National Bank of Ukraine

Non-bank Financial Sector Review

May 2021

In Q1, transaction volumes decreased slightly across all segments of the non-bank financial market compared to Q4. Such dynamics are typical for the start of the year. At the same time, volumes of insurance premiums, lending, and financial leasing transactions grew markedly over the year, compared to the start of 2020. Only factoring transactions fell in annual terms. Since a large share of factoring is related to purchasing bad debts, demand for these services declined after the acute phase of the crisis ended. However, this did not prevent financial companies from making large profits in Q1. Other market segments also generated profits. Only non-life insurers made small profits in Q1, in contrast to the previous year's record highs. Market transformation, including the exit of a number of companies, continues to influence the market's performance. This trend will last throughout 2021.

Sector Structure and Penetration

The transformation of the non-bank financial services market continued in 2021. It was mostly dormant companies that quit the market, although some of them had sizeable assets. The voluntary surrender of licenses followed by removal from the State Register of Financial Institutions remained the main mechanism for exiting the market.

Having reinforced its regulatory framework, the NBU since the start of the year has been able to respond resolutely to violations of regulatory requirements by market participants, especially solvency requirements. The regulator applied corrective measures to a number of violators, suspending their licenses and sending them requests to comply. The corrective measures were mainly imposed on participants of the more risk-prone market sectors – insurers and credit unions. If market participants do not eliminate the detected violations in a timely manner, the severity of supervisory actions increases, up to enforced withdrawal from the market.

A typical violation is the non-submission of reports, which affects the market's aggregated indicators. In particular, a number of financial institutions failed to submit their Q1 reports. The majority of these institutions are in serious financial difficulty. Some of them have faced corrective measures, and a few institutions plan to wind down.

In the meantime, new institutions entered the market – mainly finance companies that received licenses for providing factoring, financial leasing, and lending services.

Overall, Q1 saw a significant decrease in assets of finance companies, the market's largest segment. The share of non-bank financial institutions (NBFIs) in assets of NBU-regulated financial sector thus shank by 1 pp (down to 11%).

Insurers

Insurers' assets declined somewhat in Q1. Gross insurance premiums decreased slightly compared to Q4 2020, primarily on the back of smaller proceeds from corporate and life insurance. However, in year-on-year terms, premiums grew by 6%, both for non-life and life insurance. A decline in life insurance is usual for the first quarter of the year. Concurrently, claims paid by non-life insurers grew by 20% over the quarter, the increase being driven by payments made by a single insurer. For life insurers, claim payouts increased by only 2%.

Reinsurance premiums have been declining for a year already, reaching 19%. Nonresidents' premiums grew and accounted for a half of reinsurance premiums. These trends mean that the opaque internal reinsurance market is shrinking. Premiums paid by individuals prevail in the composition of net insurance premiums. The proportion of these premiums remained unchanged in quarterly terms, standing at 55%. The share of net insurance premiums of voluntary types of insurance decreased to 71% over the quarter. The most common types of insurance remain car insurance (comprehensive coverage, compulsory third party liability insurance, and Green Card) and health insurance.

The loss ratio of non-life insurance was, as usual, quite volatile in quarterly terms. Compared to the previous quarter, in Q1 it dropped for both compulsory and voluntary types of insurance. At the same time, the annualized figures were more stable, at 47% for compulsory insurance and 41% for voluntary.

The operational efficiency of non-life insurers was affected by the excessive proportion of operating costs, which accounted for around 70% of net insurance premiums. The combined ratio was 111%, although this indicator varied across insurers. The operating ratio, which takes in account investment income, grew to 107% quarter-on-quarter. These indicators show that non-life insurers have a low capacity to generate operating income from their core activity.

A large share of their profits came from the difference between other incomes and expenses not related directly to insurance business. The financial performance of non-life insurers was very weak, as such expenses increased markedly in Q1.

The operating results of life insurers remained stable, with the ratio of premiums to claims paid remaining almost unchanged. Their administrative expenses grew over the quarter, which led to a noticeable year-on-year decline in profits. Investment income accounted for a large share of life insurers' income – 15%.

The number of companies in breach of solvency requirements remained high. As of 1 April 2021, 44 licensed insurers were failing to comply with solvency or asset risk requirements. Insurers that fail to comply with the requirements must submit recovery plans to the NBU. Those unable to eliminate the violations are to close their business.

Credit Unions

The credit union segment continues to stagnate, with assets and lending growing very slowly. The aggregated data were heavily affected by the failure of Hromada – the largest credit union until recently – to submit its reports for Q1. In late 2020, it declared almost all of its portfolio, which mainly consisted of business loans to the agricultural sector, to be nonperforming. As a result, Hromada made losses of UAH 362 million, and its capital turned negative. In view of this breach of requirements, the NBU in April suspended the credit union's license for lending and taking deposits. In addition, the State Enforcement Service seized Hromada's accounts this February due to lawsuits filed by the union's depositors. The credit union's financial difficulties and the failure to submit reports were most likely driven by its inability to restore its performance to an acceptable level. Therefore, Hromada should be excluded when considering the situation on the credit union market.

The assets of the majority of institutions grew moderately on the back of an increase in lending. The largest growth was seen in business loans to private farms. In Q1, the NPL ratio (both total and by loan type) exceeded the pre-quarantine level of 2020 by 2–4 pp. At the same time, the reliability of loan portfolio quality declared by credit unions will undergo additional analysis.

Operating income, particularly net interest income, decreased somewhat compared to the previous period, but increased compared to Q1 2020. This was driven by a larger interest rate spread: with an almost unchanged loan rate of 36%, the deposit rate declined from 22% to 19%. The ratio of operating expenses to operating income decreased. Concurrently, credit unions' provisioning expenses declined. These factors enabled credit unions to generate profits in Q1.

Equity increased somewhat on account of these profits. Deposit volumes remained practically unchanged. Additional share contributions as a percentage of total funding continued to decrease. It is worth noting that the additional share contributions attracted and returned over the year exceeded the balances as of 1 April. Therefore, this funding component is not stable.

The lack of a significant improvement in the financial performance of credit unions has led to numerous violations of requirements. Nine credit unions were in breach of the capital adequacy requirement as of 1 April.

Finance Companies

The assets of finance companies decreased significantly in Q1. This was mostly due to one large company leaving the market. Volumes of financial services provided over the quarter also dropped. In particular, finance companies issued lower volumes of corporate loans. However, a large share of these transactions reflect only the redistribution of funds within business groups. On the other hand, retail lending has been on the rise for three quarters straight.

Factoring transactions fell the most in absolute terms. Most of these transactions were related to purchasing bad debts, and finance companies became less active in this segment at the start of the year. Volumes of financial leasing transactions thus also decreased, driven primarily by seasonality and a decrease in business activity in Q1. In Q1 2021, finance companies generated record-high profits compared to the same period of the previous three years.

Pawnshops

In Q1 2021, volumes of new lending declined by almost 8% compared to the previous period, but rose slightly compared to Q1 2020. The collateral coverage ratio grew to 120%. The income composition was almost unchanged, with interest income prevailing. Pawnshops were profit-making.

Prospects and Risks

In early 2021, NBFIs began to actively disclose and simplify their ownership structures. New requirements for ownership structure disclosure took effect in mid-April. Financial institutions will have time until October to bring their ownership structure into compliance with the new requirements.

