National Bank of Ukraine

Non-bank Financial Sector Review

November 2021

Q3 continued to see a rise in the assets of non-bank financial institutions and the provision of financial services by them. Collected nonlife insurance premiums grew moderately, while collected life insurance premiums increased at a faster pace. The loss ratio decreased slightly, despite insurance business expenses remaining substantial. A significant increase in the volumes of services provided enabled finance companies to make record profits. The performance of credit unions gradually improved – their credit portfolios expanded, while their operating income enabled them to cover high administrative expenses and generate profits. Pawnshops remained profitable, but did not step up operations. All non-bank market sectors markedly improved their compliance with regulatory requirements. The better compliance resulted, among other things, from the NBU's taking appropriate corrective actions against violators, such as revoking their licenses.

Sector Structure and Penetration

The transformation of the non-bank financial services market continued in Q3. As before, companies that had not engaged in any business activity and that had surrendered their licenses voluntarily left the market. These companies were taken off the State Register of Financial Institutions. At the same time, there was an increase in the number of companies excluded from the register by the regulator for not having any valid licenses. In Q3, 93 companies had all of their licenses revoked, with about half of these licenses being cancelled as corrective actions taken in response to violations, such as noncompliance with Ukrainian laws. The NBU also suspended the licenses of another 39 financial institutions pending the rectification of detected violations. At the same time, the regulator reinstated licenses for four institutions that had corrected detected violations. Most of the violators were finance companies.

New institutions entered the market: one pawnshop, four lessors, and 29 finance companies. The NBU also actively registered collection agencies.

All sectors saw their assets grow, despite there being a decrease in the number of financial institutions. The assets of finance companies grew the most. The share of non-bank financial institutions (NBFIs) in the assets of the NBU-regulated financial sector remained unchanged, at 12%.

Insurers

Insurers continued to step up their operations. In Q3, gross nonlife insurance premiums rose by 3%, while gross life insurance premiums grew by 9%. As a result, insurance premiums in the retail segment increased, while those in the corporate segment declined slightly. In nonlife insurance, claims payments rose after a decline in Q2. Claims paid on life insurance have been on the rise for five quarters running.

The share of insurance premiums of voluntary insurance was about 70%. 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 and claims paid.

In Q3, only 16% of insurance premiums were ceded for reinsurance. This share declined over the quarter. Nonresident reinsurers accounted for 59% of ceded premiums. Claims payments on reinsurance agreements were of differing types. In domestic reinsurance, the largest amount of claims paid was for car insurance. Nonresidents mostly reinsure substantial risks, albeit less often.

The loss ratios of nonlife insurance dropped in Q3, but were rather varied across various insurance types. More specifically, the loss ratio of Green Card increased due to larger claims payments. The loss ratios of property insurance and fire-related risk insurance surged due to payments made by one insurer. Meanwhile, the loss ratio of health insurance declined amid higher risk premiums.

The operational efficiency of nonlife insurers has been stable. A decrease in their loss ratio was counterbalanced by higher acquisition costs, other operating expenses and sales costs. The combined ratio was little changed, at 89%. Net investment income dropped slightly in Q3, to 3% of earned premiums, while the operating ratio declined to 86%.

Life insurers increased their investment income, mainly thanks to the income they earned from government bonds. The ratio of income from domestic government debt securities to insurance provisions stood at 2% in Q3, while the ratio of deposit income to insurance provisions was 0.6%.

Insurers remained profitable. An increase in the operating expenses of nonlife insurers was offset by a rise in other operating and non-operating income. Meanwhile, the operating expenses of life insurers were offset by larger investment income.

Insurers' compliance with regulatory requirements improved noticeably. Since 1 July 2020, the date when the NBU became the market regulator, the number of companies in violation of the solvency and capital adequacy ratios has dropped by almost four times, while shortages of eligible assets have fallen by a factor of seven. The asset risk ratio – which shows the amount of eligible assets insurers hold to cover provisions – has improved even more pronouncedly. The number of violators has shrank by six times, to four insurers, while asset shortages have tumbled by over 100 times. As of 1 October 2021, 16 insurers were in violation of at least one out of the two solvency ratios. In October–November, half of the insurers that failed to comply with the requirements had their licenses revoked and were excluded from the State Register of Financial Institutions.

Credit Unions

The assets of credit unions grew slightly in Q3, despite a decrease in the number of these financial institutions. About half of the credit unions saw their assets grow, with those credit unions that have aggressive lending models and that are related to an institution's management reporting the most rapid growth.

New lending dropped by 4% in Q3, despite a slight increase in the overall loan portfolio. New corporate loans shrank by 15%. At the same time, demand for consumer loans remained high among credit union members. The quality of the loan portfolio remained unchanged – the reported share of loans past due by more than 90 days was 14%. The NBU pays particular attention to whether or not credit unions provide correct information about loan servicing.

Q3 witnessed an increase in the operating income of credit unions, including their net interest income from transactions with customers. An important contributor to the increase was the growing spread between loan and deposit rates – credit unions retained high interest rates on all types of loans, while decreasing their interest rates on deposits. As a result, the ratio of operating expenses to operating income dropped to 78%. Provisioning expenses remained moderate. Most credit unions saw their profits rise.

This increased the retained earnings of credit unions and the share of these earnings in liabilities. Additional share contributions as a percentage of total funding decreased after some credit unions that drew additional share contributions rather than taking deposits left the market.

As of 1 October, based on an analysis of reporting, only five credit unions were in violation of the solvency ratio. The NBU continues to verify the reliability of the information provided by credit unions about the quality of their loan portfolios in order to establish their actual financial standings and identify any hidden risks.

Finance Companies

The assets of finance companies returned to the pre-crisis high seen in 2019. Finance companies generated the most rapid growth in the sector through significantly expanding the volumes of all types of financial services they provided over the quarter.

Finance companies continued to actively lend to households – retail loans have increased for five quarters in a row. In Q3, these loans grew by 6%. However, the largest increase came from corporate loans – these loans increased by almost one third over the quarter. Corporate loans – a large proportion of which reflect only the redistribution of funds within business groups – accounted for 80% of the finance companies' loan portfolio.

Factoring transactions reached a record high. After a long hiatus, finance companies have been active in providing guarantees for two quarters running. Financial leasing transactions also increased, albeit at a slower pace compared to other financial services. Legal entity lessors remained the main providers of these services.

In January–September 2021, finance companies reported record profits compared to the same periods of the previous three years. Finance companies' rates of return were also at a historic high.

Pawnshops

New loans contracted slightly in Q3. A large number of loans were repaid, as a result of which the collateral coverage ratio dropped to 104%. Pawnshops had a higher rate of return, but there was no revival in their business activity.

Prospects and Risks

The adoption of new laws on the regulation of the non-bank financial services market will be a key event in Q4. On 18 November, parliament passed the draft law on insurance (No. 5315) at second reading and as a whole. It is expected that parliament will consider and adopt two other draft laws[1] in early December. The passing of these draft laws will help ensure that all market participants have transparent ownership structures and enhanced solvency, and that they manage their risks properly and protect consumer rights.

