Working Paper

The Role of Credit Unions in dealing with financial exclusion in NMS

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1. Introduction

According to Microfinance Centre study, the predominant part of microfinance[1] institutions in Central and Eastern Europe and New Independent States, are credit unions[2]. They are dominant in Central and Eastern Europe - 5,338 institutions - the majority of which (4,304) are located in Romania[3] (Pytkowska, 2002).

Credit unions serve many poor people, but even middle income customers are also among the members. Mixed types of members allow them to provide financial services to the poor to a greater extend than specialized microfinance institutions (Cuevas, Fischer, 2006). In countries with high level of financially excluded population, like post-communist NMS, credit unions or other member-based institutions shall play important role in reducing financial exclusion. As we will present in this paper, in many cases they have not achieved to do that either due to their low share in the market or due to more commercialized approach towards financial services provision.

From the methodological point of view, one of the key issues is the strict classification of what is and what is not a credit union. Credit unions are not regulated by any European Directive, so there are no strict criteria of classification. On local level their names differ

[1] Although credit unions may be treated as microfinance institutions, not all microfinance institutions are credit unions.

[2] According to P. A. Jones (2001): "Credit unions are not-for-profit, financial co-operatives that offer low-cost financial services to their members. They are based on international co-operative and democratic principles which have remained essentially unchanged since the days of the co-operative pioneers of the nineteenth century. […] Since then, they have developed in two distinct but related directions. In most European countries, they became the European co-operative banks. These are now dominant consumer financial providers that serve the general public. In North America, a different model of financial co-operative enterprise took hold. Using, for the most part, the name "credit union", these member co-operatives have a much more local and autonomous structure than their European cousins. They are based on a strong notion of a common bond, understood as a relationship that defines a certain unity between the members. Membership of a credit union is, in fact, restricted to people who share the common bond. This is, determined, usually, as either living or working in a particular locality, being employed by a particular employer, following a particular occupation or being a member of an association or society. Credit unions, as known in Britain, Ireland and Eastern Europe, developed out this North American model."

[3] According to WOCCU only 11 credit unions were really operating (World Council of Credit Unions – 2005, 2006 Statistical Report).

across countries.[4] Thus we used the list of institutions provided in article 2 of 2006/48/EC Directive that are exempted to apply Basel II regulations. The general purpose of this article was not to apply Basel II to institutions with special functions, also to credit unions. According to that list, credit unions shall be recognized in Latvia, Lithuania and Poland.

Out of the countries covered *explicite* by the project (Bulgaria, Lithuania, Poland and Slovakia), credit unions operate in three of them (except Slovakia[5]), but – as we will explain below – in Bulgaria they have specific features and cannot be treated unquestionably as credit unions. In most of the rest of post-communist NMS, i.e. Czech Republic, Estonia, Hungary, Slovenia and Romania there are some kind of co-operative financial institutions (credit unions, credit co-operatives or savings and loans associations).

Credit unions in CEE countries grew till the beginning of the World War II. After WW II, during communists time, their lost the original features or were just liquidated. The re-born came with political and economic changes (Jedlinski, 2002). Some of those institutions turned to become open to non-member customers and cannot be treated as credit unions any longer.

Below, we present the role of credit unions as follows. Each chapter begins with general overview of situation in post-communist NMS, then we present situation in covered countries.

2. What is the share of credit unions in the banking market?

In most of CEE countries (except Poland, where credit unions have a larger market share in deposits and credits), credit unions have market share not exceeding 1%. Though it should be noticed, that their market share has been increasing over time. In most cases, credit unions perform in small local communities, where they serve the needs of local people. If we

[4] Under the term CFI (cooperative financial institutions) are understood institutions that bear different names but are essentially identical. The most common expressions used for CFI are: financial cooperative (FC) with it Spanish translation *cooperativa financiera*, savings and credit cooperative (SACCO) with its Spanish translation *cooperativa de ahorro y credito, CAC* or *COPAC*, and credit union (CU) with its Spanish translation *union de credito*. There are also the non-English expressions such as the French *caisse* with its variations—*agricole, populaire, mutuelle*—of which *populaire* is probably the most common, with its Spanish translation of *caja* or in Portuguese *caixa*. Under CFI there is also a number of institutions known as cooperative banks (CB). The expression cooperative bank is often used to represent a CFI that holds a banking license, but also a number of other very disparate structures, such as: the apex of a CFI network that holds a banking license (Germany, Colombia); a joint stock banking subsidiary of an apex of a CFI network (Brazil, Finland); a joint-stock bank subsidiary of an apex of a non-financial cooperative network (U.K., Switzerland); or an entire network of CFI, usually with a relatively high level of integration that holds a banking license (Netherlands' *Rabobank*). On the other hand, the expression caisse, *caja, caixa* is also often used to represent what in English is know as a "savings and loans association" (S&L) of mutual ownership, which are actually not cooperatives. These latter are not the subject of this paper.

