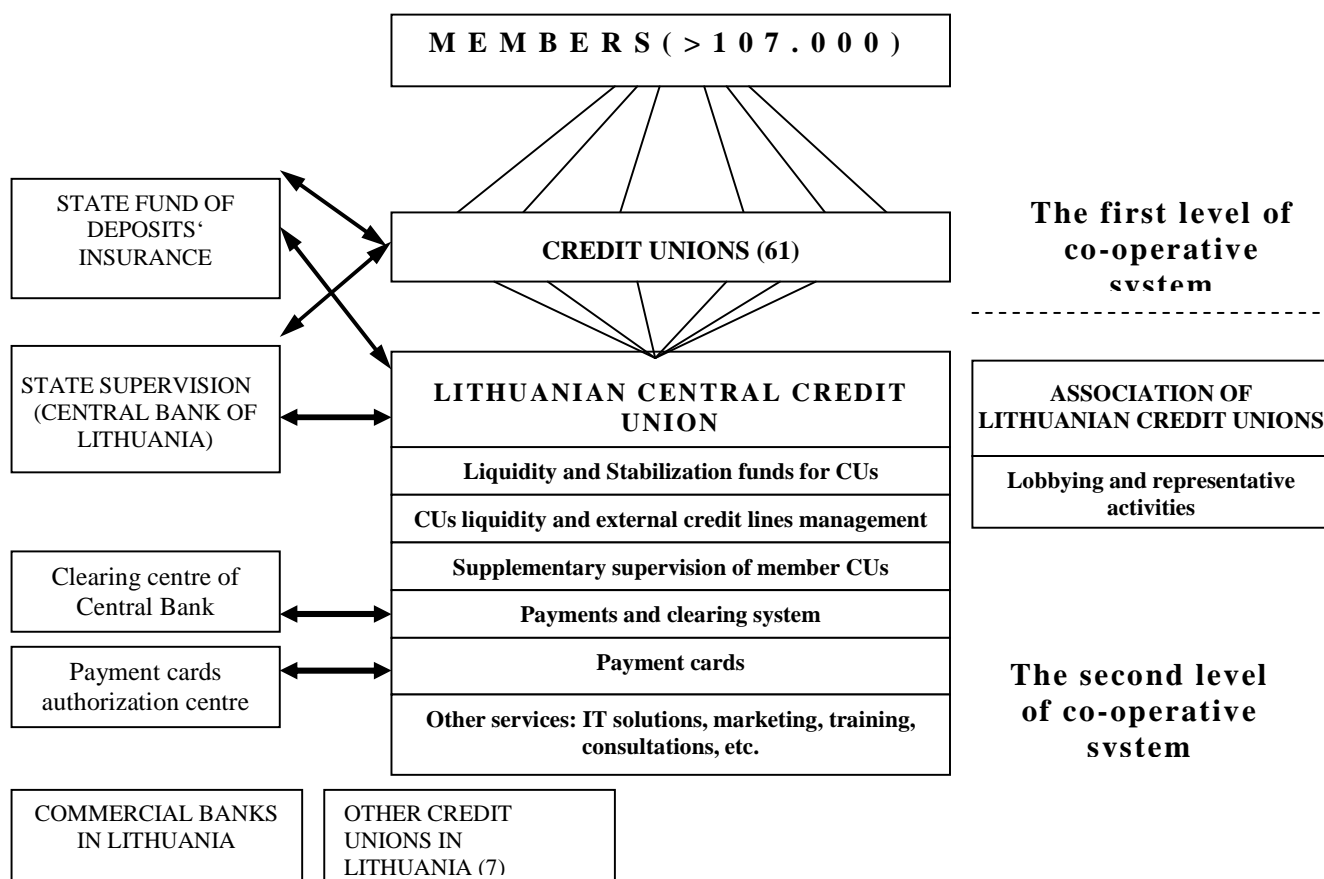
The Chart 3 shows the share of credit unions belonging to LCCU and ALCU and non-member credit unions as of July 1, 2010. Non-member credit unions own only 5,8% of the total credit unions' assets in Lithuania, 7,9 % of accumulated savings and 9,4% of disbursed loans.

