National Bank of Ukraine

Non-bank Financial Sector Review

August 2021

In Q2, all non-bank financial institutions saw an increase in their transaction volumes and assets. Neither voluntary market exit nor enforced license suspension of some institutions prevented the increase, as said institutions were dormant. Collected insurance premiums grew markedly across most types of insurance. At the same time, the loss ratio has been rising gradually, and insurance business expenses remained significant, albeit being on the decline. An increase in the volumes of all types of transactions enabled finance companies to generate record profits. The performance of credit unions gradually improved, underpinned by higher operating income, a gradual resumption of lending, and inflows of additional funds under international projects. However, this segment was still developing more slowly than the rest of the market.

Sector Structure and Penetration

The NBU has been the regulator of a larger part of the non-bank financial institutions market for more than a year. Over this period, solvency requirements for financial institutions were based mainly on regulations approved by the previous regulator. Financial institutions thus had enough time to bring their activities in line with these requirements. As time passed, the NBU switched to more resolute corrective measures in response to violations of the Ukrainian law.

Based on the results of off-site and on-site supervision, including cases when inspectors were denied access, the NBU in Q2 applied corrective measures by suspending and/or revoking licenses of dozens of insurers, finance companies, and pawnshops. Many of the market participants that violated the solvency requirements were given time to eliminate the violations. If financial institutions fail to meet the requirements, they will have to close their business.

Companies that were not running any business activity and had no valid licenses to provide financial services left the market voluntarily in Q2. At the same time, new institutions entered the market: 1 pawnshop, 4 legal entity lessors, and 25 finance companies.

Assets of all market players increased in Q2. Assets of finance companies grew the most. The share of non-bank financial institutions (NBFIs) in assets of NBU-regulated financial sector thus rose by 1 pp, to 12%.

Insurers

Market exit of a number of institutions was a notable event in Q2 2021. However, this had almost no impact on the quarterly results of the insurance market: its assets even grew slightly. Gross insurance premiums, both in non-life and life insurance, increased compared to the previous quarter. The growth in insurance premiums was seen in both retail and corporate segments. Claims paid on life insurance have been on the rise for the last four quarters. Claim payments on non-life insurance remained almost unchanged.

The share of insurance premiums of voluntary insurance exceeded 75%. Car insurance (comprehensive coverage, compulsory third party liability insurance, and Green Card) and health insurance have established themselves as the leaders by the amount of premiums. Premiums of compulsory insurance grew by 30%, especially in compulsory third party liability car insurance, nuclear insurance[1], and aviation insurance. The growth in two former types of insurance was usual for Q2, while the significant increase in aviation insurance came from transactions of a single insurer.

The share of reinsurance premiums did not change in Q2, accounting for less than one-fifth of accrued insurance premiums. This included 66% of premiums ceded to nonresident reinsurers. The growth is explained, among other things, by an increase in premiums of aviation and nuclear insurance, in which risks are reinsured due to large amounts of liability.

In Q2, the loss ratio rose in both voluntary and compulsory types of insurance. It was typically higher for compulsory insurance, in particular for compulsory third party liability car insurance, with its loss ratio reaching 56%.

The calculation methodology of non-life insurers' operational efficiency has been updated for the purposes of the quarterly report: insurers' expenses not related to their operating activities have been excluded. The updated combined ratio was 90%. If the calculation method had remained unchanged, the combined ratio would have exceeded 100%, albeit having declined since the start of the year.

Although investment income of non-life insurers increased by 9% qoq, the investment income ratio remained within the range of 3%–4%. The operating ratio thus equaled 86%.

Bank deposits accounted for the largest share of non-life insurers' investment portfolio. However, they also invested in

[1] Compulsory civil liability insurance for nuclear damage

domestic government debt securities – the share of income received from these securities grew over the quarter. Life insurers were also increasing their holdings of government securities, which accounted for the major share of their investment income.

Profits of non-life insurers rose in Q2 thanks to the growth in premiums. Apart from the pickup in insurance, profits were supported by a decrease in liquidation costs, administrative costs, and other expenses. Life insurers were also profitable, primarily thanks to income from financial investments. At the same time, premiums were not enough to cover core business expenses.

The number of insurers in violation of solvency requirements and requirements for risky transactions declined markedly. As of 1 July, 23 licensed insurers did not meet the solvency and capital adequacy ratios or the asset risk ratio. Two of the licensed insurers did not have any violations in Q1, and one of them has already eliminated the violations.

Credit Unions

Credit union assets have been growing at a moderate pace. However, the growth was uneven, with almost 70% of it coming from five credit unions. The common feature of these credit unions is their non-standard approach to business: aggressive lending to borrowers, which sometimes implies relatedness to an institution's management.

In April, credit unions received UAH 11.2 million in repayable financial assistance under the Credit for Agriculture Producers project (CAP). The project is being implemented by the World Council of Credit Unions (WOCCU) supported by USAID. The financing was first provided to the Ukrainian Joint Credit Union, and then distributed to credit unions for issuing targeted loans to agricultural producers. The Joint Credit Union of the National Credit Union Association will also receive the financing. Total financing to be provided under the CAP project will amount to USD 1 million.

Credit unions' loan portfolio increased by 4%: the average loan grew, while the number of borrowers continued to drop. New lending grew by 11% qoq, including consumer lending, which was up by 21%. The quality of the loan portfolio remained unchanged. Credit unions reported the share of loans past due for more than 90 days to be 14%, which corresponded to the pre-pandemic level.

Net interest income grew compared to the previous quarter. Average interest rates on loans, in particular mortgages, rose as deposit rates went down. However, the ratio of operating expenses to operating income remained almost unchanged over the quarter (81%), still being moderately high. Provisioning expenses decreased considerably. Most credit unions saw an increase in their profits.

Improved profitability of credit unions had a positive impact on their solvency. The number of credit unions violating the capital adequacy ratio declined. However, financial standing indicators presented by some credit unions might still be unreliable.

Finance Companies

The assets of finance companies increased in Q2, fueled by the growth in volumes of all types of financial services provided over the quarter.

New loans increased only due to lending to households. Finance companies have been increasingly active in this lending segment: volumes of retail loans have been on the rise for four quarters running. On the other hand, volumes of corporate loans, a large proportion of which reflect only the redistribution of funds within business groups, remained virtually unchanged.

Financial leasing transactions were up significantly. As before, these changes were primarily driven by legal-entity lessors, which accounted for 98% of all financial leasing transactions. Transactions on issued guarantees also increased noticeably, after being almost absent for two years in a row. New factoring transactions grew slightly, but they were still down from last year.

In H1 2021, finance companies reported record profits compared to the same periods of the previous three years. However, the failure of some market participants to provide audit reports for 2020 casts doubts over the correctness of their profit or loss data.

Pawnshops

Volumes of new loans increased by 5% in Q2 2021. The collateral coverage ratio surged to an all-time high of 133%. Interest income accounted for a larger share of pawnshops' income (88%). Pawnshops continued to be profit-making.

Prospects and Risks

In Q3, the NBU will launch registration of debt collection agencies under new rules. Companies that fail to pass the registration will not be able to collect sold problem debts.

Active work will continue to amend the Ukrainian legislation on regulating the non-bank financial services market. Three main draft laws[2] that will determine the operating conditions for the market are being prepared for the second reading in the parliament. The adoption of the new laws is, among other things, a precondition for a gradual development of a deposit guarantee system for credit unions, and potentially for providing guarantees to life insurance policyholders. The concept of their implementation is currently under development.

