National Bank of Ukraine

Non-bank Financial Sector Review

December 2020

As quarantine restrictions were eased in Q3, non-bank financial institutions (NBFIs) started to recover their operations. Lending grew the fastest, especially lending provided by finance companies and pawnshops. Assets of these financial institutions increased as well, allowing them to get a larger share in the sector's total assets. Meanwhile, assets of insurers decreased somewhat. However, it had no impact on insurance premium volume, which grew compared to the previous period and the pre-crisis levels of Q1. At present, credit unions are performing the worst, as they are the slowest in recovering the volumes of their operations and as they made losses for the first three quarters of 2020. This comes in a stark contrast to the results of the rest of NBFIs, which are highly profitable despite the crisis.

Sector Structure and Penetration

Assets of some NBFIs increased in Q3. Assets of pawnshops rose markedly, whereas insurers' assets decreased somewhat. This led to a change in the sector structure. Overall, total assets of NBFIs have remained almost unchanged. However, because of a sizeable growth in the banking sector, the share of NBFIs in the assets of the NBU-regulated financial sector dropped. Thus, Ukraine is still ranking low compared to other European countries in terms of penetration of non-bank financial services. The number of NBFIs, especially finance companies, continued to decline due to voluntary surrender and revocation of licenses. This tendency may last as the number of dormant companies is still large.

Insurers

Insurers' assets continued to drop in Q3. At the same time, gross insurance premiums grew noticeably, by 26% compared to Q2 and by 3% compared to the pre-crisis Q1 2020. Nevertheless, this is still below the last year's level. Insurance claims paid have been growing at a similar pace. Therefore, the ratio of claims paid remained almost unchanged, at 36% for non-life insurance and 12% for life insurance.

Premiums on comprehensive vehicle insurance (CASCO), property insurance, fire insurance, and financial risk insurance grew the fastest. Premiums on MTPL (compulsory motor third party liability insurance) increased somewhat slower. Overall, the structure of insurance premiums has not changed much over the quarter. Life insurance, voluntary health insurance, and accident insurance generated 28% of total premiums, same as in the previous quarter.

In Q3 2020, the loss ratio of non-life insurance was 18%. Such unusually low level is explained by the release of loss provisions in civil aviation insurance that were made in Q1. This one-off effect put aside, insurers' loss ratio increased to 41%. The ratio is higher for compulsory insurance, reaching 53%. The loss ratio of voluntary insurance is 38%. Both indicators increased compared to Q2.

The operational efficiency of non-life insurers remains low. A high combined ratio is driven by expenses on running the insurance business other than claim settlement and provisioning. These expenses remain stable throughout the year, reaching 56% of insurance premiums adjusted for unearned premium reserves. The change in the combined ratio is mostly explained by the volatility of the loss ratio.

Investment income accounts for an insignificant share of insurers' total revenues. This share is larger for life insurance, making up to 20% of total revenues. Investment income mainly include proceeds from bonds (particularly domestic government debt securities), which rose in Q3, and deposits. Non-life insurers receive less than 5% of their income from investments, which are mostly deposits.

Largely thanks to recovery of insurance operations volume, insurers' financial performance improved in Q3. The return on assets is 1.3%.

The number of companies that violated the regulator's solvency requirements decreased over the quarter. However, 45 licensed insurers failed to fully comply with solvency requirements as of 1 October. The quality of assets that cover solvency requirements did not change much over the quarter. However, the share of claims to reinsurers decreased. Real estate that is most likely overvalued still accounts for a large share of assets of mostly small insurance companies.

Credit Unions

Although the economy is gradually recovering, the assets of credit unions are growing rather moderately and unevenly, as is their lending, with a few large players leading this growth. Growth opportunities are being stifled by the overall decline in households' financial standing and the unpreparedness of unions to provide remote services. Impediments to growth include the focus on cash payments and the underdevelopment of e-products. Among credit union members, 23% are active, meaning that they use services provided by credit unions.

At the same time, the quality of the loan portfolio has been rapidly deteriorating. In addition to borrowers' low paying capacity, this has been driven by the lack of instruments to manage NPLs. In particular, credit unions and other creditors cannot fine households for falling past due on their loan repayments. About a third of loans are more than 90 days past due, twice as much as in Q2. Business loans, much of which has been restructured, are performing the worst. This portfolio is characterized by the highest concentration. A significant proportion of loans have been made to individuals who may be associated with the management of credit unions.

Despite the worsening of loan portfolio quality, the provisioning costs reported by credit unions declined in Q3. Meanwhile, income from the release of provisions over the past six months has exceeded provisioning costs. Among other things, this enabled credit unions to turn a profit in Q2 and Q3. All of this means that credit unions' losses are significantly underestimated.

Operating income, in particular net interest income from transactions with credit union members, declined from both Q2 and the same period last year. At the same time, average interest rates on all types of loans decreased. The ratio of operating expenses to operating income increased. The ratio is much higher for small credit unions.

Low profitability leads to a decrease in equity as a share of credit unions' funding. At the same time, deposits are growing at a moderate rate. As of 1 October, a total of 11 credit unions failed to meet regulatory capital requirements. Credit unions should further reevaluate loan provisions as loan portfolio quality deteriorates, and properly reflect the share of overdue loans after applicable regulatory requirements take effect. This will most likely lead to a deterioration in the solvency of a number of players.

Finance Companies

Despite a decrease in their quantity, the assets of finance companies increased in Q3 2020, mostly thanks to resuming lending to the real economy. Specifically, the amount of retail loans increased by 47% during the quarter, while corporate loans rose by 58%. The loan portfolio is dominated by corporate loans with longer maturity.

Leasing is recovering along with lending. Leasing transactions increased in volume by 46% qoq, and by 6% yoy. The factoring transactions of finance companies edged down. However, this figure remains higher than in the same quarter last year.

In Q3, finance companies continued to generate profits. Though still lower than in the same period last year, profitability remained at last year's level.

Pawnshops

After a short-lived drop in transactions, pawnshops in Q3 2020 stepped up lending, bringing it close to last year's levels. The collateral coverage ratio also increased to reach 115%. Sales of pledged property hiked. However, they account for only 11% of pawnshops' income. Over 86% of their income comes from interest income, which increased year-on-year. Operating profitability inched down to 7.2% in a repeat of previous years' trends.