In addition to increasing transparency, NBFIs must improve their performance, which includes compliance with prudential capital requirements. To this end, financial institutions should enhance their efficiency, and some even need to increase capital.

Work continues on new draft laws on the non-bank financial market. Their adoption will tighten solvency requirements and strengthen the overall resilience of the market.

Sector Structure and Penetration

NBFI assets declined markedly in Q1. A sizeable decrease was seen in the finance company segment, as one large company voluntarily surrendered its license. Insurers' assets also dropped by 1%. The assets of credit unions and pawnshops grew somewhat. The number of financial institutions declined.

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

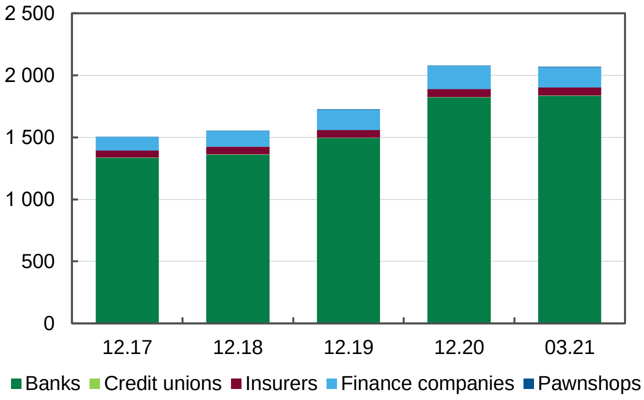
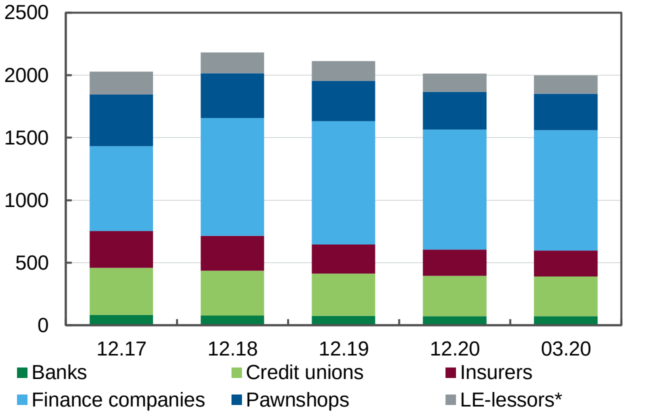


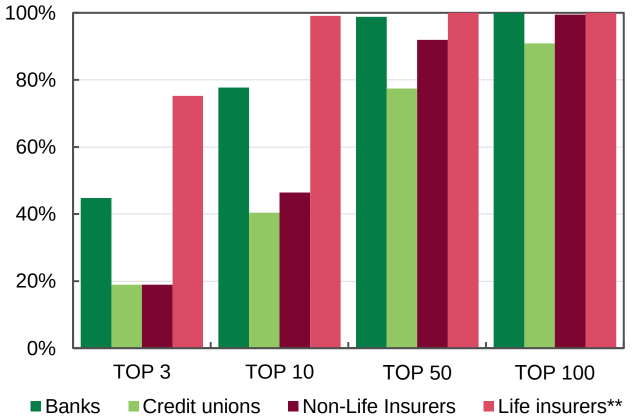
Figure 2. Number of financial service providers



* 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 the highest in banks and the life insurance sector, which consists of 20 companies.

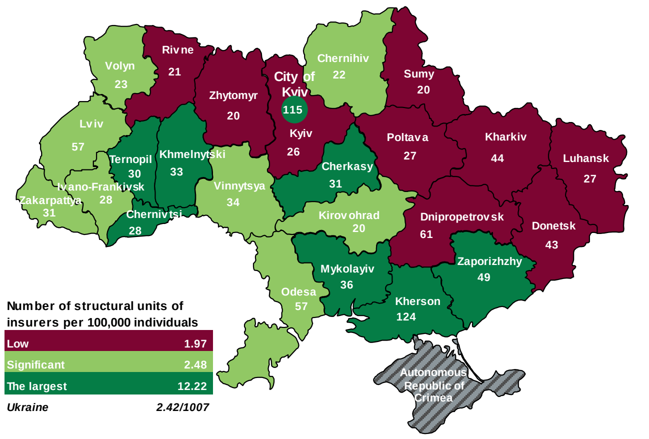
Figure 3. Concentration* of insurance companies and credit unions compared to banks



* 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 20 insurance companies provide life insurance.

Insurance penetration is slightly higher in the southern and western regions of Ukraine.

Figure 4. Number of structural units of insurers by region, units



Unlike NBFI assets, banks' assets grew in Q1. This brought the market share of NBFIs down to 11%.

Table. Financial institutions under NBU regulation*

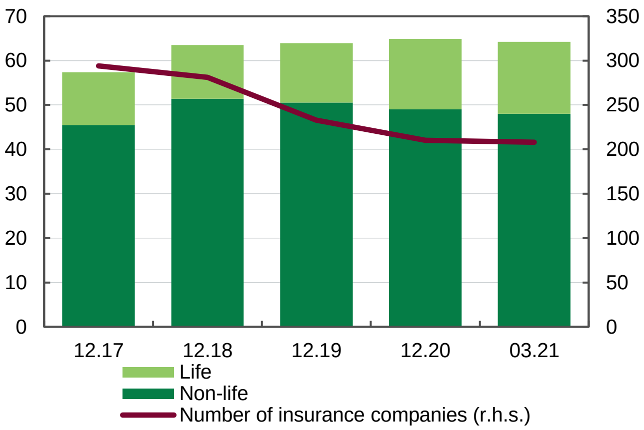
		2016	2017	2018	2019	2020	03.21	Qoq change
Insurers	Assets, UAH millions	56 076	57 381	63 493	63 866	64 920	64 247	-1.0%
	Number of companies	310	294	281	233	210	208	-2
Credit Unions	Assets, UAH millions	2 033	2 170	2 218	2 510	2 317	2 335	0.8%
	Number of companies	462	378	358	337	322	316	-6
Finance Companies	Assets, UAH millions	67 401	107 534	125 322	162 197	186 501	162 310	-13.0%
	Number of companies	650	677	940	986	960	964	4
Pawnshops	Assets, UAH millions	3 318	3 764	3 721	4 265	3 867	3 935	1.8%
	Number of companies	456	415	359	324	302	292	-10
Banks	Assets, UAH millions	1 256 299	1 333 831	1 359 703	1 493 298	1 822 814	1 835 527	0.7%
	Number of companies	96	82	77	75	73	73	0

* Along with Q1 2021 earnings reports, the NBFIs were able to clarify reporting data for Q4 2020. They made retrospective adjustments to certain indicators, in particular the size of assets for this period.