The start-up credit unions in Lithuania were established in 1994 by foreign donors: Canadian International Development Agency (CIDA) and USAID. As a result of two independent donors two separate projects were running at the same time: Développement International Desjardins (DID) and World Council of Credit Unions (WOCCU). After several years of activity it became clear to leaders of Lithuanian credit unions, that a dependency on grants is not sustainable. DID project was extended twice in 1997 and 2000 but on a condition that credit unions will create a consultancy in Lithuania, which will be fully maintained by credit unions. Mainly due to this reason the Association of Lithuanian credit unions (ALCU) was founded in 1997 on the premises of DID project and it started to collect small fees from credit unions. These small contributions at the very beginning helped credit unions to get used to the idea that the consultancy needed to be financed with their own funds and only a self-sustainable movement had chances of surviving in a long term.

Until the establishment of the Central Credit Union in Lithuania, ALCU in parallel with DID project provided all necessary services to credit unions – marketing, training, IT solutions, assistance with licensing, consultations, lobbying, credit lines and credit unions' liquidity management, monitoring. The second association of credit unions, which were established by WOCCU, was created in 1997. But this association ceased its activities when the financing from USAID stopped.

After several years of ALCU activity it was decided that financial services should be provided by a separate centralized financial facility. Consultations regarding the establishment of a central financial facility in Lithuania started in 1999. A model of the Central Credit Union (central financial facility) was created in line with the existing model of a two-tier Desjardins credit unions system in Quebec (Canada) with some exceptions relevant to Lithuanian legal environment. A separate law for the Central Credit Union was passed on the 18th of May 2000. Lithuanian Central Credit Union was established by 28 credit unions and the Government of Lithuania in 2001 and licensed by the Central Bank of Lithuania at the end of 2002.

Chart 4. Structure of credit unions network in Lithuania



Source: LCCU data, 2010

The structure of credit unions network in Lithuania is presented in the Chart 4. Credit unions and their members constitute the first level of credit unions' system in Lithuania. According to the banking legislation in Lithuania only credit unions and commercial banks have status of a credit institution and are allowed to accept deposits from the public. Credit unions together with commercial banks are included in a state deposits insurance system and supervised by the Central Bank of Lithuania. On the second level of co-operative system two organisations are established: the Lithuanian Central Credit Union and the Association of Lithuanian Credit Unions.

The Lithuanian Central Credit Union is a co-operative member-based financial institution, which provides all necessary services to credit unions. LCCU main functions are as follows:

- To ensure liquidity of credit unions. In order to fulfil this function the Liquidity Reserve from credit unions deposits is established (credit unions shall hold 1,2 % of their deposits in this reserve). The amount of the Liquidity Reserve was LTL 8,18 million (EUR 2,37 million) as of 1 July, 2010.
- To restore impaired solvency of credit unions. The Stabilization Fund was established in order to maintain the financial stability of credit unions (credit unions pay annual fee of 1,5 % from their deposits). The amount of the Stabilization Fund was LTL 5,55 million (EUR 1,6 million) as of 1 July, 2010.
- To carry out additional supervision of its member credit unions.

- To provide financial services (deposits, loans, current accounts, etc.) to member - credit unions
- To provide payment services. Through the Central Credit Union credit unions are connected to Payment and clearing centre of the Central Bank and Payment cards authorization centre.
- To fulfil other functions that are necessary for credit unions (IT systems, marketing, training, consultations, etc.).

The Association of Lithuanian Credit Unions acts as a lobbyist and representative for credit unions and together with the LCCU works to ensure consistent and fair public image of its members. Nevertheless the development of credit unions system was influenced not only by the efforts of credit unions managers and elected officers, but also by favourable legal environment which is going to be discussed further.

2. Legal environment of credit unions in Lithuania

The first Law on Credit Unions was passed in 1995. The law stipulated that credit unions – co-operative credit institutions could be founded by at least 50 real members that shall be connected by membership criteria. Membership could be based on the following features:

- Employment in the same enterprise, institution;
- Belonging to the same professional group;
- Belonging to a certain formal registered association;
- Residing in the same location – a town or village.

Only natural persons could be accepted as members of a credit union. The minimum share capital requirement for credit unions was set LTL 15.000 (EUR 4.344). The minimum value of a single share for a member should be LTL 300 (EUR 87).

According to the law credit unions could:

- Receive term and demand deposits from its members, other credit unions, associations of credit unions, public organisations of the Republic of Lithuania, religious communities, institutions authorised by the Government of the Republic of Lithuania and/or local governments, and international charitable (sponsorship) foundations and/or such foundations of foreign states;
- Provide short-term and long-term loans to its members only for the purposes provided for in the bylaws;
- Lend money to other credit unions or associations of credit unions, or borrow money from other credit unions or associations of credit unions and shall invest liquid funds of the credit union into government securities.