Prospects and Risks

As expected, the volume of NBFI operations mainly increased as economic activity began to recover. This trend is set to continue. Most sectors are expected to report profits for the year. Credit unions will be the last to recover from the effects of the crisis, and are likely to end the year in the red.

As before, the regulator will pay special attention to NBFIs that are in violation of the minimum requirements. These entities need to take steps to improve their performance. At the same time, there is as much concern over companies that manipulate their reporting indicators to demonstrate formal compliance with the requirements when in fact these companies fall short of a sufficient margin of solvency. To identify and eliminate these problems, the NBU plans to strengthen control over the correctness of reporting.

In addition, to verify the correctness of how insurers present their assets and liabilities, the regulator will assess the overall financial standing of insurers starting 1 January. The assessment will come in two stages: first, external auditors will verify the quality of reporting of insurers' assets, reserves, and off-balance sheet liabilities, and second, based on these estimates, the NBU will determine whether insurers comply with solvency requirements. Also planned for next year are changes to the characteristics of assets eligible to cover insurers' reserves. In particular, the role of real estate will be reduced, as it is often illiquid and cannot be quickly used by non-life insurers to meet their commitments.

Sector Structure and Penetration

In Q3, NBFI assets increased slightly. The highest increase in assets was reported by pawnshops (up about 4% from Q2). Insurers' assets inched lower. The number of operating insurance companies continues to decrease, primarily through the voluntary surrender of licenses.

Figure 1. Financial sector asset structure, UAH billions

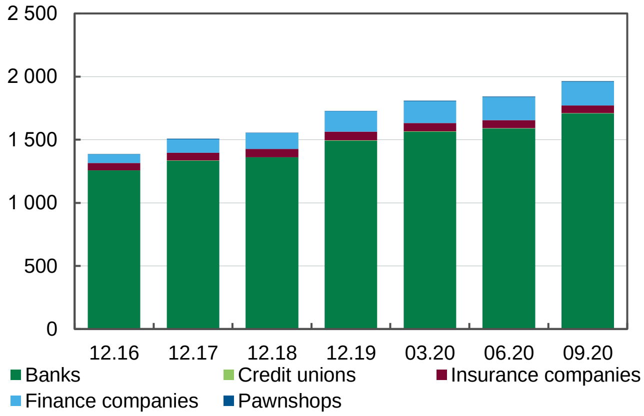
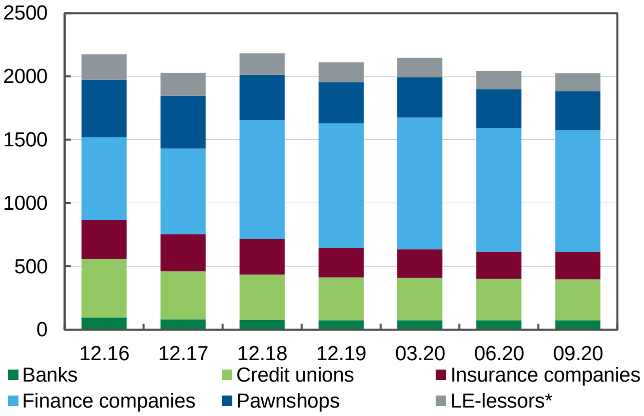


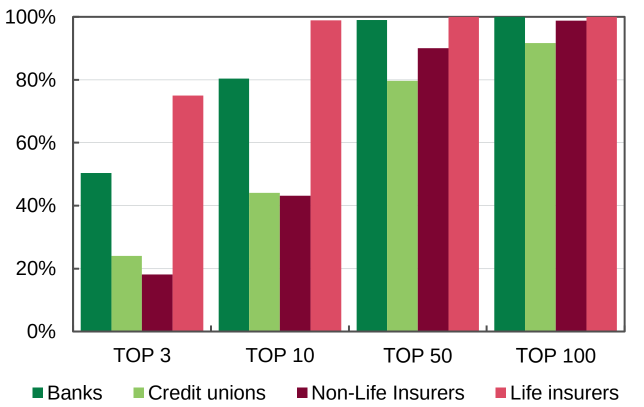
Figure 2. Number of financial service providers



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

As with the previous quarter, the highest concentration is in banks and the life insurance sector, which consists of 20 companies.

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

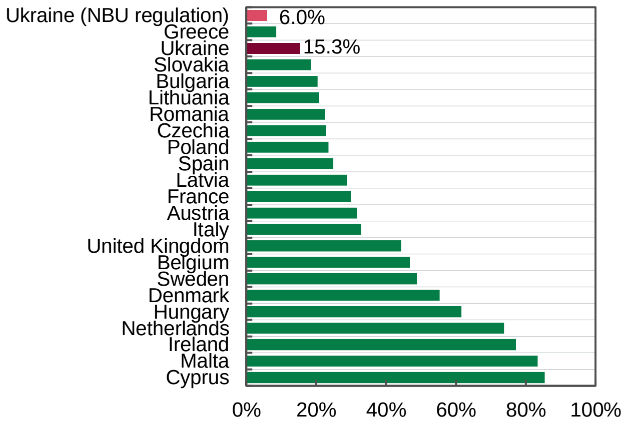


* Concentration was estimated in terms of assets for banks and credit unions, premiums for non-life insurers, and insurance technical provisions for life insurers.

** A total of 20 insurance companies provide life insurance.

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.

Rapid growth in bank assets reduced the NBFI share.

Table 1. Financial sector's assets

		2016	2017	2018	2019	03.20	06.20	09.20	Change qoq
Insurers	Assets, UAH millions	57 811	59 313	66 126	66 916	65 115	61 888	61 626	-0.4%
	Number of companies	310	294	281	233	225	215	215	0
Credit Unions	Assets, UAH millions	2 033	2 170	2 218	2 510	2 543	2 564	2 603	1.5%
	Number of companies	462	378	358	337	335	327	324	-3
Finance Companies	Assets, UAH millions	67 401	107 534	125 322	162 197	172 845	184 108	186 936	1.5%
	Number of companies	650	677	940	986	1 040	976	965	-11
Pawnshops	Assets, UAH millions	3.318	3.764	3.721	4.265	4.353	3.943	4.117	4.4%
	Number of companies	456	415	359	324	319	306	304	-2
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	7.4%
	Number of companies	96	82	77	75	75	75	74	-1

* Together with Q3 2020 earnings reports, the NBFIs were able to update reporting data for Q2 2020. They made retrospective adjustments to certain indicators, in particular the size of assets for this period.