[5] Using a single European passport three credit unions opened their branches in Slovakia: Rajka és Vidéke Takarékszovetkezet (in 2006, from Hungary), Komercní sporitelní a úverní družstvo DOMOV (2006, Czech Republic) and Fio (Czech Republic, 2007).

calculated credit unions market share in rural areas or in particular segments (e.g. small loans segment), their share would be significant.

In CEE countries credit unions shall be important for marginal groups, refused to serve by banks or living in rural areas, where people have limited access to financial services. Demand for such type of services continues to grow, along with the growth of the market share of credit unions.

Table 2: Market share and credit unions' members in Bulgaria in years 2001-2005

Bulgaria	**2001**	**2002**	**2003**	**2004**	**2005**
Market share by assets	0,25%	0,22%.	0,19 %	0,42%	0,36%
Market share by loans	n/a	n/a	0,21%	0,18 %	0,17%
Market share by deposits	n/a	n/a	n/a	n/a	n/a
Members	n/a	n/a	n/a	n/a	13000
Members as % of population	n/a	n/a	n/a	n/a	0,001%

Source: data available on www.bnb.bg, www.popbankbg.com and Schemes for crediting micro, small and mediumenterprises, Institute of Economic Policy, Sofia, 2007; own calculations.

Table 3: Market share and credit unions' members in Lithuania in years 2001-2005

Lithuania	**2001**	**2002**	**2003**	**2004**	**2005**
Market share by assets	0,22%	0,41%	0,55%	0,63%	0,66%
Market share by loans	0,29%	0,52%	0,65%	0,70%	0,67%
Market share by deposits	0,25%	0,47%	0,68%	0,80%	0,91%
Members	10758	21000	32000	45000	57000
Members as % of population	0,31%	1,00%	1,00%	1,00%	2,00%

Source: www.lb.lt, ECB Banking structures 2006, own preparation.

Table 4: Market share and credit unions' members in Latvia in years 2001-2005

Latvia	**2001**	**2002**	**2003**	**2004**	**2005**
Market share by assets	0,07%	0,09%	0,09%	0,08%	0,07%
Market share by loans	0,04%	0,06%	0,07%	0,07%	0,06%
Market share by deposits	0,04%	0,06%	0,07%	0,06%	0,07%
Members	n/a	n/a	n/a	n/a	n/a
Members as % of population	n/a	n/a	n/a	n/a	n/a

Source: www.fktk.lv, ECB Banking structures 2006, own preparation.

Table 5: Market share and credit unions' members in Poland in years 2001-2005[6]

Poland	**2001**	**2002**	**2003**	**2004**	**2005**
Market share by assets	0,37%	0,52%	0,68%	0,78%	0,96%
Market share by loans	0,59%	0,76%	0,94%	1,17%	1,30%
Market share by deposits	0,55%	0,82%	1,09%	1,31%	1,53%

[6] In Poland, except credit unions, co-operative banks are also operating with about 5% market share. There are treated like credit institutions and not analyzed here.

Members	525 055	703 012	924 153	1 168 697	1 394 784
Members as % of population	1,36%	1,83%	2,40%	3,03%	3,62%

Source: www.skok.pl and www.nbp.pl, own preparation.

In Bulgaria there are no exact credit unions, since they are not collecting deposits from their members (e.g. mutual kassas, popularna kassas, mostly focused on providing micro loans). They were not mentioned in article 2 of 2006/48/EC Directive, but some of them are co-operating with WOCCU (mostly Russe Popular Kassa) in order to re-built credit unions network[7]. This reason convinced us to include Bulgaria in the study. Below we used the notion credit organizations instead of credit unions just to underline the difference.

3. What is the regulatory structure?

The legal framework is one of the most important factors for the development of credit unions. Membership criteria, limitations for the size of the loan, types of collateral required to grant the loan, licensing requirements (if any), initial capital, initial membership – all those criteria are crucial for the development of credit unions. In some countries the risk of the credit unions is limited very strictly (e.g. in Lithuania credit unions have to meet liquidity and capital adequacy requirements, that are even higher than for the banking sector) and this is one of the factors that limits the development of credit unions, but in other countries (e.g. Poland) the regulations regarding their activity are more liberal than for the banking sector, what allows CUs for easier growth on the competitive market.

Table 6: Basic information on credit unions' regulation

Country	Re-born date	Bank status	How regulated ?	How supervised?	Other
Bulgaria	1992	No	Professional Unions Law from 1988 and the Law of the co-operatives from 1999 and 2006	They are not regulated by the BNB, and are not allowed to take deposits except from their members in the form of capital that can be re-loaned.	There is no law regarding the approval procedure from the BNB on depository and credit operations.
Latvia	1995	No	Credit union law, Effective as of 1 January 2002, other regulations by Financial and Capital Market Commission.	By Financial and Capital Market Commission, like banks and other financial institutions	-
Lithuania	1995	Credit institution status	Law on Credit Unions from 1995, amended in 2000.	By Central Bank of Lithuania, like banks	Profit tax reduced by 100 % for the first 3 years of activities, later – 75 % reduction. Participants in

[7] The World Council Bulgaria Project, initiated in 1999. Funded by the U.S. Agency for International Development (USAID), a three-year modernization program for credit unions has been conducted.

