National Bank of Ukraine

Non-bank Financial Sector Review

April 2021

In Q4 2020, the volume of transactions and assets in the non-bank financial sector remained almost unchanged. In 2020 overall, most segments scaled up operations and recorded solid profits despite the coronavirus crisis. Insurers' profits hit five-year highs last year. Credit unions, which made loan loss provisions in Q4, were the only NBFIs to take losses. As a result, shares as a component of their sources of financing declined significantly. Without adequate capital, credit unions have very limited development opportunities, especially given their low profitability. Passing new laws on financial services, finance companies, insurance, and credit unions is vital to maintaining the sector's solvency and sustainability in the long run.

Sector Structure and Penetration

In Q4, the structure of the non-bank financial sector was little changed. NBFI assets decreased slightly, most notably in credit unions and pawnshops. Insurers' assets, on the other hand, increased somewhat. In 2020, finance companies accounted for 72% of assets of NBFIs regulated by the NBU, while insurers represented 26%.

In a trend that persisted throughout the year, dormant participants gradually exited the market. Specifically, the number of NBFIs decreased by 17 in Q4 alone. As before, this was primarily due to the voluntary surrender of licenses by dormant companies. Some finance companies also surrendered licenses to provide financial guarantees, as they never actually give these. At the same time, new licensed finance companies entered the market.

In late 2020 through early 2021, finance companies began to actively disclose and streamline their ownership structures. Going forward, this process is expected to accelerate, promoting the sector's transparency.

Insurers

In Q4, the volume of insurers' assets increased compared to Q3. The volume of gross insurance premiums of insurers also grew, more noticeably for life insurance. During the year, however, total gross insurance premiums declined by 12%, mainly due to the exit of a number of insurers and a drop in non-life insurance in the crisis-hit Q2. At the same time, the volume of insurance premiums of non-life insurers that filed financial statements for 2020 was up by 11%.

The insurance claims payouts to premiums ratio was 35% for non-life insurance and 13% for life insurance, almost flat from a year ago.

Reinsurance premiums, which accounted for 17% of all premiums in 2020, declined slightly in Q4. Individuals paid 57% of net insurance premiums. During Q4, they slightly decreased in volume, but grew by 3% for the year. Were we to exclude from the previous periods the data for insurers that did not file their 2020 financial reports, the annual increase in these premiums would come in at 6%. This indicates that insurance services were still in demand from the public. Insurance premiums paid by legal entities grew on an annual and quarterly basis. Overall, the share of supplementary insurance held steady at 80%.

The most common types of insurance were car insurance (comprehensive coverage, compulsory third party liability insurance, and Green Card) and personal insurance (health and life). Over the year, premiums for these types of insurance increased in volume. Compared to 2019, only property and fire risk insurance premiums fell significantly, as market leaders exited these segments.

The loss ratio of non-life types of insurance customarily grows at the end of the year. The loss ratio of mandatory types of insurance stood at 55% in Q4. For supplementary insurance, this figure is usually lower, but in late 2020 it reached 66%. Such a high value was due to the accumulation of a significant amount of reserves by one insurer. With this effect excluded, the loss ratio of supplementary insurance in Q4 would be 33%.

As the loss ratio increased amid almost constant supplementary operating costs, the operating performance of non-life insurers deteriorated over the year. Investment income as a share of total income was 18% for life insurers and only 4% for their non-life peers. During the year, the share of investment income from bonds, including domestic government debt securities, expanded.

The drop in performance indicators in Q4 weighed down the growth in the segment's profitability. However, insurers posted a record UAH 2.2 billion in profits in 2020. Their ROA stood at 3.4%. By this measure, insurers outperformed other NBFIs.

The number of companies in breach of solvency requirements remained high. Several insurers were nonetheless able to correct their violations. As of 1 January 2021, 46 licensed insurers failed to fully comply with solvency or asset risk requirements.

Credit Unions

Credit unions are the smallest NBFIs, but they are also the most vulnerable to crises. The losses that credit unions took as their loan portfolio quality worsened affected their Q4 performance.

The diminished solvency of borrowers and a legal ban on fines for overdue loan repayments eroded loan portfolio quality. The share of loans that were over 90 days past due rose to 27% for the year. For loans for business needs this ratio was even higher, at 54%. This prompted credit unions to significantly ramp up their loan loss provisions in late 2020.

The bulk of the provisioning was done by one of the largest credit unions as of now, which provisioned for its entire loan portfolio. And although more than half of credit unions slowly built up their assets, this gain was too marginal to offset the negative contribution made by the segment's leader. As a result, the segment's assets were down 11% for the quarter.

The gross loan portfolio grew slowly. The volume of loans for the purchase, construction, and renovation of real estate increased at the fastest pace, while the volume of consumer loans – the industry staple – declined. Credit unions find themselves increasingly hard-pressed to compete with other lenders, such as banks and finance companies. Unable to provide a greater range of supplementary services and perform more transactions online, credit unions are losing ground to bigger players. Credit unions' loan rates were down, averaging 37.5%.

These NBFIs continued to show substandard operating performance. Many credit unions made just enough net interest income to cover their administrative costs. Despite the drop in loan interest, the rate on deposits remained high at 22.2%. Coupled with sizable losses from provisioning, these conditions made the segment loss-making.

The significant losses ate away at own capital, which shrank noticeably over the quarter. This poses risks to the financial resilience of credit unions: nine institutions failed to meet the minimum solvency requirements. However, many credit unions continued to pay out their earnings to members, rather than reinvest them in capital stock, including reserve capital.

At the same time, the structure of funding underwent gradual change. Specifically, credit union members returned additional share contributions, which shrank both in volume and as a share of credit union balance sheets. Some members of credit unions instead opted not to withdraw their deposits, choosing deposit interest as a more predictable type of income.

Finance Companies

The assets of financial companies decreased slightly in Q4, but increased by 12% in 2020. This was mainly due to a significant increase in factoring transactions and active lending in Q3 and Q4. Thus, the volume of loans made to households during the quarter increased by 20%. The volume of transactions with legal entities also increased; these transactions rather reflected the redistribution of funds within groups under joint control. In Q4, factoring transactions surged in volume, which was almost equal to the volume of lending. Most of these involved the purchase of overdue debt. The volume of financial leasing transactions surged by 44% in Q4 compared to the previous quarter, but was somewhat lower in annual terms. These changes were primarily driven by the activity of legal-entity lessors, which accounted for 93% of all financial leasing transactions.

In Q4, finance companies continued to generate profits. Overall, they generated more profit in 2020 than a year ago.

Pawnshops

In Q4 2020, the amount of new loans made by pawnshops was almost unchanged from 2019. Loan portfolio structure by type of collateral remained unchanged over the course of the year. The collateral coverage ratio also held steady at 115%. At the end of the year, pawnshops' expenses on salaries and legal services increased, representing 20% of all costs. At the same time, their main source of income – accrued interest – was little changed. These changes worsened the profitability of pawnshops to some extent.

Prospects and Risks

Throughout the year, all segments of the non-bank financial market remained active and scaled up transactions, despite the fallout from the COVID-19 crisis. Some segments boasted record-high profitability. This recovery is expected to continue.

In March, the NBU approved temporary licensing conditions for NBFIs, introducing a number of innovations. In particular, the regulator gave NBFIs the right to submit paperwork in electronic form, determined the procedure for revoking a license at an institution's request, and obligated NBFIs to submit annual audit reports.

The key event in 2021 is expected to be the passage of new laws governing the non-bank financial market. bills have already been registered in the Verkhovna Rada. The NBU emphasizes the importance of regulating the issues of transparent ownership structure, solvency, proper risk management, and consumer protection by all market practitioners without exception, as stipulated in the respective bills. Their adoption will contribute to the further development of the market and increase its competitiveness.