Insurers

Insurers' assets continue to decline slowly. Share of illiquid assets at life insurers decreased during the quarter, with long-term investments and receivables declining to 22% from 33%. The composition of non-life insurers' assets did not change significantly.

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

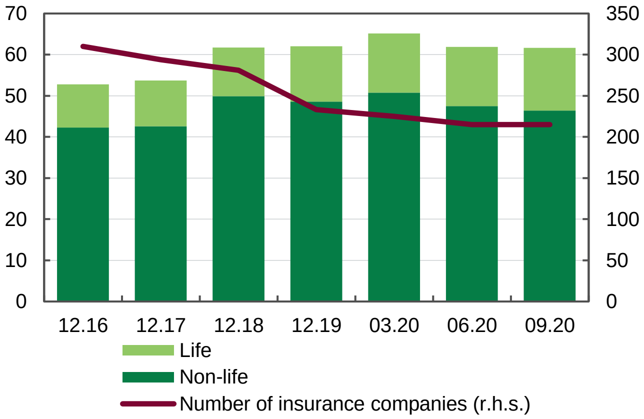
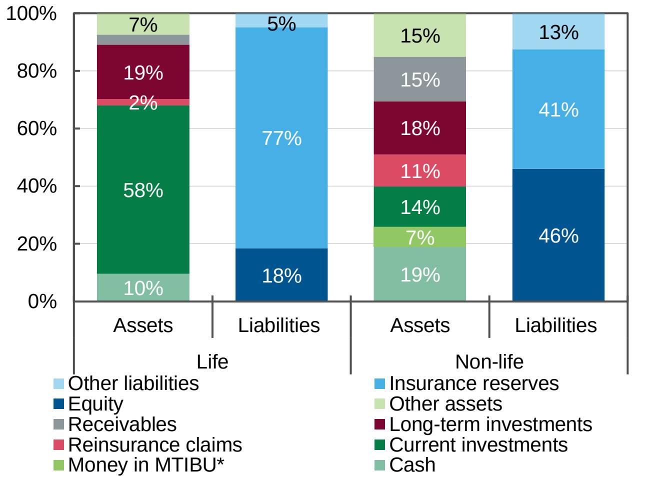


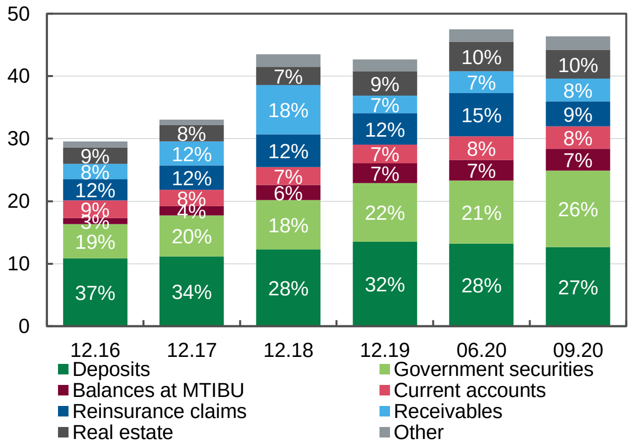
Figure 6. Assets and liabilities of insurers as of 1 October 2020



* Motor Transport Insurance Bureau of Ukraine.

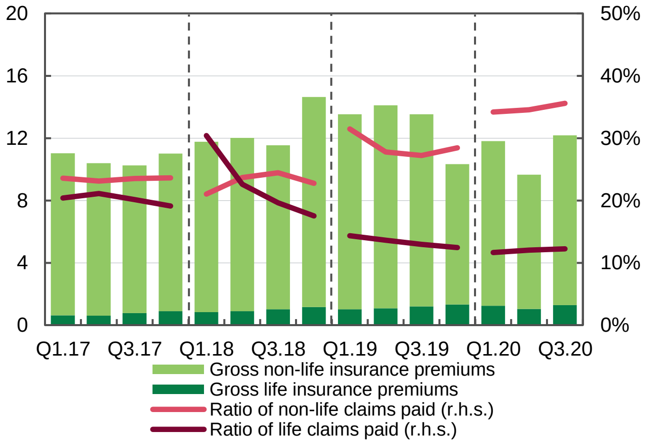
Over the quarter, rights of claim against reinsurers as a share of eligible assets changed the most, shrinking to 9%. Share of government securities increased.

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



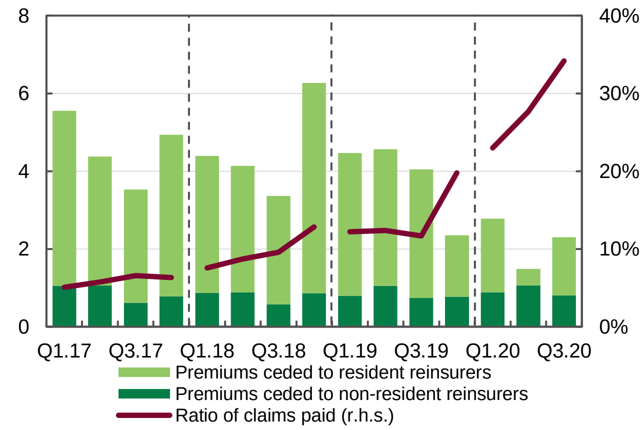
The level of insurance payments has hardly changed compared to Q2 and is 36% for non-life and 12% for life insurers.