					deposit protection scheme, participant in State Loan Guarantee scheme.
Poland	1992/1996	No	Law on credit unions dated 14 Dec. 1995 Law on co-operatives dated 16 Sept. 1982	Self-supervision provided by the central credit union (Kasa Krajowa, KSKOK)	Income tax exemption; have own, independent deposit protection scheme

Source: own preparation

In Lithuania (from 2002) and Poland (from the beginning) credit unions are organized as a structure with central credit union[8], that is central institution coordinating operations of individual credit unions and fulfilling other assigned tasks. All credit unions are exempted from Capital Requirements Directive (2006/48/EC)[9], implementing Basel II, except Central credit union in Lithuania, which has also the requirement of share capital not less than 1 million EUR. In Latvia credit unions are united in the Association of Cooperative Credit Union of Latvia and in Bulgaria there is the Bulgarian Association of Cooperative Credit Organizations.

As mentioned above, central credit unions as bodies ensuring stability and liquidity of the network are typical for Poland and Lithuania. The Law passed in 1992 enables in Poland the National Association of Credit Unions (Kasa Krajowa, KSKOK) to provide services to credit unions by taking deposits from credit unions and granting credits to those credit unions, which face problems of greater demand for loans. In the same year stabilisation fund was set up. All the credit union structure was created from "top to ground". This principle of foundation of credit unions created a strong basis for future development of these institutions (Nowak, 2001). Central credit union in Poland was created to solve liquidity problems, when due to large withdrawals credit unions may face liquidity problems. Polish central credit union also ensures stability of the system (e.g. supervision department performs inspections of credit unions, grants recommendations for the application of special measures to credit unions which do not comply the risk mangement requirements).

Creation of Lithuanian Central Credit Union was one of the most important steps in development of credit unions in this country. The organisational model of Lithuanian Central Credit Union was taken from Canada Desjardins credit union movement, Rabobank cooperative banks systems in Netherlands and Kasa Krajowa in Poland. Lithuanian Central Credit Union is very important institution for achieving economies of scale and helping to survive on the market. Lithuanian Central Credit Union manages liquidity funds between the

[8] Central credit union may create preconditions for the widening of the range and scope of operations performed by credit unions and increase the public confidence in their activities as well.
[9] Directive 2006/48/EC did not mention institution analyzed as credit unions in case of Bulgaria.

credit unions, performs supplementary supervision of credit unions, manages stabilisation fund, provides marketing, training and other services essential for credit unions movement.

Bulgaria

Co-operative credit institutions in Bulgaria are regulated by a "Standard statute for the organization of the activities of the credit organizations at the Professional Unions" (from 1988) and by the Law for the co-operatives (from 1999 with further amendments). There is no specific law regarding credit unions.

Latvia

Latvian credit unions are regulated by law passed in March 29, 2001, though first credit unions were founded in 1995. Until approving this specific law credit unions were operating according to Law on credit institutions. By new law credit institutions status of credit unions was cancelled, though their activities remained the same. Credit unions are supervised by Financial and Capital Market Commission of Latvia.

Lithuania

First Law on Credit Unions was passed by Lithuanian Parliament at the February, 1995. After legislation on credit unions was passed, the first credit union in Lithuania opened its doors at the end of 1995. In 1997 eleven credit unions founded Association of Lithuanian Credit Unions. In 2000 several laws regulating credit unions activities were passed by the Lithuanian Parliament (Seimas): amended Law on Credit Unions, amended Deposit Insurance Law (possibilities for credit unions to take part in the Deposit Insurance System). In the same year Law on Central Credit Union, enabling the foundation of a new cooperative financial centre of Lithuanian credit unions, was passed. Starting from year 2001, deposits in all the credit unions are insured in state Deposits and Investments Insurance Company. The activities of Lithuanian credit unions are supervised by the Central Bank of Lithuania.

Poland

First credit union in Poland was set up in 1992. Also in 1992 the central credit union was founded. It was possible according to the Law on trade unions issued in May 1991, but this regulation was not adequate for safe and sound development of credit unions. They were not limited in providing even risky services to their members. In December 14, 1995 Polish Parliament (Sejm) approved new Law dedicated to credit unions (SKOK). Supplementary character has the Law on co-operatives approved in 1982, since credit unions are co-operatives. All credit unions operating in Poland are supervised by the central credit union (Kasa Krajowa) and not by banking supervision. Also deposit protection is provided by the central credit union with protection limit is 22.500 EUR with 100% coverage (no co-insurance).[10]

4. What consumer markets do they serve?

Credit unions in general serve only their members of the definite common bond, which may be defined as follows:

- territory principle - people who live, have property or undertake entrepreneurship on definite territory;
- employment principle - people who work with the same employer;
- common interest principle - people from the same professional group (farmers, students, doctors, etc.)
- principle of belonging to the same organization – people who are members of the same organization.

This rule is confirmed in legal acts regarding credit unions' in analyzed countries. Limitation of common bond helps to decrease risk of lending and increase safety of the small filfinancial co-operative. In general credit unions serve individuals (physical persons) and micro or/and small enterprises.