Certainly, improving performance will be the main task for the majority of financial institutions and complying with the regulator's requirements for the institutions which violate prudential requirements.

[2] Draft laws *On Financial Services and Financial Companies* (No. 5065), *On Insurance* (No. 5315), and *On Credit Unions* (No. 5125).

Sector Structure and Penetration

NBFI assets grew in Q2. The largest increase was seen in assets of finance companies. Assets of insurers’, credit unions, and pawnshops also grew, but at a slower pace. Some financial institutions went out of business: either voluntarily or due to being excluded from the register because of the lack of valid licenses.

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

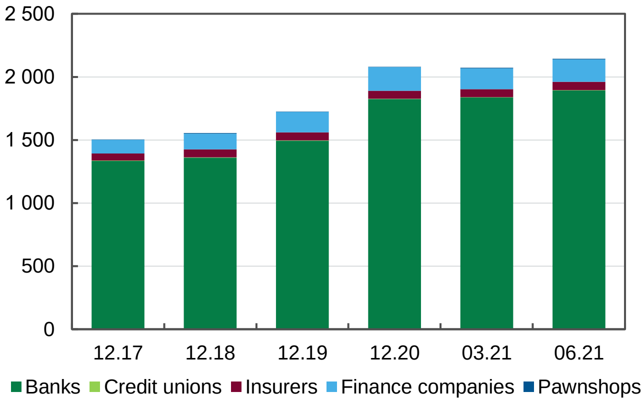
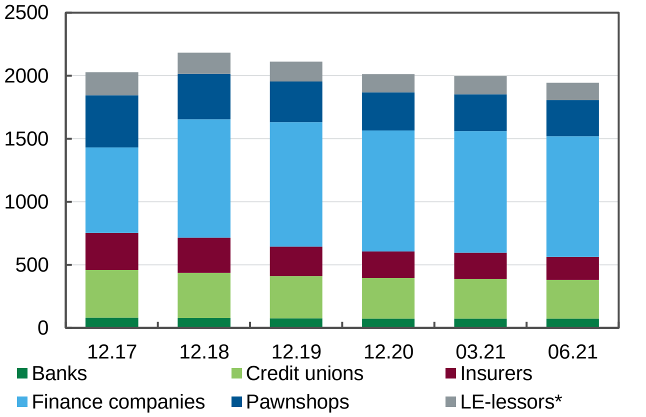


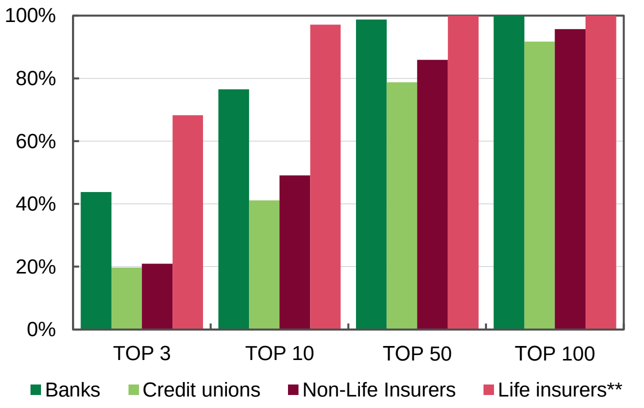
Figure 2. Number of financial service providers



* 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.

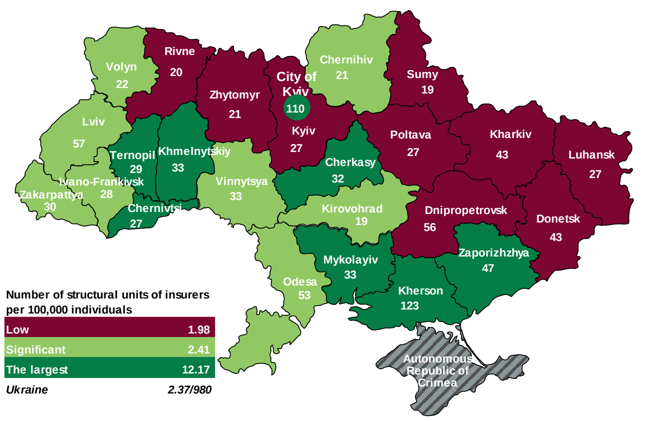
Figure 3. Concentration* of insurance companies and credit unions compared to banks



* 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.

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

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



In Q2 NBFI assets grew faster than assets of banks. This brought the market share of NBFIs up to 12%.

Table. Financial institutions under NBU regulation*

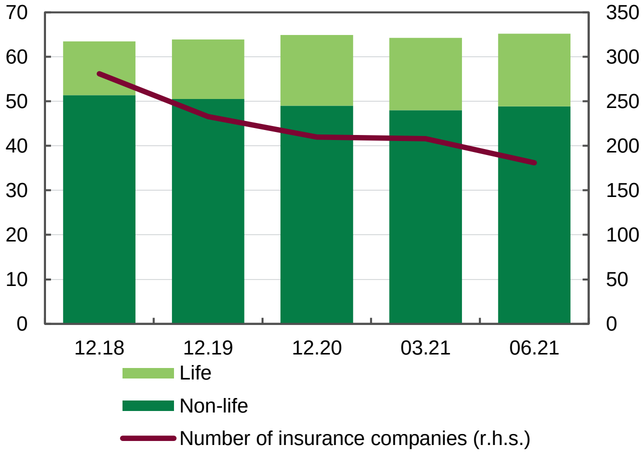
		2017	2018	2019	2020	03.21	06.21	Qoq change
Insurers	Assets, UAH millions	57 381	63 493	63 866	64 920	64 266	65 186	1.4%
	Number of companies	294	281	233	210	208	181	-27
Credit Unions	Assets, UAH millions	2 170	2 218	2 510	2 317	2 335	2 394	2.5%
	Number of companies	378	358	337	322	316	308	-8
Finance Companies	Assets, UAH millions	107 534	125 322	162 197	186 501	166 102	179 536	9.0%
	Number of companies	677	940	986	960	964	958	-6
Pawnshops	Assets, UAH millions	3 764	3 721	4 265	3 867	3 966	4 119	3.8%
	Number of companies	415	359	324	302	292	287	-5
Banks	Assets, UAH millions	1 333 831	1 359 703	1 493 298	1 822 814	1 835 527	1 892 468	3.1%
	Number of companies	82	77	75	73	73	73	0

* Along with Q2 2021 earnings reports, the NBFIs were able to clarify reporting data for Q1 2021. They made retrospective adjustments to certain indicators, in particular the size of assets for this period.

Insurers

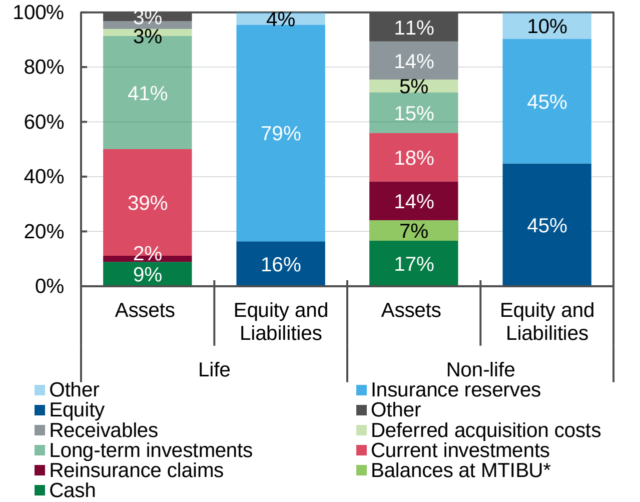
Insurers' assets grew despite the fact that some companies exited the market.