The NBU has already made public the ownership structures submitted to it by non-bank financial institutions. The regulator is currently verifying whether or not these structures are transparent and meet the relevant requirements.

New rules for information disclosure by non-bank financial institutions will require them to disclose more information. More specifically, companies will be required to disclose their registration data, the conditions and procedures for conducting business, a list of their websites, and annual and consolidated financial statements certified by independent auditors. The NBU has also launched quarterly publication of the key performance indicators of each non-bank financial institution.

[1] Draft laws *On Financial Services and Finance Companies* (No. 5065) and *On Credit Unions* (No. 5125).

Sector Structure and Penetration

The assets of all NBFIs grew in Q3. The largest increase was seen in the assets of finance companies. The overall number of financial institutions decreased, with most institutions leaving the market voluntarily.

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

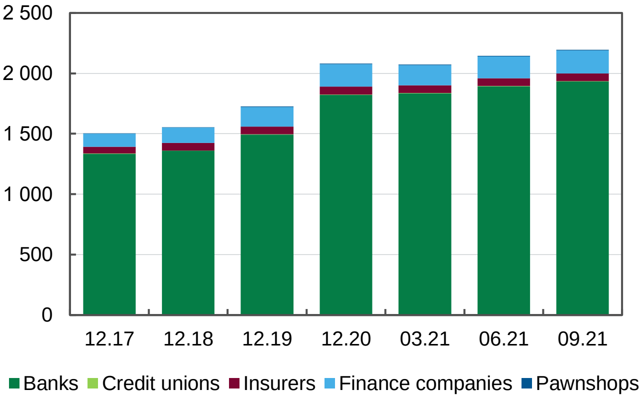
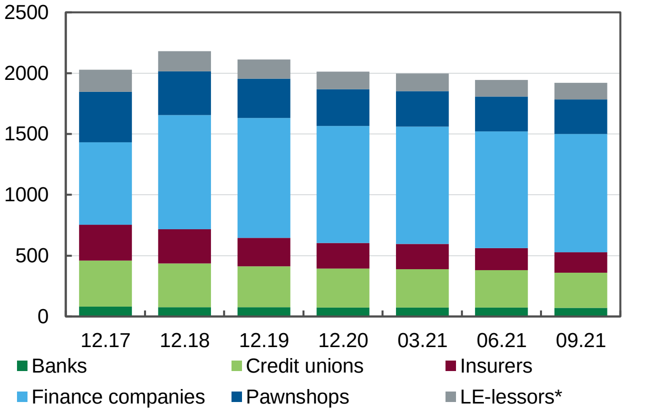


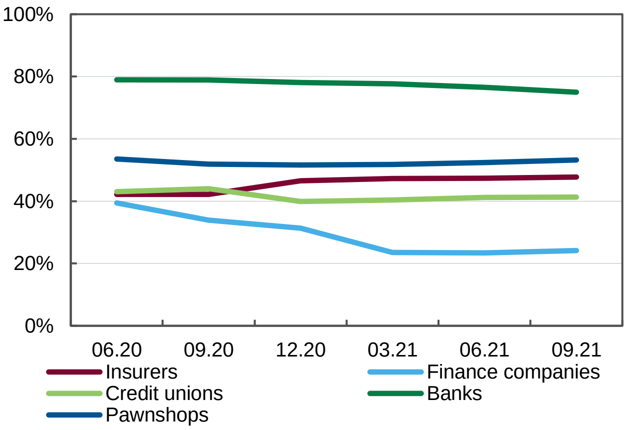
Figure 2. Number of financial service providers



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

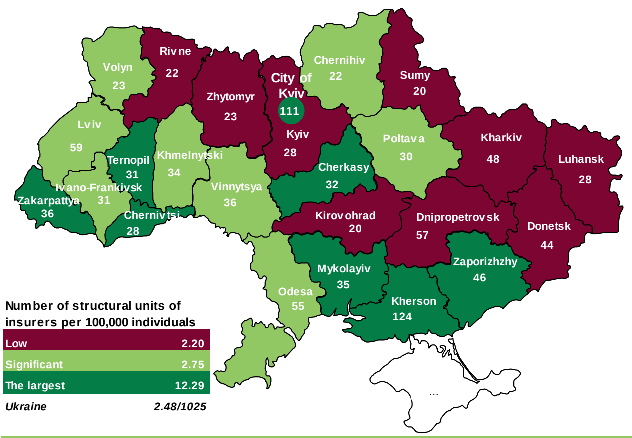
Concentration in finance companies and credit unions is gradually decreasing, while that in the insurance sector is rising.

Figure 3. Share of assets of the TOP 10 institutions in the segments



Insurance penetration is higher in the southern and western regions of Ukraine, and in the city of Kyiv.

Figure 4. Number of structural units of insurers in regions as of 1 October 2021, units



The assets of NBFIs and banks grew moderately in Q3. The market share of non-bank financial institutions was 12%.

Table. Financial institutions under NBU regulation*

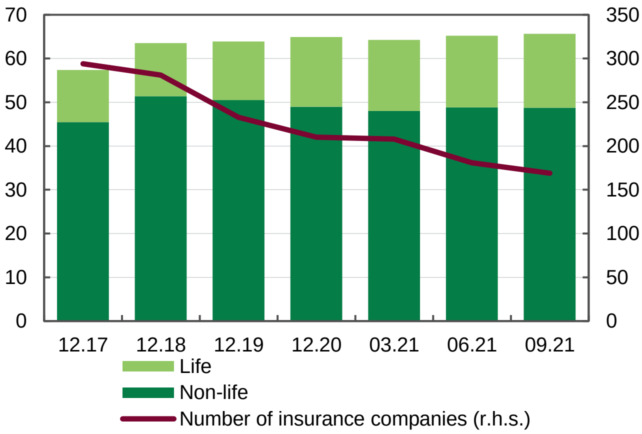
		2017	2018	2019	2020	03.2021	06.2021	09.2021	Change in Q3, qoq
Insurers	Assets, UAH millions	57 381	63 493	63 866	64 920	64 266	65 178	65 636	0.7%
	Number of companies	294	281	233	210	208	181	169	-12
Credit Unions	Assets, UAH millions	2 170	2 218	2 510	2 317	2 335	2 394	2 438	1.9%
	Number of companies	378	358	337	322	316	308	289	-19
Finance Companies	Assets, UAH millions	107 534	125 322	162 197	186 501	166 102	179 864	190 704	6.0%
	Number of companies	677	940	986	960	964	958	971	13
Pawnshops	Assets, UAH millions	3 764	3 721	4 265	3 867	3 966	4 126	4 205	1.9%
	Number of companies	415	359	324	302	292	287	283	-4
Banks	Assets, UAH millions	1 333 831	1 359 703	1 493 298	1 822 814	1 835 527	1 892 468	1 931 916	2.1%
	Number of companies	82	77	75	73	73	73	71	-2

* Along with Q3 2021 earnings reports, the NBFIs could clarify reporting data for Q2 2021. They made retrospective adjustments to certain indicators, in particular the size of assets for this period.