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



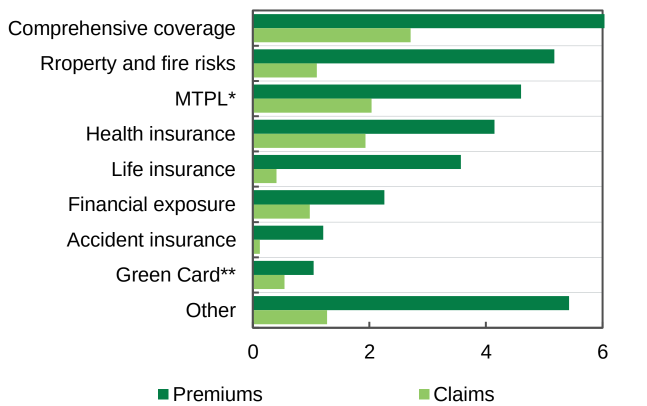
Reinsurance payments have been growing steadily since the end of 2019 and stand at 34%. The breakdown of premiums payable to resident and non-resident reinsurers approached Q1 figures.

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



In Q3, the most growth occurred in CASCO premiums and property and fire insurance premiums. The share of MTPL slightly declined, but overall the portfolio structure remains almost unchanged.

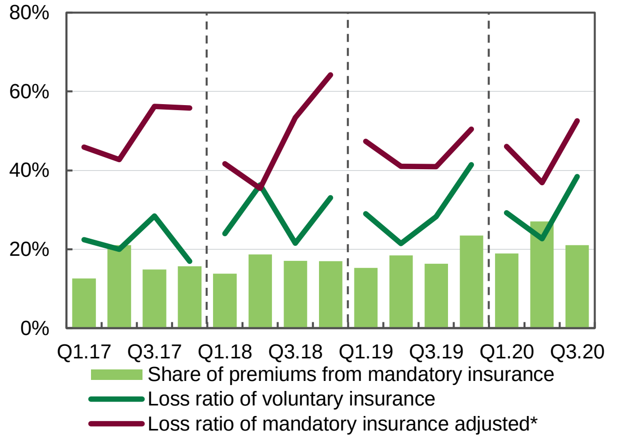
Figure 10. Breakdown of insurance premiums and claim payments by most popular types of insurance, UAH billions



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

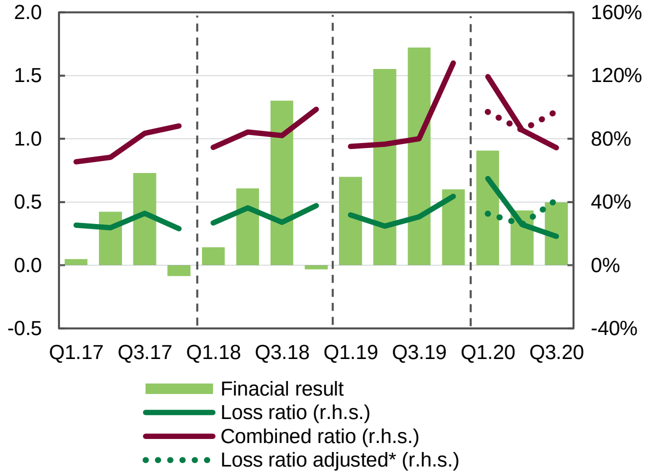
Compulsory non-life insurance still has the highest loss ratio of 53%. The loss ratio of voluntary non-life insurance is 38%. Both indicators increased compared to Q2, not counting the effect from the release of aviation insurance provisions. The operational efficiency indicators (combined ratio) of non-life insurers remain subpar.

Figure 11. Share of compulsory insurance premiums and loss ratio* of non-life insurance



* Excluding the aviation insurance loss provisions released over the course of the year. Respective indicators prior to adjustment were 159% and (-59%), respectively.

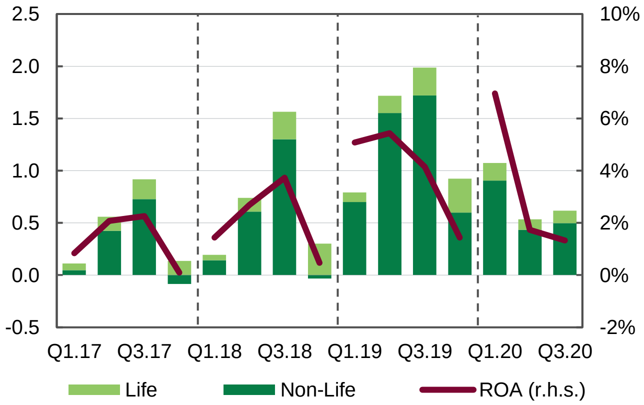
Figure 12. Financial result (income/loss), cumulative total and operational indicators of non-life insurers, UAH billions



* 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.

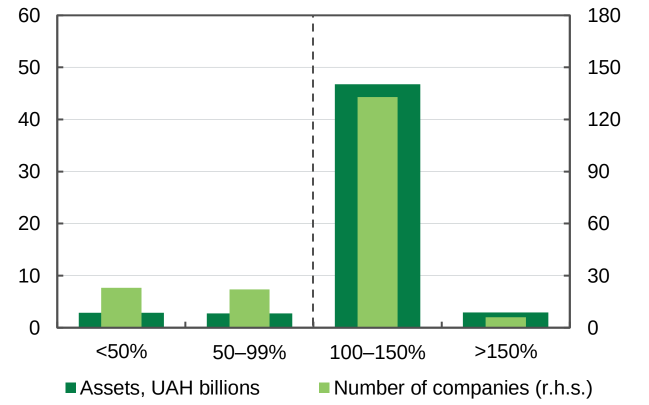
Insurers' profits increased slightly compared to Q2. Return on assets inched down to 1.3%.

Figure 13. Profit or loss of insurers, cumulative, UAH billions



A large number of insurers do not comply with the requirements for capital adequacy and solvency and need to restructure their assets or increase capital.

Figure 14. Distribution of number and assets of insurers by ratio of eligible assets to required solvency margin, as of 1 October 2020



* This figure is based on data from 185 companies.

Credit Unions

Credit unions' assets have remained almost unchanged for three quarters running. The share of credit unions that take deposits from their members is expanding. The loan portfolio is nearly flat from previous periods, accounting for about 90% of credit unions' assets. In Q3, the breakdown of the portfolio returned to where it started the year, while loan portfolio quality worsened significantly. About a third of loans are NPLs*, up from just 15% in Q2. Loans made to finance business needs have the highest NPL ratio.