Sector Structure and Penetration

In Q4, NBFI assets declined slightly. Credit union assets decreased the most (by about 11% compared to Q3). Insurer assets increased slightly. The number of financial institutions kept declining gradually.

Figure 1. Asset structure of the financial sector, UAH billions

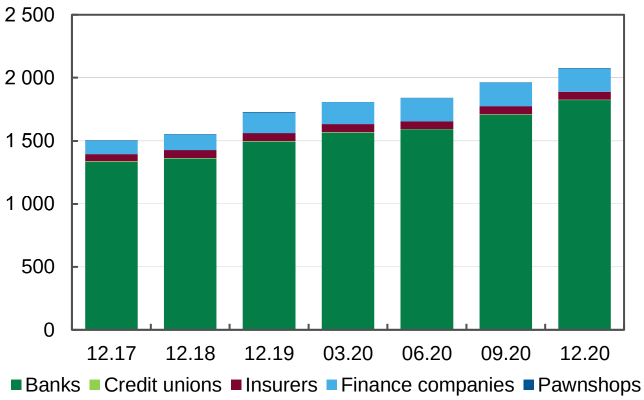
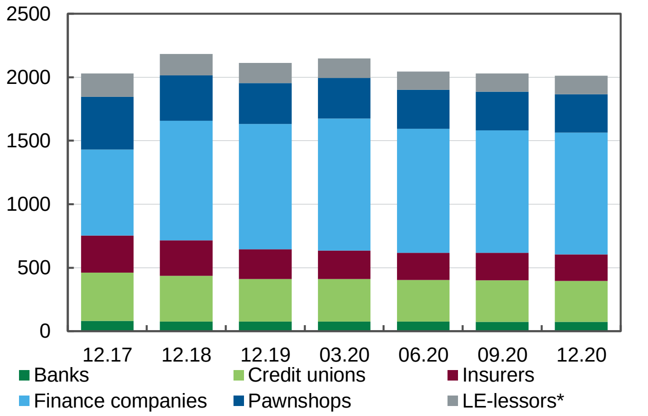


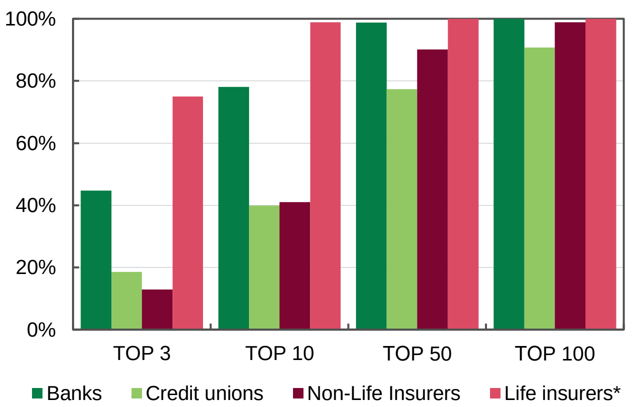
Figure 2. Number of financial service providers



* Legal-entity lessors do not belong to finance companies, but financial leasing services are regulated by the NBU.

As in the previous quarter, concentration is highest in banks and the life insurance sector, which consists of 19 companies.

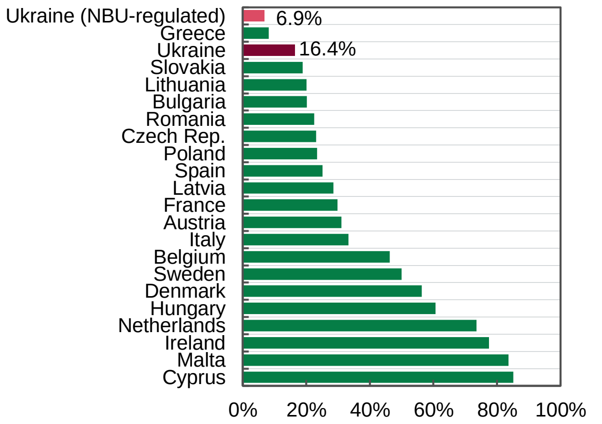
Figure 3. Concentration* of insurance companies and credit unions compared to banks



* Concentration was estimated in terms of assets for banks and credit unions, premiums for non-life insurers, and insurance technical provisions for life insurers.
** A total of 19 insurance companies provide life insurance.

Non-bank financial services in Ukraine have one of the lowest penetration rates of all European countries.

Figure 4. Share of NBFI assets* in European countries and Ukraine as of 1 October 2020



* That includes central banks, deposit corporations, investment funds, and other financial intermediaries (insurers, pension funds, etc.).
Source: Eurostat, NBU.

In Q4, bank assets grew faster than non-bank ones, while the share of NBFIs fell. In 2020, NBFI assets increased by 7%.

Table 1. Financial sector's assets*

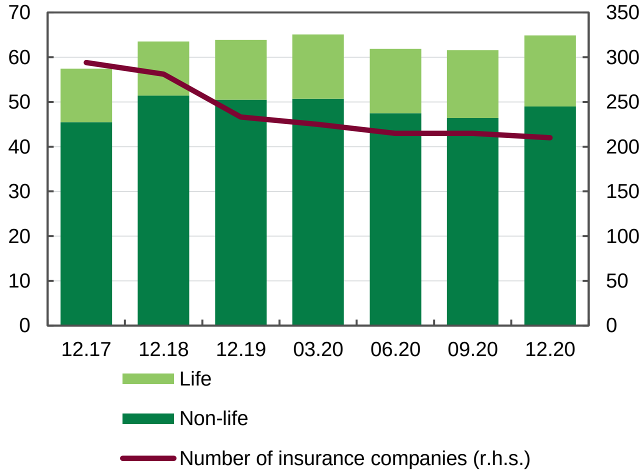
		2016	2017	2018	2019	2020				Qoq change	Yoy change
						03.20	06.20	09.20	12.20		
Insurers	Assets, UAH millions	56 076	57 381	63 493	63 866	65 115	61 888	61 617	64 925	5.4%	1.7%
	Number of companies	310	294	281	233	225	215	215	210	-5	-23
Credit Unions	Assets, UAH millions	2 033	2 170	2 218	2 510	2 543	2 576	2 587	2 310	-10.7%	-8.0%
	Number of companies	462	378	358	337	335	328	327	322	-5	-15
Finance Companies	Assets, UAH millions	67 401	107 534	125 322	162 197	172 845	184 108	187 437	182 130	-2.8%	12.3%
	Number of companies	650	677	940	986	1 040	976	965	960	-5	-26
Pawnshops	Assets, UAH millions	3.318	3.764	3.721	4.265	4.353	4.067	4.123	3.859	-6.4%	-9.5%
	Number of companies	456	415	359	324	319	306	304	302	-2	-22
Banks	Assets, UAH millions	1 256 299	1 333 831	1 359 703	1 493 298	1 564 275	1 589 647	1 707 732	1 822 814	6.7%	22.1%
	Number of companies	96	82	77	75	75	75	74	73	-1	-2

* Along with Q4 2020 earnings reports, the NBFIs were able to clarify reporting data for Q3 2020. They made retrospective adjustments to certain indicators, in particular the size of assets for this period.