Insurers

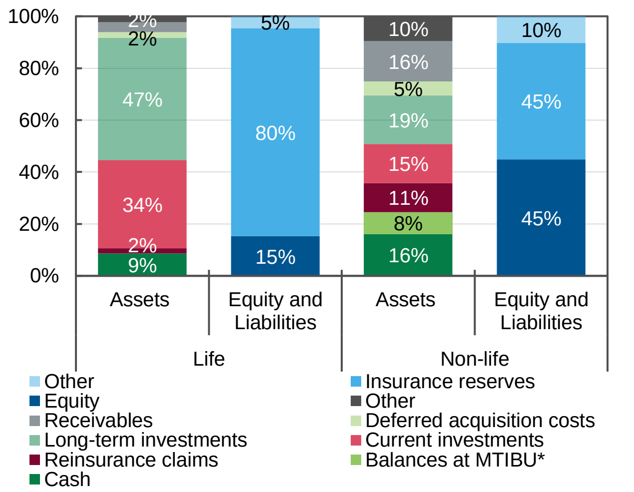
Insurers' assets remained practically unchanged, despite some companies leaving the market.

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



The share of insurers' long-term investments rose as current investment and other assets decreased.

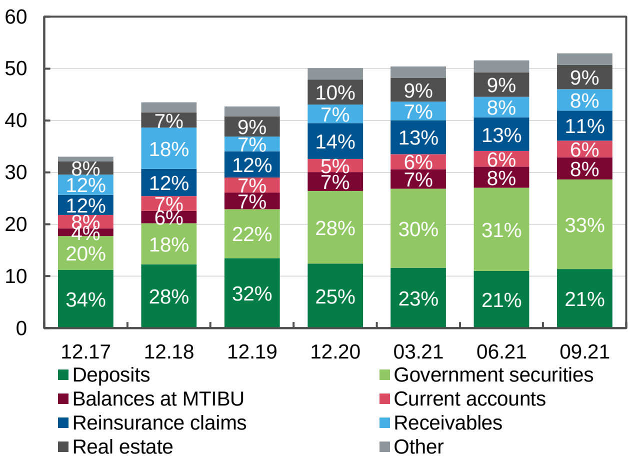
Figure 6. Assets, equity, and liabilities of life- and nonlife insurers as of 1 October 2021



* Motor (Transport) Insurance Bureau of Ukraine.

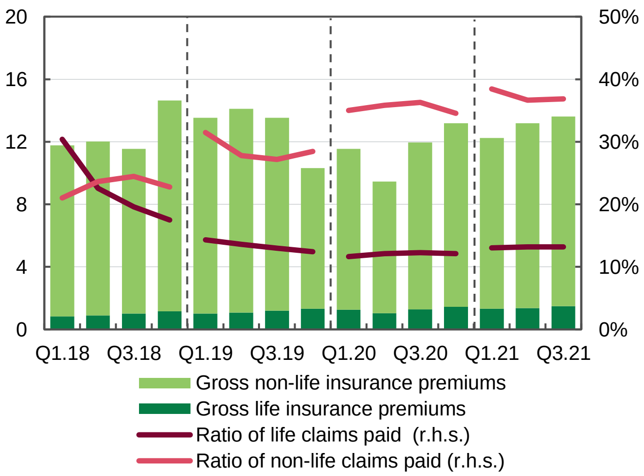
Nonlife insurers ramped up their investment in government securities.

Figure 7. Structure of assets eligible to cover provisions of nonlife insurers, UAH billions



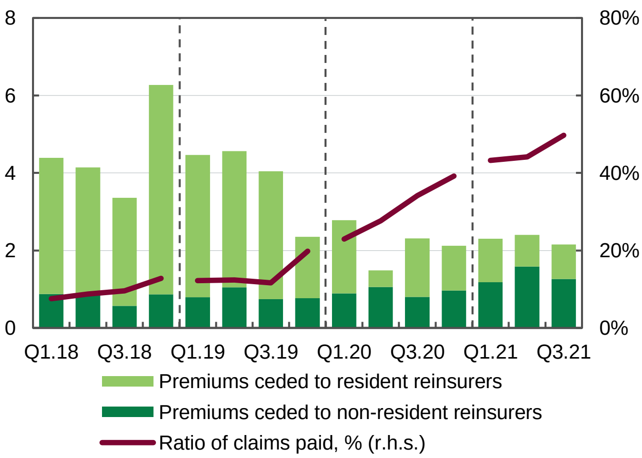
Claims paid on life insurance have been unchanged for two years, at 13%, with those paid on nonlife insurance rising every year.

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



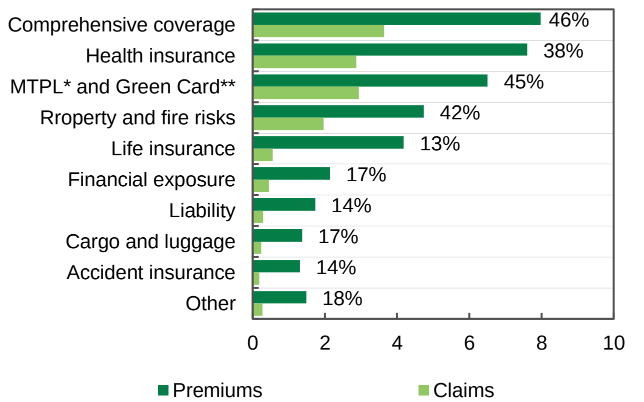
Claims paid on reinsurance have been on the rise for two years, reaching 50%.

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.

Figure 10. Breakdown of insurance premiums and claim payments by most popular types of insurance in Q3 2021, UAH billions



The percentage value indicates the claim payouts to premiums ratio of the respective type of insurance. * Compulsory motor third party liability insurance. ** International Motor Insurance Card System.

The net premiums of life and nonlife insurers grew further in Q3 2021. The insurance premiums that nonlife insurers received from their retail customers rose by 11%, while those received from corporate customers dropped by 4% over the quarter.