Figure 15. Total assets of credit unions (CU) and share of credit union members who took out loans

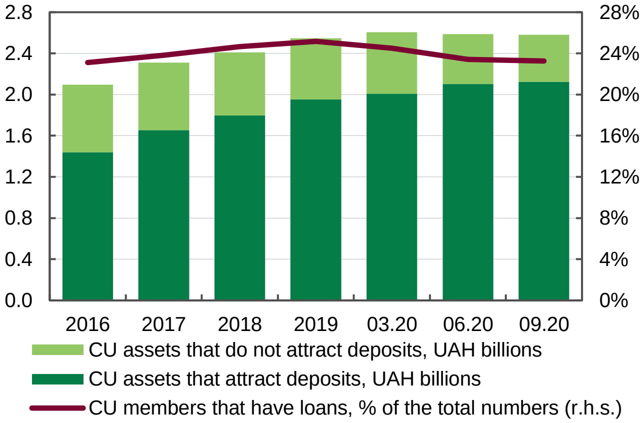
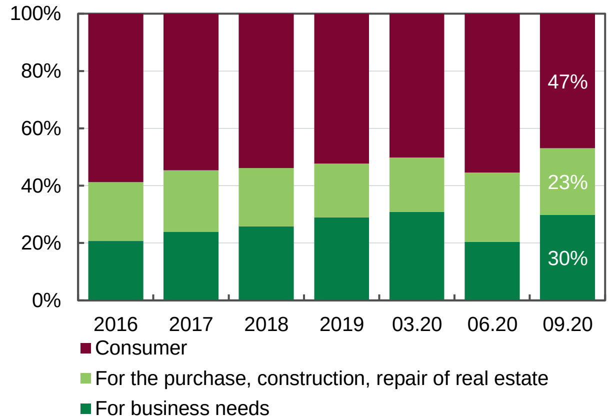


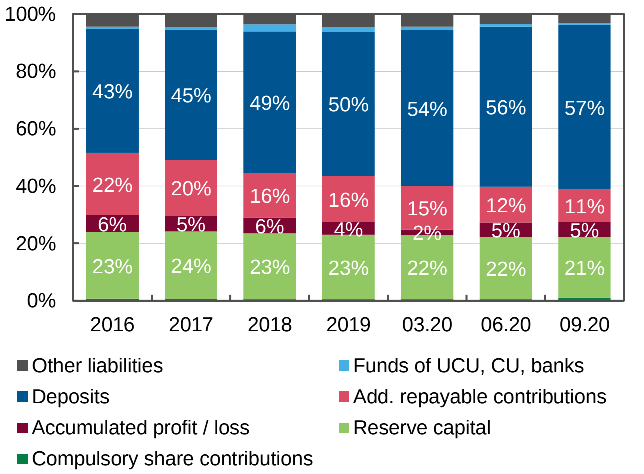
Figure 16. Structure of outstanding loan principal, UAH billions



* Loans past due more than 90 days.

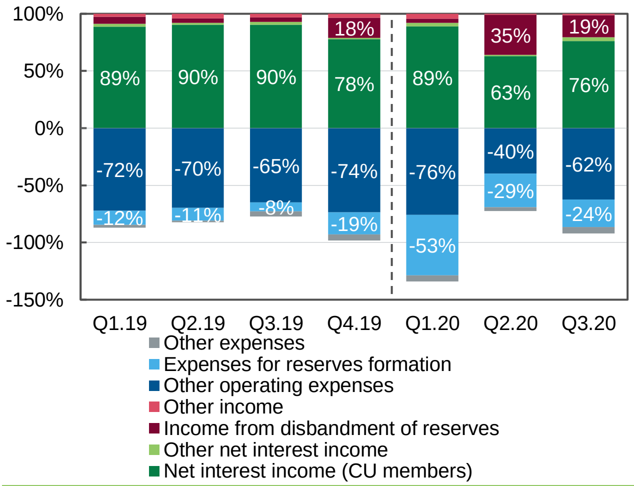
Short-term deposits as a share of funding continue to grow. Additional share contributions as a percentage of total funding decreased.

Figure 17. Composition of funding sources



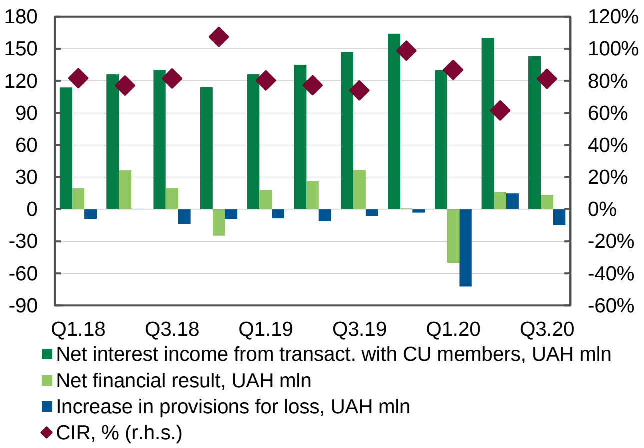
In Q2–Q3, the share of income from the release of provisions increased significantly. This component is not a stable source of income and indicates a possible overstatement of profits.

Figure 18. Structure of income and expenses, UAH billions



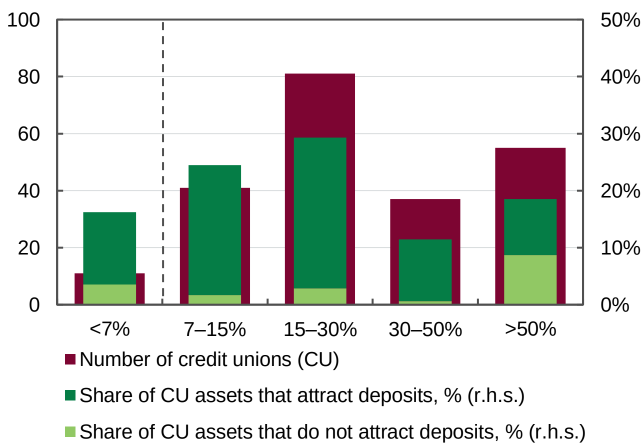
Operational efficiency is low. In the first nine months of 2020 they made losses, The small gains in Q2 and Q3 were primarily due to the insufficiently conservative presentation of losses from the deterioration of portfolio quality.