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



The share of life insurers' long-term investments rose as current investment and reinsurance claims decreased. The assets and liabilities structure of non-life insurers' remained almost unchanged over the quarter.

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



The term of investment of life insurers became longer over the year: the share of short-term investment decreased, giving way to long-term investment. The structure of assets and liabilities of non-life insurers was more volatile but did not change much over the year.

Figure 7. Assets, equity, and liabilities of life-insurers

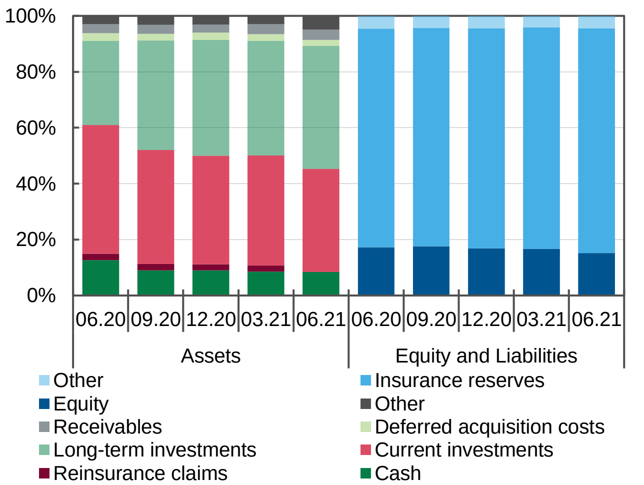
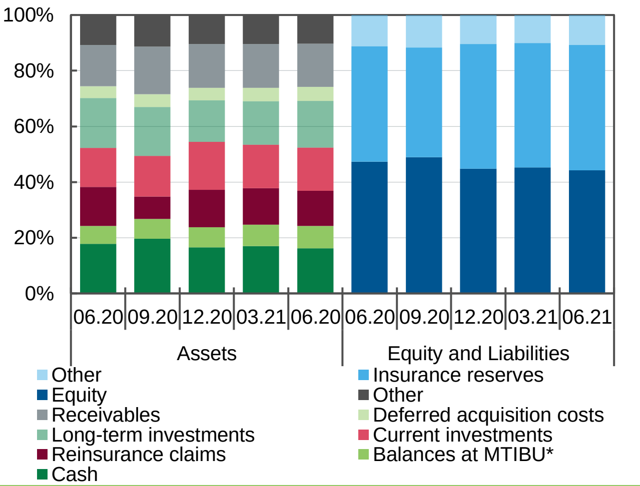
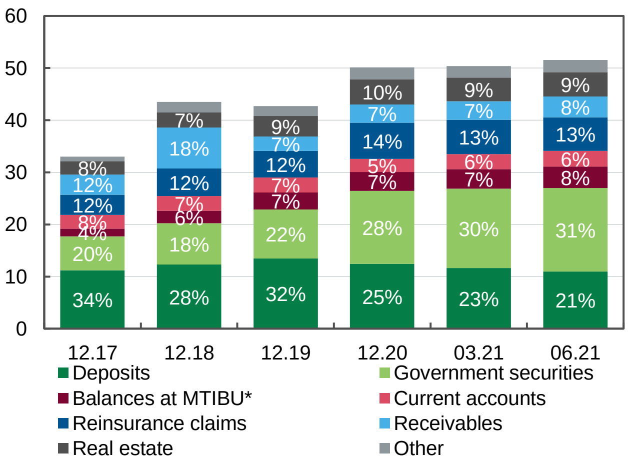


Figure 8. Assets, equity, and liabilities of non-life insurers



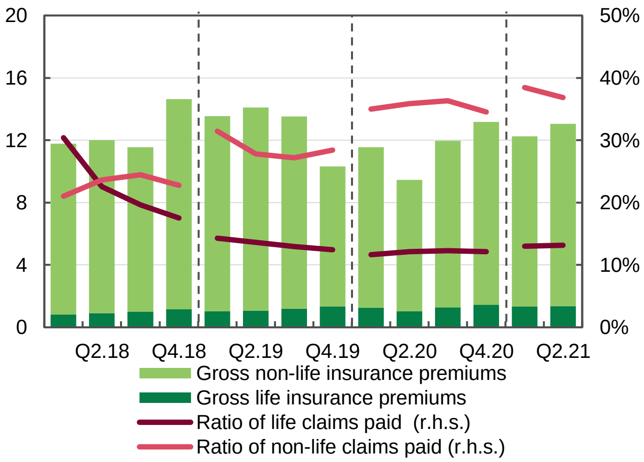
The share of government securities in eligible assets continues to grow.

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



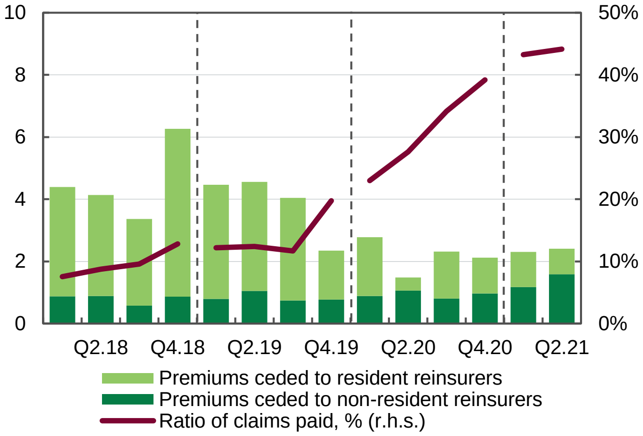
The claims paid ratio almost did not change over the quarter, standing at 13% for life insurance and 37% for non-life.

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



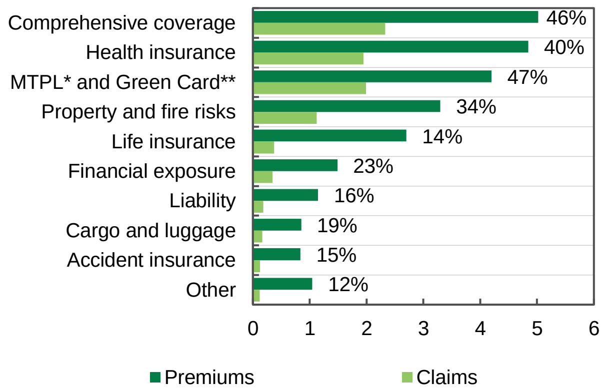
The share of external reinsurance in reinsurance premiums grew to 66%.Reinsurance claim payments continued to grow, reaching 44%.

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



The largest share of insurance premiums came from car insurance and health insurance. Claims paid remained low across most types of insurance.

Figure 12. Breakdown of insurance premiums and claim payments by most popular types of insurance in Q2 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.

Net premiums of life and non-life insurance resumed their growth in Q2 2021, having decreased slightly in Q1. Insurance premiums non-life insurers received from their retail and corporate customers rose by almost 10% qoq.