Bulgaria

The main consumer market is the small business and micro enterprises, handcraft market, agriculture. The share of the consumer market financed by micro-credits is around 3 % from all other forms of financial services. The members of the co-operative credit organizations are in general owners of micro and small firms. The main incentive for their participation is the limited access to bank credit.

Latvia

In order to increase lending resources of savings and credit unions, municipalities and non-government organizations can join their financial cooperatives. That makes links between people, municipality and uniting organizations of the same community stronger.

Savings and Credit Union Membership Survey[11], made by Association of Co-operative Credit Unions of Latvia and the biggest Latvian credit union - Railroad CU (March 2002), shows, that net income of one family member is for:

[10] In deposit protection scheme for banks the limit is also 22.500 EUR, but up to 1000 EUR there is a full coverage and from 1000 EUR to 22.500 EUR - 90% coverage.

- 64,1% credit union members - less than 100 lats [12];
- 27% credit union members - 100-200 lats;
- 3,9% credit union members - 200-300 lats;
- 1% credit union members - more than 300 lats;
- 4% credit union members - did not declare.

This survey shows, that 95% of people, who use credit union services, are really people with low income per family member.

Lithuania

Credit unions members are mostly individual persons (98%). Until the second amendment of the Law on Credit Unions legal persons have had no right to become credit union member. Now enterprises owned by credit union members can also join credit union. Credit unions serve only small and medium enterprises, which employ not more than 49 people.

Table 7: Structure of credit unions loan portfolio 2002-2005 (in litas???)

Purpose	2002		2003		2004		March 2005	
	Amount	% total	Amount	% total	Amount	% total	Amount	% total
Consumer loans	10223872	23%	21858861	26%	32701013	26%	35009924	27%
Mortgage loans	3437314	8%	10886938	13%	18220270	14%	20406710	16%
Small and medium business	15365696	35%	24635297	29%	29497121	23%	26077704	20%
Agriculture	7627784	17%	9475587	11%	17692950	14%	21388306	16%
Other	6955852	16%	17109966	20%	29184751	23%	28049967	21%

Source: Levišauskaite, Kaupelyte, Keršys (2005).

The structure of credit unions loan portfolio shows that loans granted to small and medium business make 20 % of total loan portfolio (for March, 2005). The extent of credit unions financing for agriculture has remained about the same (17 % in 2002 and 16 % in March, 2005). Credit unions in Lithuania grant business loans not only to enterprises, but also to individuals, who run their own business. This form of financing is more convenient for credit unions members due to lower costs and the duration of the procedures.

Outside the big towns in Lithuania, small business and farming entities are not able to provide sufficient collateral or to prove a certain level of income in order to be financed by the bank. Credit unions grant loans, even micro loans on easier conditions. As credit unions may serve only their members, money remain in the region.

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[11] In survey participated 1193 credit union members living in Riga, Jelgava, Liepaja and Daugavpils (capital of the state and three regional centers).
[12] 1.00 LATVIAN LAT (LVL) = 1.4335 EURO (EUR)

Poland

Credit unions members are individuals (physical persons)[13]. Services are provided also to member individuals running their own small business and civil partnerships related to small business activity. It was possible according to new Law on economic activity that amended the Law on credit unions[14], which came into force from 1 January 2001. Before that change in the law, credit unions were not allowed to finance micro and small business. There is a limit for credit unions' exposures to business lending - all credits granted for business activities to its members cannot exceed 150% of credit unions' core own funds. Additionally some amendments to the Tax Law approved by the Parliament in September 12, 2002, changed the status of current account provided by credit unions making them equal to accounts offered by banks for tax payments.

According to Survey conducted in July 2007 within this Project about 1% of surveyed population admit to have a cash loan from credit union and 1,2% of surveyed population was rejected to get a credit/loan from credit union. There were two age groups applying or having credit from CUs – people up to 25 and people from 41 to retirement age (60 for women and 65 for men). They had either secondary/post-secondary education or vocational one. People using loans from CUs lived in small towns (up to 20 thousand inhabitants) and households monthly income was concentrated between 2001 – 3000 PLN[15] (with 5 or 2 persons living in household). People rejected to get a loan from CUs indicated either the same level of income per household or between 1001-2000 PLN (with 5 or 3 persons in the household). On average in 2006 the disposable nominal income per person was 835 PLN per month. Persons using or willing to use CUs services have in general income per person comparable to the country's average.

5. What products and services do they offer?

In CEE countries in general credit unions offer quite a limited range of services, comparing with the banking sector. The most important products are term deposits and loans, other services are not so well developed, though due to the efforts of central credit unions, individual CUs can offer more advanced services, such as debit and credit cards (Poland, Lithuania), or some insurance products and investment funds (Poland). The development of

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[13] KSKOK was asked to provide data on the income structure of members, but there was no positive answer.
[14] Approved by the Parliament in November 19, 1999.
[15] 1 EUR = 3,8 PLN (Polish Zloty)

modern services is limited because of credit unions' lack of capital and funds to invest in the development of new services.