In order to be allowed to carry out these activities, a credit union shall be licensed by the Central Bank of Lithuania, who was also obliged to supervise credit unions in Lithuania in much the same way it supervises commercial banks. Credit unions could deposit its liquid funds only in the banks that are registered in Lithuania and/ or in other states.

It was also prescribed by the law, that till 31 December 1997, credit unions shall be exempted from the profit tax of legal persons during the first two years of their operation, calculating from the moment of their registration. Since 1st January 1998 or if by that time two years will have elapsed from the date of the registration of the credit union, profit of the credit union shall be subject to the profit tax of legal persons, but the rate of it shall be reduced by 70 per cent.

Although credit unions could carry out their main functions – accept deposits and lend to their members, the legislation of credit unions still faced several serious shortcomings:

- Deposits of credit unions were not insured by state deposits’ insurance while the deposits in commercial banks were insured.
- Credit unions could not receive loans in case of impaired liquidity/ solvency (except from other credit unions or their association).
- Credit unions were lending to each other in the form of term deposits without any guaranties.
- Credit unions did not have access to payments and clearing system of the Central Bank.
- Minimum share for a single member was too high comparing to real incomes of the people in Lithuania at that time.
- Credit unions could not lend to small legal enterprises, which were established by members of the credit unions.
- Credit unions could include only one membership criteria in their by-laws.

Therefore amendments to the existing credit unions legislation were initiated by credit unions representatives with a help from Canadian experts. At a result of this initiative, a package of 4 laws was passed by the Parliament (Seimas of the Republic of Lithuania) in 2000: amendments to the Law on Credit Unions, the Law on Deposits’ Insurance and the Law on Legal Persons’ Profit Tax and a new Law on the Central Credit Union (see Table 1 for the main amendments).

Another important achievement of Lithuanian credit unions was an exemption from the EU directive on credit institutions Nb. 2000/12/EB (2000) for the minimum capital requirement, which was agreed before entering the European Union. Following negotiations with the European Union, the EU requirement for the minimum initial capital amounting to EUR 1 million was prescribed only to the Central Credit Union, excluding credit unions.

Nevertheless, Lithuanian credit unions could not form the initial capital of the Central Credit Union without a help of the Lithuanian Government. Therefore, a possibility to accept the Government as a member of Central Credit Union was prescribed in the law.

Participation scheme for the Government was set in the following way:

- The Government had to buy 1 main share and 5299 additional shares in the amount of LTL 1000. Total amount of the Government allocated means constituted LTL 5,3 million (EUR 1,53 million).
- Periodically credit unions should buy parts of the Government shares until the Government shares are fully repaid.
- Although the Government owned the largest part of the share capital, it did not have exclusive voting rights.

Table 1. Amendments to the credit unions’ legislation in 2000

Nb.	Name of the Law	The scope
1.	New version of the Law on Credit Unions	A share for a single natural member was reduced from LTL 300 to LTL 100. Share for a single legal person was set at LTL 1000. Possibility to accept small legal persons, that are established by members of the credit unions (up to 49 employees) was included.
2.	Amendments of the Law on Legal Persons Profit Tax Law	Exemption from the profit tax was extended. According to the amendment from 1 January 2000 until 1 January 2003 credit

		unions shall be exempted from the Profit Tax. Since 1 January 2003 the profit of the credit union shall be subject to the profit but the rate of which shall be reduced by 70 per cent.
3.	Amendments of the Law on Deposits Insurance	Credit unions were included in the state deposits insurance scheme. The annual rate of an insurance premium was set as follows: 1) 0,45 per cent for banks and branches of banks; 2) 0,2 per cent for credit unions.
4.	Law on the Central Credit Union	Central Credit Union is a credit institution organized on co-operative basis, established by credit unions of legal persons and the Government of the Republic of Lithuania or a body authorized by it, functioning as a co-operative society. The Central Credit Union shall function on the basis of share capital and discharge the functions of the supporting of liquidity and restoration of solvency of credit unions, accept deposits and other repayable funds, provide loans and assume the risk and responsibility related to it.

Since 1 July 2003 the Law on Financial Institutions came into power in Lithuania. This law has specified the services which are considered financial services, the requirements set for the founders, participants and heads of the financial undertakings and credit institutions engaged in the provision of financial services, the rights and duties thereof, conditions of, procedure for and peculiarities of the establishment, pursuit of business, procedure for and peculiarities of supervision of the activities of the financial institutions providing licensed financial services. The Financial Institutions Law was prepared in order to harmonise Lithuanian legal environment with the EU legal environment.