Figure 13. Net insurance premiums by type of insurance, Q1 2018 = 100%

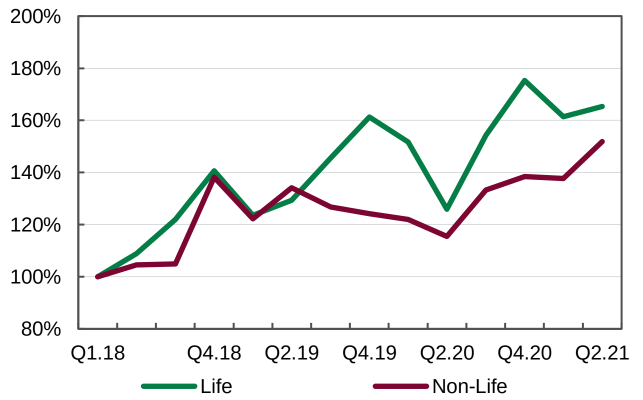
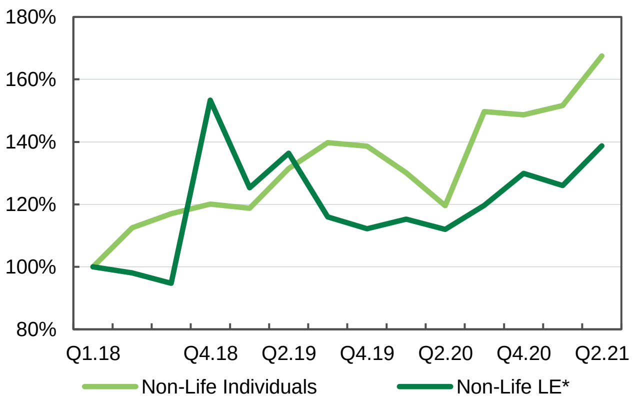


Figure 14. Non-life insurance premiums by type of policyholder, Q1 2018 = 100%



* Legal entities.

Provisioning ratios of both voluntary and compulsory insurance declined compared to Q1 2021, except the ratio of loss provisions to net claims paid. The growth in the ratio of loss provisions to net claims paid in voluntary insurance was driven by a partial release of loss provisions.

Figure 15. Provisioning rate of voluntary non-life insurance

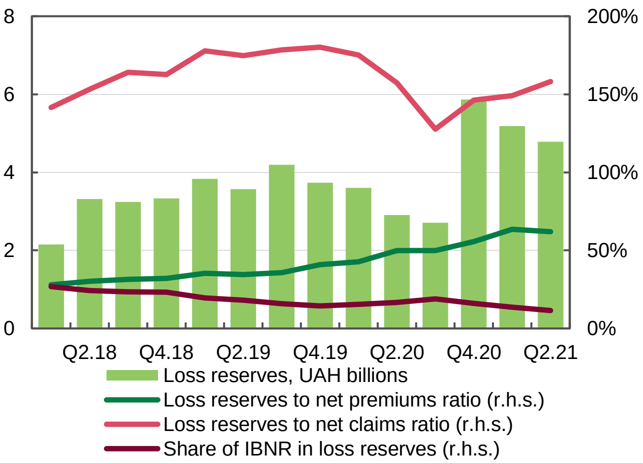
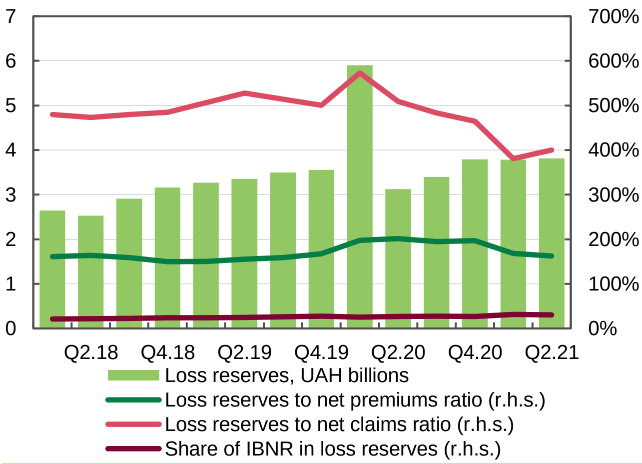


Figure 16. Provisioning rate of compulsory non-life insurance



Loss ratios rose in Q2. The largest losses were incurred in compulsory third party liability car insurance, the comprehensive coverage car insurance, and health insurance.

Figure 17. Share of compulsory insurance premiums and loss ratio of non-life insurance

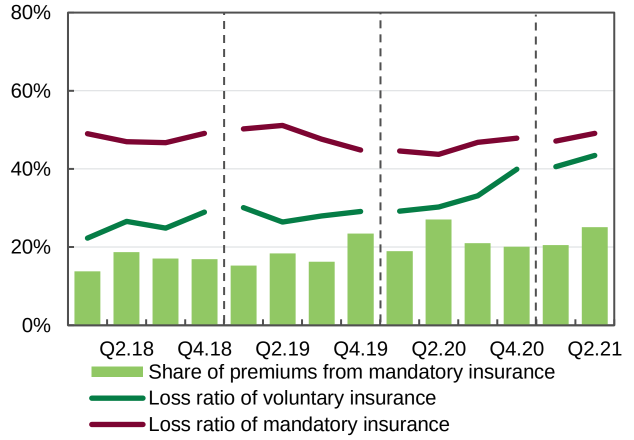
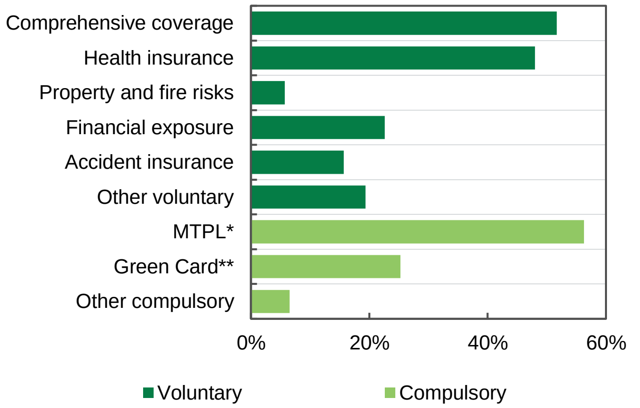


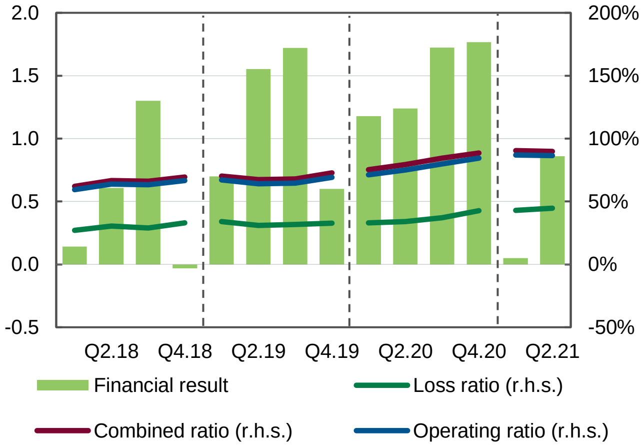
Figure 18. Loss ratio for certain types of insurance



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

Operational efficiency of non-life insurers has not changed over the quarter. The levels of the combined ratio and operating ratio were acceptable.

