Credit Unions in Estonia

Andro Roos and John Õun

Abstract The aim of credit unions and co-operative banks is collocating member deposits to allocate them as loans, so that capital could circulate among members. Market share of credit unions in Estonia is marginal at the moment (*ca*. 0.2 % of overall banking market). There exist 22 credit unions in Estonia, which have 6770 members altogether (31.07.2015). Before WWII the situation was very different. There existed 189 credit unions and two co-operative banks (central credit unions) in 1939. They had 79,100 members altogether. Market share of credit unions in overall banking market in Estonia was 52 % on that period. The article will give overview about the situation of nowadays credit union sector in Estonia, including statistical data and description development problems.

1 Introduction

The aim of credit unions and co-operative banks is collocating member deposits to allocate them as loans, so that capital could circulate among members. Comparing with other financial institutions, idiomaticalness of co-operative banking is that customers are owners/members of the institution at the same time. These members of a credit union or co-operative bank have entire control over the management of their co-operative and they attend on profit splitting according to their activeness consuming credit union services. Commercial banks at the same time are often owned by a small circle of investors and their aim is to earn profit for them. These are two main differences between commercial banking and co-operative banking.

Market share of credit unions in Estonia is marginal at the moment (*ca*. 0.2 % of overall banking market). There exist 22 credit unions in Estonia, which have 6770 members altogether (31.07.2015). Before WWII the situation was very different. There existed 189 credit unions and two co-operative banks (central credit unions) in 1939. They had 79,100 members altogether. Market share of credit unions in

A. Roos (✉) • J. Õun
University of Tartu, Tartu, Estonia
e-mail: andro@lkm.ee; John.oun@yhistupank.ee

S. Karafolas (ed.), *Credit Cooperative Institutions in European Countries*,
Contributions to Economics, DOI 10.1007/978-3-319-28784-3_15

overall banking market in Estonia was 52 % on that period (Roos 2007). The article will give overview about the situation of nowadays credit union sector in Estonia, including statistical data and description development problems.

2 Main Characteristics of Estonian Credit Unions and Co-operative Banking Sector

Theoretically, co-operative banking system consists of two levels in Estonia: credit union and central credit union (co-operative bank) level. According to the credit institution law and credit union law, banks are defined as credit institutions whereas credit unions are defined as financial institutions. In that sense, Estonia is different from other EU member states, as credit unions are not credit institutions. Hence, only commercial and co-operative banks are defined as credit institutions. There exist no co-operative bank in Estonia at the moment.

Credit unions are based on individuals and firms in Estonia. At the same time, central credit unions can be formed from credit unions and they help member unions to provide broader range of services and make greater investments in banking technology. Alternative way of establishment and functioning of a co-operative bank is that a co-operative bank itself is built up on the principle of credit union, but has the status of bank (credit institution)—it may not be central cooperative, which bases on credit unions, but can also consist of individuals and firms, like an ordinary credit union.

Relative importance (market share of credit unions is *ca.* 0.2 % of overall Estonian banking market) of co-operative banking and credit unions in Estonia is small due to the fact that there are small number of credit unions operating—at the end of 2011 there were only 18 credit unions operating and only 10 of them were operating actively. Nine credit unions belong to Estonian Union of Credit Co-operatives (EUCC), which functions mainly nominally. Actively functioning credit unions are: Loo CU (does not belong to EUCC), Eesti Korteriühistute CU (*Credit Union of Estonian House Cooperatives*) (does not belong to EUCC), Leie CU, Kehtna CU, Kambja CU, Põlvamaa CU, Tartu CU, Saaremaa CU, Eesti Evangeelne Luterlik CU (*Estonian Evangelical Lutheran Credit Union*) Maaelu Edendamise CU (*Rural Development Credit Union*) and Metsa CU (*Forestry Credit Union*). Three last mentioned credit unions function as profession-based cooperatives and all others as territory-based. These two types are allowed also by Estonian credit union law, which also states that if a credit union is established as profession-based cooperative, it may have 1000 members maximum. If a credit union is established as territory-based cooperative, it may have members from municipality the credit union is positioned, including neighboring municipalities. Still, this restriction is often interpreted in the way that these cooperatives are active all around Estonia, as all municipalities are neighboring.