Insurers

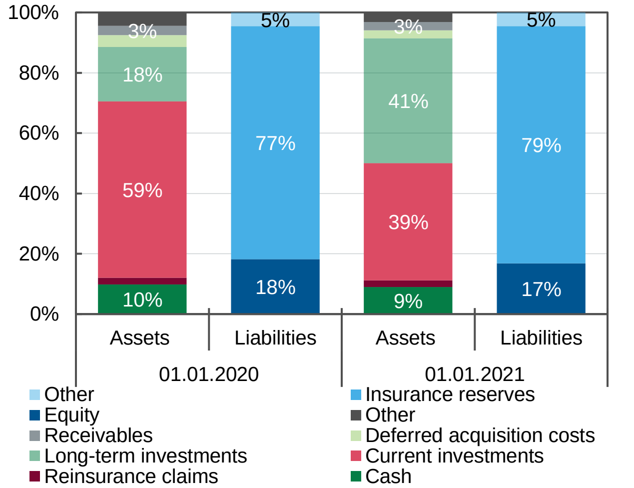
Insurer assets grew by 5% for the quarter, although the number of market participants dropped to 210.

Figure 5. Number of insurers and their assets, UAH billions



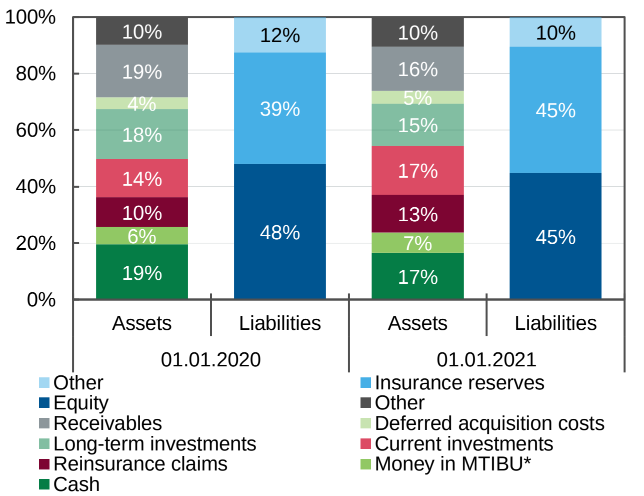
Over the year, long-term investments as a share of life insurers' balance sheets increased significantly.

Figure 6. Assets and liabilities of life insurers



The structure of assets of non-life insurers is diversified. A significant portion is made up of instruments, the value of which is hard to estimate, while liquidity, of receivables in particular, is low.

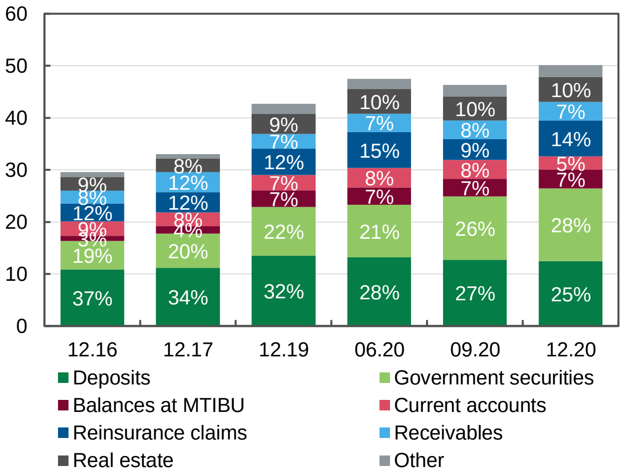
Figure 7. Assets and liabilities of non-life insurers



* Motor (Transport) Insurance Bureau of Ukraine.

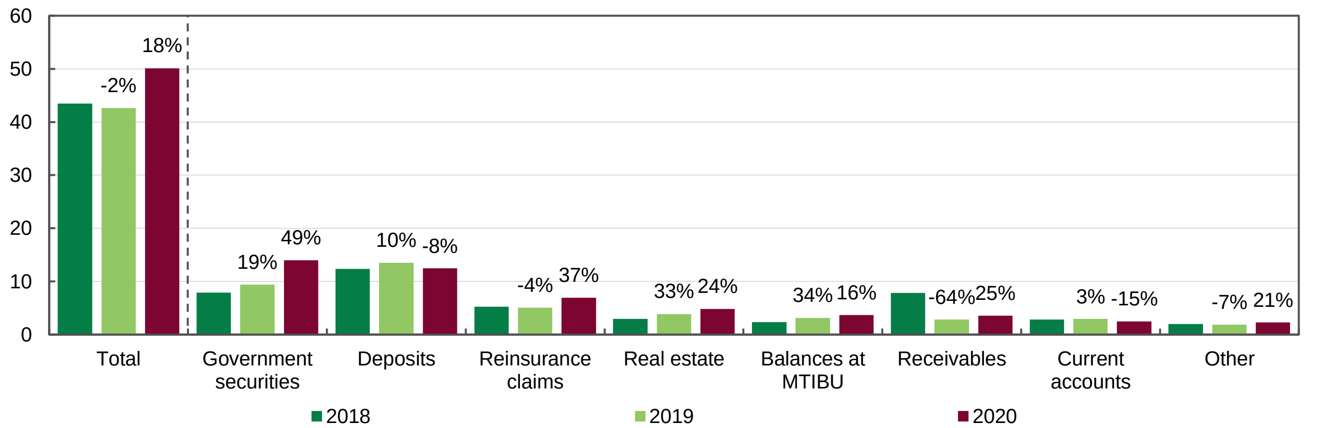
During the quarter, the share of claims on reinsurers in the assets eligible for insurance reserves increased.

Figure 8. Structure of assets eligible to cover provisions of non-life insurers, UAH billions



Compared to 2019, the volume of non-life insurer assets eligible to cover reserves increased, while their structure improved. The share of government securities increased the most.

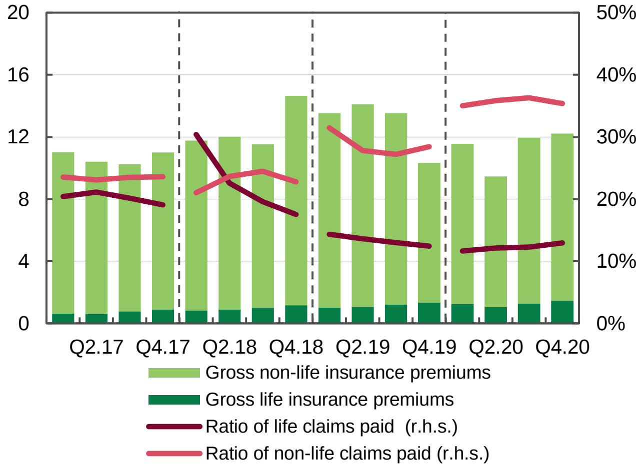
Figure 9. Assets eligible to cover provisions of non-life insurers, UAH billions



The percentage value indicates year-on-year change.

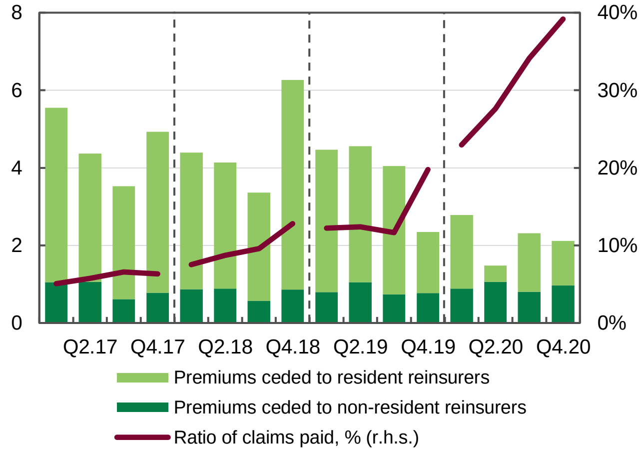
The life insurance claim payouts to premiums ratio inched higher to 13% for the quarter, while for non-life insurance, this ratio fell to 35%.

Figure 10. Premiums and ratio of claims paid* by type of insurance, UAH billions



The reinsurance claims payouts to premiums ratio had grown rapidly since Q3 2019, to 39% at the end of 2020. Overall, the share of reinsurance premiums remained at 17%, much lower than a year ago.

