



ANALYSIS OF THE STATE OF PROBLEM-BASED ASSETS IN COMMERCIAL BANKS AND THE PRACTICE OF THEIR REDUCTION

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Abstract

The article presents factors for the emergence of problem assets in commercial banks, their analysis, and proposals for reducing problem assets. Based on the study and observation of concepts such as "problem asset," "problem loan," "classification of problem assets," and "passive loan" in the scientific article, relevant approaches and recommendations have been formulated, highlighting the main mechanisms used to repay existing problem loans in the bank's portfolio.

Keywords: Commercial bank, asset, problem asset, risk, problem loan, credit risk, diversification, loan insurance, reserve creation, limitation, hedging, risk management.

Introduction

In Uzbekistan, significant attention is being paid to the transformation of commercial banks, improving the quality of their assets, and shaping them based on market principles. For instance, critical objectives such as "Completing the transformation processes in commercial banks with state ownership and increasing the share of the private sector in bank assets to 60% by the end of 2026" [1] underscore the importance of reducing the volume of problematic assets in banks. Addressing these issues has become one of the main priorities in the financial and credit sector's ongoing reforms.

It is worth noting that topics like bank assets, problematic assets, risk-weighted assets, asset quality levels, and similar areas have been extensively studied by both local and international economists. Their scientific perspectives and dissertation research have explored the causes of problematic assets and strategies for their reduction, leading to various conclusions.

In our view, one of the key tools for preventing the transformation of commercial bank assets into problematic assets in our republic is identifying the causes of such transformations and the factors influencing them. The primary reasons for assets turning into problematic ones in our country include the following:

- Insufficient expertise, knowledge, and skills of qualified specialists working with active operations in commercial banking practice.
- The absence of a unified and comprehensive system to assess clients' creditworthiness to prevent issued loans from turning into problematic loans in our banking practice.



- The lack of dedicated departments dealing specifically with problematic assets in almost all our banks, and in cases where such departments exist, their activities are not effectively coordinated with other departments.
- The absence of collector organizations that purchase and rehabilitate problematic bank assets, based on the experience of developed countries.
- The lack of a centralized database for information on clients with negative credit histories.

To address the aforementioned issues, commercial banks must identify the causes of problematic assets and the factors influencing their occurrence and take measures to eliminate them.

Literature Review

In both global and domestic banking systems, the high share of loans in the composition of bank assets has led many foreign and local scholars to associate problematic assets with problematic loans. Due to the high risk of issued loans, the likelihood of them turning into problematic loans is also significant. This situation is often caused by banks issuing loans without sufficient analysis, proper study, on-site inspection of the pledged collateral, or a thorough evaluation of the borrower's creditworthiness. Nonetheless, issues related to the quality of commercial bank assets remain relevant, as their importance only increases over time and under certain circumstances.

In the composition of commercial bank assets, the deterioration in the quality of risky assets indicates the transformation of these assets into problematic ones. Problematic assets represent a distinct category of assets intended for the activities of commercial banks.

As mentioned earlier, numerous scientific studies have been conducted on the issue of problematic assets in commercial banks.

Russian economist and professor O.I. Lavrushin has conducted a theoretical and scientific analysis of the composition and economic essence of commercial bank assets. According to his perspective, "Bank assets are entirely properties and rights formed from owned and borrowed funds, which are utilized by credit institutions in active operations" [2].

In our opinion, Professor O.I. Lavrushin has limited the formation of bank assets to owned and attracted funds from clients. However, in the current context, funds provided under socially significant state programs and resources attracted from international markets have been overlooked.

Russian professor V. Usoskin also emphasized that "ensuring the alignment of maturities between assets and liabilities is the primary criterion for mitigating and eliminating risks associated with problematic assets in commercial banks" [3]. He stressed that maintaining this balance is crucial to preventing the emergence of transformation risks in commercial banking operations, which, in turn, contribute to the occurrence of problematic assets. In our view, while maintaining the alignment of maturities is essential, it is equally necessary to address the objective and subjective reasons that may lead to assets becoming problematic.

As seen from the opinions of the aforementioned scholars, discussions on commercial bank assets primarily focus on loans, as loans constitute the largest share of bank assets in most countries. Even in



developed nations like the United States, many major banks have faced crises due to the high level of problematic assets.

The primary reason for the emergence of problematic assets within the composition of commercial bank assets is directly linked to the proper establishment of market mechanisms in the country. Specifically, if the central bank and government ensure the implementation of robust market mechanisms and rules for commercial banks and business entities, this issue becomes less pressing.