On the one hand, the number of credit unions is small because of the complexity of establishment procedures of credit unions in Estonia. Complexity of establishing a credit union is influenced by high rate of minimum share capital and minimum number of founding members. Estonia has validated high rate of founding members—25. Estonia has validated also high rate of credit union share capital—EUR 32,000. In Estonia the minimum rate of credit union share capital is over ten times greater than in the case of an ordinary co-operative. In the case of establishing a co-operative bank, it is necessary to fulfil all the same obligations set by the credit institutions law as in the case of establishing a commercial bank. The most important obligation is the requirement of minimal share capital—five million euros. A co-operative bank has to have minimum of 50 founding members. These may be credit unions, if the co-operative bank is built up as central credit union or 50 legal and natural persons, if the co-operative bank is built up on the principle of credit union.

3 Development Problems of Estonian Credit Unions

First credit unions in Estonia were established by Baltic-German people. Regaining economical and cultural independence, Estonians started to establish their own credit unions, which were not supported by special laws or state support, like in developed countries nowadays. First Estonian credit union was established in Tartu in 1902. After successful Independence war in 1918, credit unions of Republic of Estonia started to grow fast and by 1940, the share of co-operative banking was over 50 % in Estonia. After losing independence to the Soviet Union, soviet powers proscribed private ownership, including credit unions and other co-operatives. Powers of post-soviet Estonia (since 1990) have not banned co-operation, but co-operation has also not been the first priority of any post-soviet government of Estonia.

In theoretical studies, three stages of development are proposed: nascent, transitions and mature industry phases. A specific stage is achieved when distinctive attributes can be ascertained. These attributes are: asset and membership size, strength of common bond, emphasis on voluntarism, sections of society being served, range of services, central organizational development, technological development and system of deposit and loan guarantee. Analyzing credit union systems of Estonia, one can conclude that Estonian credit unions are positioned in nascent industry phase in general.

Second important problem, which has impeded the development of Estonian credit unions, is lack of state guarantee for credit union deposits. Hence, Estonian credit unions may not seem very trustworthy for public. Still, according to objective criterions, this is not true. If we compare summarized balance sheets of Estonian credit unions and commercial banks, one can see, that equity of credit unions exceeds amount of deposits four times. In the case of commercial banks it is vice versa. The amount of deposits exceeds equity six times. Hence, inter-bank risks for depositors are much smaller in the case of Estonian credit unions than in the case of commercial banks.

In the other hand, holding free resources of money in the case of Estonian credit unions, increases the risks for depositors. In the case of Estonian commercial banks it is vice versa again. According to Estonian credit union law, credit unions are required to deposit their money resources in some domestic commercial bank. These resources that Estonian credit unions hold in commercial banks can get lost in the case of bankruptcy of a commercial bank, because credit union deposits in commercial banks are not guaranteed. Commercial banks in the same time deposit their money on correspondent account of Bank of Estonia. These deposits are fully guaranteed by the government.

Collecting deposits is the main basis of loan giving activities and through that, the basis of credit union growth. International empirics has shown that to efficiently collect deposits, there are three premises: a depositor has to have full overview and quick access to his/her deposit, deposits have to be guaranteed, depositor has to be paid highest interest possible for his/her deposit. In Estonia only the third premise is enforced. Hence, in first priority in Estonia, deposits have to be state guaranteed to achieve the second premise. Right now deposits hold in credit unions are not guaranteed by state guarantee fund. In the case of deposits held in credit unions, deposit interest go under 21 % income tax. Depositors of commercial banks do not have to by income tax from interest revenue at the same time.