Insurers

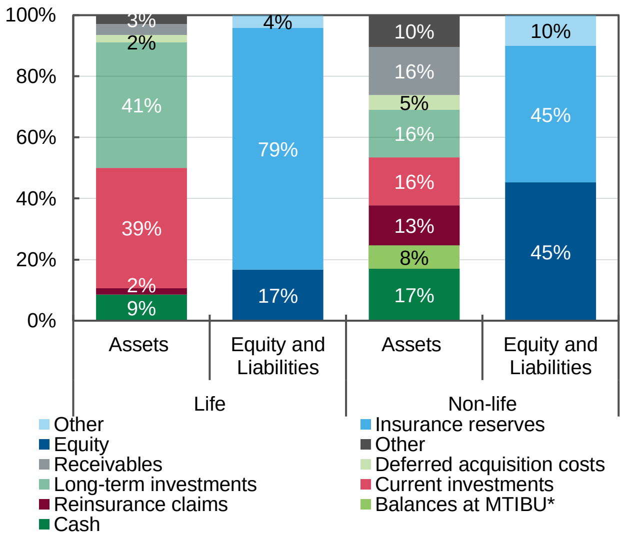
The assets of non-life insurers shrank by 2% over the quarter, whereas life insurers' assets grew.

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



The assets and equity and liabilities structure of life and non-life insurers remains stable.

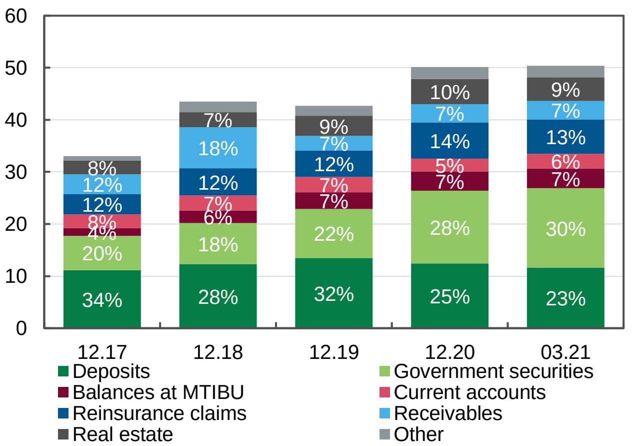
Figure 6. Assets, equity, and liabilities of life- and non-life insurers as of 1 April 2021



* Motor (Transport) Insurance Bureau of Ukraine.

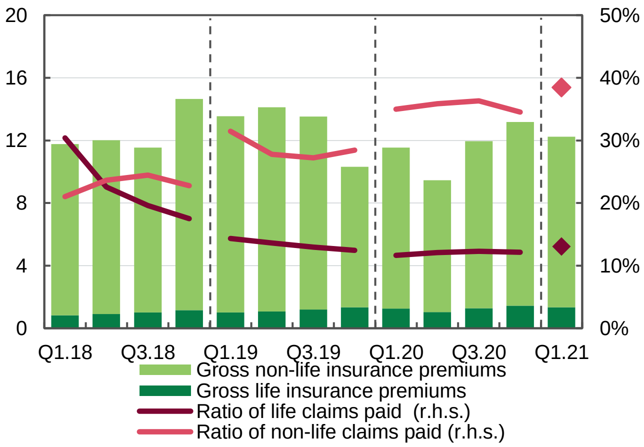
The share of government securities in eligible assets continues to grow.

Figure 7. Structure of assets eligible to cover provisions of non-life insurers, UAH billions



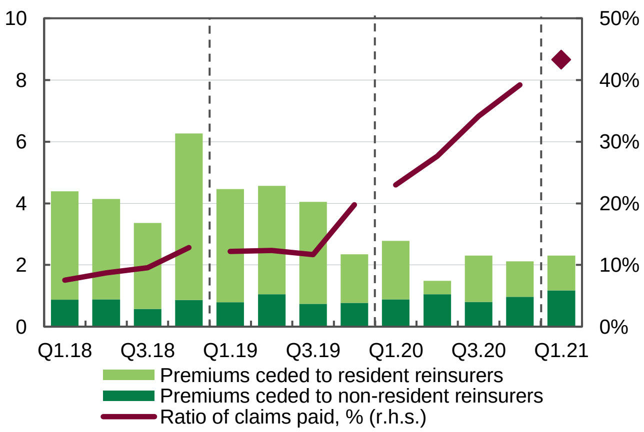
The claims paid ratio inched higher over the quarter, to 13% for life insurance and 38% for non-life.

Figure 8. Premiums and ratio of claims paid* by type of insurance, UAH billions



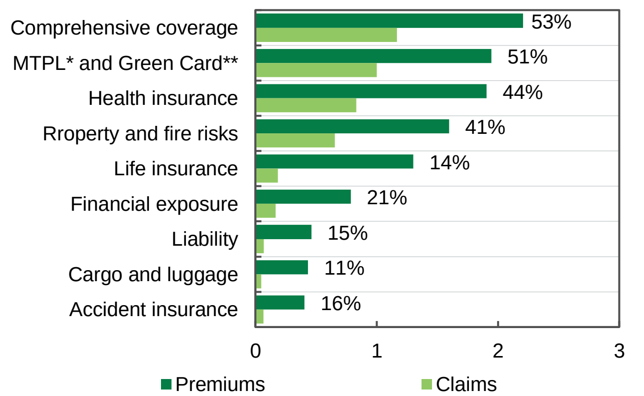
The share of reinsurance premiums grew to 19%. Reinsurance claim payments have been growing for six consecutive quarters, reaching 43%.

Figure 9. Premiums ceded to reinsurers and ratio of claims paid*, UAH billions



The largest share of insurance premiums came from car insurance and health insurance. Claim payments remain very low for some types of insurance.

Figure 10. Breakdown of insurance premiums and claim payments by most popular types of insurance in Q1 2021, UAH billions



* 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.

The net premiums of life insurers declined noticeably, which is typical of Q1. Non-life insurers' net premiums also decreased over the quarter, albeit by a small amount. The decrease was driven by lower volumes of legal entity transactions. At the same time, insurance of individuals picked up compared to Q4 2020.

Figure 11. Net insurance premiums by type of insurance, Q1 2018 = 100%

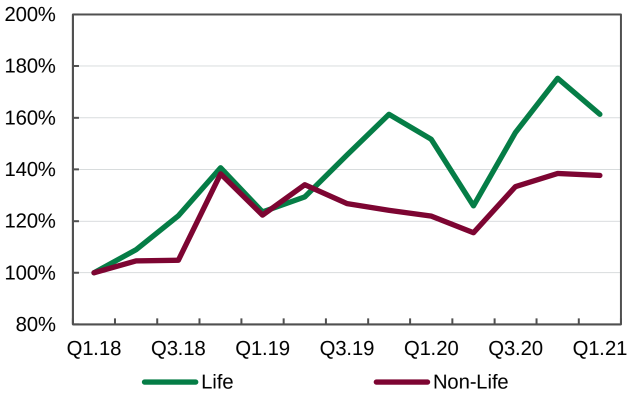
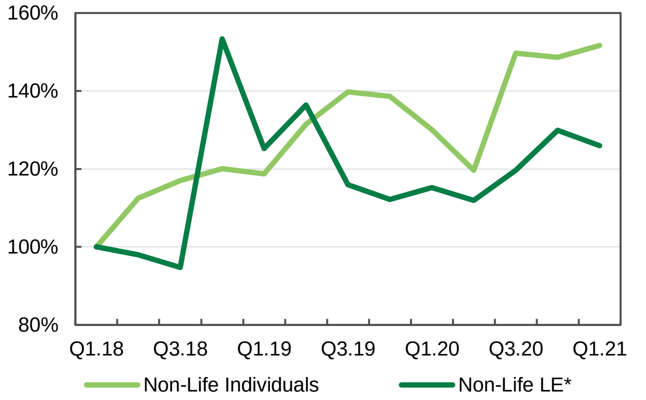


Figure 12. Non-life insurance premiums by type of policyholder, Q1 2018 = 100%



* Legal entities.