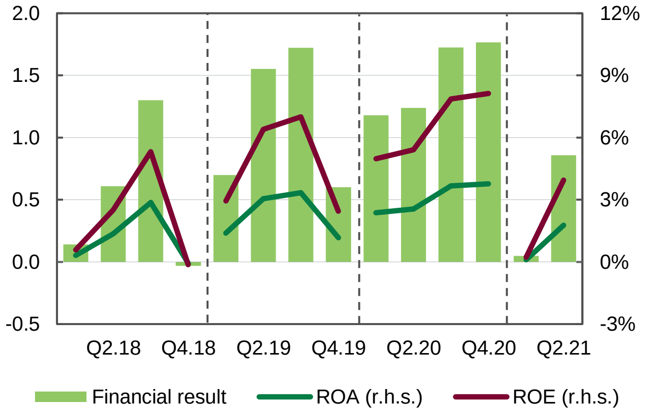
Figure 19 Cumulative profit or loss and operating performance indicators of non-life insurers, UAH billions



* The calculation method for the combined ratio and the operating ratio has been changed. Other expenses and nonrecurring expenses of insurers are now excluded.

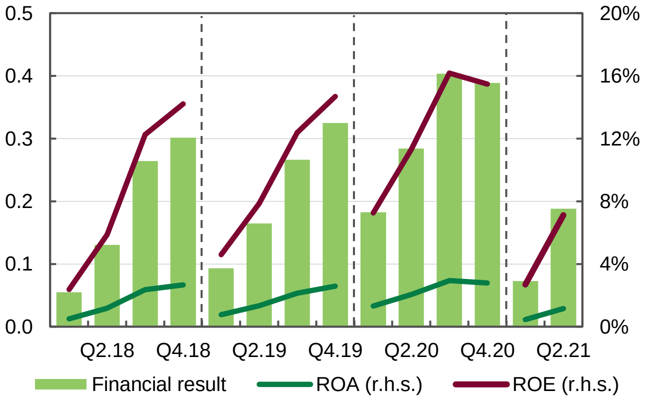
Non-life insurers were profit-making in Q2 2021. Their profitability increased but still was lower than in Q2 2020.

Figure 20. Financial performance of non-life insurers on a cumulative basis, UAH billions



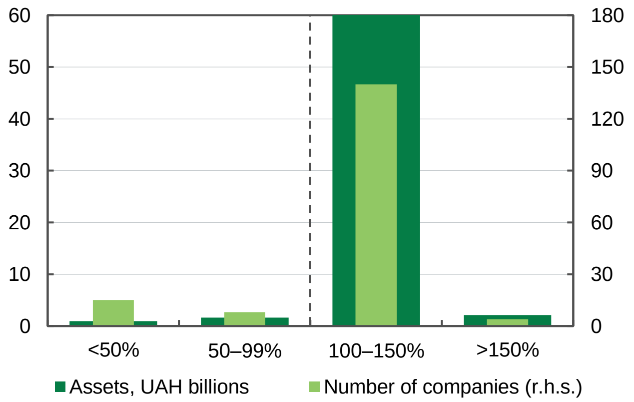
Life insurers increased their profits in Q2, and their profitability ratios returned to their usual levels.

Figure 21. Financial performance of life insurers on a cumulative basis, UAH billions



The number of insurers that do not meet solvency and capital adequacy requirements declined to 23 companies, which accounted for 4% of the market's assets.

Figure 22. Distribution of number and assets of insurers* by ratio of eligible assets to required solvency margin, as of 1 July 2021

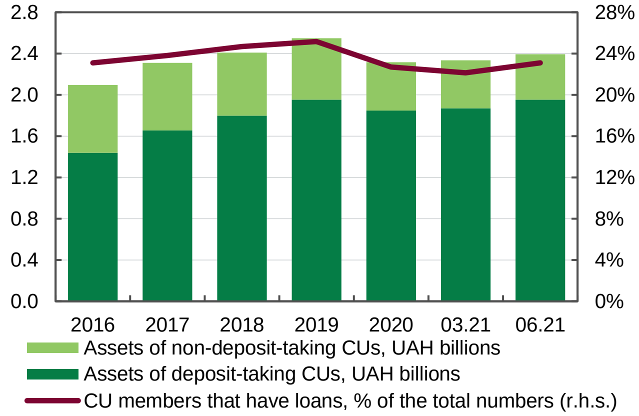


* This figure is based on data from 167 companies.

Credit Unions

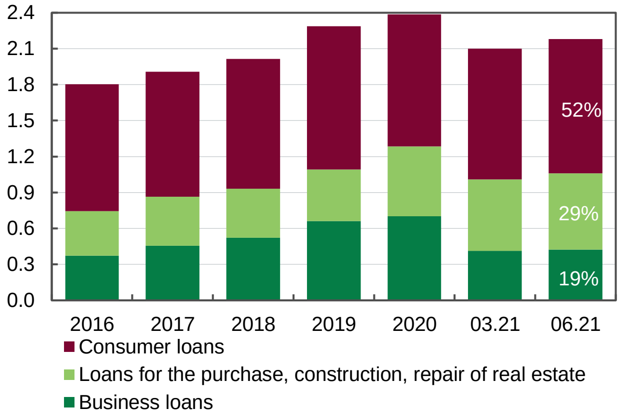
The number of credit unions continued to decrease: there were 310 of them. Assets of the institutions licensed to take deposits grew at a faster pace in Q2. They accounted for 80% of the segment's total assets.

Figure 23. Total assets of credit unions (CU) and share of credit union members who took out loans



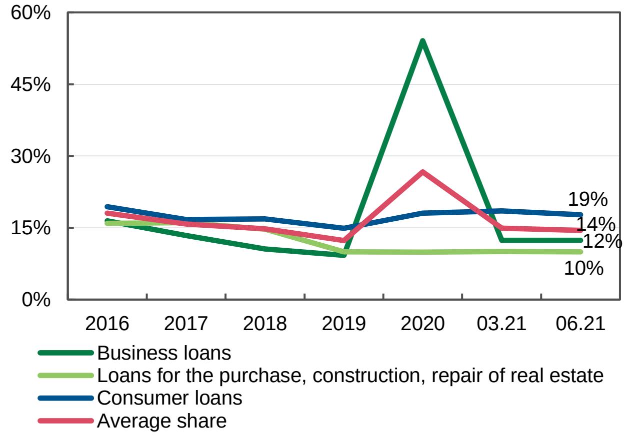
Credit unions' loan portfolio increased by 4% in Q2. Outstanding mortgages grew more rapidly, while consumer loans, which account for a larger share of the portfolio, increased at a moderate pace.

Figure 24. Structure of outstanding loan principal, UAH billions



The ratio of non-performing loans (NPL) remained almost unchanged over the quarter. Consumer loans carried higher risk: 18% of them were more than 90 days past due.

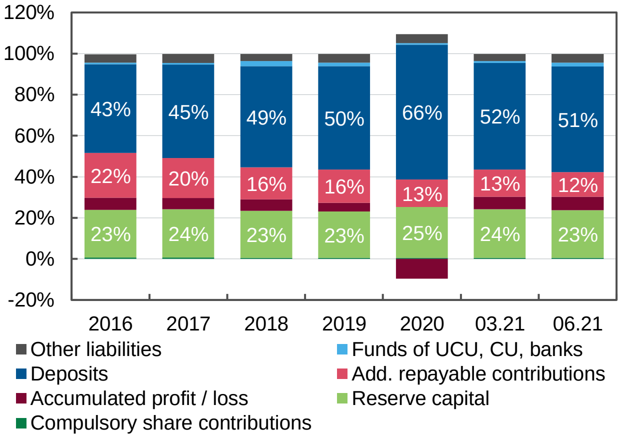
Figure 25. Share of non-performing loans* by types



* Loans overdue more than 90 days.