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

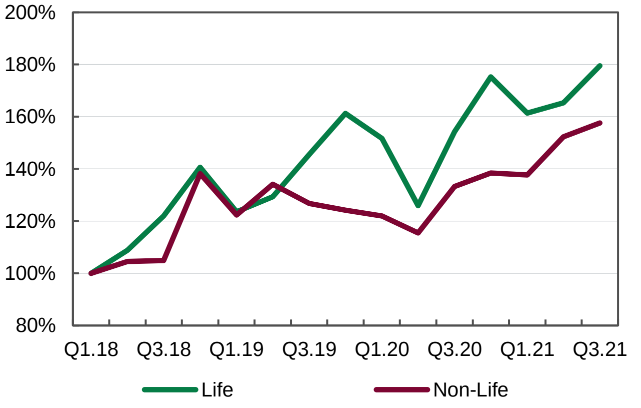
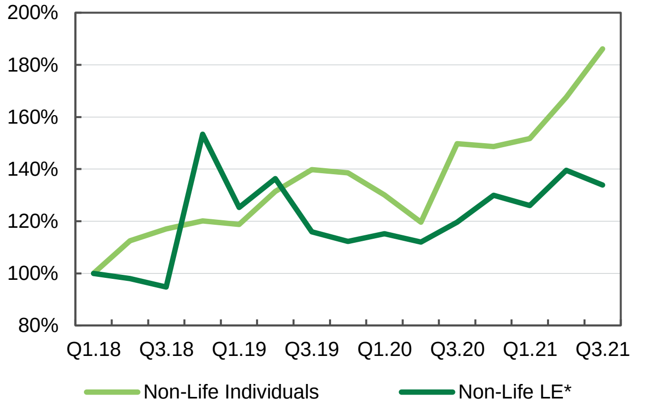
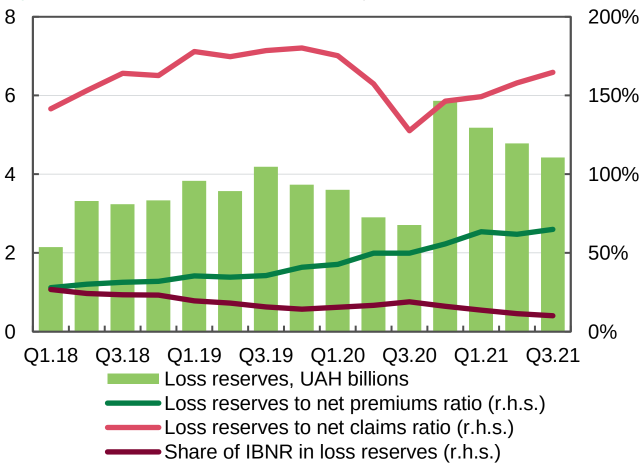


Figure 12. Nonlife insurance premiums in terms of types of policyholders, Q1 2018 = 100%



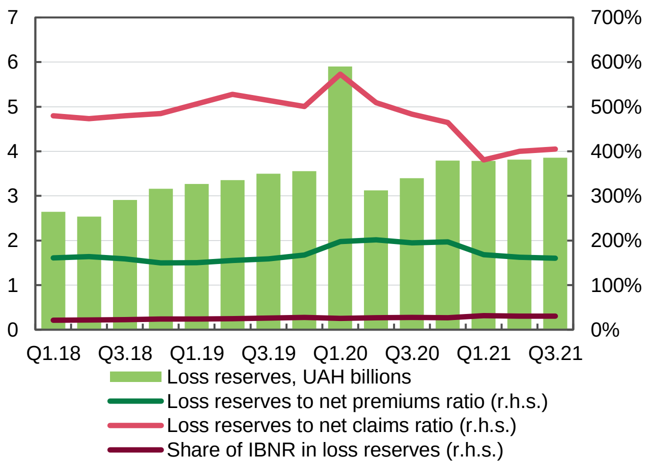
Provisioning ratios for voluntary insurance increased on the back of higher provisions made this year compared to 2020. As a result, the increase in premiums and payments was offset by large increase in provisions in annual terms. Provisioning ratios for mandatory insurance remained practically unchanged.

Figure 13. Loss reserve ratio* of voluntary nonlife insurance



* Annualized loss reserves.

Figure 14. Loss reserve ratio* of compulsory nonlife insurance



* Annualized loss reserves.

The loss ratios decreased somewhat over the quarter. Despite a decrease in their loss ratios in Q3, comprehensive coverage car insurance and compulsory third party liability car insurance continued to generate the largest losses.

Figure 15. Share of compulsory insurance premiums and loss ratio of nonlife insurance

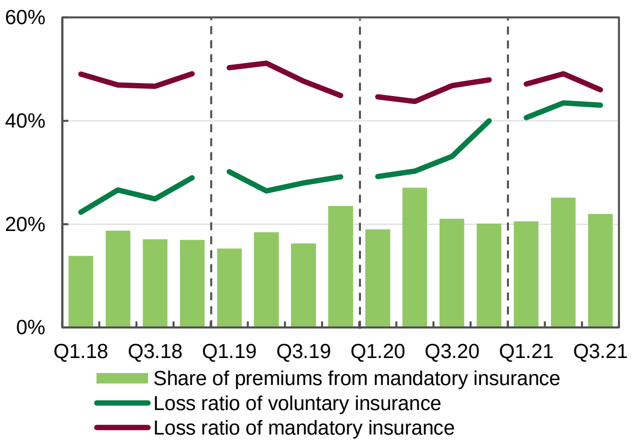
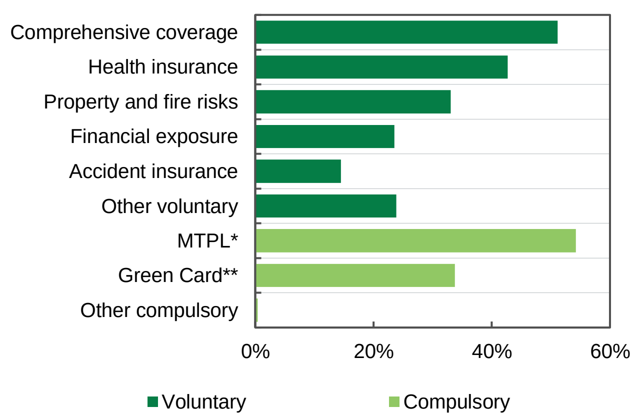
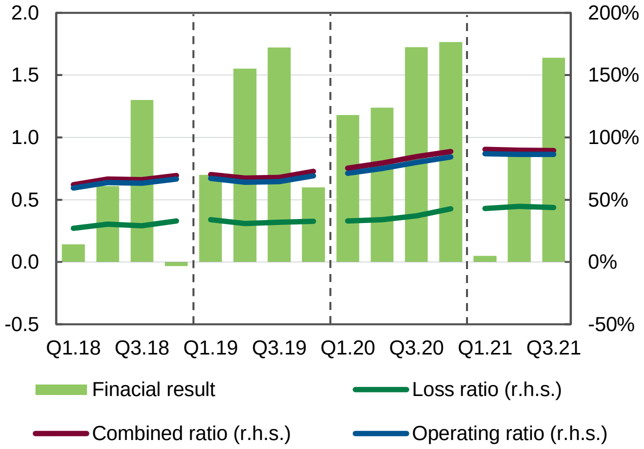


Figure 16. Loss ratio for certain types of insurance



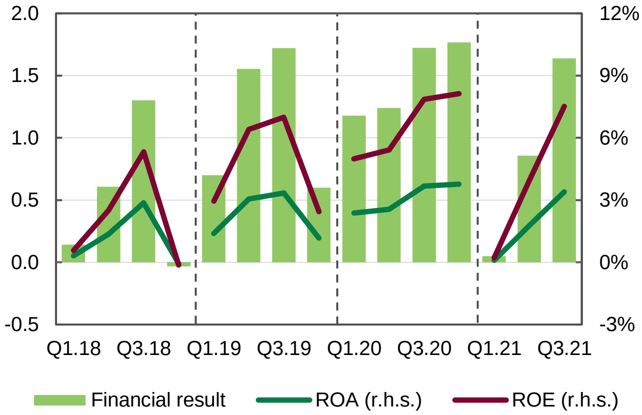
The level of operational efficiency of nonlife insurers remained acceptable. The combined ratio was flat in Q3, despite a drop in the loss ratio.