Nowadays IT-based economy demands banks and also credit unions, if they want to be competitive, to offer internet banking, ATM, debit and credit card services, so that a member could have immediate access to his/her bank account in credit union. In Estonia technological development of credit unions have not been taken as first priority, although speaking of credit union sector development, it is inevitable. The first step towards this goal would be implementing electronic customer service and accounting system for credit unions, so that they could make transactions and conduct clearing within themselves, in perspective also with Bank of Estonia and commercial banks. Following second step would be implementing on-line banking for credit unions. Technological development of credit unions gives also better chances to expand their range of services as well as target group. All these factors are important for moving to higher development phase. EUCC started to develop its own internet banking system in 2010. Following implementation of credit union internet banking system, ATM and card payment systems will be future goals.

4 Statistical Overview of Estonian Credit Union Sector

Based on the statistics of Bank of Estonia, there were 26 credit unions active from 2004 to 2011. Two credit unions went into bankruptcy in 2010, two was liquidated in 2013 and 2014. By the end of July 2015 there were 22 credit unions which have revealed statistical data about themselves. Credit unions have great potential for

Fig. 1 Members of member-CUs of EUCC on 31.03.2015

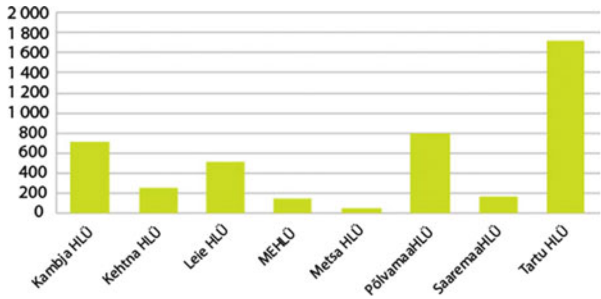
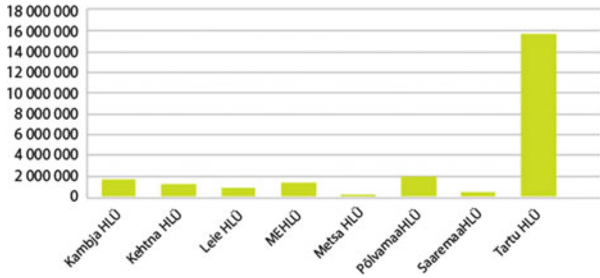


Fig. 2 Total assets of member-CUs of EUCC on 31.03.2015



expansion, due to the general economic environment being favourable. Also another advantage is the tendency of foreign commercial banks (99 % of total banking market in Estonia) as market leaders to export their profits abroad in a situation where the clients have trouble with their finances.

The total assets managed by credit unions in Estonia amounted to 47.5 million euros by the end of July 2015. Thereof 36.7 million euros was served as demands to clients (loans granted). Total equity of credit unions summated to 11.7 million (Fig. 1).

By the end of July 2015 there were a total of 6770 members in Estonian credit unions. The number of members varies considerably between different co-operatives. Largest CU—Tartu Credit Union—has 1900 members. Other larger credit unions have 500–800 members individually, where as smaller credit unions involve less than 200 members. Generally the fact is that the more members a credit union has, the more assets it manages. Largest credit union manage assets up to 17.7 million euros, compared to smaller CUs which are managing less than 0.5–1 million euros (Fig. 2).

All the credit unions operate accordingly the same regulations. However some have focused on specific areas of management. Areas have been specified by Metsa Credit Union (*Forestry Credit Union*), where the members are mainly private forest owners, and by Estonian Cooperative Housing Credit Union, which manages different Cooperative Housings' finances.