Figure 11. Premiums ceded to reinsurers and ratio of claims paid*, UAH billions



* The ratio of claims paid is the ratio of claim payments to premiums for four quarters preceding the estimate date.

The largest share of insurance premiums was made up of car insurance premiums. In Q4, the number of cargo and luggage insurance agreements by legal entities increased significantly, slightly altering the structure of the most common types of insurance.

Figure 12. Breakdown of insurance premiums and claim payments by most popular types of insurance in 2020, UAH billions

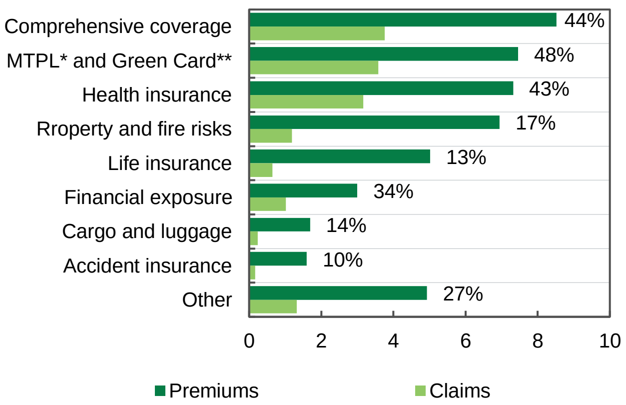
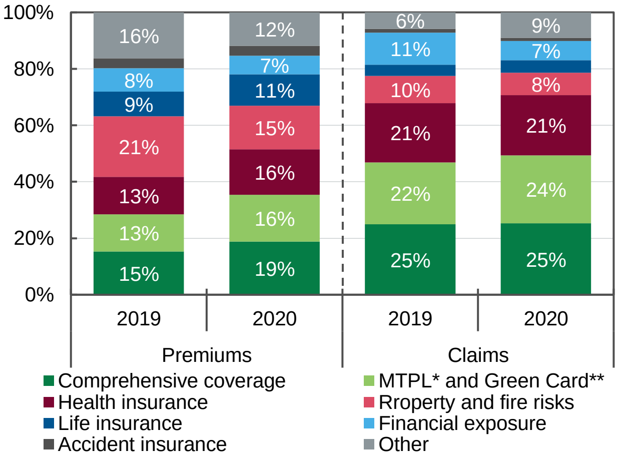


Figure 13. Breakdown of insurance premiums and claim payments by types of insurance



* Compulsory motor third party liability insurance.
** International Motor Insurance Card System.

The percentage value indicates the claim payouts to premiums ratio of the respective type of insurance.

Life insurance premiums have been growing faster than non-life insurance premiums in recent years, but this growth started from a very low level. Non-life insurance premiums declined in Q2 due to the COVID-19 crisis, primarily from individuals. However, these premiums recovered later in the year.

Figure 14. Growth rate of premiums by types of insurance (without reinsurance), Q1 2017 = 100%

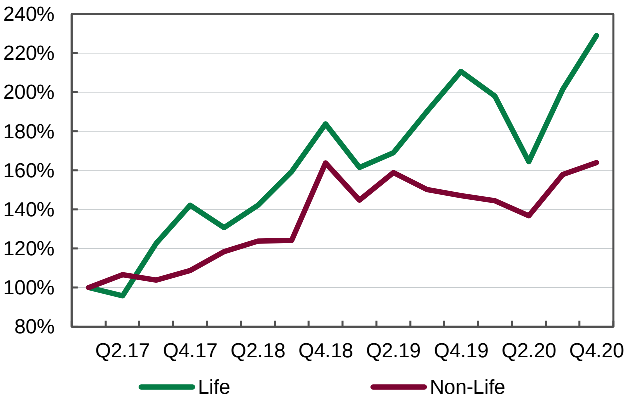
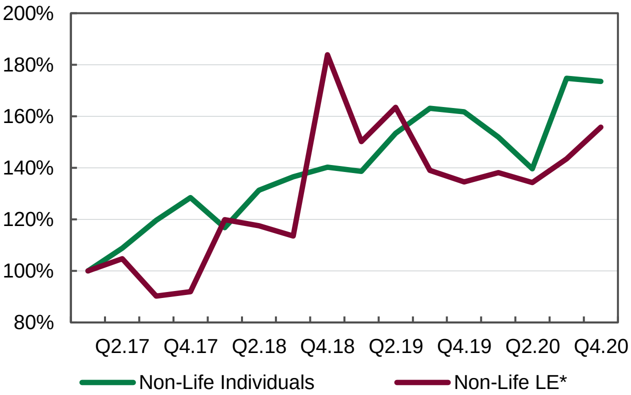


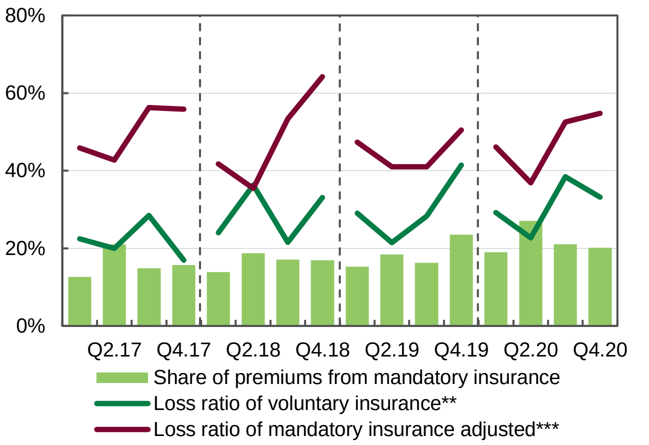
Figure 15. The growth rate of non-life insurance premiums in terms of types of policyholders, Q1 2017 = 100%



* Legal entities.

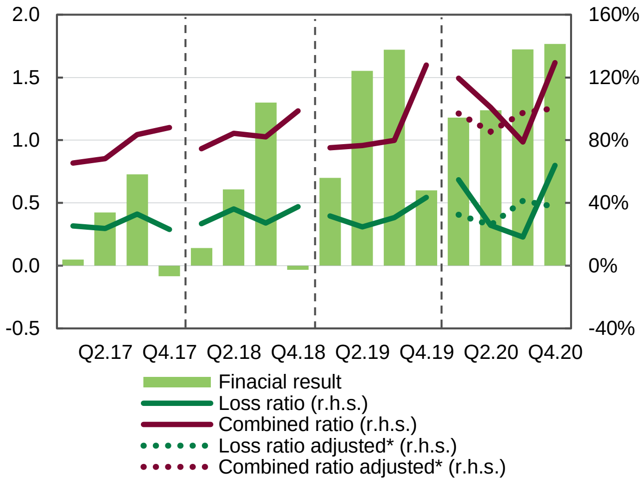
The loss ratio for voluntary insurance was 66% (or 33% after adjusting for the significant amount of reserves by a single insurer), while the loss ratio for compulsory insurance increased over the year, to 55% in Q4. Operating performance indicators (the combined ratio) of non-life insurers customarily increased in late 2020 to more than 100%.

Figure 16. Share of compulsory insurance premiums and loss ratio* of non-life insurance



* The loss ratio is the ratio of claim payments adjusted for the change in loss provisions and loss settlements to premiums adjusted for unearned premium reserves.
* Excluding the fire insurance loss provisions formed in Q4. Prior to adjustment, the ratio is 66%.
*** Excluding aviation insurance loss provisions formed over the course of the year. Prior to adjustment, the indicators are 159% and -59%, respectively.