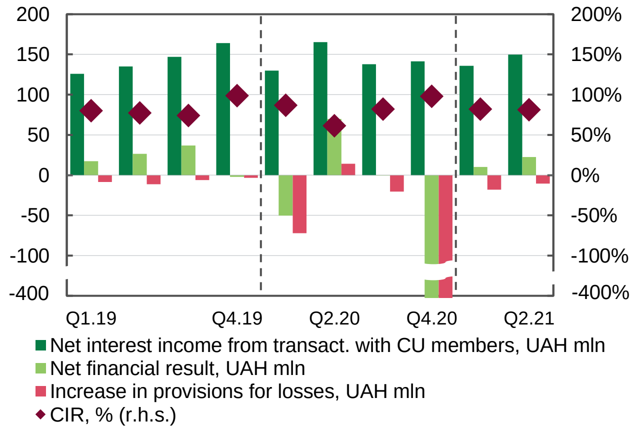
Equity decreased as a share of credit unions' liabilities in quarterly terms. Instead, the share of raised funds increased, particularly the funds borrowed from the Ukrainian Joint Credit Union under the CAP international project.

Figure 26. Composition of funding sources



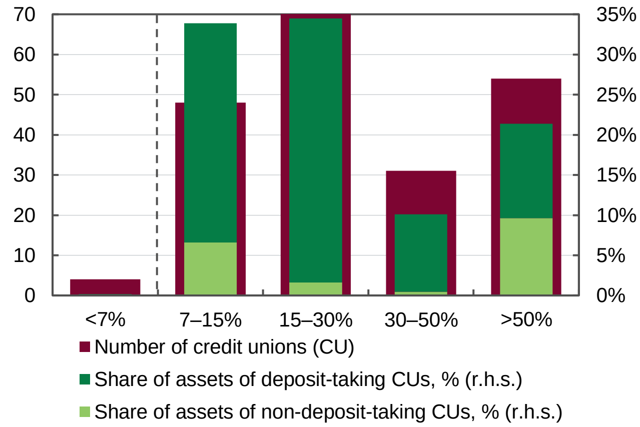
The operational efficiency of credit unions remained moderate. At the same time, net interest income increased, which is typical for Q2: average interest rates on loans grew and the cost of borrowing declined.

Figure 27. Operational efficiency



As of 1 July 2021, the number of credit unions that did not meet the minimum solvency requirements halved, to four institutions. These were mostly credit unions which did not take deposits.

Figure 28. Distribution by core capital adequacy as of 1 July 2021



Finance Companies

Assets of finance companies grew in Q2, thus offsetting most of the decline that occurred at the start of the year as some large players left the market. The assets and liabilities structure remained stable.

Figure 29. Finance companies' asset structure, UAH billions

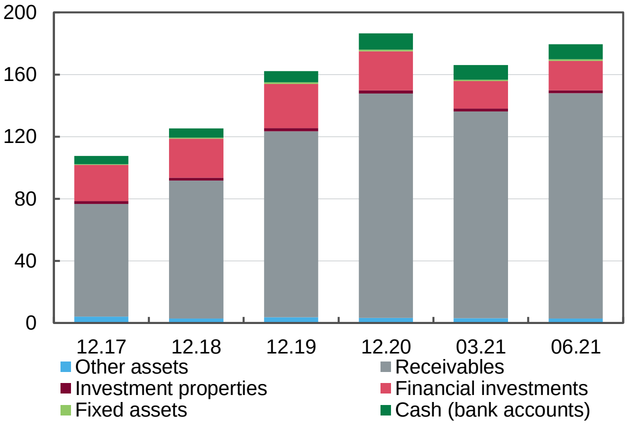
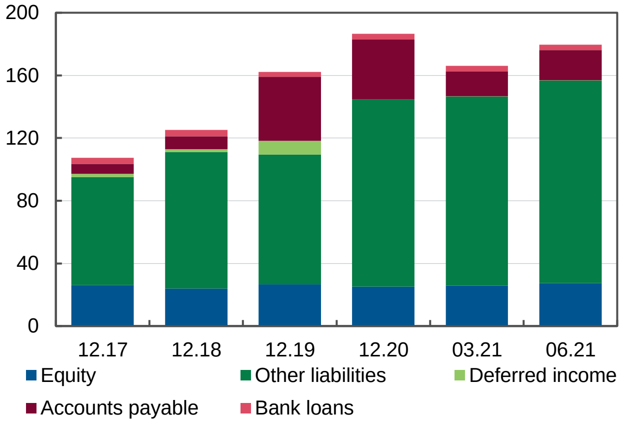
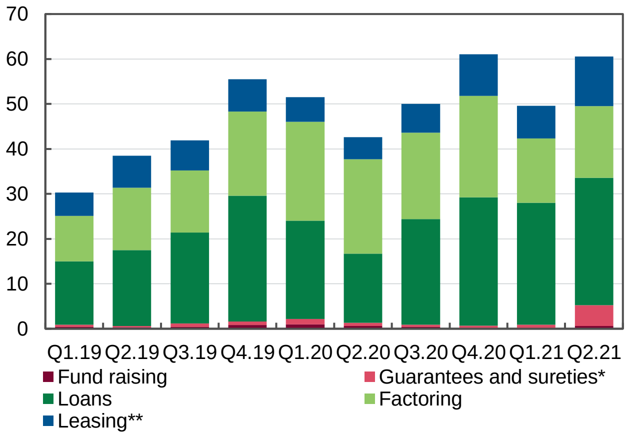


Figure 30. Composition of finance companies' equity and liabilities, UAH billions



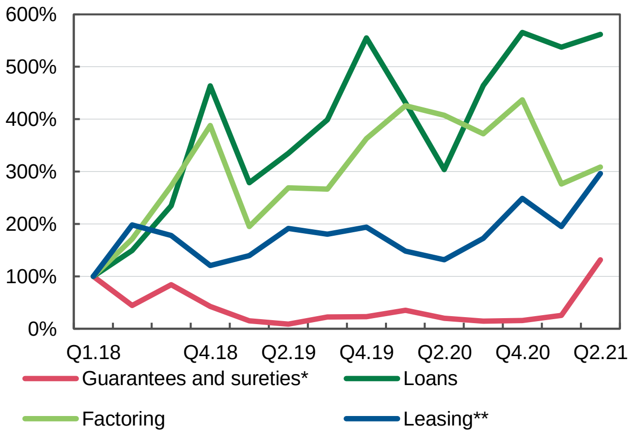
In Q2, lending accounted for almost half of the services provided by finance companies. In April–June, growth was seen across all types of financial services, especially providing guarantees, which was almost absent for a long time. Factoring and leasing transactions also grew. Legal-entity lessors provided the bulk of financial leasing services.

Figure 31. 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.