Since the law created new rules for credit institutions, the laws regulating credit unions and the Central Credit Union activity had to be adapted. Therefore new drafts of the Credit Unions Law and the Central Credit Union Law were prepared. The initial draft of the new Credit Unions Law which was prepared by Central Bank in 2004, was very restrictive and therefore was not passed by the Parliament of Lithuania. The main reason for postponing this draft law was an inadequate regulation of credit unions activity. Since credit unions were not a subject to the EU credit institutions' directive regulation, credit unions appealed to the Parliament members and the draft law was returned for more detailed preparation. Meanwhile the Lithuanian Central Credit Union fell under the EU regulation and the new version of the new Law on the Central Credit Union was passed by the Parliament of Lithuania. The new Law on the Central Credit Union came into effect on 1st May, 2004 (the first day of Lithuania's membership in the EU). This Law on the Central Credit Union established very strict qualification requirements for the managers of LCCU, more strict requirements for writing minutes of the board and other elected bodies meetings. The internal audit was also established.

After long discussions, a new Law on Credit Unions was prepared and the Parliament approved it this time. The new law came into effect on 1st January, 1999.

Its effects on credit unions' legal environment could be summed up by these main points:

- New membership conditions were created. Credit unions could be founded only on a territorial basis (original municipality and its neighbouring municipalities).
- A broader range of legal persons was allowed to be accepted as members of a credit union.
- Membership share was equalized for both natural and legal persons – LTL 100.

- New prudential requirements were set for lending – the size of the maximum loan could not be higher than 25 per cent of the credit union’s capital. This requirement is not applied until 1 January, 2013 for credit unions, which capital does not exceed LTL 2 millions.
- Strict conditions were set for the lending to the managers of a credit union.
- Qualification requirements were set to the managers of elected bodies.
- For the credit unions, which assets’ size exceeded LTL 10 million, a requirements to have both an external and internal audit were set.
- Three levels procedure for the establishment of a credit union was set. Establishment requirements were made stricter.

One more important amendment to credit unions regulation was made in 2008, when the exemption for the profit tax was abolished by the Parliament. This was influenced by the burdened economical conditions in Lithuania since 2008.

In addition, credit unions’ activity is regulated by the Civil Code, the law on Co-operative Entities, the Law on Payments. The draft Law on Consumer Credit is also being prepared and is planned to be passed this autumn’s Parliament session in 2010. During the past several years credit unions were mostly affected by the new Law on Credit Unions. According to the proposals of credit unions and their representative institutions (ALCU and LCCU) leaders, some amendments to the Law on Credit Unions have been suggested:

- To allow accepting public institutions owned by the State as associated members.
- To allow general manager of the credit union to become a member of the board of the Lithuanian Central Credit Union.
- To abolish a requirement for the 1/10 of share, when the loan is granted by the State or the European Union funds.
- Do not apply the regulation of maximum loan to loans, which were granted until the end of 2008 (when the new Law on Credit Unions came into force).
- To allow including other unredeemable means to the reserve capital of a credit union. This will ensure the possibility to add means from the Central Credit Union and the Stabilization Fund straight to the reserve capital and to ensure capital adequacy in this way.

In order to have a broader view of credit unions’ leaders attitudes to the current credit unions’ legal environment research was conducted.

3. Scope of the research and methodology

The purpose of the research is to evaluate the attitudes of credit unions’ leaders towards the legal environment of credit unions in Lithuania and to issue recommendations for the development of credit unions’ legislation in Lithuania.

In line with the research goals, a questionnaire to the managers of credit unions, which are members of the Lithuanian Central Credit Union (LCCU) and the Association of Lithuanian credit unions (ALCU), was prepared. The questionnaire was composed of 11 questions and delivered to 61 credit unions. Answers were received from 53 credit unions. Survey was conducted in July and August, 2010.

Credit unions were divided into 2 groups: small credit unions (asset size – up to 10 million LTL) and large credit unions (asset size – over 10 million LTL). This distinction was made in line with the new Law on Credit Unions, where different regulations are set for small and large credit unions.