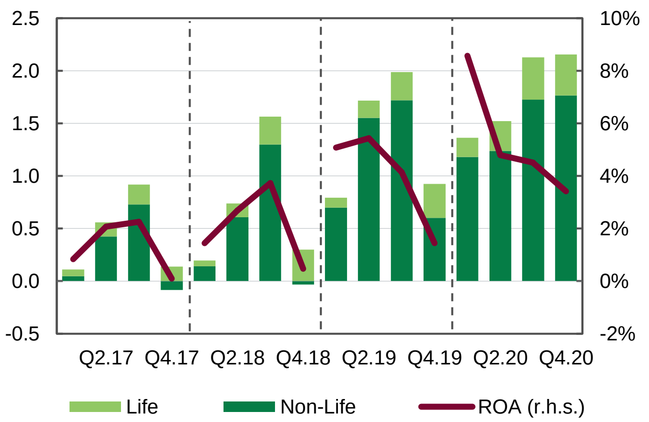
Figure 17. Financial result (income/loss), cumulative total and operational indicators of non-life insurers, UAH billions



* Excluding loss provisions made due to the crash of the Ukraine International Airlines plane in Iran in January 2020 that were released over the year.

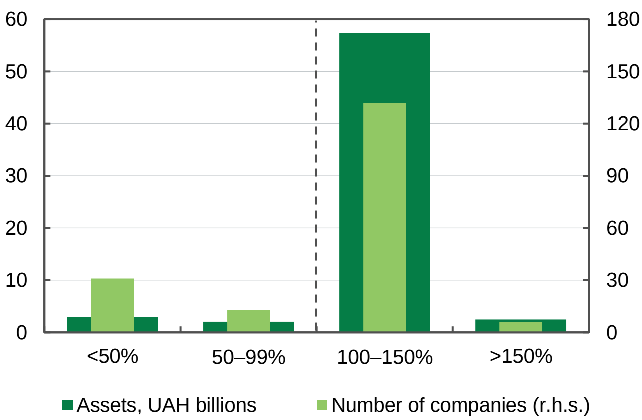
The profitability of insurers doubled compared to 2019, but in Q4, non-life insurers' profits were moderate, while life insurers recorded a small loss. Their ROA stood at 3.4%.

Figure 18. Profit or loss of insurers, cumulative, UAH billions



Insurers that do not meet solvency requirements account for only 8% of assets, although their number is significant.

Figure 19. Distribution of number and assets of insurers* by ratio of eligible assets to required solvency margin, as of 1 January 2021

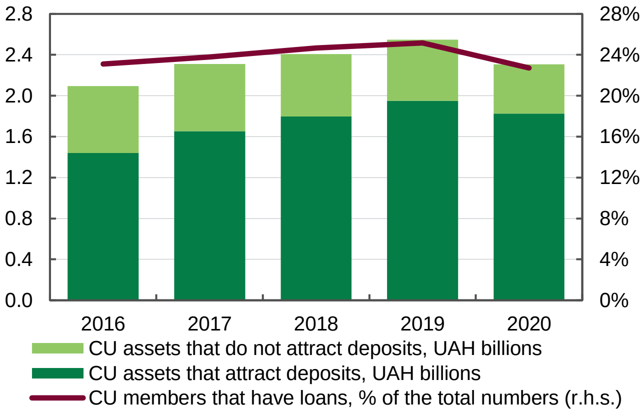


* This figure is based on data from 182 companies.

Credit Unions

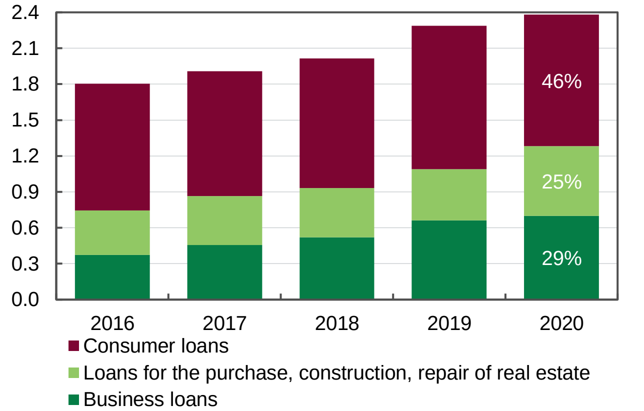
In 2020, the assets of many credit unions grew slowly, but the formation of reserves by a large market participant (Hromada CU) had a significant negative impact on performance. At the same time, the share of assets of deposit-taking NBFIs increased (to 80%). The number of credit unions fell as weak players exited the market.

Figure 20. Total assets of credit unions (CU) and share of credit union members who took out loans



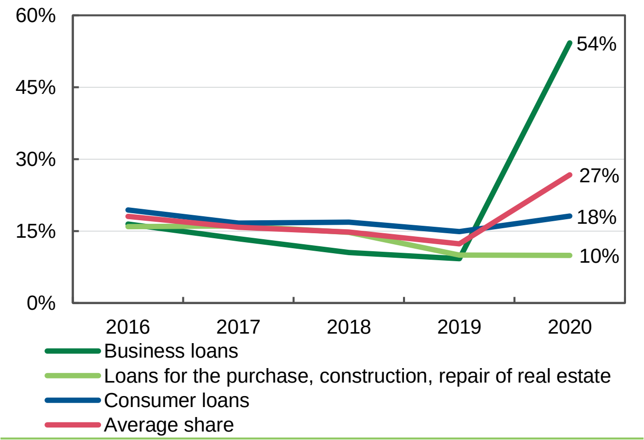
The growth in the predominant component of assets – the loan portfolio – slowed due to a decline in consumer loans, which accounted for 46% of the portfolio. Declining household incomes reduced the activity of credit union members somewhat. Among the founders of existing credit unions, 23% were dormant. Mortgages, which represent one third of the loan portfolio, rose by a third, and were the only type of assets that increased.

Figure 21. Structure of outstanding loan principal, UAH billions



Loan portfolio quality deteriorated sharply in 2020, with the NPL ratio* twice the level of a year ago. The corporate loan portfolio was more problematic.

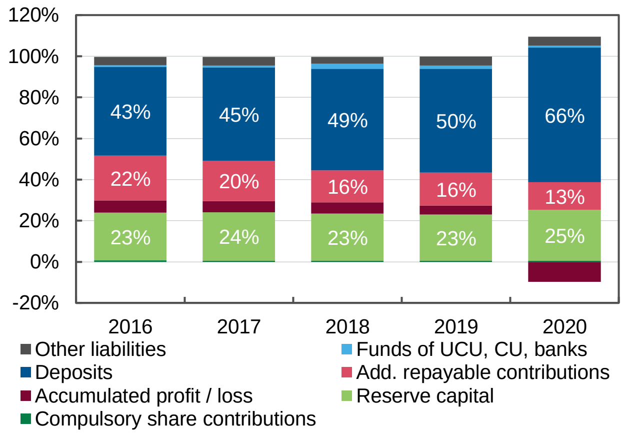
Figure 22. Share of non-performing loans by types



* Loans overdue more than 90 days.

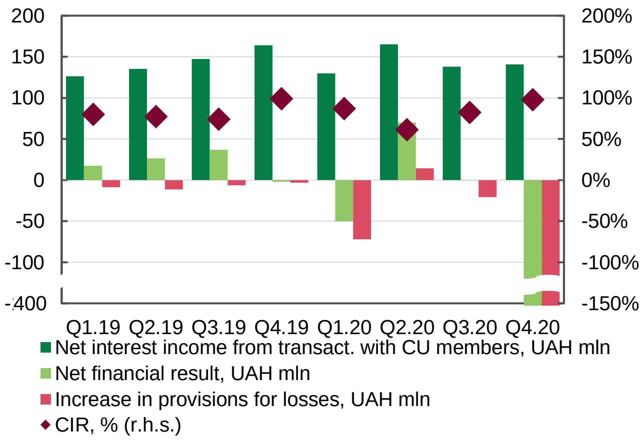
Deposits as a share of funding continued to grow. At the same time, accumulated losses and an almost 25% drop in additional share contributions reduced the share of equity.