Analysis and Results

Enhancing the efficiency of the banking system in our country is closely tied to the active participation of banks in financing the real sector of the economy. Consequently, loans constitute the largest share in the composition of bank assets. However, in practice, our banks encounter several shortcomings and issues related to lending. Notably, the presence of problematic loans among the credit portfolio, which forms the primary income-generating assets of commercial banks, has become increasingly evident. To substantiate the above points and demonstrate that the situation is similar in practice, we examine the composition of assets in Uzbekistan's commercial banks, where loans occupy the largest share, as illustrated in the following table.

1-Table The composition of the assets of the banking system[4]

Name of indicators	01.11.2023 y.		01.11.2024 y.		Changes in percentage
	billion sum	share in percent	billion sum	share in percent	
Assets					
Cash in the cash register and other payment documents	17 028	2,7%	21 441	2,8%	26%
Funds in the Central Bank	20 886	3,4%	25 763	3,4%	23%
Funds in other banks - resident	27 772	4,5%	32 551	4,3%	17%
Funds in other banks – non-resident	30 415	4,9%	43 717	5,8%	44%
Investments and other securities	31 137	5,0%	58 627	7,8%	88%
Compulsions of the clients about financial instruments	2 102	0,3%	1 039	0,1%	-51%
Loans, (net)	444 827	71,5%	505 023	67,1%	14%
Fixed assets, (net)	17 482	2,8%	23 896	3,2%	37%
Interest accrued on assets	18 313	2,9%	24 996	3,3%	36%
Other private properties of the bank	4 171	0,7%	6 225	0,8%	49%
Other assets	7 796	1,3%	9 773	1,3%	25%
Total assets	621 930	100%	753 052	100%	21%

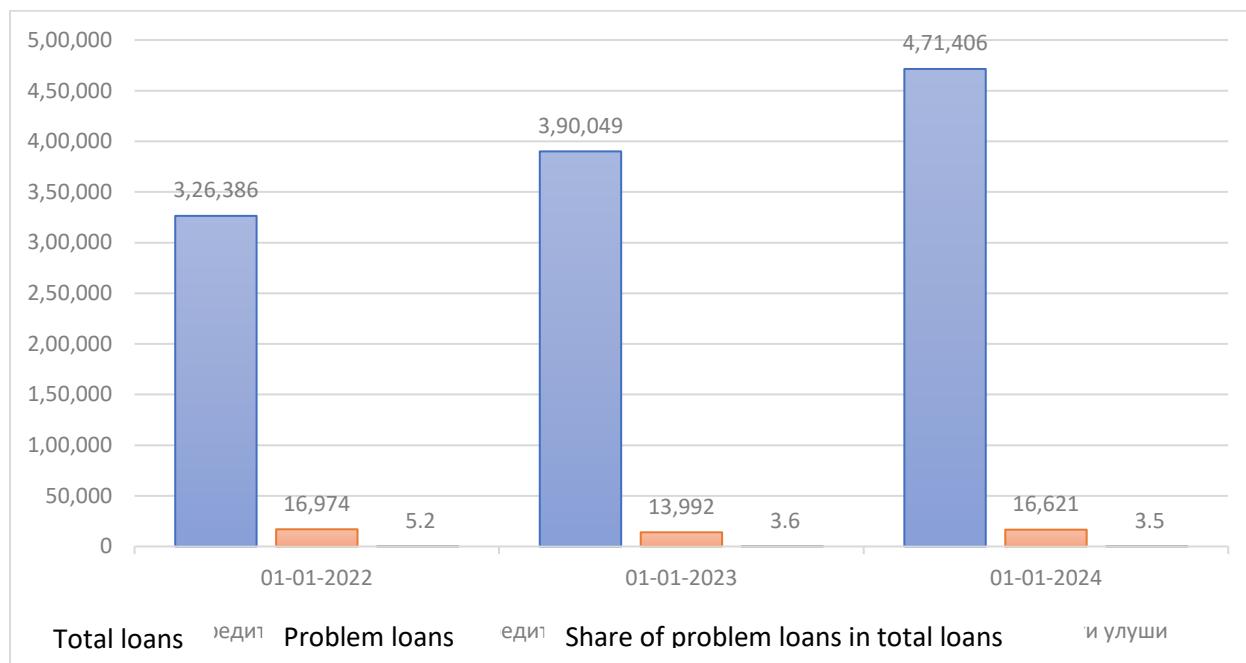


From the table data, it is evident that between November 1, 2023, and November 1, 2024, loans hold the largest share in the composition of assets of commercial banks in our republic. This can be explained by the fact that lending is the primary activity for banks.

We can observe that the total bank assets increased by 1.2 times in 2024 compared to 2023.