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



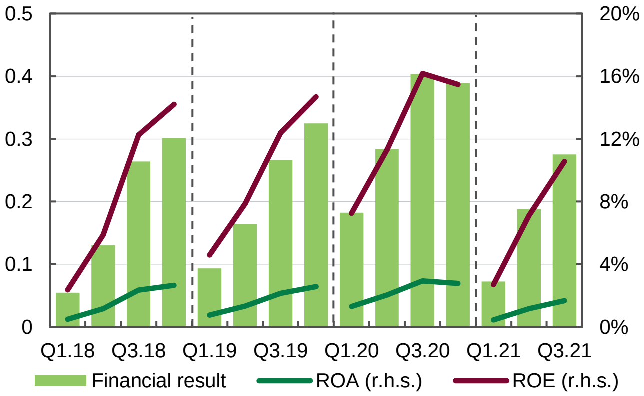
The profits of nonlife insurers spiked in Q3. This increased the profitability ratios of these insurers.

Figure 18. Financial performance of nonlife insurers on a cumulative basis, UAH billions



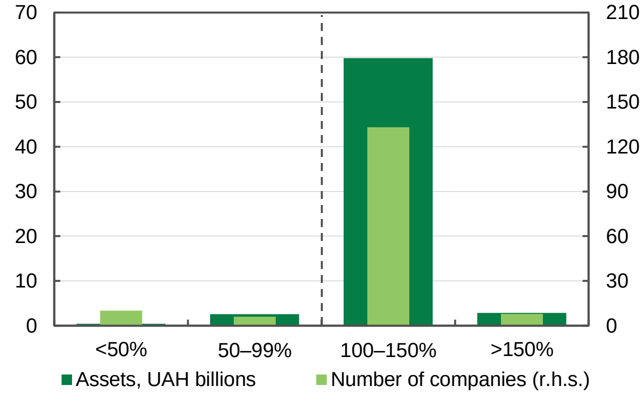
Although rising, the profits and rates of return of life insurers did not reach last year's levels.

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



As of late September, 16 insurers were in violation of the solvency ratio. These companies account for 5% of total market assets.

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

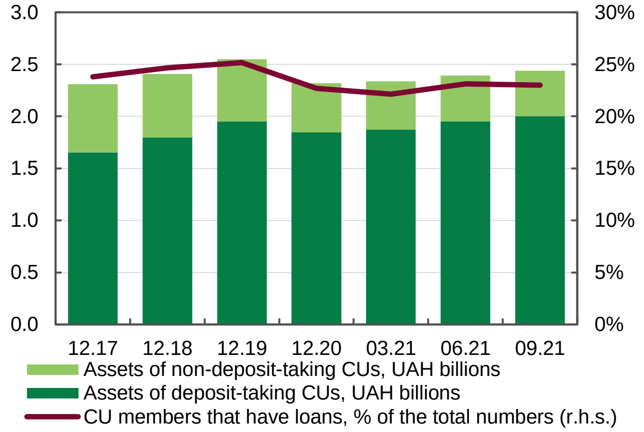


* This figure is based on data from 157 companies

Credit Unions

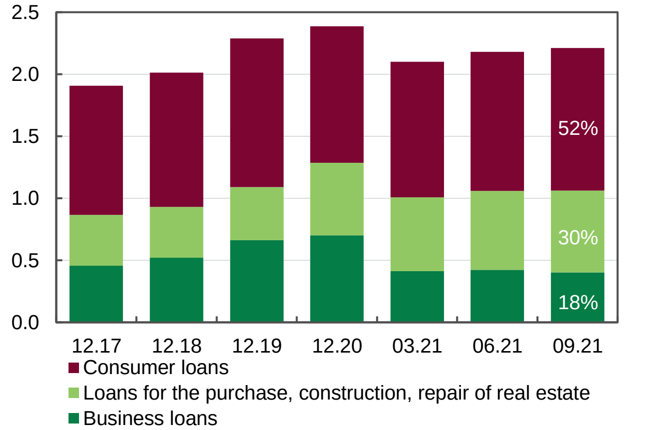
Credit unions' assets grew by 2% over the quarter. The percentage of deposit-taking institutions and the percentage of active credit union members remained unchanged, at 23%.

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



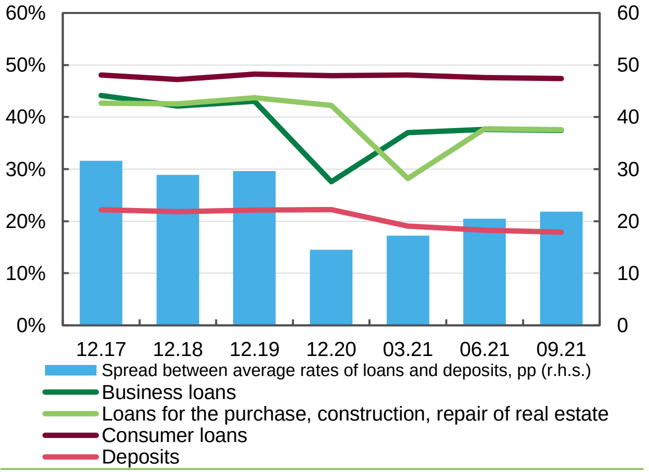
The loan portfolio increased by only 1% in Q3, driven by consumer and mortgage loans. Meanwhile, corporate lending decreased. The declared quality of the loan portfolio remained unchanged.

Figure 22. Structure of the principal amount of the share of CU members debt on loans



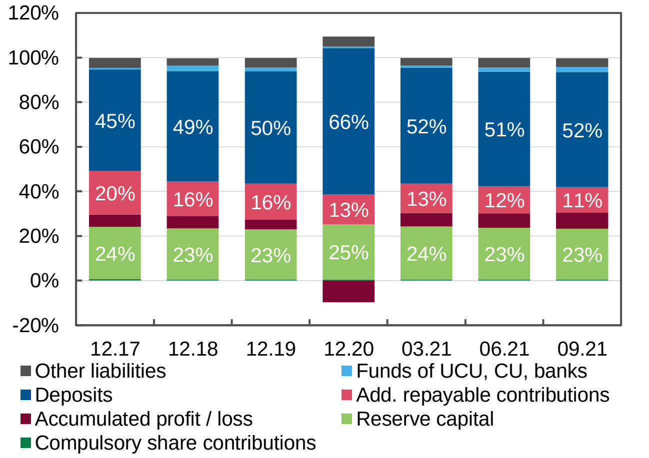
The spread between the average interest rate on loans and deposits has increased since the beginning of 2021. This resulted, among other things, from a further decrease in the cost of deposits and high interest rates on loans.