Figure 23. Composition of funding sources



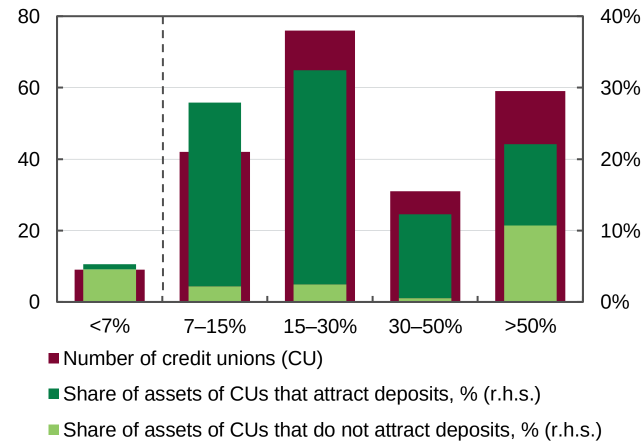
Operating performance of credit unions was low. The rapid formation in Q4 of loss provisions by the largest credit union in terms of assets resulted in these NBFIs taking significant losses in Q4, and overall in 2020.

Figure 24. Operational efficiency



Currently, most credit unions have capital adequacy in excess of the minimum requirement of 7%. At the same time, as of 1 January 2021, nine credit unions did not meet the minimum solvency requirements. Most of them did not take deposits.

Figure 25. Distribution by core capital adequacy as of 1 January 2021



Finance Companies

Over the past few years, the breakdown of assets and liabilities of finance companies has remained almost unchanged. Risks to the transparency and reliability of financial statements remain significant. In Q4, equity as a share of funding of finance companies declined to 14%.

Figure 26. Finance companies' asset structure, UAH billions

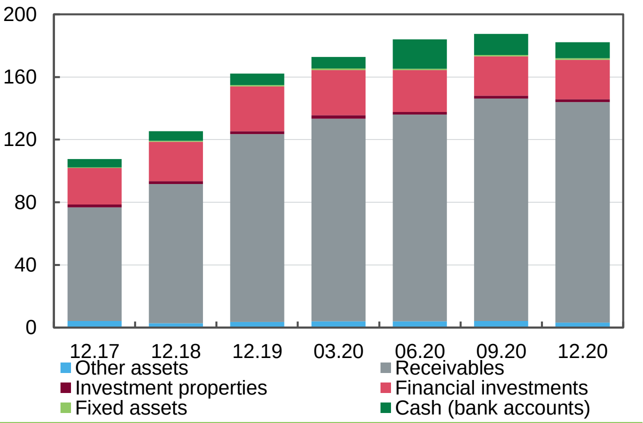
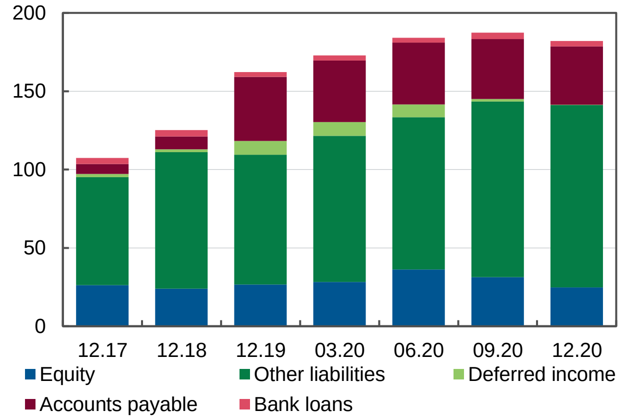
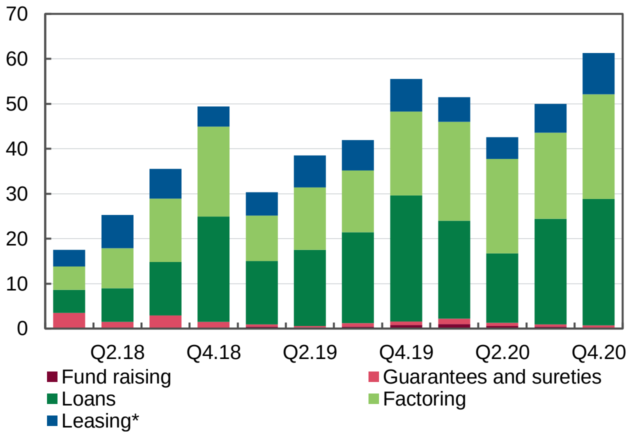


Figure 27. Composition of finance companies' liabilities, UAH billions



In Q4, lending accounted for almost half of the services provided by finance companies. Factoring and financial leasing transactions increased the most.

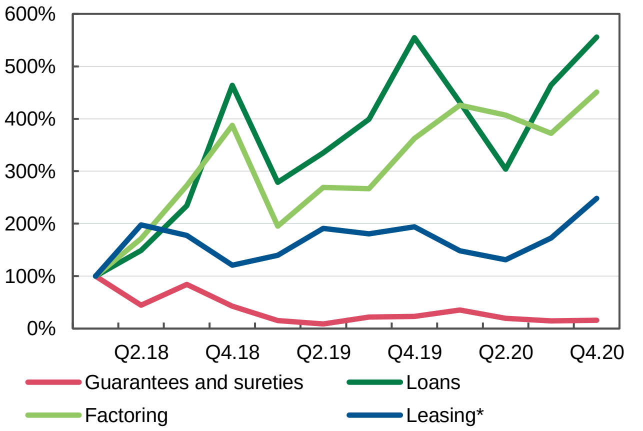
Figure 28. Volume of financial services provided by finance companies, by type of service (quarterly data), UAH billions



* Legal entities-lessors and finance companies.

Over the past three years, finance companies have been actively scaling up the volume of services provided. The highest growth occurred in loans and factoring transactions.

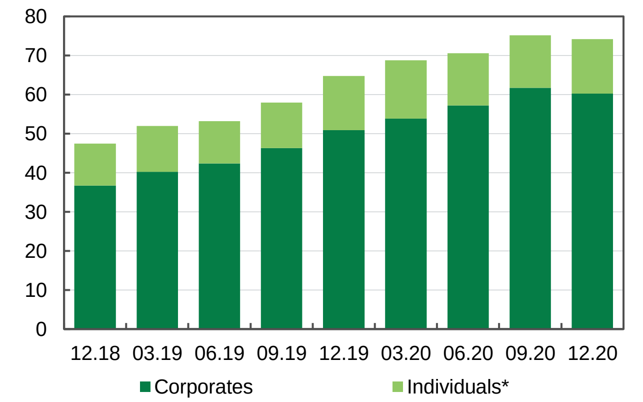
Figure 29. Volume of financial services provided by finance companies, by type of service (quarterly data), Q1 2018 = 100%



* Legal entities-lessors and finance companies.

In Q4, the gross loan portfolio of finance companies shrank slightly because of a decrease in corporate loans. Outstanding retail loans increased, although their share in the portfolio remained low, at 19%.

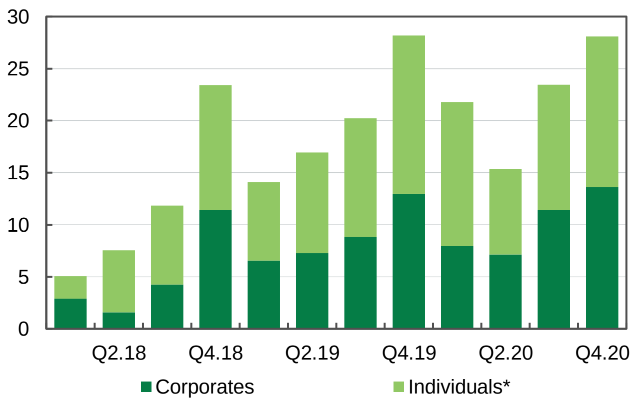
Figure 30. Gross outstanding loans of finance companies, UAH billions



* Including sole proprietors.