Compared to Q4 2020, the provisioning rate increased for voluntary insurance and decreased for compulsory insurance.

Figure 13. Provisioning rate of voluntary non-life insurance

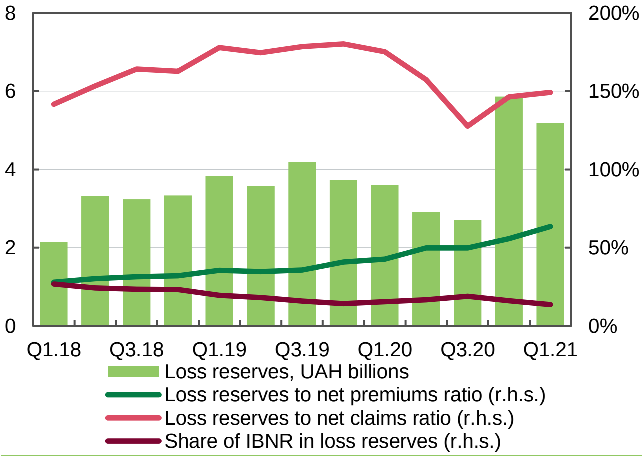
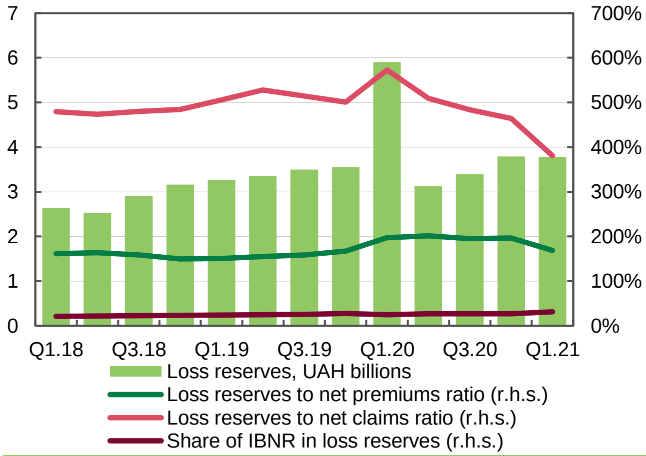


Figure 14. Provisioning rate of compulsory non-life insurance



Loss ratios remained almost unchanged over the quarter. The significant quarterly volatility of this indicator is levelled out in annual terms.

Figure 15. Share of compulsory insurance premiums and loss ratio of non-life insurance

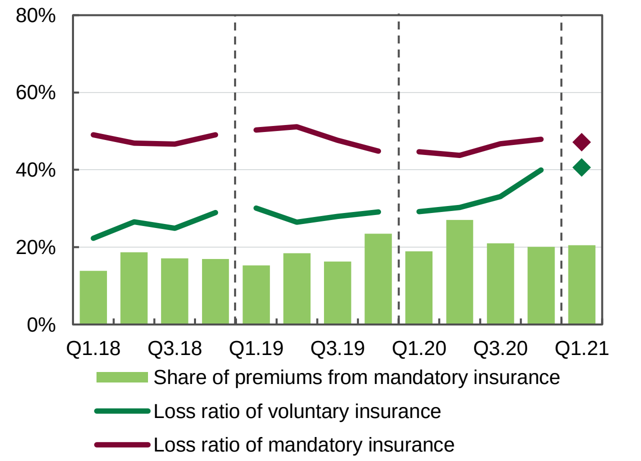
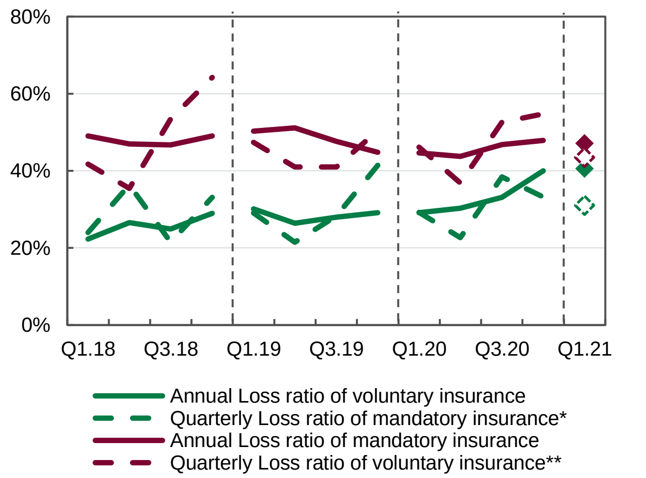


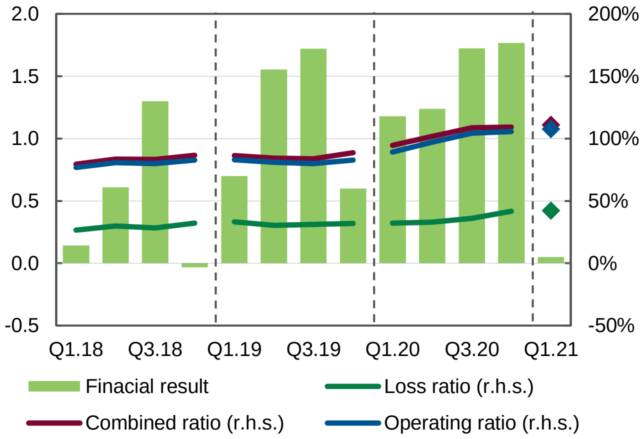
Figure 16. Loss ratio depending on the calculation period



* Excluding the fire insurance loss provisions formed in Q4 2020. Prior to adjustment, the ratio is 66%.
** Excluding aviation insurance loss provisions released over the course of the year. Prior to adjustment, the indicators were 159% and -59%, respectively.

Operational efficiency indicators – the combined ratio and the operating ratio – improved somewhat, but remained high for non-life insurers.

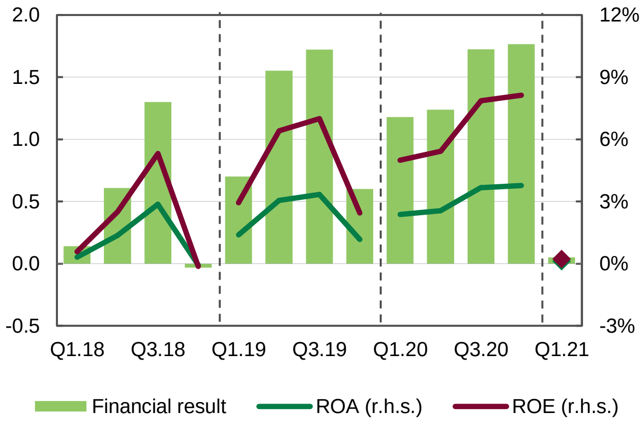
Figure 17. Cumulative profit or loss and operating performance indicators of non-life insurers, UAH billions



The operating ratio is the difference between the combined ratio and the investment income ratio. Investment income ratio is the ratio of financial income to premiums, less changes in unearned premium reserves.