Table 2. LCCU and ALCU member credit unions by assets size on July 1, 2010

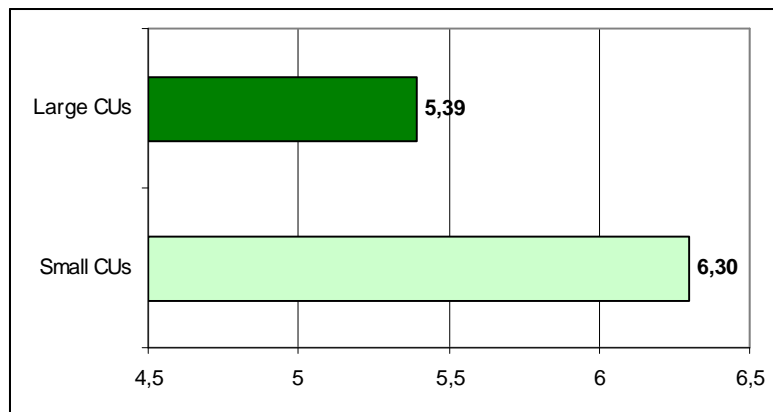
Group of credit unions	Size of credit union assets (LTL)	Number of CU managers, that participated in the survey	Number of filled questionnaires
Small credit unions	Assets <10 million	34	30
Large credit unions	Assets > 10 million	27	23

Source: LCCU data, 2010

4. The research findings: attitudes of Lithuanian credit unions’ managers about Lithuanian legal environment of credit unions

The Chart 5 reflects credit unions opinion on their legal environment in Lithuania. According to the results, small credit unions gave more favourable evaluation – 6,30 and large credit unions – 5,39 (out of 10 scores). In general credit unions’ evaluations were ranging from 3 till 10 scores.

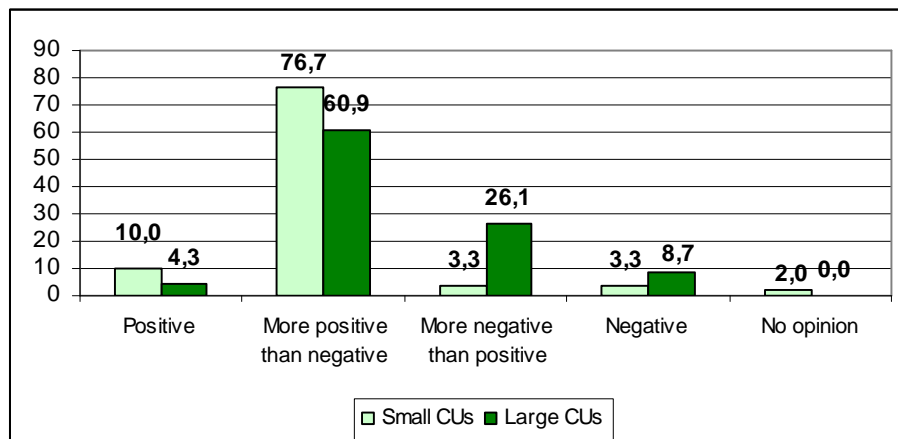
Chart 5. Evaluation of credit unions’ legal environment



Source: data of the survey, 2010

The Chart 6 reflects credit unions’ evaluation of the new Law on Credit Unions, which came into effect on 1 January, 2009. The opinion of large and small credit unions was very similar – most of leaders indicated that their opinion on this law was more positive than negative (76,7 % of small credit unions and 60,9 % of large credit unions).

Chart 6. Evaluation of the new Law on Credit Unions (effective since January 1st, 2009)

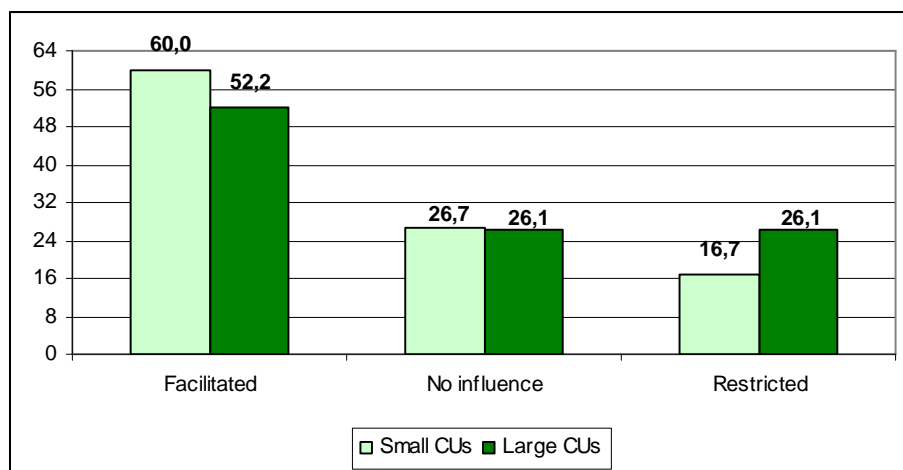


Source: data of the survey, 2010

The opinion on membership conditions according to the new law was very positive. 60,8 % of small credit unions and 52,2 % of large credit unions indicated that membership conditions were positively facilitated. The main reasons for the positive evaluation were the following: members can be accepted from the neighbouring municipalities, no additional membership criteria is required, a single share for the legal persons was reduced (from LTL 1000 till LTL 100), children of members may be accepted for limited services without a membership share.

