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O'ZBEKISTON RESPUBLIKASI BANK-MOLIYA AKADEMIYASI ILMIY JURNALI



International standards for financial sustainability assessment of commercial banks

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ARTICLE INFO

Received: 26.07.2022

Accepted: 01.08.2022

Key words: *assets, liabilities, asset quality, bank capital, stability, basel committee, liquidity, risk, roa, profit, roe, profitability, liability, securitization.*

Abstract

This article presents the recommendations of the financial stability indicators of commercial banks provided by the experts of the International Monetary Fund. In addition, the financial stability indicators of commercial banks of Uzbekistan were analyzed, proposals and recommendations were developed based on the study of international experience in improving their stability.

Introduction

The concept of financial stability is the subject of widespread debate in many economic literatures today. Financial stability refers to the ability of a financial system, in particular, a system of financial markets and financial institutions to perform key functions in an unstable economic environment. The global financial and economic crisis put many financial institutions, particularly commercial banks, at risk of failing to perform their key functions. The main reason for this was the insufficient financial stability of banks. After this crisis, strict requirements were introduced for the financial stability and sustainability of financial institutions around the world.

The large-scale measures taken to further strengthen the financial stability of banks have a positive impact on their ability to receive international credit ratings. In particular, the international rating agency Moody's gave a "stable" rating to the prospects of development of the banking system of Uzbekistan during last sixth years. Standard & Poor's and Fitch Ratings also rate Uzbekistan's banking system as "stable." To date, 33 commercial banks operating in the country and almost all of them have "stable" ratings from reputable international rating agencies. The main indicators of the banking system, in particular, "sufficient capital of banks", "liquidity of commercial banks", "dynamics of deposits", "changes in the volume of loans" at the end of 2021. Banks are mostly taking large-scale measures to develop high-tech technological renewal and modernization of production, which have been identified as priorities for 2021.

Resolution of the President of the Republic of

Uzbekistan PF-6003 dated June 2, 2020 "On improving the position of the Republic of Uzbekistan in international rankings and indices and the introduction of a new mechanism of systematic work with government agencies and organizations"(PF-6003,2020) laid the foundation for strengthening financial stability of banks. In order to increase the stability of banks, the Decree of the President of the Republic of Uzbekistan Sh. Mirziyoyev PF-5992 dated May 12, 2020 "On the strategy of reforming the banking system of the Republic of Uzbekistan for 2020-2025" was adopted (PF-5992,2020)). The above-mentioned regulations serve to further strengthen the financial stability of Uzbek banks. The Strategy was developed by the Central Bank and the Ministry of Finance in cooperation with the World Bank, taking into account the main findings and recommendations of the current state of the country's banking system, as well as the experience of foreign financial sector transformation and international financial trends.

Literature review

Numerous studies have been conducted by foreign scholars on ensuring the financial stability of banks. Oliver M.B. Sprague a professor of finance and banking at Harvard University, was the first scientist to conduct research on the sustainability of banks. His research promoted the idea of ensuring the bank's financial stability by increasing the confidence of the bank's customers. In recent years, the development of science has created new methods to ensure the financial stability of banks. Methods based on the latest modern computer programs are used in practice today. According to Robert C. Merton, an increase in the level of pure competition between financial institutions

and the provision of data transparency will lead to a strengthening of the level of financial stability. Columbia University professor Frederick S. one of the leading experts in the field of banking finance. Mishkin noted that an increase in the level of uncertainty in the banking system, an increase in the level of uncertainty reduces the financial stability of banks. According to T.I.Bobakulov - one of the economists of our country, the main factor in ensuring the financial stability of banks is to ensure the balance between the bank's assets and liabilities in terms of time and volume.

Research Methodology

During preparation of this article, it was analyzed existing theories of foreign scholars about factors influencing the financial stability of banks in our country. The research used mainly comparative assessment and scientific abstraction methods. Annual reports of commercial banks of the Republic of Uzbekistan and annual reports of the JSCMB "Ipoteka-bank" were used as statistical sources.

Analysis and results

The main purpose of calculating the financial stability

indicators of commercial banks is to provide users with information on how stable the financial institution is. An international comparison of these indicators serves to shed more information on the nature of the indicator. To this end, the International Monetary Fund experts first developed and recommended financial stability indicators in 1992. Some changes were made in 2002 and last in 2006. These financial stability indicators are in total 39 and they are divided into 2 groups (Adam Gersl and Jaroslav Hermanek, CNB, 2006). The first group includes key indicators (related to the banking system) and consists of 12 financial indicators. The second group of 27 indicators is recommended for use in the calculation of financial stability of non-bank financial institutions, enterprises and households. Since the activity of commercial banks is the object of study, we found it necessary to study the indicators of the first group. The recommendations in Table 1 below are the recommendations of the International Monetary Fund and are currently being put into practice by the European Central Bank. We have studied these recommendations in assessing the financial stability of commercial banks in the Republic of Uzbekistan. Here are their contents:

Table 1.

International Monetary Fund financial stability indicators

Nº	Category	Indicators
1.	Capital Adequacy	The ratio of total capital to risk assets
2.	Asset quality	The share of NPL in total loans
3.	Revenue and utility level	Return on Asset (ROA) Return on Equity (ROE)
4.	Liquidity level	Share of liquid assets in total assets
5.	The level of risk associated with foreign exchange	The ratio of the bank's net open currency position to capital

From the above indicators, the capital adequacy ratio shows the degree of financial tolerance of the bank to sudden financial losses, and the quality of assets reflects the degree of solvency of the bank. Profitability and utility indicators show the degree to which losses can be offset if they do not affect the bank's capital. The level of liquidity reflects the extent to which the bank solves the cash problem. The risk in foreign currencies reflects the extent

to which changes in the market value of the bank's foreign currency assets affect the bank's operations. The main purpose of the study is to analyze the above indicators using the practice of banks in Uzbekistan. In order to achieve this goal, we analyzed the indicators of financial stability of the banking system of the Republic of Uzbekistan.