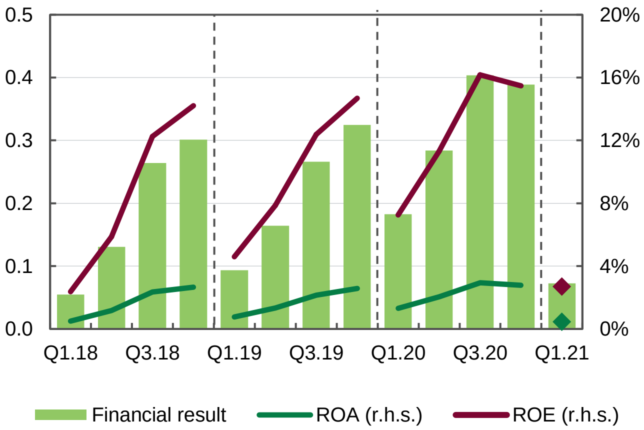
Non-life insurers reported low profits in Q1 2021, which brought their profitability close zero.

Figure 18. Financial performance of non-life insurers on a cumulative basis, UAH billions



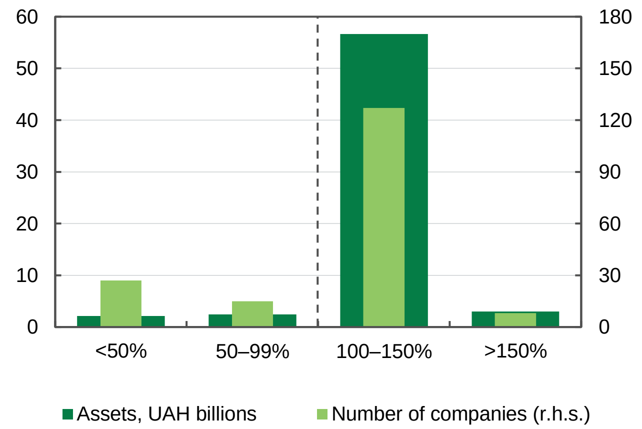
Life insurers were generating profit, but their profitability ratios declined compared to Q1 2020.

Figure 19. Financial performance of life insurers on a cumulative basis, UAH billions



Insurers that do not meet solvency requirements account for only 7% of assets, although their number is still significant.

Figure 20. Distribution of number and assets of insurers* by ratio of eligible assets to required solvency margin, as of 1 April 2021

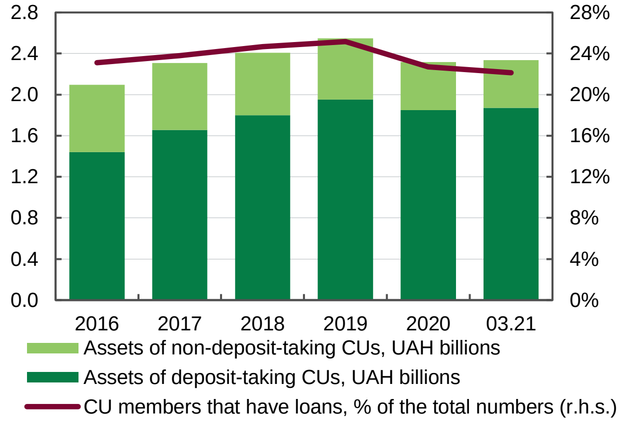


* This figure is based on data from 177 companies.

Credit Unions

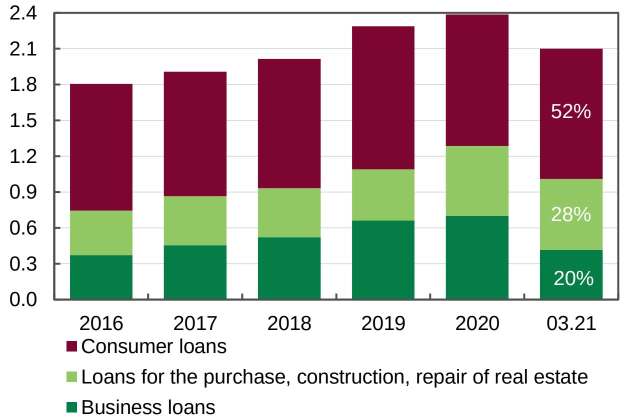
The number of credit unions decreased to 316 compared to the start of the year. Their assets grew somewhat, especially the assets of those credit unions licensed to take deposits. Of the existing credit unions, 78% remained dormant.

Figure 21. Total assets of credit unions (CU) and share of credit union members who took out loans



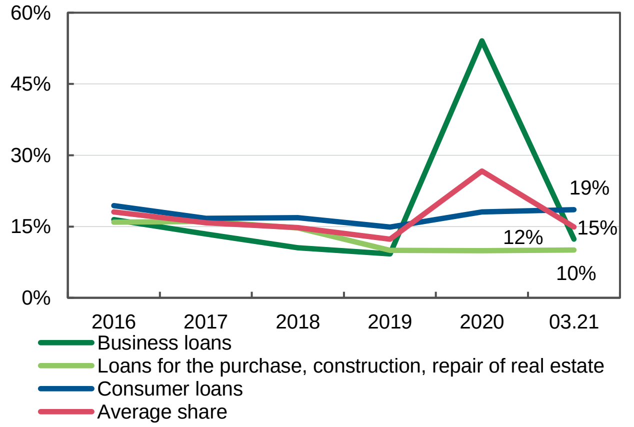
The loan portfolio of credit unions shrank by 12%. Volumes of consumer loans, an important component of the loan portfolio, declined somewhat. However, there was a major impact from a 41% decrease in business loans, as the performance of the Hromada credit union was not reflected in the statistics.

Figure 22. Structure of outstanding loan principal, UAH billions



The share of loans past due by more than 90 days almost halved, reaching 15%. This was also an effect of excluding the business loans issued by Hromada.

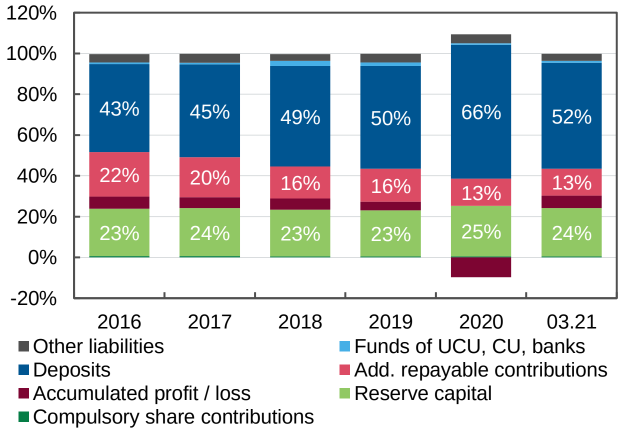
Figure 23. Share of non-performing loans* by types



* Loans overdue more than 90 days.

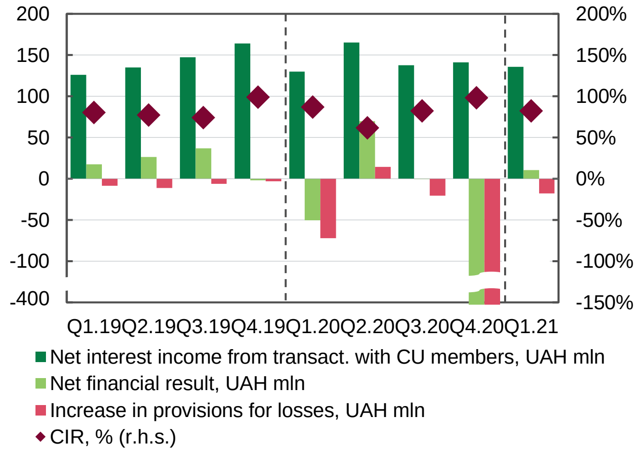
The removal of the loss-making credit union Hromada from the statistics also impacted the funding structure. In particular, the equity of active credit unions accounted for 6% of their liabilities. Its size grew slightly in quarterly terms on account of profits.