Most new loans in Q4 were retail loans made by finance companies. Both corporate and retail lending increased by about 20%.

Figure 31. Loans issued during quarter, by borrower category, UAH billions



* Including sole proprietors.

Most of these were short-term. In total, 36% of new loans were made for up to 31 days, and 57% for up to one year. Over 60% of new retail loans were granted for up to 30 days, while more than 85% of corporate loans were provided for three months to a year.

Figure 32. Breakdown of loans issued during quarter, by maturity

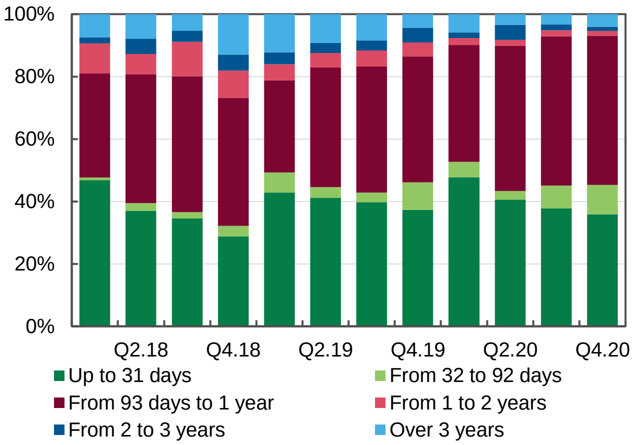
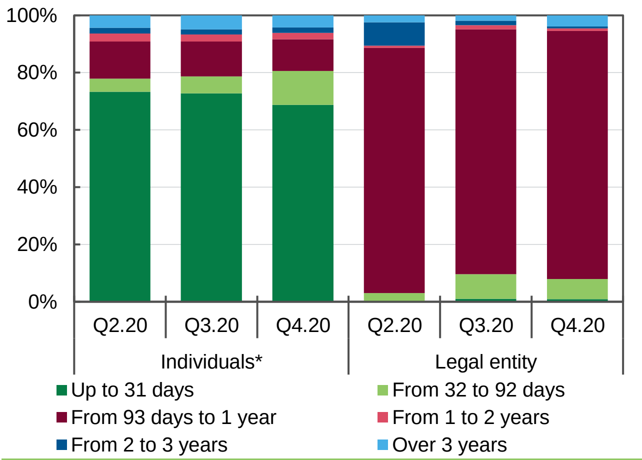


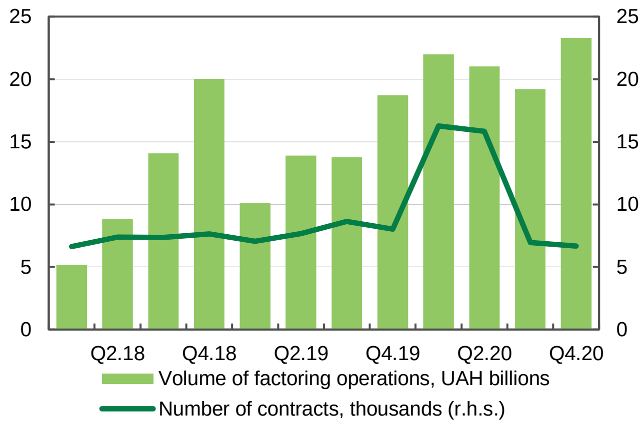
Figure 33. Breakdown of loans issued during quarter, by maturity and client's type



* Including sole proprietors.

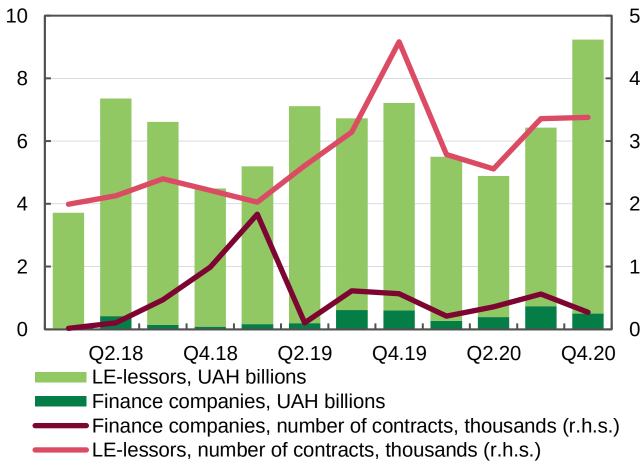
In 2020, finance companies increased their factoring transactions by almost 50%. Specifically, the volume of these transactions rose by 21% in Q4.

Figure 34. Volume and number of factoring agreements



Among financial services, the volume of leasing transactions in Q4 increased the most. This was driven by the growth in financial leasing by corporate lessors. Finance companies, by contrast, made fewer transactions.

Figure 35. Volume and number of financial leasing agreements



In 2020, finance companies posted greater profits than a year ago, despite the crisis. Accordingly, profitability at the end of 2020 was better than in the previous year.

Figure 36. Financial performance of finance companies on cumulative basis, UAH billions

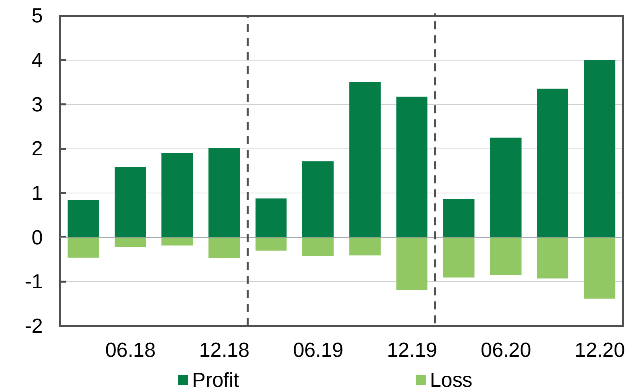
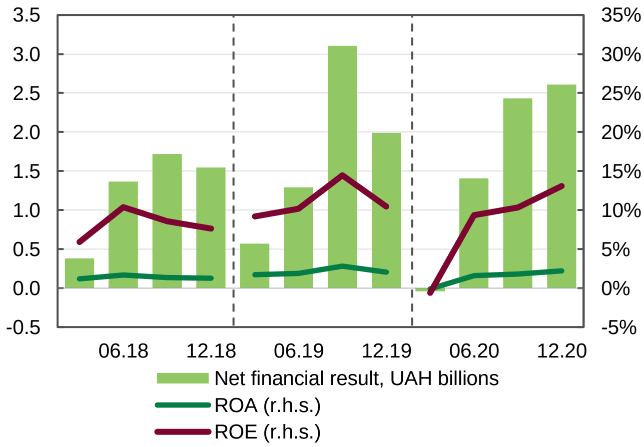


Figure 37. Financial performance of finance companies (on cumulative basis) and their return ratios



Pawnshops

In Q4, pawnshop assets decreased somewhat, mainly due to a reduction in the loan portfolio. Loans make up 71% of their assets. Equity made up more than 43% of their balance sheets.