Table 2.

Changes in some indicators of financial stability of the banking system in the example of JSCMB "Ipoteka-Bank"

Nº	Indicators	01.01.2020	01.01.2021	01.01.2022
1.	Capital adequacy ratio	40.1	24.9	20.2
2.	Asset quality	3.1	1.23	5.56
3.	ROA	3.75	1.66	0.93
4.	ROE	36.8	19.3	5.2
5.	Current liquidity level	208.5	377.7	246.6

Source: Prepared by the author based on the data.

The table above shows the trend of change in the indicators of financial stability of the banking system of the Republic of Uzbekistan for 3 years. The assessment of the capital adequacy of the banking system of the country is

based on the recommendations of the Basel standard. Our analysis shows that there is a downward trend in the capital adequacy of commercial banks. 40.1% in 2019, 24.9% in 2020, and 20.2% in 2021. At the same time, the

decrease in the volume of NPL of commercial banks has led to an improvement in asset quality. In particular, during the period under review, the share of long-term non-performing loans of commercial banks in total loans amounted to 3.1% in 2019, 1.23% in 2020 and 5.56% in 2021. In 2021, the level of return on assets of commercial banks decreased. As of January 1, 2022, the ROA was 0.93%, while the ROE was down 14.1%. ROA indicates the level of profitability of a bank's assets. That is, how much profit does a sum bet on an asset bring. In the domestic banks, this figure was 3.75% in 2019, but in 2020 it remained almost unchanged and reached 1.66% at the end

of the year. The return on assets was 0.93% in 2021, a positive change from the past. The next indicator is ROE. It increased by about 14.1% in 2021 compared to 2020, but in 2019 this figure decreased by 17.5%. The current liquidity ratio of commercial banks in 2019 and 2020 was 208.5% and 377.7% respectively. In 2021, this figure fell to 246.6% due to the growth of current liabilities of commercial banks. The factor influencing the level of financial stability of commercial banks is the level of risk. Therefore, we tried to analyze the assets of banks by risk level.

Table 3.

Classification of JSCMB "Ipoteka-bank"s assets by risk level (in billion)

No	Assets risk group	01.01.2020	01.01.2021	01.01.2022
1.	Group I (assets with a risk level of 20%)	539.2	558.7	1460,3
2.	Group II (assets with a risk level of 50%)	2608.5	4846,9	979,2
3.	Group III (assets with 100% risk)	10360.9	13592,3	20957,4
4.	Group IV (assets with a risk level of 150%)	430.7	1915,7	5711,2
5.	The total amount of assets at risk	14251.9	22898,5	33984,6

Source: Prepared by the author based on the data.

The table above shows the classification of assets of JSCMB "Ipoteka-bank", one of the top 5 banks in the Republic of Uzbekistan, by risk level. Our research has shown that a large proportion of the bank's assets fall on the share of risky assets. In particular, in 2019, the share of bank assets recognized as 100% risky in total risk assets amounted to 10 360.9 billion soums. This figure is expected to reach 13 592.3 billion soums in 2020. and in 2021 decreased to 20 957.4 billion soums. In contrast to the trend of change, the assets that have changed are group I and II assets. In 2019, it was 539.2 billion soums and increased by 3.5% in 2020. The following year, the figure was 1 460.3 billion soums. Assets recognized as 50% risky in 2019 was amount 2 608.5 billion soums. This figure reached 979.2 billion by the end of 2021. The total amount of risky assets of commercial banks has grown sharply over the years. In 2019, this figure amounted to 14 251.9 billion soums, in 2020 it was 22 898.5 billion soums and 33984.6 billion soums in 2021. In 2020, the volume of high-risk assets of bank assets increased. As of January 1, 2022, the volume of assets with a risk level of 100% increased from 13592.3 billion soums to 20957.4 billion soums. However, assets with a risk level of 20% were increased from 558.7 billion soums to 1460.3 billion soums during that period.

Today, effective management of assets and liabilities is a key tool in ensuring the financial stability of banks. Attracting resources in the short term and placing them in the long run destroys the financial stability of the bank. In order to maintain the stability of the bank, the coordination of the timing and amount of assets and liabilities should be the main task of the manager of the bank. In order to determine the compatibility of assets and liabilities of domestic banks, we conducted the following analysis.

Conclusions and suggestions

In short, ensuring the financial stability of banks prevents the scope of exposure to risks arising in banking activities. As a result of our above research, we have come to the following conclusions:

Firstly, share of non-income assets in total assets is high;

Secondly; the share of high-risk assets in total assets is very high;

Thirdly, underdevelopment of investment operations of banks with securities;

Fourthly; low return on bank assets (ROA).

Having studied foreign experience (in particular, the banking systems of Germany and Japan), we have developed the following proposals:

to pave the way for the purchase and sale of securities by banks in order to ensure their financial stability, in particular, to attract sustainable resources;

improving corporate governance at banks using international standards and best practices;

introduction of new methods of effective management of assets and liabilities of banks (derivative tools widely used in Germany and Japan);

the process of privatization of state-owned banks will provide access to advanced technological solutions and best practices in banking, as well as reputable and high-quality shareholders with sufficient financial resources;

development of banking supervision and risk management systems at banks, including the introduction of risk-based supervision.

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