Figure 24. Composition of funding sources



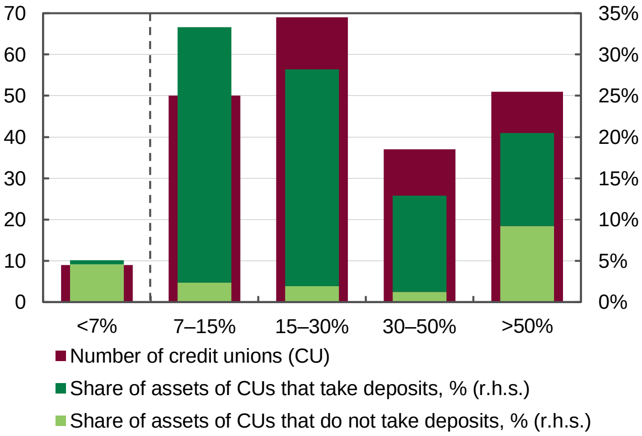
The operational efficiency of credit unions is still low, although they made profits in Q1. Their profitability was, among other things, influenced by lower expenses on loan loss provisioning.

Figure 25. Operational efficiency



The number of credit unions that did not meet the minimum solvency requirements increased by a third as of 1 April 2021. Of these nine credit unions, most did not take deposits.

Figure 26. Distribution by core capital adequacy as of 1 April 2021



Finance Companies

The assets of finance companies decreased significantly in Q1, while their structure remained stable. Despite the decrease in assets and the exit of some companies from the market, finance companies' equity remained almost unchanged. The share of equity in equity and liabilities thus grew to 16%.

Figure 27. Finance companies' asset structure, UAH billions

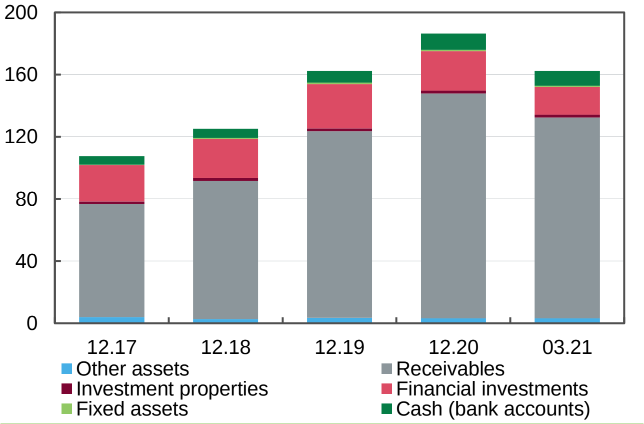
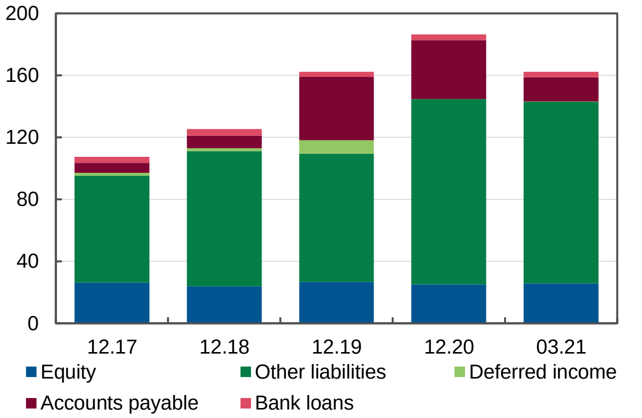
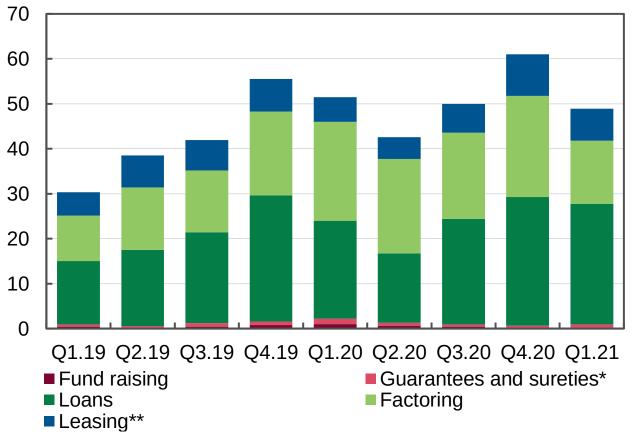


Figure 28. Composition of finance companies' equity and liabilities, UAH billions



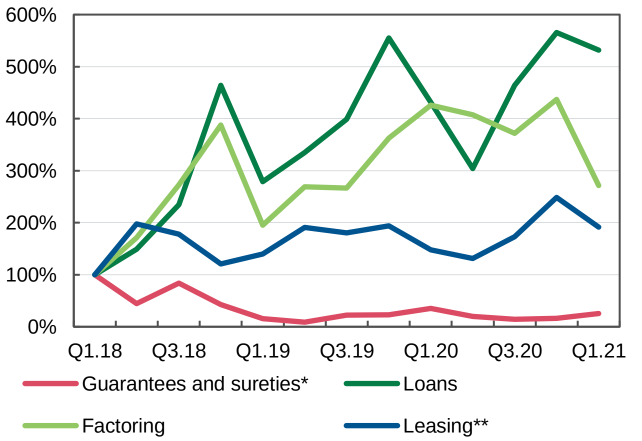
In Q1, lending accounted for more than a half of the services provided by finance companies. Almost all financial services declined over the quarter. Factoring transactions fell to the level of mid-2019.

Figure 29. Financial services provided by finance companies, by type of service (quarterly data), UAH billions



* Until 1 July 2020 includes guarantees and sureties, afterwards – guarantees only.
** Legal entities-lessors and finance companies.

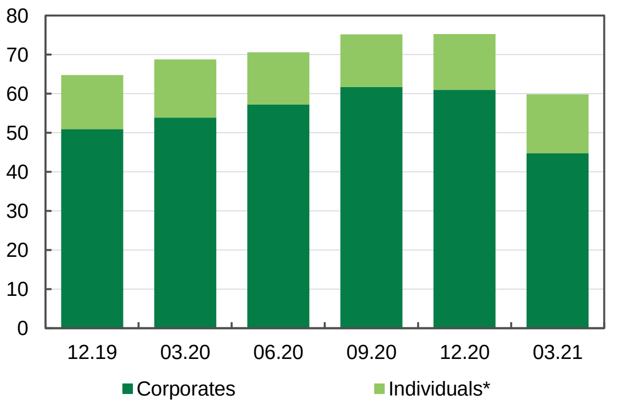
Figure 30. Financial services provided by finance companies, by type of service (quarterly data), Q1 2018 = 100%



* Until 1 July 2020 includes guarantees and sureties, afterwards – guarantees only.
** Legal entities-lessors and finance companies.