In 2023, loans accounted for 71.5% of the total asset composition of commercial banks. By 2024, this figure decreased to 67.1%. The decline can be attributed to the increase in funds directed toward investments and other securities, which grew from 5% to 7.8%, and the increase in funds held in other banks (non-resident) from 4.9% to 5.8%.

It is worth noting that investments in and funds directed toward other securities demonstrated a growth trend between 2023 and 2024.



1-picture Problem loans of commercial banks in terms of total loans in billion sums [5]

The table data shows that at the beginning of 2022, the volume of problematic loans amounted to 16,974 billion UZS. By the beginning of 2023, this figure had decreased to 13,992 billion UZS, reducing the share of problematic loans in total loans from 5.2% to 3.6%. This decline indicates that banks have taken significant measures in recent years to reduce problematic loans.

However, by 2024, while the share of problematic loans decreased by 0.1 percentage points, the total volume increased by almost 3 billion UZS. This is primarily attributed to the fact that total loans grew by 1.2 times compared to the previous year.

Given that loans account for a significant portion of problematic assets and overall bank assets, problematic loans receive considerable attention. Reserves allocated for problematic loans increase the expenses of commercial banks and reduce their revenues.



The following table examines the reserves allocated by our country's banking system for problematic loans.

2-table “Classification of the loan portfolio of commercial banks and the status of created reserves”

Loans classification	01.01.2018 y.		01.01.2019 y.		01.01.2020 y.		01.01.2021 y.		01.01.2022 y.	
	share in total loans	percent age of reserves created	share in total loans	percent age of reserves created	share in total loans	share in total loans	percent age of reserves created	share in total loans	percent age of reserves created	share in total loans
	in percent	in percent	in percent	in percent	in percent	in percent	in percent	in percent	in percent	in percent
Standard	90,6	15,3	92,1	13,6	91,8	13,6	89,8	13,2	87,4	12,5
Substandard	8,2	55,3	6,6	54,6	6,6	54,6	6,8	53,1	7,4	54,6
Unsatisfied	0,7	6,7	0,7	7,4	0,7	7,4	0,9	7,2	1,9	7,0
Suspicious	0,2	9,1	0,3	7,5	0,3	7,5	0,4	7,3	1,5	7,1
Hopeless	0,3	13,6	0,3	16,9	0,6	16,9	0,8	19,2	1,8	18,8
Total	100	100	100	100	100	100	100	100	100	100

The table data shows that in 2018, the largest share of reserves allocated by commercial banks for problematic loans was attributed to loans classified as substandard, accounting for 55.3%. By 2022, this figure had decreased to 54.6%, which can be attributed to the sharp increase in the share of loans classified as hopeless. Reserves allocated for hopeless loans accounted for 13.6% of total reserves in 2018, rising to 18.8% by 2022. The increase in reserves for hopeless loans can be explained by the growth in the volume of unsecured loans allocated by banks.

The emergence of problematic assets, including problematic loans, can lead to the following negative consequences:

- Loss of trust in the bank by clients and other investors, as well as a decline in the bank's reputation.
- Increase in the operational expenses of commercial banks.
- Decline in the bank's liquidity and solvency.
- Reduction in bank income due to the creation of reserves for potential losses on problematic assets, along with a deterioration in other key performance indicators critical to the bank's operations.

Addressing this issue requires prioritizing the management and analysis of problematic assets' nature and characteristics, in line with the risks and specifics inherent to modern market economy entities. It is also essential to improve practices for accounting and auditing problematic assets.

The analysis and studies indicate that an increase in the share of highly liquid assets in commercial banks may, over the long term, weaken their financial stability and, in some cases, even lead to bankruptcy.



Conclusion

Currently, commercial banks in our country establish two types of reserves related to assets: special and general reserves.

The low share of investments directed toward securities within the structure of our Republic's commercial banks' assets is considered a negative indicator of their performance.

The fact that loans account for more than 50% of the structure of commercial bank assets during the analyzed period is regarded as a positive aspect.

The concentration of commercial bank loans in certain sectors indicates a very low level of diversification in the credit portfolio of banks.

Commercial banks need to regularly analyze the quality and diversification level of their credit portfolio. This is crucial for managing loans, improving the quality of the credit portfolio, and consequently increasing the bank's profitability.

To reduce the volume of problematic assets, banks must focus on the following:

- Implementing an effective credit policy.
- Strengthening risk management and introducing mechanisms to prevent problematic assets.
- Enhancing bank supervision, particularly strengthening the oversight of the Central Bank.
- Expanding the practice of restructuring problematic assets and transferring them to specialized organizations.

- Ensuring macroeconomic stability to positively impact the quality of the loan portfolio.

We hope that the above conclusions and recommendations will contribute to a deeper understanding of the economic essence of reducing the volume of commercial banks' problematic assets and will help to significantly lower their share.

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