Besides focusing on different areas of management, some credit unions have also defined themselves by the territory, where they operate. Examples of that kind of credit unions are brought above in the article. One credit union which has shown

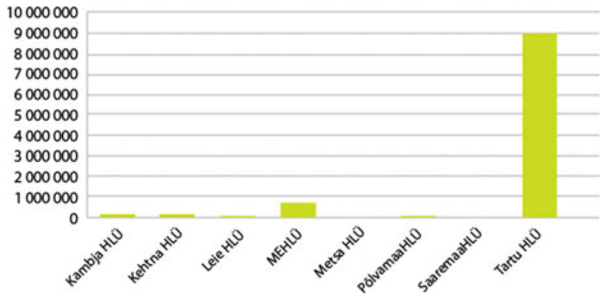


Fig. 3 Loans to business of member-CUs of EUCC on 31.03.2015

great growth in last 2 years, is Tartu Credit Union, which has HQ in Tartu (second largest city in Estonia) and branches in Tallinn (capital) and Narva (third biggest city). Tartu Credit Union also has its own monthly newspaper and weekly broadcast in radio and monthly show in TV. Due to following of the co-operative principle, the competition between credit unions is minimized. This in turn allows to focus on offering of competitive services compared to services commercial financial institutions offer.

In most credit unions there are both, natural persons and legal persons, who use financial services. The market can be segmented in different ways, but most common practice in Estonian CUs is making difference in three separate segments: private clients, businesses and non-profit companies. Most of the clients value the most: low credit costs, personal relationship between the directors and members and the support offered to local businesses to flourish (Fig. 3).

Financing local businesses is an integral part and goal of credit unions. The largest business financiers are Tartu Credit Union, Loo Credit Union and Maaelu Edendamise Credit Union. Estonian credit union all together serve 23.5 million euros in loans to local businesses.

Another goal of credit unions is to provide means to people to pool their savings and provide lending opportunities. The largest share of private loans is provided by Põlvamaa Credit Union, followed by Kambja Credit Union and Loo Credit Union. Estonian credit union all together serve 11.6 million euros in loans to private persons (Fig. 4).

To understand how rapid the growth of credit unions has been, we can take a look at Estonian largest Tartu Credit Union progress during the past 2 years. At the end of 2013 total assets managed by Tartu Credit Union was 8,074,739 €, number of members 1107 private and legal persons. At the end of July 2015 total assets managed was 17,550,706 €, number of members 1857 (Figs. 5 and 6).

This will also increase the income and costs of the credit union operations. Right now the yearly interest from deposits is 5 % and loan interest is 7 %, the increase in members will also allow for higher profits in the future. With an increase in the amount of deposits the amount of loans granted will also be able grow (Fig. 7).