Table 8: Basic information on products and services

Country	Current account	Deposit taking	Loan granting	Money transfers	Debit cards	Credit cards	Life insurance	Property-casualty insurance	UCITS (investment funds)
Bulgaria	NO	NO	YES*	NO	NO	NO	NO	NO	NO
Latvia	YES	YES	YES*	YES	NO	NO	NO	NO	NO
Lithuania	YES	YES	YES*	YES	YES	YES	NO	NO	NO
Poland	YES	YES	YES*	YES	YES	NO	YES**	YES**	YES**

* Also housing loans
** Provided by institutions linked to central credit union (KSKOK)
Source: own preparation

Bulgaria

The products and the services that co-operative credit organizations in Bulgaria offer are limited to small loans. They are delivering loans for: production, consumer credits, agriculture, transport, services, house building, trade. Over 50% of the delivered loans are for the start up of a micro or small business. The credit unions offer consultancies and other help to their members.

Latvia

Latvian credit unions have the right to accept deposits from their members, provide loan and leasing services to members, make transfer payment, sell investment instruments and foreign currency, provide consulting services. Commercial banks prefer not to have branches in each small region and people need to travel to neighbouring places in order to receive financial services from commercial banks.

Lithuania

Lithuanian credit unions provide savings and loan products to members and also make transfer payment. Saving products are – current account, savings account, children savings account, retirement savings account, also short term and long term deposits. Most popular loans types are business loans, consumer loans, agricultural loans and loans for studies. Credit unions also make different settlements for their members: collect taxes for commodity enterprises, payments for goods and other services. A member of a credit union can also receive money transfers from other persons to his/her account. Since 2007 credit unions have started to issue credit and debit cards.

Poland

Credit unions operating in Poland (both in towns and in villages) are providing basic banking services, including money transfers abroad. In October 2006 another amendment related to credit unions came into force[16]. It changed the term for which loans could be granted. Before October 2006 there was a limit of 3 years for loans' duration, except loans for housing purposes that were allowed for 5 years' duration. According to amendment there is no time limit, so they may be granted for e.g. 25 years. This opened to credit union members the possibility to get housing loans on term's condition comparable to commercial banks. The same Law gave the credit unions the opportunity to provide housing loans supported by the state.

In Poland there are not only credit unions with the central one, but also – within the same group – mutual insurer (organized in the same way like credit unions), life insurer (owned by mutual insurer and central credit union) and investment fund.[17] Such structure allows to provide wide range of financial services to members. They may also offer some kind of retirement plans (accounts).

6. What is the track record (changes from the beginning of the transformation)?

In CEE countries credit unions have gone through difficult track of development. The biggest challenges were to establish a proper legal framework for activities and to gain trust not only from the society but also from public authorities. In most CEE countries, despite all the efforts credit unions did in development of local economies or lowering the rates of financial exclusion, they are viewed as risky institutions, which should be monitored and regulated in a very special way. Or , in contrary, government bodies are aside of solving the problems related to credit unions regulation and activities. Every year there are worries (even on European level) related to setting standards for credit unions' activities in all the countries.

Bulgaria

The reconstruction of the credit organizations started soon after the change of the economic system. The necessity for delivering credits to people with small chances to get credit from the commercial banks is sensible in Bulgaria, but credit organizations have arisen with difficulty and those who have been created were financed by foreign financial sources (e.g. USAID or EC). The major factor supporting their development is the lack of other sources of

[16] Law on state support for families in housing financing dated September 8, 2006.

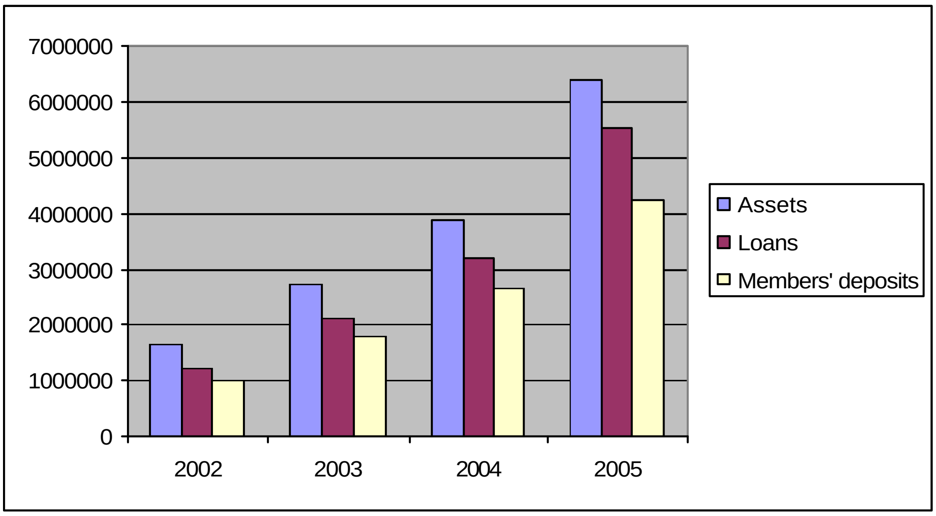
[17] Credit unions applied for banking licence in order to set up a bank supporting their activities, but the decision has not been issued yet.

financing for the micro and small enterprises, as well as for other activities of the small producers at regional level. Since 2000-2003, and with the implementation of the WOCCU project, different courses have been organized in order to educate the staff of the credit organization. The adaptation of international standards for co-operatives improved the economic stance of the credit organizations in Bulgaria.