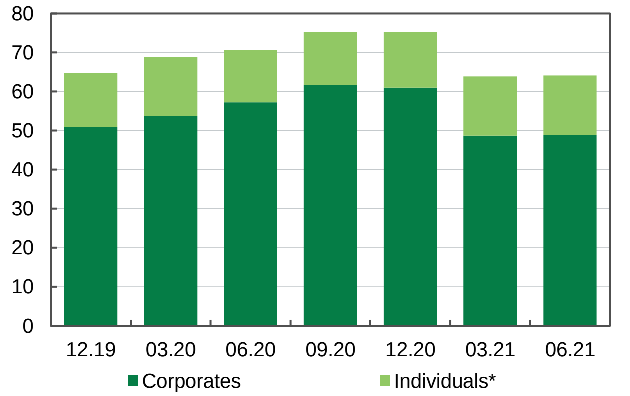
Figure 32. Financial services provided by finance companies, by type of service (quarterly data), Q1 2018 = 100%



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

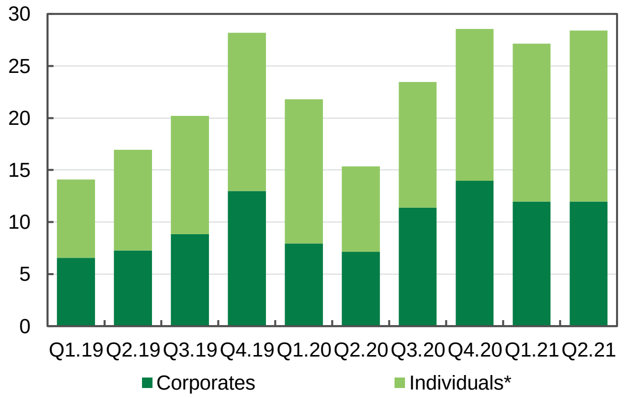
The gross loan portfolio of finance companies remained unchanged in Q2. Lending volumes decreased somewhat in annual terms, mainly due to a decline in outstanding loans of corporate borrowers. That said, outstanding retail loans grew by 15% over the year. Most new loans were also issued to households in Q2. Retail lending has been on the rise for four quarters straight.

Figure 33. Gross outstanding loans of finance companies, UAH billions



* Including sole proprietors.

Figure 34. Loans issued during quarter, by borrower category, UAH billions



* Including sole proprietors.

New loans issued by finance companies were mostly short-term. In total, 35% of new loans had maturity of up to 31 days, and 59% of up to one year. Around 60% of new retail loans were granted for up to 31 days, while 90% of corporate loans were provided for a term from three months to a year.

Figure 35. Breakdown of loans issued during quarter, by maturity

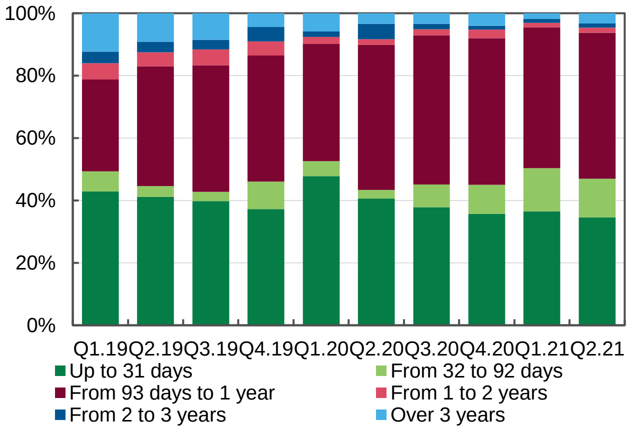
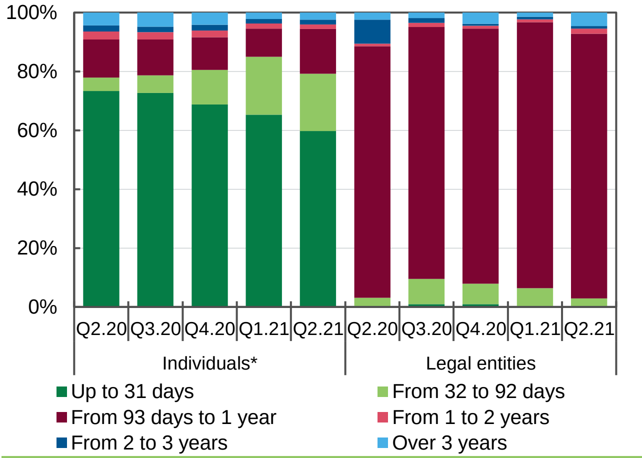


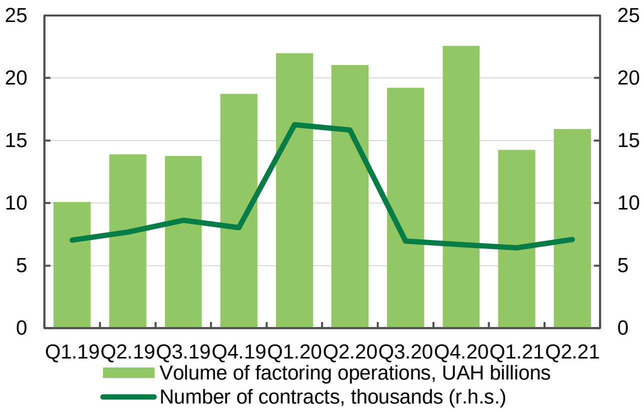
Figure 36. Breakdown of loans issued during quarter, by maturity and client's type



* Including sole proprietors.[9]

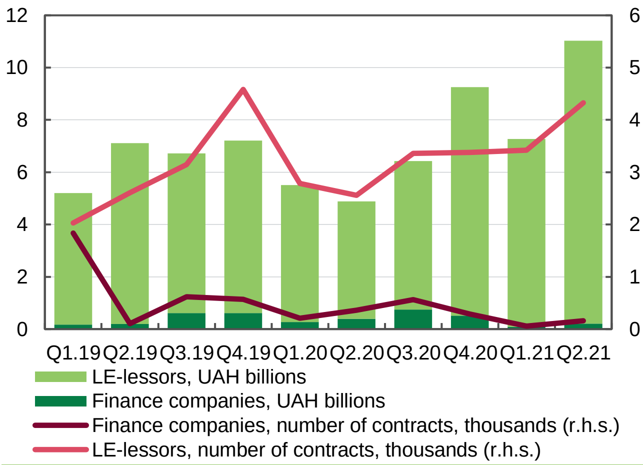
Volumes of finance companies' factoring transactions grew somewhat in Q2. However, they were much smaller than in 2020.

Figure 37. Volume and number of factoring agreements



Financial leasing volumes increased markedly in Q2, reaching a record high seen in recent years. Finance companies accounted for a tiny share of the transaction volumes. Legal-entity lessors were the main service providers.

Figure 38. Volume and number of financial leasing agreements



Finance companies made profits in Q2. That said, their profits were larger than in the same periods of previous years. Profitability indicators remained higher than in previous years.

Figure 39. Financial performance of finance companies on cumulative basis, UAH billions

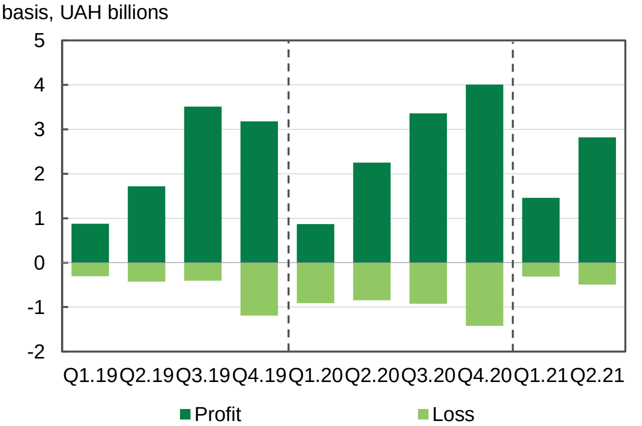
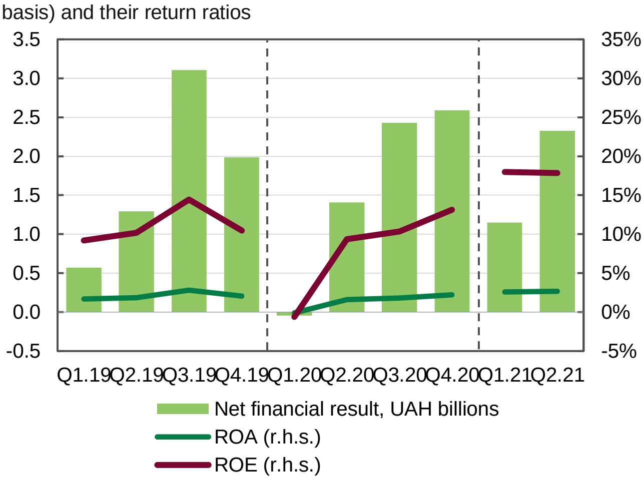


Figure 40. Financial performance of finance companies (on cumulative basis) and their return ratios



Pawnshops

Pawnshop assets increased somewhat in Q2, primarily due to new lending and purchasing fixed assets. Assets and liabilities composition has remained unchanged for a long time.