Figure 23. Average interest rates on outstanding loans and deposits of CU members



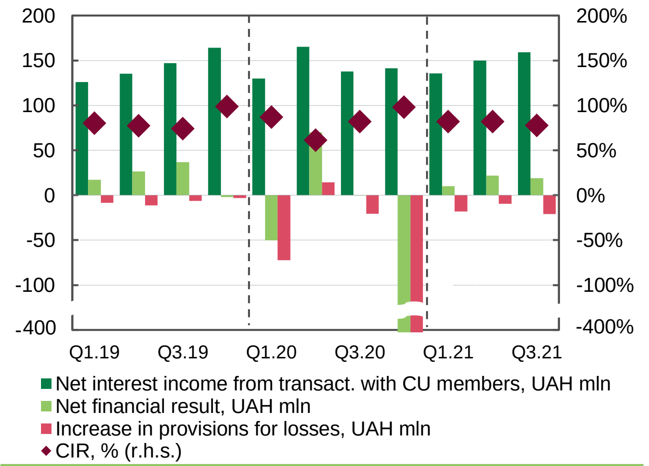
Deposits accounted for over half of total funding, while additional share contributions as a percentage of total funding declined. Retained earnings also increased.

Figure 24. Composition of liabilities and equity of credit unions



The net interest income grew in Q3, fueled by the higher interest rate spread. This pushed up both operational efficiency and profits.

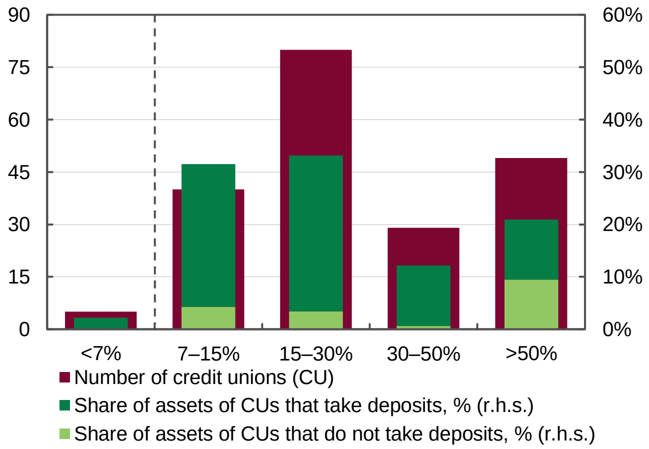
Figure 25. Operational efficiency*



*CIR – Cost-to-Income Ratio, ratio of operating expenses and operating income

As of 1 October 2021, there were only a few credit unions that breached the solvency ratio.

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



* Reporting data submitted as of 1 October 2021

Finance Companies

In Q3, finance companies' assets recovered to the historic high seen in late 2020. This growth resulted from an increase in accounts receivable. The assets and liabilities structure remained stable.

Figure 27. Finance companies' asset structure, UAH billions

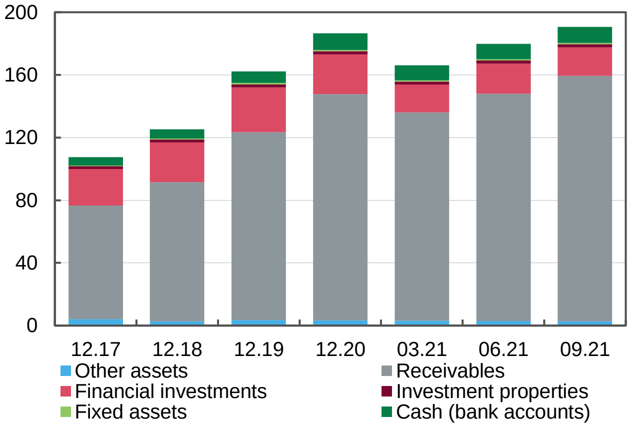
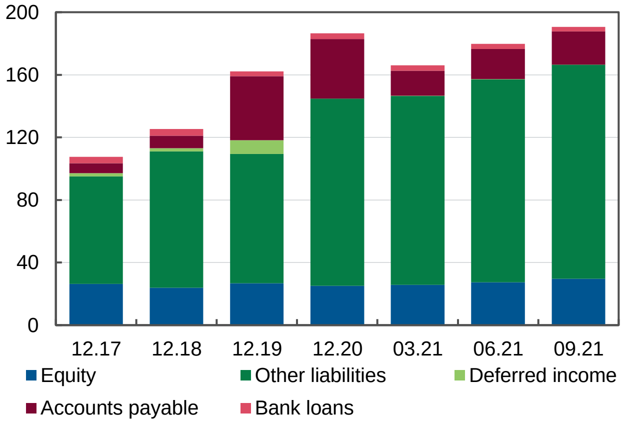
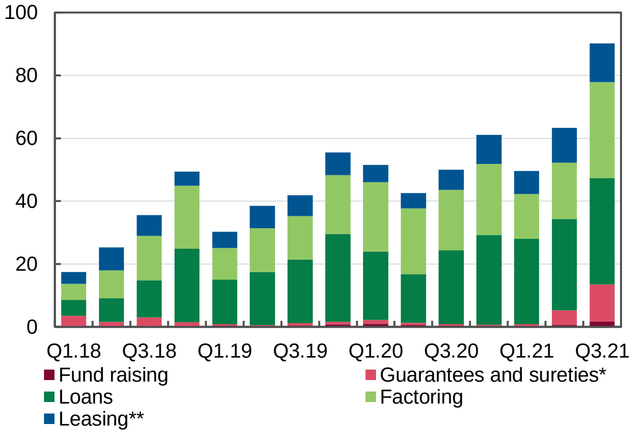


Figure 28. Composition of finance companies' equity and liabilities, UAH billions



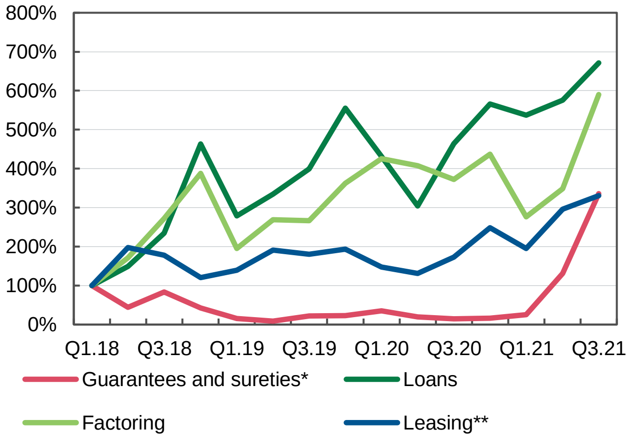
Q3 saw a surge in the provision of financial services, with factoring transactions rising at the fastest pace. Lending and leasing transactions grew much more slowly. Finance companies have been increasing the volumes of guarantee provision, which was almost absent for a long time. That said, lending still accounts for the largest share of services provided by finance companies.

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.