Latvia

After the gap of more than 50 years, in 1992, the first enthusiasts started to renovate credit union movement in Latvia. It was rather difficult because of absence of legal acts regulating operation of savings and credit unions. The independent state took as a priority establishment of strong banking system and did not pay much attention to other kind of so-called credit institutions. Only in 1995 the first savings and credit union was founded in independent Latvia.

Figure 1. Assets, Loans and Members Deposits in Latvian credit unions 2002-2005, in Lats.



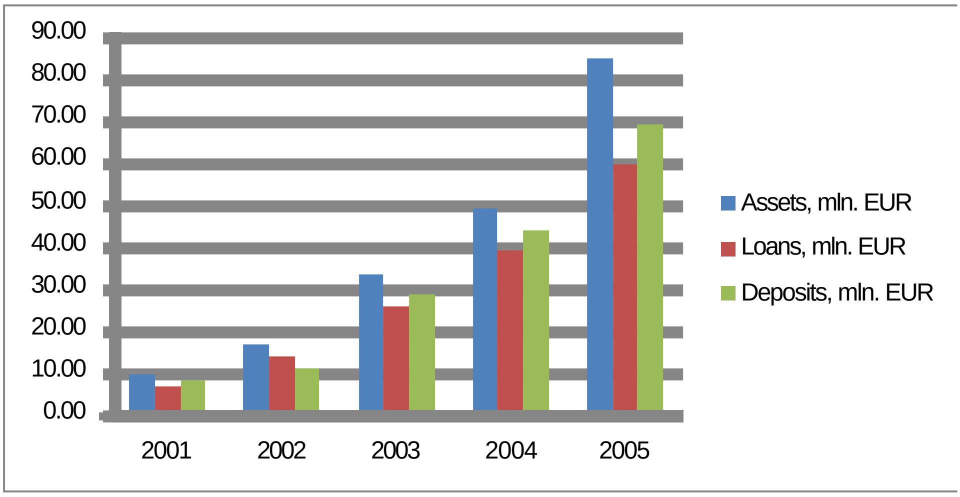
Source: Financial and Capital Market Commission of Latvia (2006)

Credit unions in Latvia continue to grow, as people needed an alternative to commercial banks. Unfortunately there are still a lot of people, who have no idea of co-operative financial services). In the 2002 – 2005 the growth rates of credit unions were impressive due to increasing purchasing power of inhabitants and rapid growth of Latvian economy. In four years assets of credit unions grew almost 4 times (3,86).

Lithuania

After privatization in 2000-2003, major part of Lithuanian commercial banks, seeking for better results, closed their branches outside the towns. Lithuanian credit unions began to penetrate that niche retail market. The rapid growth of credit unions proves that credit unions are needed in Lithuania. For small loans financing in most cases credit unions are the only source.

Figure 2. Assets, Loans and Deposits in Lithuanian credit unions.



Source: Lithuanian Central Bank, 2005

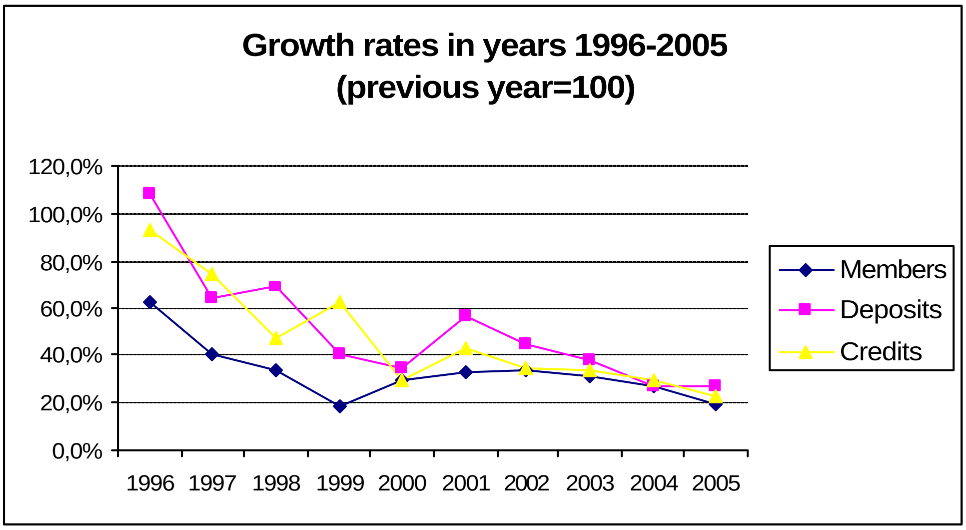
In many cases credit union become a community centre. In most cases community centre is the church, but in smaller villages the only credit union play this role, in bigger – credit unions are in very close contact with the church. Credit unions sponsor and organise a lot of social activities. In credit unions people are getting not only financial services, but also advices – on farming, business development, etc. Therefore, a credit unions in Lithuania are treated not only as financial, but also as social institutions (Bubnys, Kaupelyte, 2004).