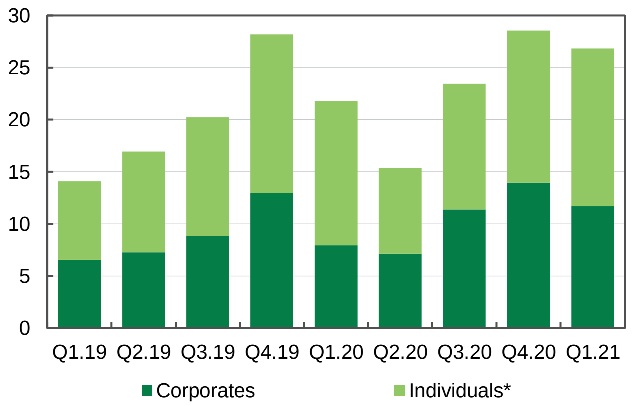
The gross loan portfolio of finance companies decreased in Q1. This was driven by a 27% decrease in outstanding corporate loans, most of which were not issued on market terms but reflected intragroup transactions. That said, outstanding retail loans grew, with their share in the portfolio rising to 25%. Most new loans were issued to households in Q1. Retail lending has been on the rise for three quarters straight.

Figure 31. Gross outstanding loans of finance companies, UAH billions



* Including sole proprietors.

Figure 32. Loans issued during quarter, by borrower category, UAH billions



* Including sole proprietors.

Finance companies issued new loans mainly for short terms. In total, 37% of new loans were made for up to 31 days, and 59% for up to one year. Over 65% of new retail loans were granted for up to 31 days, while more than 90% of corporate loans were provided for three months to a year.

Figure 33. Breakdown of loans issued during quarter, by maturity

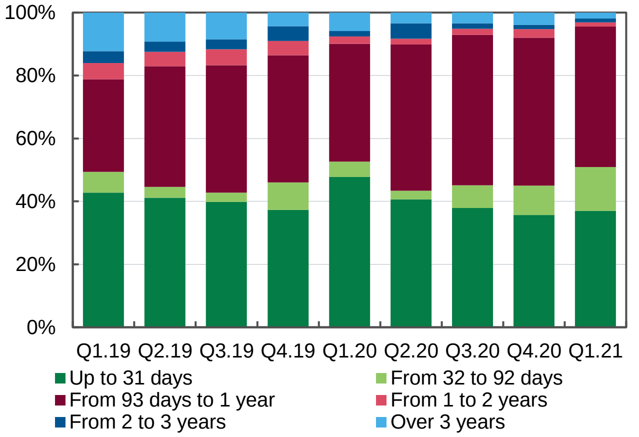
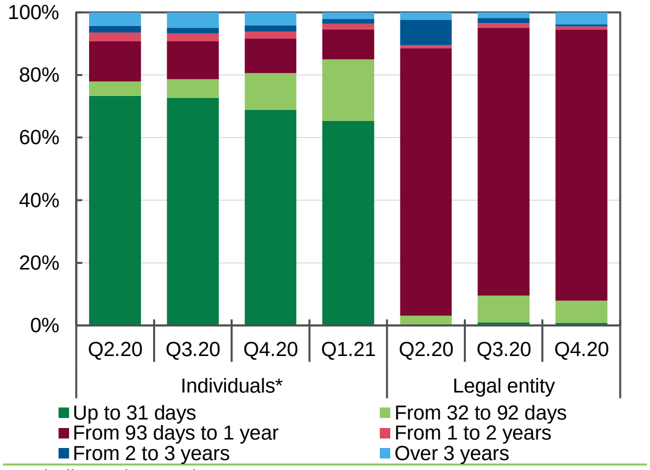


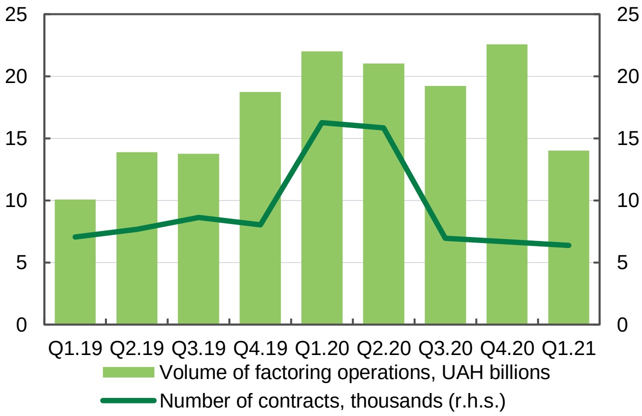
Figure 34. Breakdown of loans issued during quarter, by maturity and client's type



* Including sole proprietors.

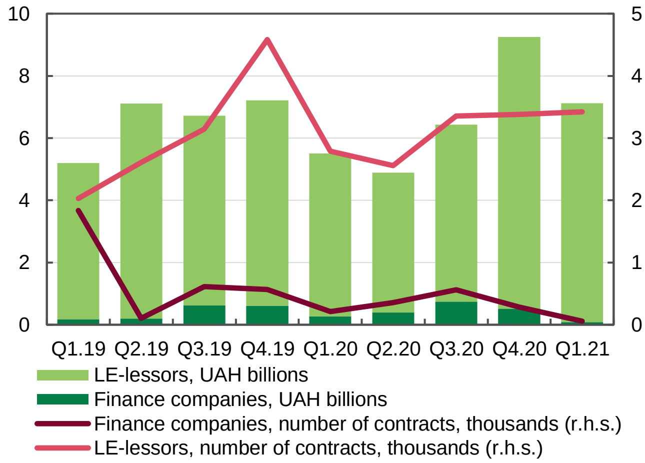
Finance companies' factoring transactions almost halved in Q1. Comparable volumes and number of agreements were seen in the middle of 2019.

Figure 35. Volume and number of factoring agreements



Financial leasing volumes declined in Q1, but still were higher than in Q1 2020. Finance companies practically stopped providing leasing transactions.

Figure 36. Volume and number of financial leasing agreements



In Q1 2021, finance companies earned higher profits than in the first quarters of the three previous years. Their profitability thus improved as well.

Figure 37. Financial performance of finance companies on cumulative basis, UAH billions

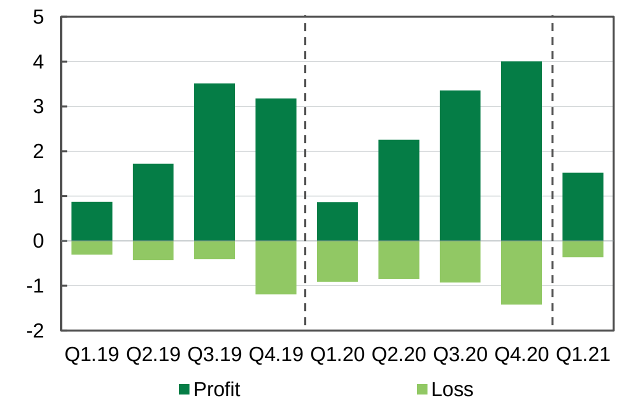
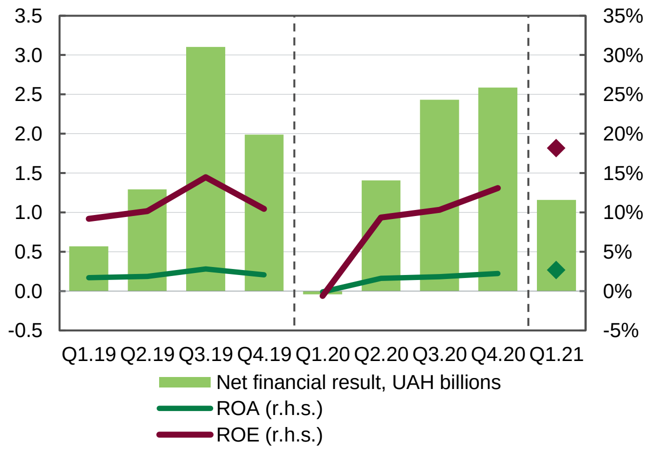


Figure 38. Financial performance of finance companies (on cumulative basis) and their return ratios



Pawnshops

Pawnshops' assets were practically unchanged in Q1. Their asset structure remained stable, as did the structure of their liabilities. Issued loans accounted for 73% of assets, and equity accounted for over 43% of equity and liabilities.