Figure 19. Operational efficiency



Currently, most credit unions have regulatory capital adequacy in excess of the minimum requirement of 7%. However, 11 credit unions did not meet the minimum solvency requirements as of 1 October 2020.

Figure 20.Distribution by core capital adequacy as of 1 October 2020



Finance Companies

The composition of assets and liabilities of finance companies remains almost unchanged. The share of receivables increased slightly, in part due to the growth in credit assets. Risks to the transparency and reliability of financial statements remain high.

Figure 21. Asset structure

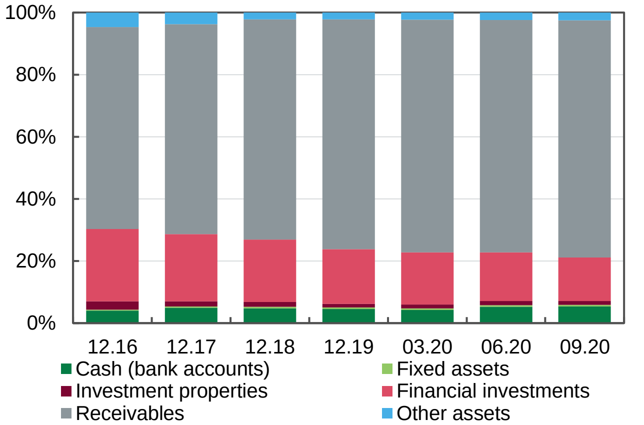
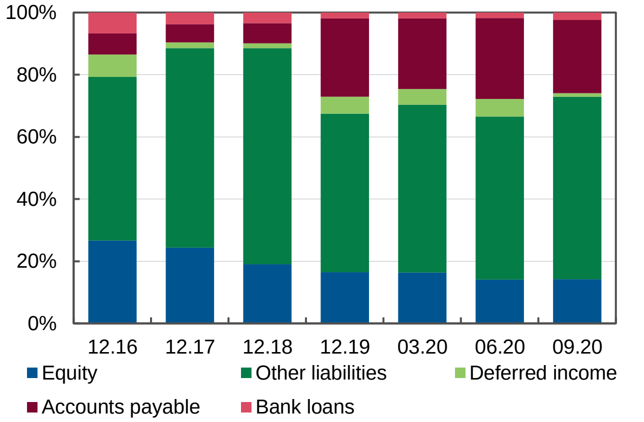
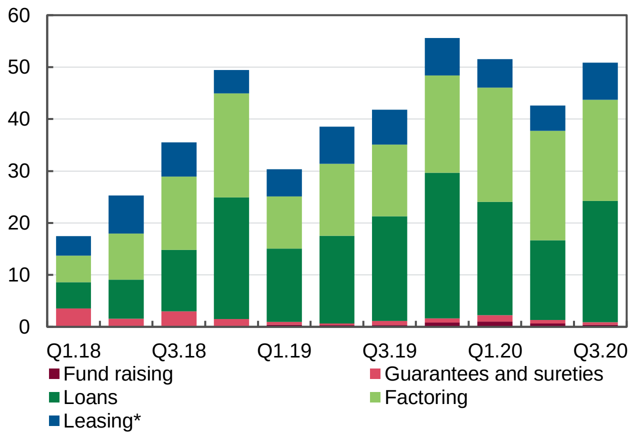


Figure 22. Composition of finance companies' liabilities



In Q3, lending accounted for the largest share in the volume of services provided by finance companies. Factoring volumes decreased slightly from the previous quarter, while leasing transactions increased by 46%.

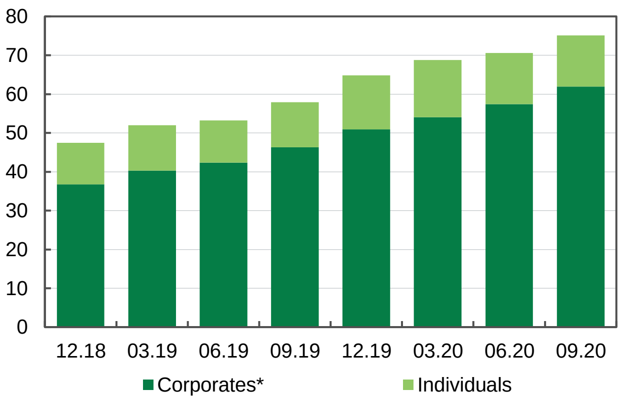
Figure 23. Volume of financial services provided by finance companies, by type of service (quarterly data), UAH billions



* Legal entities-lessors and leasing companies.

In Q3, the gross loan portfolio of finance companies grew by 6%. Outstanding business loans grew faster, and their share in the portfolio remains significant at 82%.

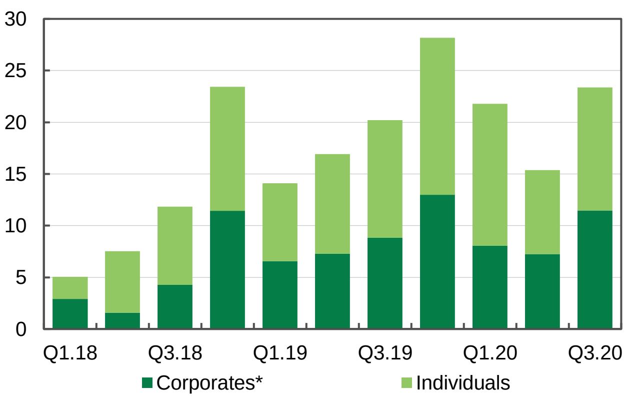
Figure 24. Gross outstanding loans of finance companies, UAH billions



* Including sole proprietors.