Most successful period for the development of credit unions started from year 2000, when the amendments of Credit Union Law were passed by Lithuanian Parliament. The decrease of minimal stake from 300 Lt to 100 Lt helped credit unions to attract more members. Possibility to participate in Deposits Insurance System increased trust into the credit unions. At the same time the economy of Lithuania started to grow at constant rates and people gained more and more trust in financial services. Government started to support and encourage lending activities. That resulted in the increase of the loan portfolios of banks, and, at the same time – credit unions.

Poland

During the analyzed period credit unions in Poland has been growing significantly, faster than the banking sector. The number of members, total amount of credits and deposits as well as number of branches grew during almost the whole period not less than 20% per year. The exception was 2006 and 2004-2006 for the number of outlets.

Figure 3: Growth rates for credit unions in Poland in years 1996-2005



Source: KSKOK data, own preparation

The growth of credit unions is balanced due to attraction of new customers. Although the market share is low the number of branches is high in comparison to the banking sector. At the end of 2006 credit unions have 1589 branches (together with credit unions themselves) all over Poland, while co-operative banks have 3797 outlets (many of them in rural areas) and commercial banks – 8485 outlets. We mentioned above, that credit union will have easier way to grant housing loans. Thus shall speed up the growth rates, but the barrier may come from the deposit side.

7. What is the role of government?

The role of the government shall be considered in at least two aspects. First of all, is there a sound regulatory framework for credit unions (passive role). Then, is the government interested in supporting the development of credit unions in order to increase financial inclusion (active role)? As described below, the role of the government is mostly passive in analyzed NMS. One of the reasons is the actual lack of discussion regarding financial exclusion.

Bulgaria

According the clause 1 ?. Journal of the State Nr. 13 of 2003 the State can assist and encourage the credit organizations in their activity. The State assigns the right to the credit organizations to remise 50 % of the income tax in order to be transferred into funds of the national credit organizations in the period when the taxes must be carried in the budget.

In Bulgaria there is no act regarding directly the activities of credit unions. There were two drafts submitted to Parliament in 2001 (Draft Law on credit cooperatives and societies) and 2003 (Draft Law on credit cooperatives) but both have not been discussed. They have been stopped by the prevailing experts' opinions that they will not be supervised and regulated and it will be a pre-condition for the emergence of some kind of "financial pyramids". The final outcome is that the government did not provide satisfactory legal framework.

Latvia

Credit unions in Latvia are supported by government and municipality institutions, participate in various regional and small business development programmes. It is being considered to involve them into deposits insurance system. The large number of unions do not actively operate despite having a licence.

Lithuania

Government of Lithuania actively participated in establishment of Central Credit Union by investing 5,3 mln Litas[18] in the share capital. Credit unions do not pay income tax for the first 3 years of activities, later the income tax for credit unions is reduced by 75%. By participating in the State Investments and Deposit Insurance Scheme credit unions pay 0,2 % from deposits base, instead of 0,45 % (paid by banks).

Poland

Credit unions enjoyed till the end of 2006 tax exemption – they were not paying income tax if the income is used for their statutory purposes. There is no other explicit state support.

8. Are there threats/signals (from the market or from the regulatory side) for important changes in this sector, that could reduce their role in serving people art risk of financial exclusion? Or, on the contrary, are there signals for a strengthening of this role ?

The signals coming from analyzed post-communist NMS are different, but the main obstacle seems to be the shortage of capital to develop their operations. This may affect also the prices of services. Another issue is the proper supervision over their activities.

Bulgaria

Bulgarian credit organizations have harsh necessity to increase their own capital. The main sources of capital are: internal instalments done by the members, as well as financing from abroad. The payment of dividends under the conditions of the law is almost impossible and this constitutes an impediment for their development. There are also problems with the refinancing, since they cannot collect deposits due to legal barriers.

Latvia

The main weakness of Latvian credit union movement is the difference in the level of development of credit unions in Riga and other regions. Credit unions are experiencing lack of credit funds and deposit attraction is not effective. Also their growth is affected by strong and well developed banking system.

Savings and credit unions shall be used as intermediates in distribution of resources of different aid programs and special funds, as also state subsidies. Credit unions, providing services for defined groups of people, accumulate information and credit history of their members, which can be used for efficient evaluation of credit risk and business projects of program target auditory (mostly the same "vulnerable" category of clients, who often do not have any other credit history at other credit institutions).