Figure 39. Assets, UAH billions

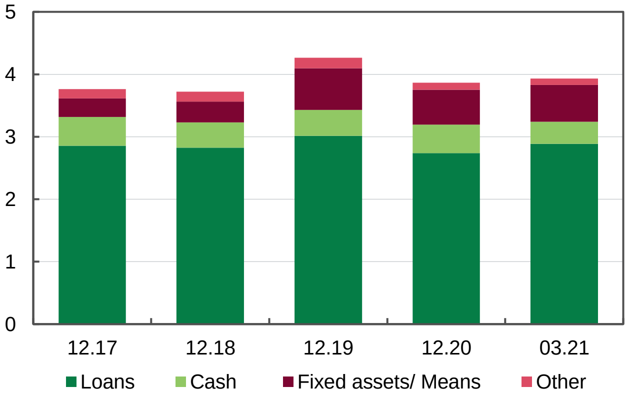
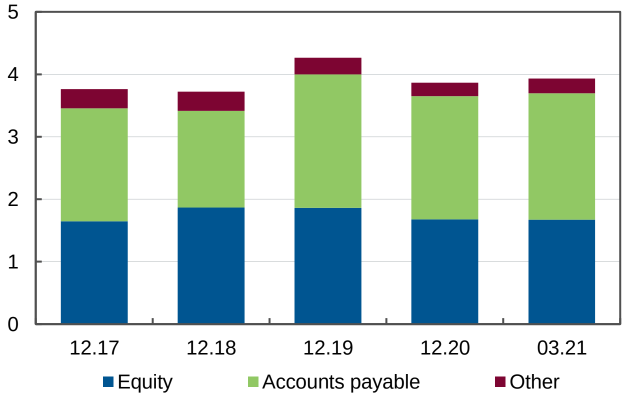


Figure 40. Liabilities and equity, UAH billions



Volumes of new loans dropped by almost 8% in Q1 2021, which corresponds to the level seen in Q1 2020. The collateral coverage ratio grew to 120%. The loan portfolio structure by type of collateral was unchanged.

Figure 41. Amount of loans issued during the quarter and collateral coverage ratio

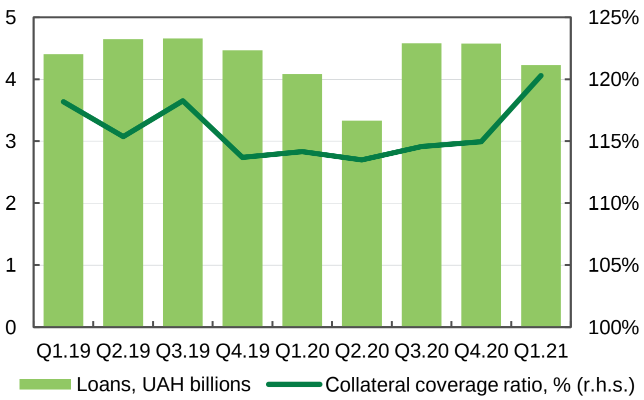
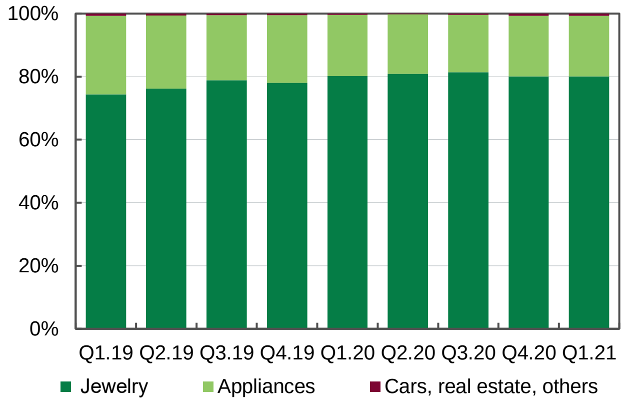


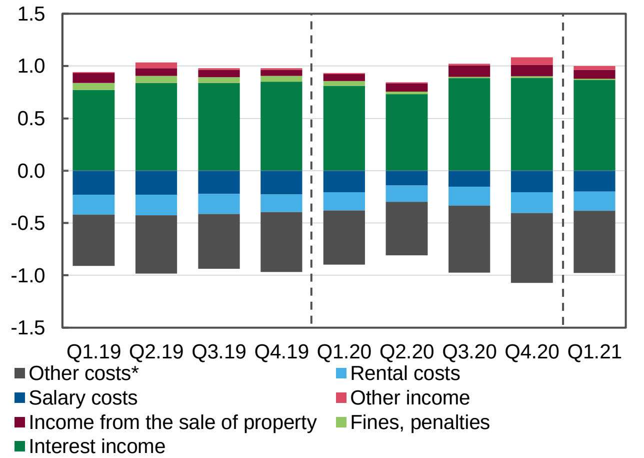
Figure 42. Loan portfolio structure by type of collateral



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

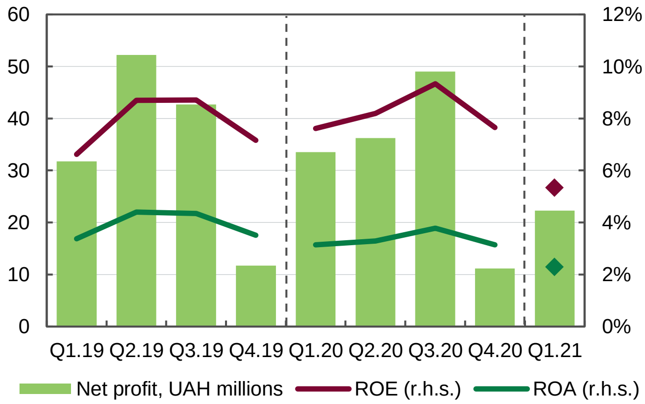
In Q1 2021, pawnshops earned 7.3% more income year-on-year. However, their expenses also increased. Thus, the profitability of pawnshops declined to 5.3%, although their activities remained profitable. These dynamics are generally in line with previous years.

Figure 43. Structure of income and expenses, UAH billions



* Including expenses related to selling and maintaining pledged property.

Figure 44. 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 Q1 2021, NBFIs, at the NBU's request, adjusted their improperly compiled reporting figures for previous periods (including Q4 2020 and the whole 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
IBNR	Incurred but not reported (claims)
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
UCU	Union of credit unions
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