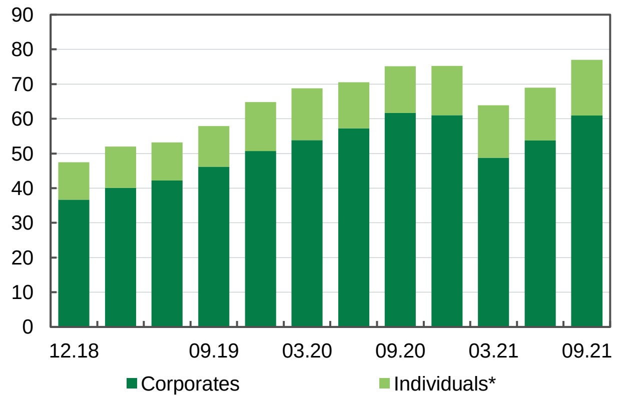
Figure 30. Financial services provided by finance companies, by type of service (quarterly data), Q1 2018 = 100%



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

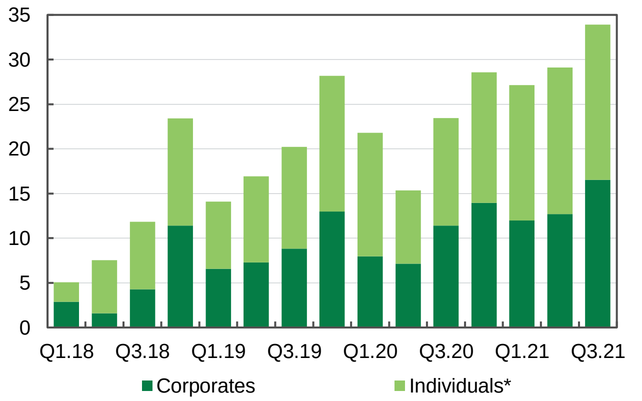
The gross loan portfolio of finance companies grew in Q3. The growth was mostly generated in corporate loan portfolio. Although retail loans accounted for only 20% of the total loan portfolio, households remain the main recipients of new loans.

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.

New loans issued by finance companies were mostly short-term. Overall, one third of new loans were made for up to 31 days, and 59% for up to one year. Over 60% of new retail loans were granted for up to 31 days, while 90% of corporate loans were provided for three months to a year.

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

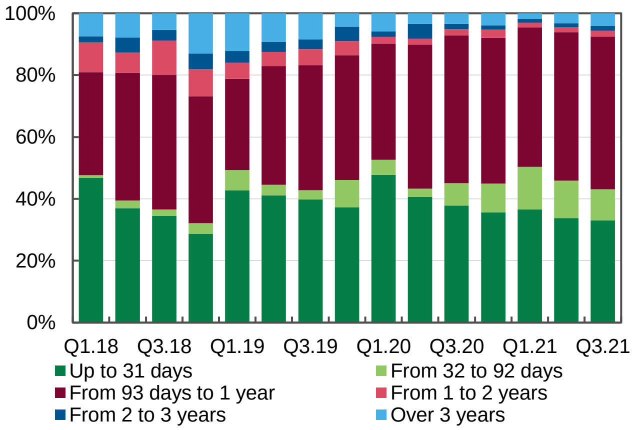
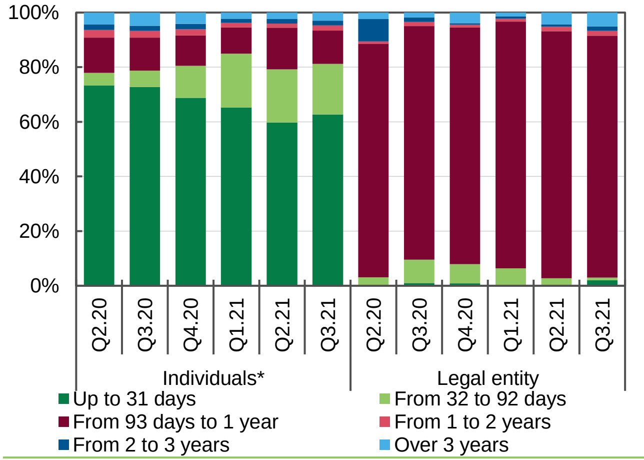


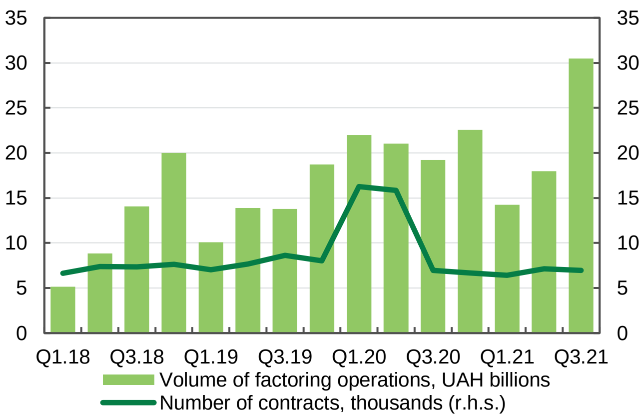
Figure 34. Breakdown of loans issued during quarter, by maturity and client's type



* Including sole proprietors.

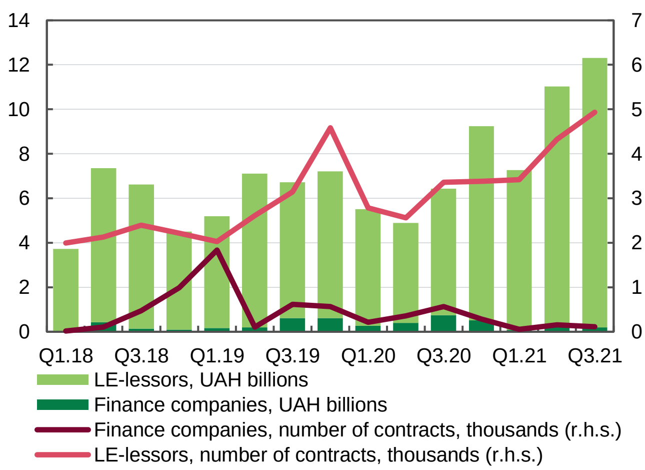
Factoring transactions increased markedly in Q3, reaching a record high in recent years.

Figure 35. Volume and number of factoring agreements



Financial leasing transactions have been on the rise for two quarters running. Despite that, finance companies accounted for only a tiny share of total transactions. Services were mainly provided by legal entity lessors.

Figure 36. Volume and number of financial leasing agreements



LE – legal entity.

Finance companies made record profits in the first three quarters of 2021. Their profits were larger than in the same periods of previous years.

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

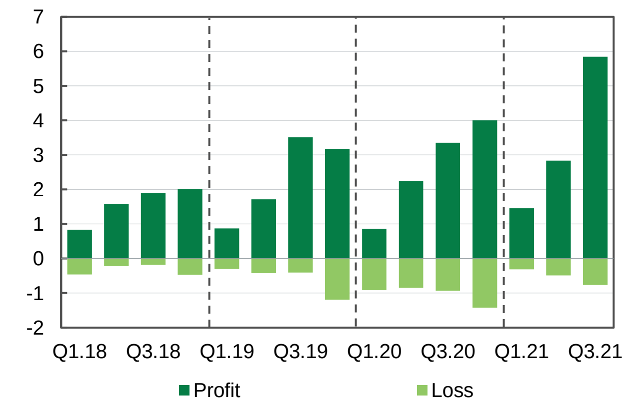
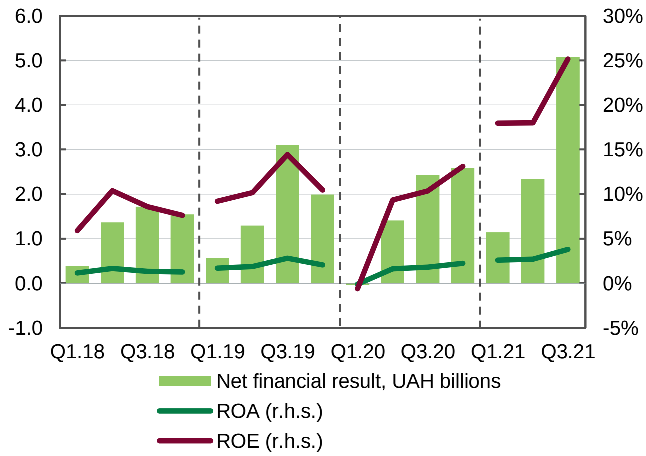


Figure 38. Financial performance of finance companies (on cumulative basis) and their return ratios



Pawnshops

Pawnshop assets grew by less than 2% in Q3, mainly due to an increase in pawnshop funds resulting from loan repayments. The assets and liabilities structure has remained practically unchanged for a long time.