Figure 38. Assets, UAH billions

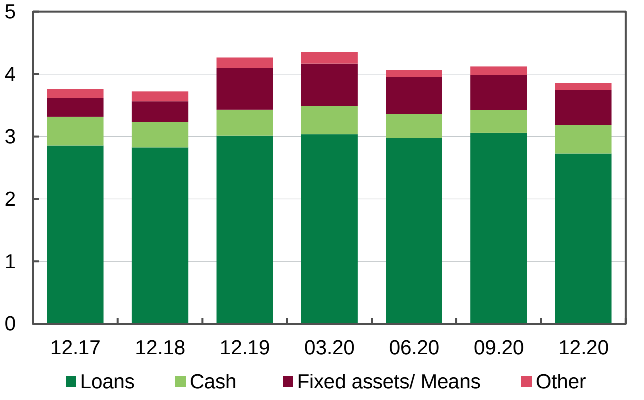
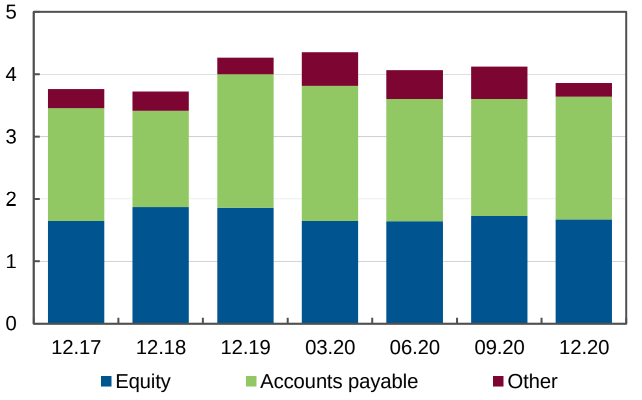


Figure 39. Liabilities and equity, UAH billions



The volume of new loans was almost unchanged in Q4 2020 from the same quarter of 2019. The collateral coverage ratio remained unchanged during the year, as did the breakdown of outstanding loans by type of collateral.

Figure 40. Amount of loans issued during the quarter and collateral coverage ratio, UAH billions

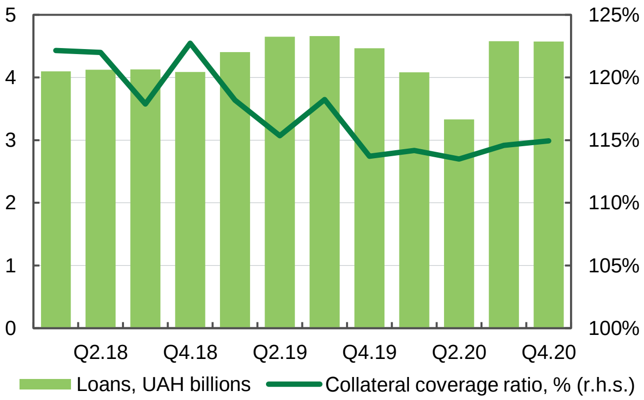
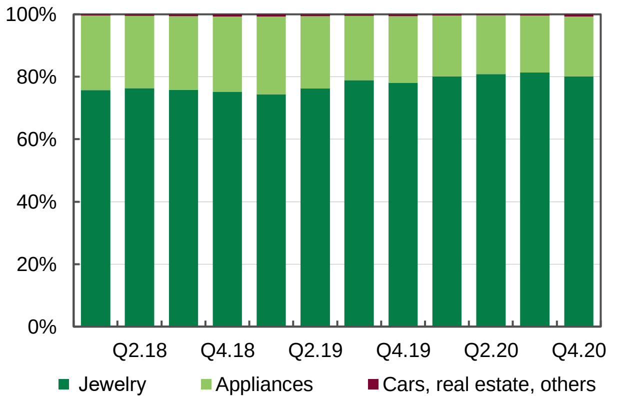


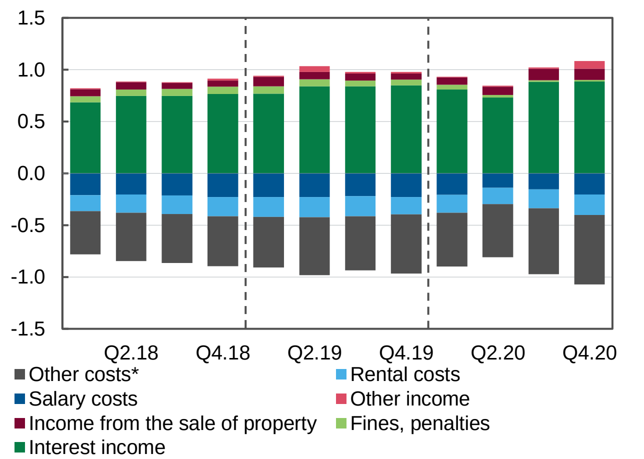
Figure 41. Loan portfolio structure by type of collateral



The share of loans secured with cars, real estate, and other assets is 0.7%.

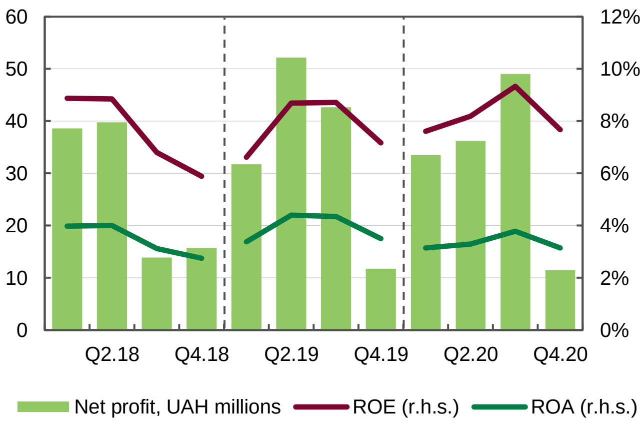
In Q4, pawnshop expenses grew faster than revenues. The increase in the latter was due only to noncore components. Meanwhile, pawnshops' expenses on salaries and legal services increased noticeably at the end of the year. Thus, the profitability of pawnshops declined to 7.7%, although their activities remained profitable. This change in indicators is generally in line with previous years.

Figure 42. Structure of income and expenses, UAH billions



* Including expenses related to selling and maintaining pledged property.

Figure 43. Financial performance indicators



Notes:

The source for the data is the National Bank of Ukraine unless otherwise noted.

This review covers non-bank financial institutions (NBFIs) that are regulated by the National Bank of Ukraine unless otherwise noted.

The NBU continues work to improve reporting control procedures in order to enhance data quality and ensure the full and proper disclosure of information about operations of NBFIs in the future. As they filed their earnings reports for Q4 and all of 2020, NBFIs, at the NBU's request, adjusted their improperly compiled reporting figures for previous periods (including Q3 2020 and the first nine months of 2020). Therefore, individual indicators in this survey were adjusted in accordance with the clarifications provided.

Unless otherwise noted, the sample consists of institutions that were solvent at each reporting date and submitted their reports.

The sum of individual components and total sum may differ due to the rounding effect.

Terms and Abbreviations:

CIR	Cost-to-income ratio. The ratio of operating expenses to operating income
Combined ratio	The loss ratio plus the ratio of operating expenses to premiums adjusted for unearned premium reserves
CU	Credit unions
Green Card	International Motor Insurance Card System
LE	Legal entity
Loss ratio	The ratio of claim payments adjusted for the change in claims provisions and claims handling expenses to premiums adjusted for unearned premium reserves
MTIBU	Motor (Transport) Insurance Bureau of Ukraine
NBU	National Bank of Ukraine
NBFIs	Non-bank financial institutions
NPL	Nonperforming loans
MTPL	Compulsory Motor third party liability insurance
Ratio of claims paid	The ratio of claim payments to premiums for four quarters preceding the estimate date
ROA	Return on assets
ROE	Return on equity
pp	Percentage point
UAH	Ukrainian hryvnia
USD, US dollar	United States dollar
Q	Quarter
H1 / H2	First / second half (of a year)
mln	million
r.h.s.	Right-hand scale
yoy	Year-on-year
qoq	Quarter-on-quarter