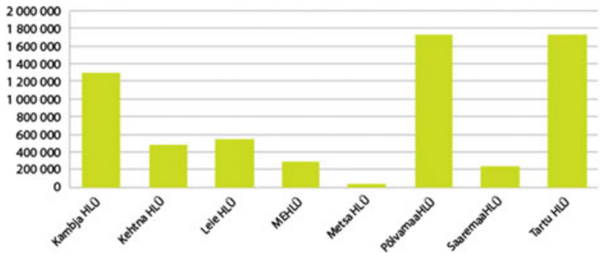


Fig. 4 Loans to persons of member-CUs of EUCC on 31.03.2015

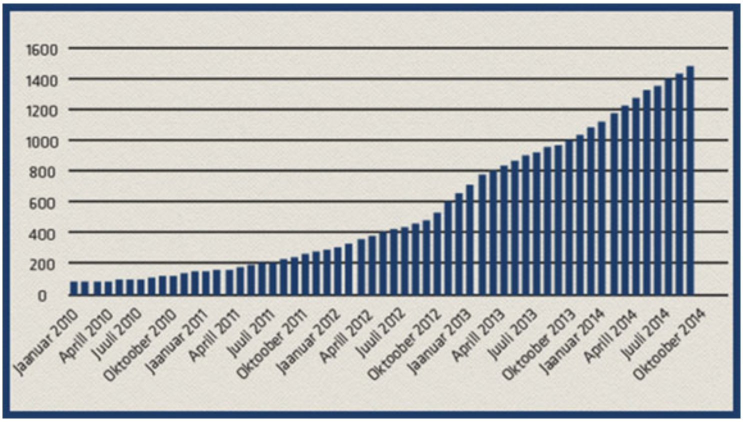


Fig. 5 Number of members of Tartu Credit Union January 2010–October 2014

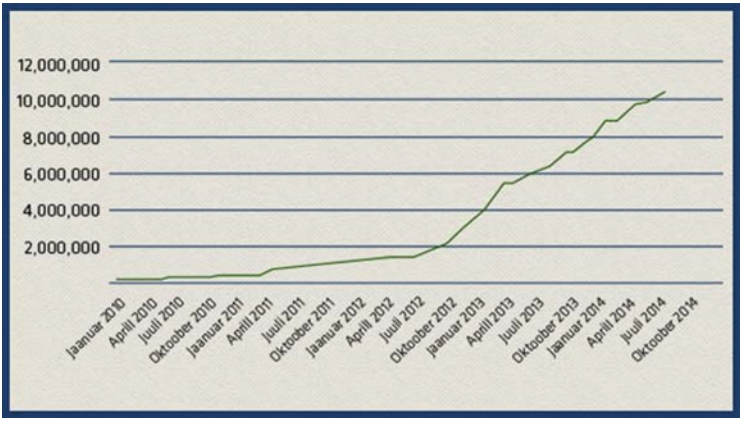


Fig. 6 Deposits of Tartu Credit Union January 2010–October 2014

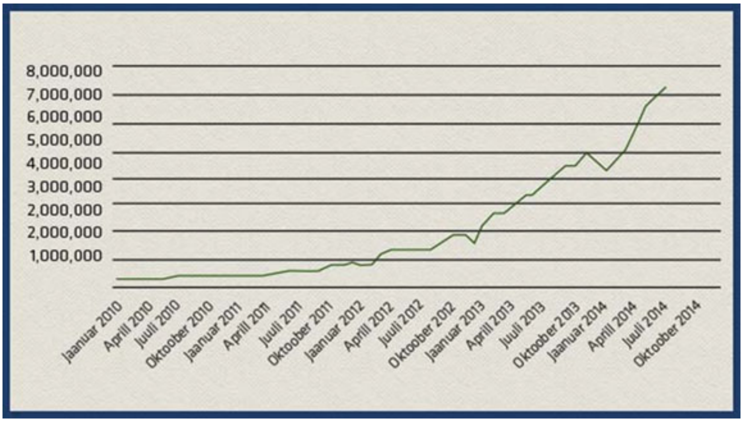


Fig. 7 Loans granted of Tartu Credit Union January 2010–October 2014

5 Conclusion

Market share of credit unions in Estonia is marginal at the moment (*ca*. 0.2 %), but it was the opposite in 1939—52 % of overall banking market. One reason for this is governments policy (in CUs deposit interests are taxed, in banks not; deposits in commercial banks are guaranteed by the state fund, in CUs not etc). On the other hand CUs themselves are been quite passive to date.

Still, as CUs started to develop common internet banking system and as the second largest CU Tartu Credit Union has started to offer innovative services to members as factoring, leasing, issuance of alternative currency, guarantee letters, insurance etc, there is much potential for fast growth in Estonian credit union sector.

As the number of members in credit unions continue to grow, together with amount of deposits and served loans, the credit unions will have more options to finance local businesses, to offer competitive interest rates that are suited better for specific purposes and also be able to improve the quality of financial services they are offering.

Reference

Roos A (2007) Ühistulise panganduse roll ja arenguvõimalused Balti riikides. MA thesis, University of Tartu, 150 p. http://www.metsaraha.ee/dokumendid/Artiklid/Hoilaenumagistritoeoe.pdf