16,7 % of small credit unions and 26,1 % of large credit unions indicated that membership conditions were restricted because members cannot be accepted from non-neighbouring municipalities.

Chart 7. Opinion about the membership conditions according the new Law on Credit Unions

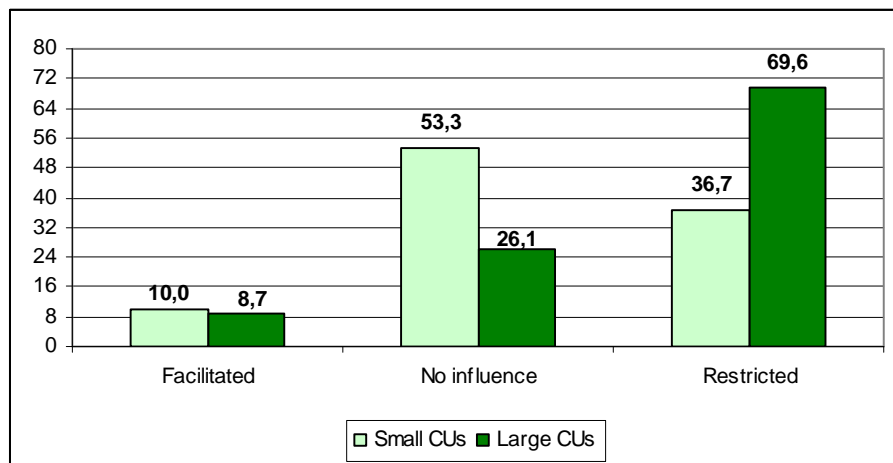


Source: data of the survey, 2010

Credit unions' leaders opinion about the lending conditions was more negative (see the Chart 8). 69,6 % of larger credit unions and 36,7 % of small credit unions said that lending conditions were restricted. Most of them indicated the maximum loan size requirement for members and managers as

the reason. Several credit unions indicated that lending conditions were facilitated, because procedures for small loans were not longer so complicated.

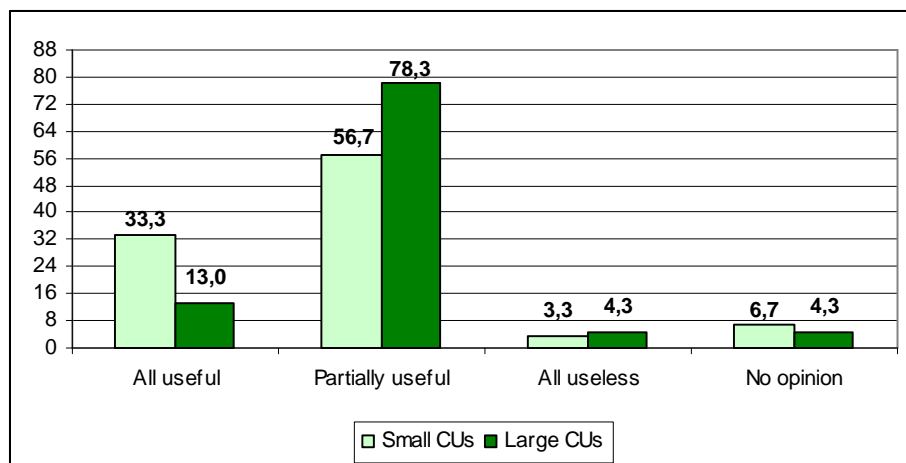
Chart 8. Opinion about the lending conditions according the new Law on Credit Unions



Source: data of the survey, 2010

Prudential requirements of credit unions were evaluated as partially useful by 56,7 % of small credit unions and 78,3 % of large credit unions (see the Chart 9). 33,3 % small and 13 % large credit unions indicated that all prudential requirements were useful to credit unions.