Figure 39. Pawnshop's assets, UAH billions

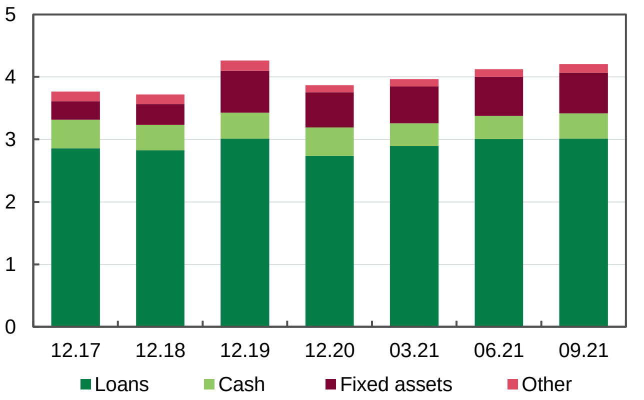
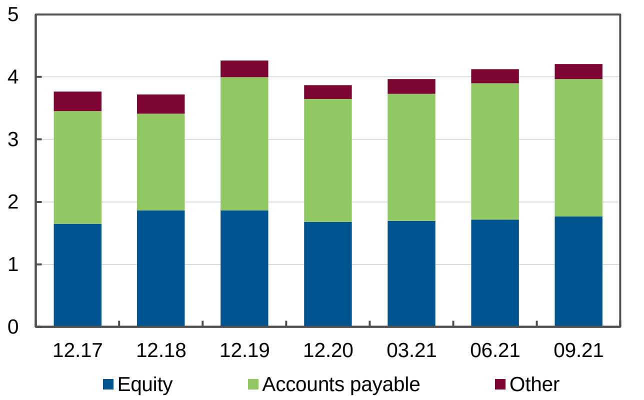


Figure 40. Pawnshop's liabilities and equity, UAH billions



New loans contracted slightly in Q3. At the same time, borrowers actively repaid loans they received earlier. This decreased the cost of pledged assets (by 22%) and the collateral coverage ratio (to 104%). This was the lowest figure in the last three years.

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

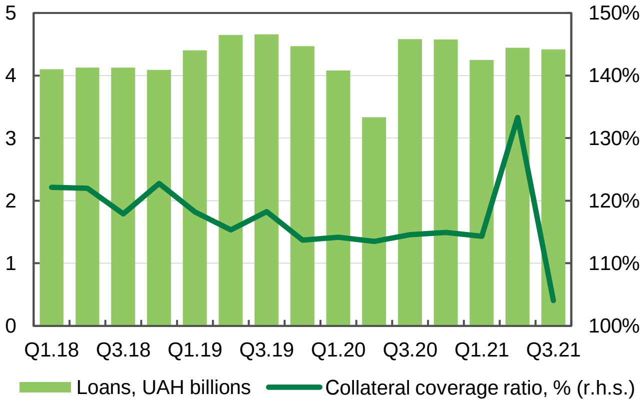
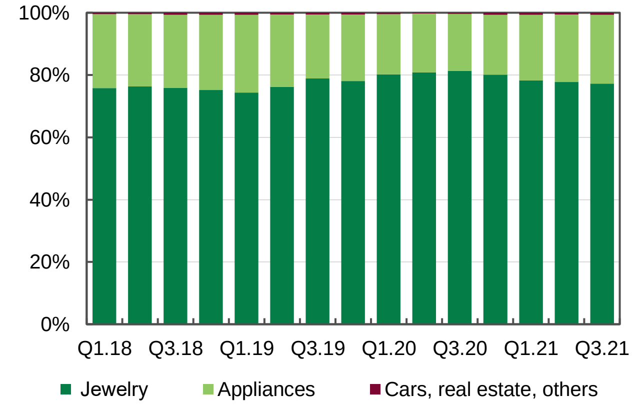


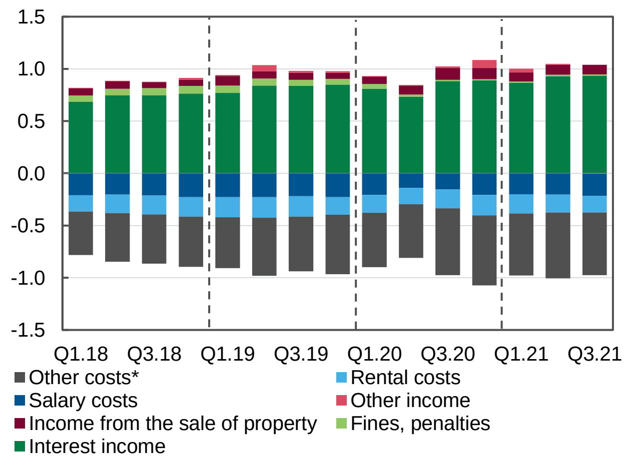
Figure 42. Loan portfolio structure by type of collateral



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

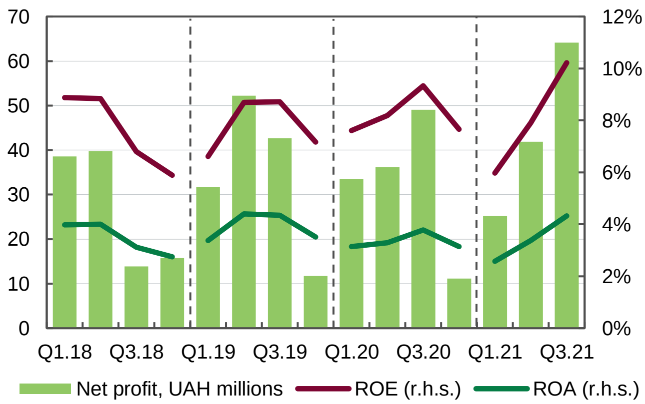
As before, income grew faster than expenses in Q3 2021, which led to an increase in pawnshops' profits. Over the last three years, pawnshops' rate of return has risen to a record high of 10%.

Figure 43. Structure of income and expenses of pawnshops, UAH billions



* Including expenses related to selling and maintaining pledged property.

Figure 44. Financial performance indicators of pawnshops



Notes:

The source of 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 Q3 2021, NBFIs, at the NBU's request, adjusted their improperly compiled reporting figures for previous periods (including Q2 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.

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