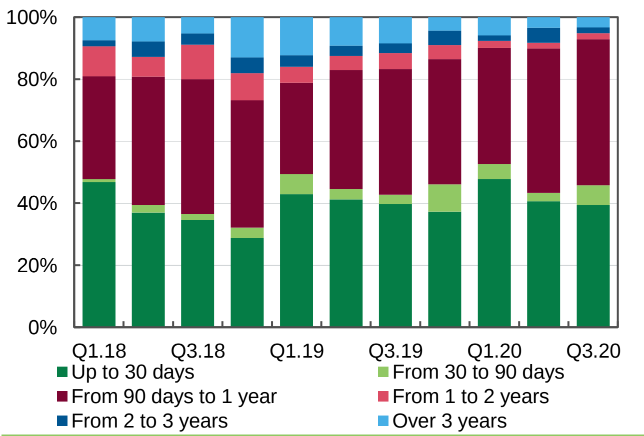
At the same time, finance companies in Q3 granted most of the new loans to households. Most of these are short-term. Around 40% of new loans were issued for up to 30 days and 53% for up to 12 months. In contrast to the previous two quarters, the volume of both retail and corporate lending increased for the quarter.

Figure 25. Loans issued during quarter, by borrower category, UAH billions



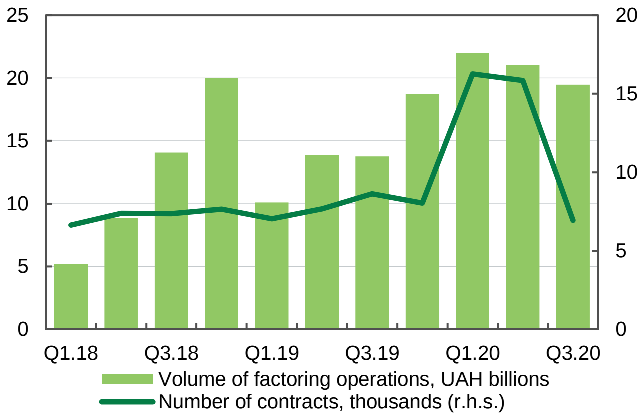
* Including sole proprietors.

Figure 26. Breakdown of loans issued during quarter, by maturity



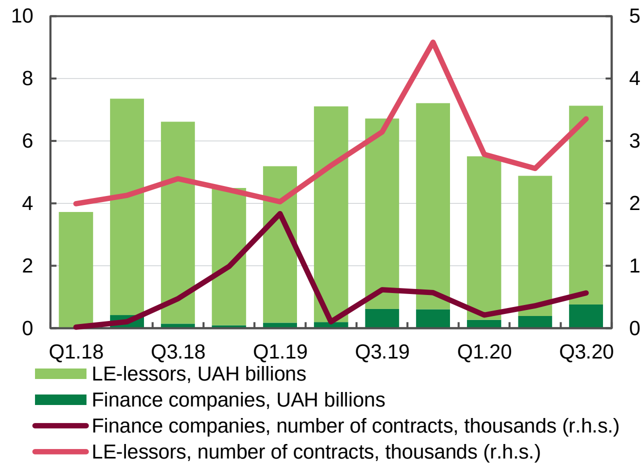
Factoring agreements continue to show significant volatility. In Q3, the total volume and number of transactions declined.

Figure 27. Volume and number of factoring agreements, UAH billions



Legal entity lessors and finance companies increased the volume of leasing transactions in Q3. Finance companies generate only one tenth of total leasing volumes.

Figure 28. Volume and number of financial leasing agreements



In the first three quarters of the year, finance companies continued to generate earnings, though they were lower than last year. This year's profitability indicators are comparable to those of 2019.

Figure 29. Financial performance of finance companies on cumulative basis, UAH billions

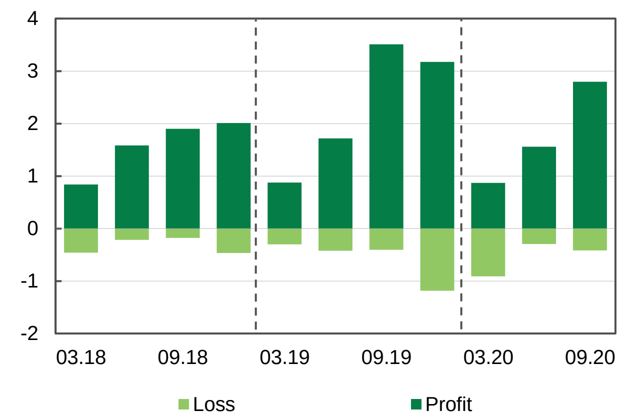
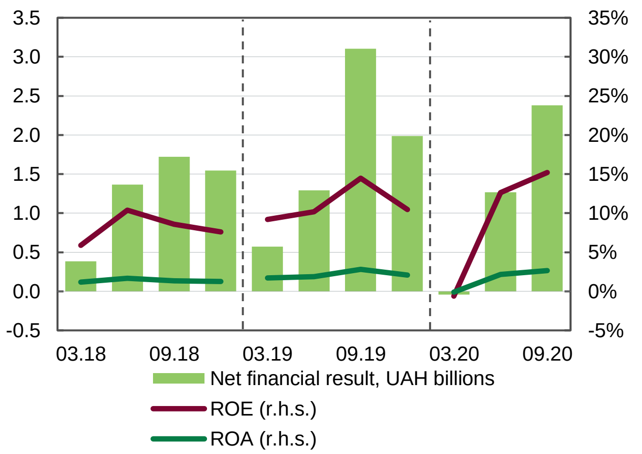


Figure 30. Financial performance of finance companies (on cumulative basis) and their return ratios



Pawnshops

Pawnshop assets increased somewhat, primarily due to lending. Loans make up 74% of assets. Equity makes up 42% of total liabilities. In Q3, equity increased.