Chart 9. Opinion about prudential requirements according the new Law on Credit Unions

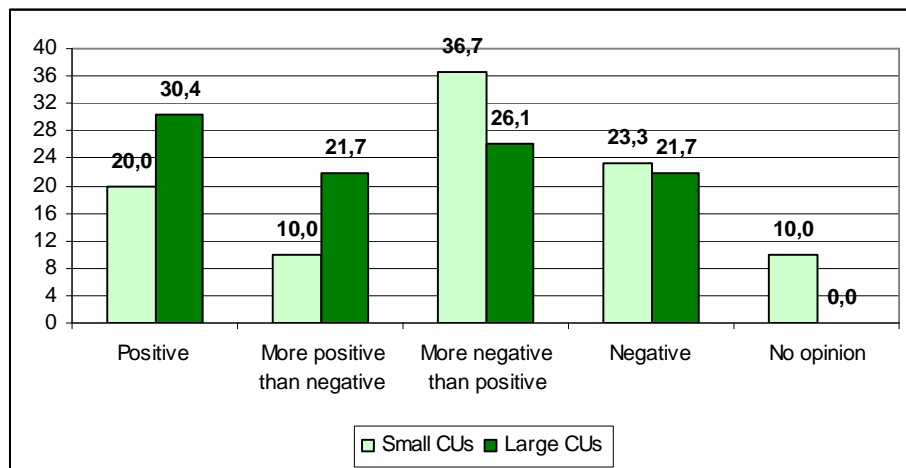


Source: data of the survey, 2010

Only part of the credit unions (20 % of small and 30,4 % of large credit unions) expressed positive opinion on about the requirement to have an independent audit of the financial statements. 10 % of small and 21,7 % of large credit unions had more positive than negative opinion about an independent audit (see the Chart 10).

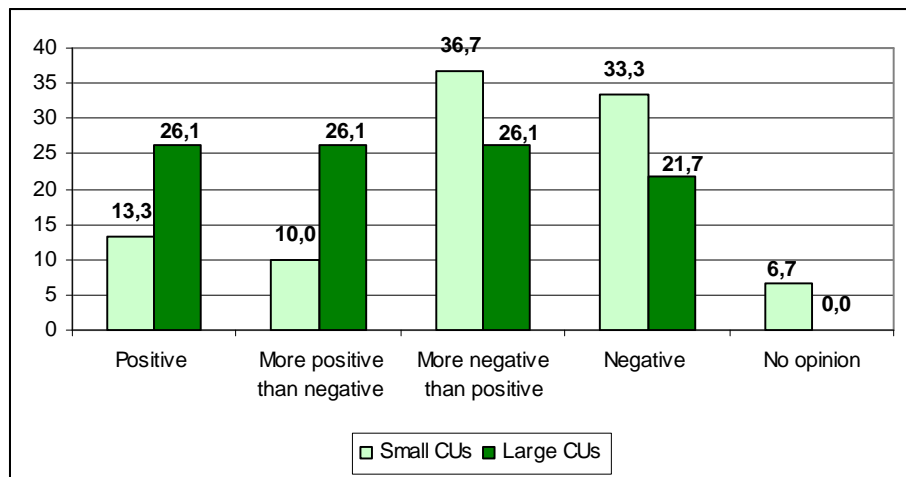
More small than large credit unions were negative about the requirement to have an internal audit. The negative opinion about the external and internal audit was mainly influenced by the costs of an audit, which is relatively expensive to small credit unions (see the Chart 11).

Chart 10. Opinion about the requirement to have independent audit, when CU assets exceeds 10 million LTL



Source: data of the survey, 2010

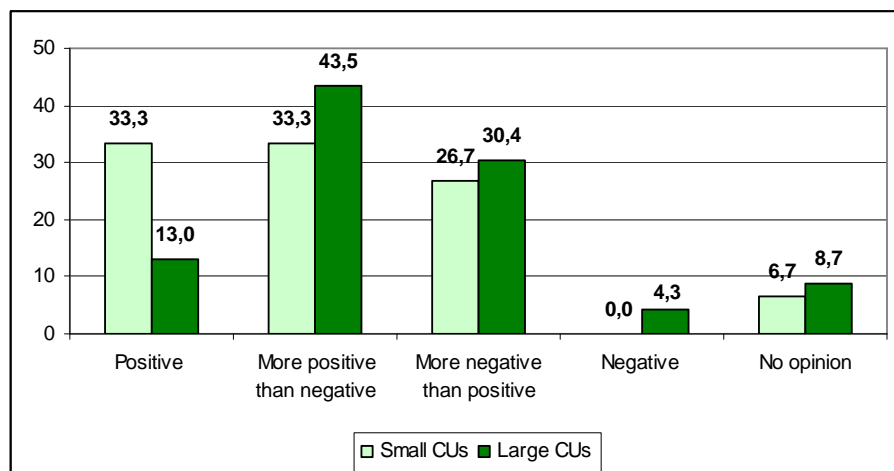
Chart 11. Opinion about the requirement to have internal audit, when CU assets exceeds 10 million LTL