Lithuania

The major threat for credit unions is a new (amended) Law on Credit Unions which now is being discussed in the parliament. The earlier version of the Law, proposed by the Central Bank of Lithuania suggested the following changes in credit unions legislation:

- Limitation of maximum term of credit union loans - it is proposed to limit repayment term of loans secured by guarantees up to 2 years term, and repayment term of mortgage loans up to 5 years;

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[18] 1.00 LITHUANIAN LITAS (LTL) = 0.2896 EURO (EUR)

- More restrictive common bond criteria. Currently credit unions may unite members upon the following criteria: professional, geographical, work in one company or membership in one organization. Credit unions can chose 2 of these 4 criteria. In the new proposals there won't be such a possibility. Under the current arrangements credit unions may have associated members[19], but new arrangements prohibit this.
- Decrease in the minimum required number of members from 50 to 10.
- Cancellation of the possibilities to receive amounts on term and demand deposits from public organizations of the Republic of Lithuania, religious communities, institutions authorized by the Government of the Republic of Lithuania and/or local governments, and international charitable (sponsorship) foundations and/or such foundations of foreign states.
- Establishment of new more complicated procedures to found a credit union.

Now the project is discussed with the Central Credit Union and the Association of Credit Unions. If any of the restrictions named above would be taken, it could affect the development of credit unions at a large scale.

Poland

There is the debate whether to include credit unions under the financial supervision.[20] Credit unions do not have the same regulations (e.g. capital requirements according to Basel I) as banks, so there is a worry about the consequences of changing the way of supervision. As examples of Latvia and Lithuania shows this may not constitute the barrier for further development. This debate has mostly political character, since the ruling party (PiS – Law and Justice) is regarded as a supporter of credit unions' movement. When integrating supervision over the financial market in 2006 due to political reasons, the question on supervising credit unions by the public supervisory authority was back, but was not solved. In many experts' opinions the actual financial situation of all credit unions and the central one is not clear enough, since they are not using the accounting and regulatory standards similar to those applicable to banks and are not disclosing financial statements in the similar way. In some opinions this may be a "silently ticking bomb". Including credit unions network under the

[19] Associated members are members that do not fulfill the membership criteria, but live in the same area as credit union is operating.

[20] There is a temporary situation in Poland, since there are two supervisory authorities – Financial Supervisory Commission (FSC as target integrated supervisor) and Banking Supervisory Commission (BSC). The responsibilities of BSC shall be transferred to FSC at the beginning of 2008, but there is a political debate on postponing that process.

official supervision seems to be important due to their growing share in assets of all financial institutions operating in Poland and the number of people that are their members.

Due to changes in the legal environment in 2006, their role might be strengthened in providing long-term financial services for housing. Another issue is that they started to have quite commercial features – like UCITS and insurance sale. Due to the low level of financial education, one cannot expect that low income credit unions members are able to manage their personal finance completely properly. On one hand there is a question – should offering such services be the primary activity in the country with high level of financial exclusion? As another research proved, current account and services related to it are not the cheapest in credit unions network in comparison to commercial banks (IBnGR, 2006). On the other hand, such kind of services may attract the middle income members and allow to compete for them on the market.

9. Conclusions

Unquestionably, credit unions shall play an important role in NMS in preventing from financial exclusion, as they did e.g. in North America or Ireland. One of the key challenges for all NMS is the public understanding of the role they have to play in the society and their expected positive impact on employment and further - on the economic growth. The necessary step is also the long term informative campaign on the role of credit unions in order to increase the knowledge and understanding in the society. Except some economic aspects, like shortage of capital, their success in dealing with financial exclusion lays in hands of public authorities and the level of financial education.

Credit unions proved in NMS their usefulness and the growing number of members as well as the size of their activities showed that they contributed to some extend to the reduction of financial exclusion. As presented above, in Lithuania, Latvia and Bulgaria they play important role for micro-financing.

We identified key success factors for the analyzed countries for the future. They shall help credit unions movement to develop and to contribute to the reduction of financial exclusion.

- For Bulgaria these are: improvement of the legal framework (mostly attraction of deposits and new members), increasing the activities' scope of existing credit unions via setting up new branch offices; building up a national coordination mechanism in order to make them stronger and supervise them properly.
- For Latvia these are: state support in the form of favourable legislation and state guarantee loans for those credit unions which are operating outside Riga (capital city); interest of the

population in undertaking of both social and business activities; small and weak savings and credit unions should merge on territory basis to improve their financial and market position; central savings and credit union should be established in order to provide financial services to credit unions; credit unions are not eligible to provide financial services to each other, but commercial banks' services are rather expensive.

- For Lithuania this is: changing the regulatory environment in a way that will not squeeze the credit unions network.
- For Poland these are: including them under the official supervision, like in the Baltic states and other countries (e.g. Czech Republic and Great Britain) and supporting them in activities related directly to the reduction of financial exclusion, i.e. providing current and savings account with associated services at low cost in order to increase financial inclusion.

In post-communist NMS special attention shall be drawn to credit unions as an « instrument » for dealing with financial exclusion. Now in some cases (e.g. for Lithuania) credit unions are regulated and evaluated very strictly, with taking not into account that by granting loans to the poor or by opening branches in the area not attractive for banks, they decrease the level of financial exclusion. In case of simple and necessary (in the modern society) financial services they shall be supported *explicite* or *implicite* by the government. On the other hand, if credit unions entered more risky operations (like e.g. long-term mortgage loans), they shall be supervised in a proper way in order not to sink the whole system.

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