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## RISK MANAGEMENT IN UZBEKISTAN'S COMMERCIAL BANKS

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### Abstract:

*This article explores the importance of risk management in Uzbekistan's banking sector amid ongoing economic reforms. It addresses key risks such as credit, market, and operational risks that arise from increased credit demand, foreign investments, and digital transformation. The piece highlights the role of Basel III standards in enhancing capital adequacy and liquidity management. It also emphasizes the need for integrated risk monitoring platforms and the use of AI-driven systems to mitigate operational and cybersecurity risks. By adopting global best practices and adapting to local needs, Uzbekistan's banking system can strengthen its resilience and contribute to sustainable economic growth.*

### Keywords:

*Risk Management, Commercial Banks, Uzbekistan, Economic Liberalization, Credit Risk, Operational Risk, Basel III, Digital Banking, Non-Performing Loans, Regulatory Framework, Credit Scoring, Market Risk, Systemic Risk, Financial Reforms, Operational Audits, Cybersecurity, AI-driven Monitoring.*

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## INTRODUCTION

Risk management in commercial banks is crucial to the integrity of Uzbekistan's financial system, especially as the country implements significant economic changes aimed at liberalizing markets and supporting private sector growth. Commercial banks in Uzbekistan's risk management methods must meet the problems and possibilities posed by the country's distinct economic and regulatory environment.

1. The significance of risk management in Uzbekistan stems from economic liberalization. Uzbekistan has embraced market reforms, such as foreign exchange liberalization and the creation of a competitive banking industry.

These reforms subject banks to new risks such as market volatility, currency fluctuations, and competitive pressures. Commercial banks continue to face major challenges in dealing with non-performing loans.

2. Increasing Credit Demand. The expansion of important industries including manufacturing, construction, and agriculture has raised demand for loans.

In order to prevent defaults and keep loan portfolios in good condition, credit risk management is essential.

3. The role of foreign investments is growing. Exposure to international financial risks is increased by the growth of international partnerships and foreign direct investments (FDIs). To control currency and interest rate volatility, banks need to implement strong market risk management procedures.

4. Modifications to Regulations. In accordance with international norms like Basel III, the Central Bank of Uzbekistan (CBU) has implemented more stringent guidelines for capital adequacy, liquidity, and credit risk management. Compliance with these requirements necessitates the use of current risk management systems and procedures.

5. Digital Transformation. The growing use of digital banking services exposes institutions to cybersecurity and operational threats.

Managing operational risks becomes increasingly crucial when banks integrate cutting-edge technologies.

Effective risk management in commercial banks is critical for Uzbekistan to meet its ambitious economic reform targets. By tackling current issues and exploiting possibilities for reform, Uzbekistan's banking industry can strengthen its resilience, increase stakeholder trust, and contribute to the country's overall economic development.

## LITERATURE REVIEW

Jean Tirole in "The Theory of Corporate Finance" [1] claims that "risks in banks stem from systemic shocks and governance failures, with a significant focus on credit and liquidity risks. "Tirole's work focuses on the macroeconomic and governance elements of bank risk. Unlike operational-focused definitions, this takes into account both external



economic influences and internal managerial dynamics. This viewpoint is useful for synchronizing risk management and policymaking, but it may be difficult to implement without robust systemic risk modeling tools.

According to Merton, credit risk is "the probability that a borrower's obligations exceed their assets, leading to default [2]." Merton's approach is essential for comprehending credit risk quantitatively. By incorporating options theory, it creates a formal framework for risk assessment. However, its reliance on market assumptions, such as constant volatility, may restrict its utility in less established or unpredictable financial markets.

Jorion defines risk as "the uncertainty of returns in financial portfolios," [3] and introduces the idea of Value at Risk (VaR) to measure prospective losses. Jorion's emphasis on VaR popularized a widely used tool for quantifying aggregate portfolio risk. While VaR is commonly used due to its simplicity, its shortcomings, such as the inability to foresee extreme losses (tail risks), highlight the necessity for additional measures such as Conditional VaR.