Figure 41. Assets, UAH billions

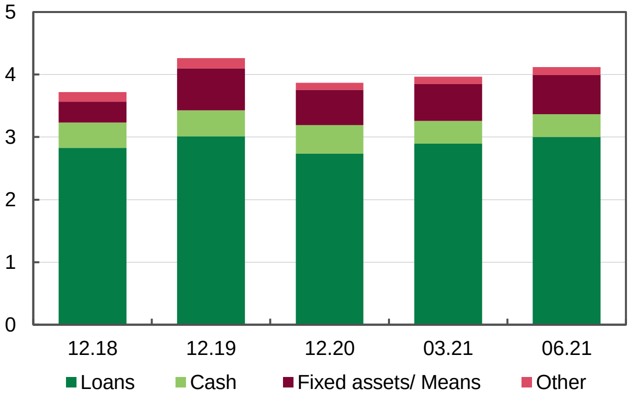
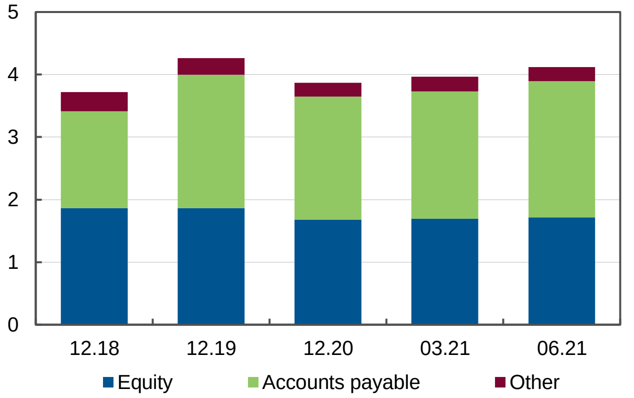


Figure 42. Liabilities and equity, UAH billions



Volumes of new loans increased by almost 5% in Q2 2021. The collateral coverage ratio reached a several-year record high, making 133%.

Figure 43. Amount of loans issued during the quarter and collateral coverage ratio

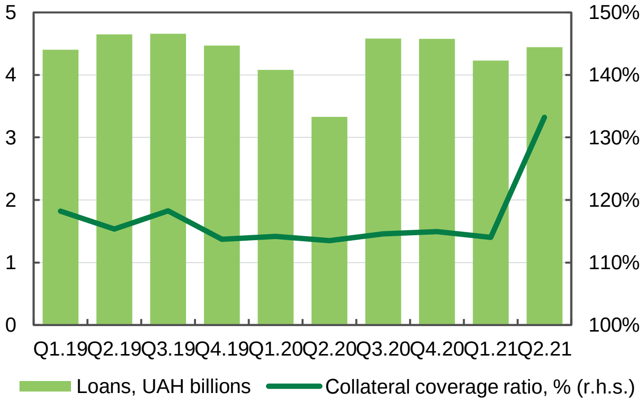
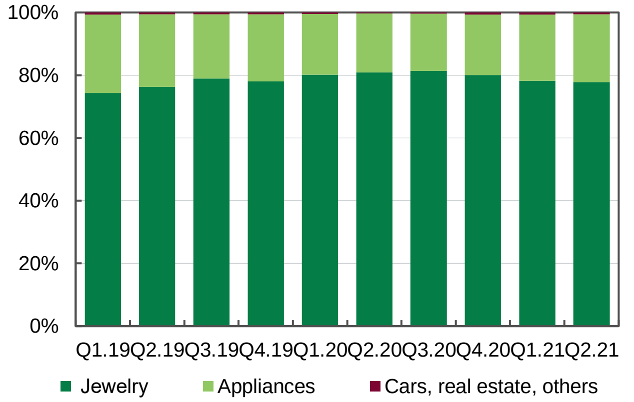


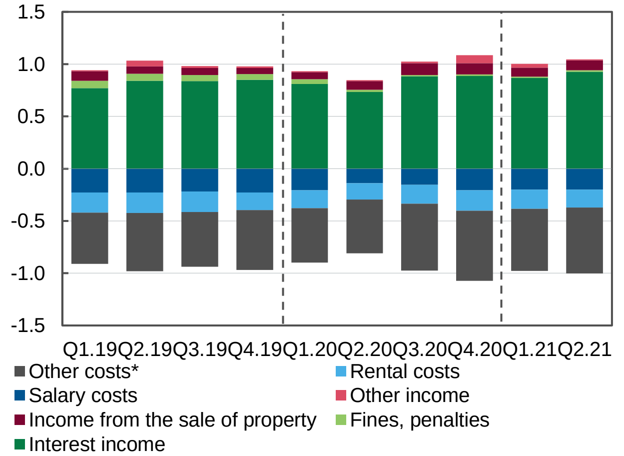
Figure 44. Loan portfolio structure by type of collateral



The share of loans secured with cars, real estate, and other assets is 0.6%.

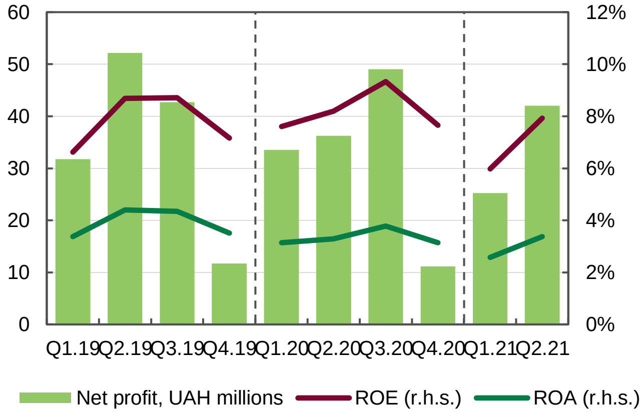
Income grew faster than expenses in Q2 2021, which led to an increase in pawnshops' profits. Pawnshops' rate of return thus rose to 7.9%, approaching the previous year's level.

Figure 45. Structure of income and expenses, UAH billions



* Including expenses related to selling and maintaining pledged property.

Figure 46. 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 Q2 2021, NBFIs, at the NBU's request, adjusted their improperly compiled reporting figures for previous periods (including Q1 2021). 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.

In Q2, the NBU refined methodology for calculation of the combined ratio and operating ratio. Now, the calculation does not include other costs and extraordinary expenditures of insurers.

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
Legal entity lessors	A legal entity that is not a financial institution entitled to provide a single financial service which is financial leasing. They can engage in other economic activities, such as operating leasing.
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