Source: data of the survey, 2010

Opinion on the competence and powers of the Central Bank according to the Law on Credit Unions was mainly positive. Nevertheless 26,7 % of small and 30,4 % of large credit unions had more negative than positive opinion and 4,3 % of large credit unions had negative opinion (see the Chart 12).

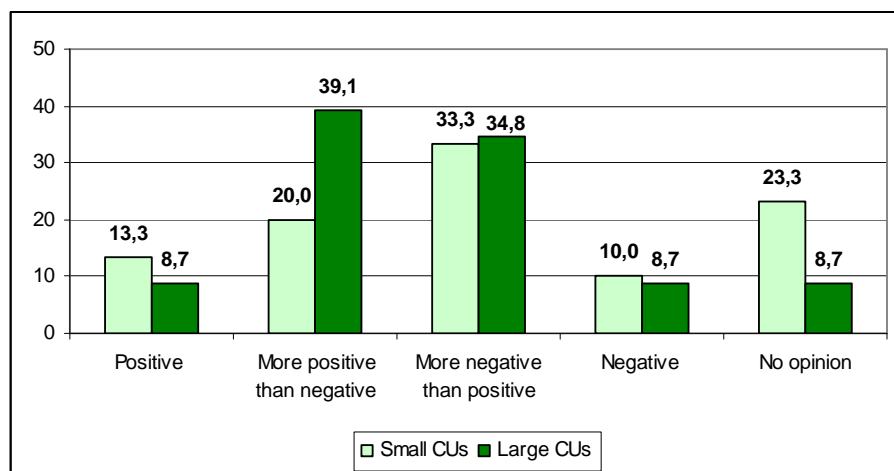
Chart 12. Opinion about the competence and powers of the Central Bank according the Law on Credit Unions



Source: data of the survey, 2010

Tax laws were evaluated positively by 33,3 % of small and 47,8 % of large credit unions. Mostly credit unions indicated that taxation for credit unions is no longer favourable because the exemption of the profit tax was abolished (see the Chart 13).

Chart 13. Evaluation of tax laws, which are applied to credit unions in Lithuania



Source: data of the survey, 2010

In total, 50 % of small credit unions and 73,9 % of large credit unions expressed the opinion that the Law on Credit Unions shall be amended. There were fewer leaders (30 % small CUs and 43,5 % large CUs) who suggested amending other laws, which regulate credit unions activity.

Conclusions:

1. The network of credit unions in Lithuania is structured as a two level co-operative system with credit unions and their members on the first level and the Lithuanian Central Credit Union and the Association of Lithuanian Credit Unions on the second level.
2. The development of credit unions system was influenced not only by the efforts of credit unions managers and elected officers, but also by a favourable legal environment. The main advantages of credit unions' legislation are as follows:
 - Status of a credit union as a credit institution, which allows accepting deposits from the public.
 - Credit unions' inclusion in the system of the State's deposit insurance.
 - Profit tax exemption that was applied to credit unions for more than 10 years.
 - Safety and stability instruments, established by the Law on Central Credit Union, dedicated to the maintenance of credit unions' liquidity and capital adequacy.
 - The Government's support to the establishment of the Lithuanian Central Credit Union: investment in the initial capital of LCCU (LTL 5,3 million) and donation to the Stabilization Fund (LTL 0,7 million).
 - Exemption from a minimum capital requirement from the EU directive on credit institutions.
3. Small credit unions evaluated credit unions' legal environment in Lithuania more positively than large credit unions. New Law on Credit Unions (effective since 1 January, 2009) in general was evaluated positively. According to the opinion of credit unions leaders, the biggest restriction by the new law was a requirement for the maximum size loan to be related to a credit unions capital.
4. Credit unions' taxation was evaluated positively by 33,3 % of small and 47,8 % of large credit unions. Other credit unions indicated that taxation of credit unions is no longer favourable because the exemption of the profit tax was abolished. Since credit unions face capital accumulation problems, an exemption of the profit tax shall be extended.

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