According to Vasiliev, operational risks arise from "mismanagement, technical failures, or inadequate internal processes." [4] This approach is closely related to the Basel perspective, but it emphasizes the qualitative aspects of risk, such as managerial control. It emphasizes the human component as critical to risk prevention, yet it lacks objective measures for thorough evaluation.

Most definitions agreed on classifying risks as operational, credit, market, and liquidity concerns, although their concentration varies.

**Quantitative Approaches:** Merton and Jorion advocate the use of models and metrics to precisely quantify risk.

**Qualitative approaches:** Authors such as Vasiliev emphasize the crucial nature of managerial and systemic variables.

Integrating these points of view leads to a more comprehensive understanding of risks, particularly in emerging markets where constraints on data and external instabilities are key factors.

## ANALYSIS AND RESULTS

Uzbekistan has established a number of regulatory frameworks and tactics to reduce risks in the banking sector as part of its ongoing financial reforms. The Central Bank of Uzbekistan (CBU) is responsible for supervising banks and ensuring their stability. It reviews ownership arrangements, monitors governance processes, and assesses managerial ability to reduce risks including related-party loans and financial misbehavior. Implementing strong licensing standards promotes openness in shareholder and management qualifications, leading to improved operational resilience. Banks' minimum capital requirements will increase from UZS 100 billion to UZS 500 billion by 2025 [5],

enhancing financial buffers and managing systemic risks. Prudential laws guarantee banks have enough liquidity buffers to withstand market shocks and credit risks. Digital banking advances and international standards, like the Basel frameworks, are being used to improve risk management skills. This includes better monitoring of credit, operational, and market risks. [6] The government plans to privatize key banks to minimize state influence in the banking industry. This is supposed to boost competition and eliminate political meddling, which has traditionally been a risk issue.

These reforms are intended to align Uzbekistan's banking industry with worldwide best practices, decrease vulnerabilities, and promote economic growth by creating a stable and transparent financial environment. If you require more information on specific rules, reports from the Central Bank of Uzbekistan or international institutions such as the World Bank can provide thorough insights.

Uzbekistan's banking sector must combine international best practices with local adaptation to manage risks effectively. Uzbekistan may successfully minimize and manage risks in its banking industry by taking the following specific actions:

- Banks can decrease loan default risk by implementing a consolidated credit scoring system. This entails developing a single platform that examines borrowers' financial reliability in real time. Banks can collaborate with technology companies to create complex models that examine past financial data, market movements, and even behavioral patterns to anticipate whether a borrower will return their loan. This approach makes loan decisions more precise and efficient, considerably reducing the likelihood of loans becoming non-performing. This tool enables banks to make informed judgments and avoid dangerous loans.

- To effectively manage operational risks, banks should take proactive efforts to safeguard their systems and procedures. Enforcing required cybersecurity frameworks is a vital step. This involves requiring banks to adhere to international security standards such as ISO 27001, which ensures the proper management of sensitive information and data. As digital banking expands, this framework helps protect against cyber risks, ensuring that clients' data and the bank's reputation are secure.

Furthermore, operational risk audits are required. The Central Bank should mandate banks to perform these audits every quarter. These audits are designed to detect process inefficiencies and technological vulnerabilities. By doing so on a regular basis, banks may address potential issues before they worsen, keeping operations running smoothly and lowering the likelihood of costly disruptions. This combination of cybersecurity and consistent auditing contributes to a strong defense against operational risk factors.

- To improve risk management, banks should establish an integrated risk tracking platform. This would include establishing an artificial intelligence (AI)-powered system for collecting and analyzing information obtained from all banks in actual time. The

platform would function as a dashboard, providing banks and regulators with a clear glimpse of possible dangers as they emerged. By detecting these risks early, banks can take response before they become serious difficulties, thereby contributing to the stability of the banking system. It's essentially a preventative instrument that keeps individuals well-informed and prepared to deal with potential risks as they arise.

By taking these precise steps, the country's banking sector can enhance its risk management methods, increase resilience, and conform with global regulations.

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