Figure 31. Assets, UAH billions

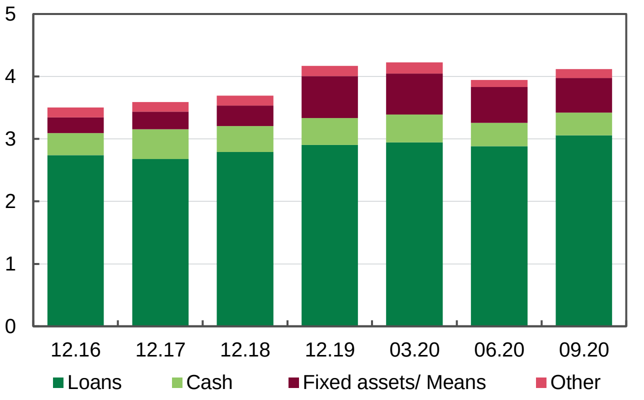
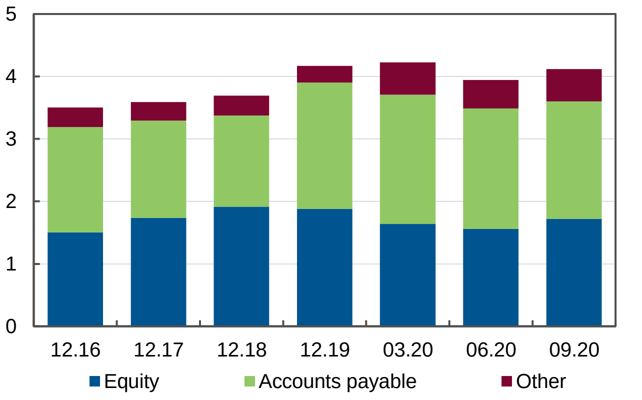


Figure 32. Liabilities, UAH billions



The volume of new loans increased significantly in Q3 2020, but remains 3% lower compared to the same period in 2019. The collateral coverage ratio has been decreasing gradually, currently totaling 115%. Loan portfolio structure by type of collateral remains unchanged. Loans are predominately secured with jewelry.

Figure 33. Amount of loans issued during the quarter and collateral coverage ratio, UAH billions

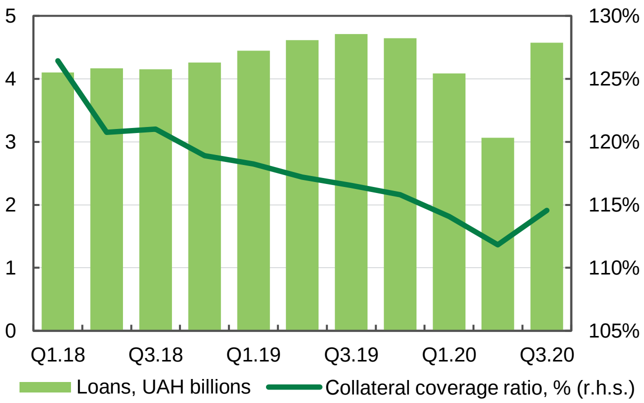
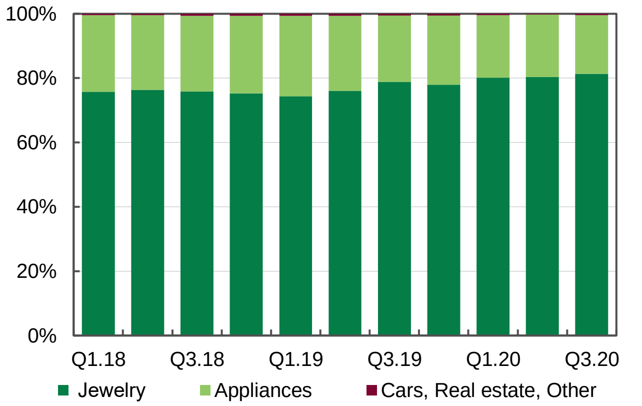


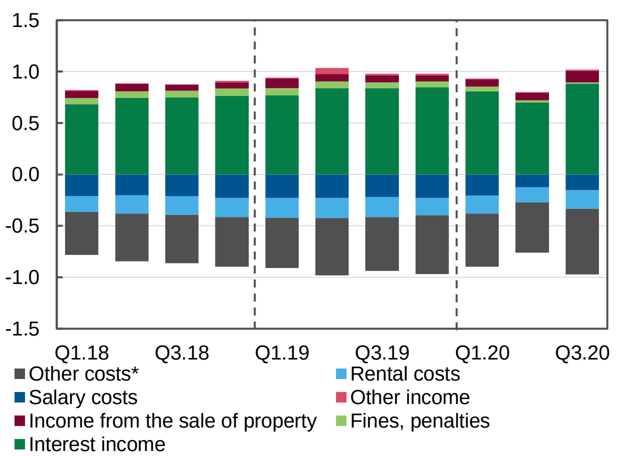
Figure 34. Loan portfolio structure by type of collateral



The share of loans secured with cars, real estate, and other assets is 0.4%.

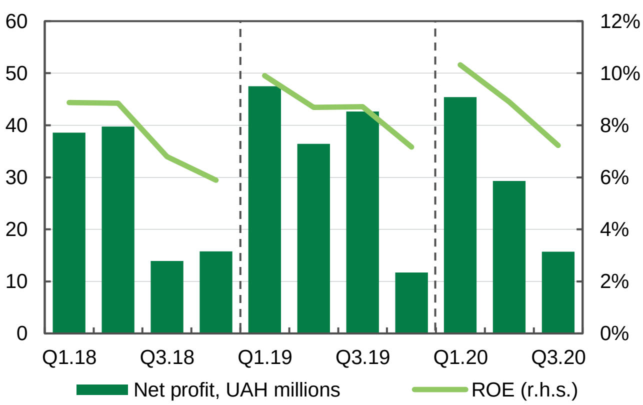
In Q3, income and expenses of pawnshops increased, approaching 2019 levels. Income from the sale of mortgaged property grew significantly, although its share in income remains small. Pawnshops are making profits. Their return on capital decreased slightly for the quarter, to 7.2%, in line with the overall trend seen in previous years.

Figure 35. Structure of income and expenses, UAH billions



* Including expenses related to selling and maintaining pledged property

Figure 36. 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.

NBFIs filed their Q2 and Q3 reports with their new regulator, the National Bank of Ukraine. The transition period is not yet over. During this period, NBFIs are supposed to adopt new reporting algorithms. This means that their reporting statements for previous periods may have been adjusted in order to bring performance indicators into line with the new algorithms. The generalized reporting statements may thus differ in some aspects (breakdowns). The National Bank of Ukraine understands the current situation and is working to streamline its reporting control procedures in order to improve the quality of data and ensure that, going forward, the documents disclosing information about the activities of the NBFIs will be as complete and correct as possible.

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:

CASCO	Comprehensive vehicle insurance
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
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)
r.h.s.	Right-hand scale
yoy	Year-on-year
qoq	Quarter-on-quarter