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## Ways of improving credit risk management in the activities of commercial banks

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### Abstract

#### Annotation

The article identifies problems due to the improving the management of credit risks in the activities of commercial banks of the Republic of Uzbekistan, as well as, scientific proposals aimed at solving these problems were developed.

**Keywords:** credit, classified loans, overdue loans, credit risk, commercial bank, central bank, allocation of reserves, loss, interest rate, inflation, refinancing rate

### Introduction

Due to the fact that loans occupy a high place in the structure of assets of commercial banks, credit risk extension will have a strong negative impact on the financial position and liquidity of banks. In this regard, special attention is paid to the credit risk management in international banking practice.

Strategy actions in five priority areas of the Republic of Uzbekistan in 2017-2021 years defines as necessary conditions, in particular, ensuring the sustainability of macroeconomic growth, ensuring the financial sustainability of commercial banks, expanding lending to small and private entrepreneurship through promising investment projects and commercial banks <sup>[1]</sup>. This necessitates improving the risks of banks and, ultimately, the practice of managing credit risks.

### Analysis of the literature on the topic

Credit risk management was scientifically researched by foreign and Uzbek scholars, as well as relevant conclusions and recommendations were defined.

According to H. Wang and D. Wang, the content of credit risk management is to create a mechanism to balance the level of profitability and the level of risk on loans <sup>[2]</sup>.

However, the authors did not take into account the effect of credit risk on bank liquidity.

From J. Sinking's perspective, commercial banks should regularly conduct a review of loans in order to avoid credit risk extension. It allows us to determine the required amount of reserve capital provided for covering losses on loans <sup>[3]</sup>.

The given J. Sinking's opinion is of great practical importance for banks in Uzbekistan. This is due to the fact that commercial banks in our country do not conduct regular reviews of loans.

In the view of V. Ushakov, credit risk can be assessed as a negative change in the loan portfolio or a loss in the initial quality of assets or default on obligations by counterparties, pledgers to pay the principal and interest on the loan <sup>[4]</sup>.

According to J. Isakov, the low quality of decisions of bank credit committees is one of the main problems in improving the practice of managing credit risk. The credit committee (commissions) still do not hold meetings in commercial banks, sign protocols on paper only and make decisions on lending, even if the committee members do not have one hundred percent participation. In particular, such cases lead to the emergence of bad loans and the ineffective termination of credit relations <sup>[5]</sup>.

According to I. Alimardonov, in order to reduce the level of credit risk in the process of lending to small businesses, it is necessary to retrofit the interest rate on loans. At the same time, a certain percentage of loans to small enterprises is paid with a guarantee from the state budget to a commercial bank <sup>[6]</sup>.

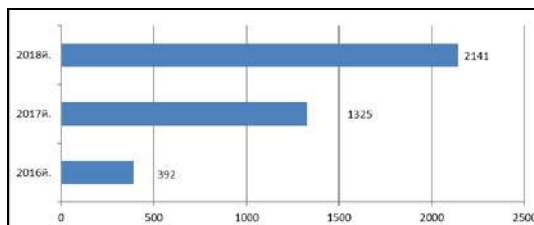
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In our opinion, Alimardonov's conclusion is based on international best practices and is successfully applied in the banking sector of developed countries, in particular in the banking practice of Germany and France.

### Analyses and Results

In the banking practice of the Republic of Uzbekistan, credit risk management in the activities of commercial banks is carried out centrally (by way of the establishment of economic standards by the Central Bank of the Republic of Uzbekistan) and decentralized (due to measures established by the credit policies of banks).

Credit risk management of commercial banks is used for a number of indicators. One of these indicators is the indicator of the amount of overdue loans.



**Fig 1:** Amount of overdue payment on loans granted by commercial banks of the Republic of Uzbekistan, billion soums [7]

The data presented in Figure No. 1 show that over the past 3 years (2016-2018), the country's commercial banks tended to increase the amount of overdue payments for loans provided by commercial banks. In addition, during the analyzed period there was a high growth rate of overdue loans. In 2018, the growth rate of overdue loans compared to 2016 amounted to 61.6 percent. Therefore, it is a negative point in terms of improving the practice of credit risk management.

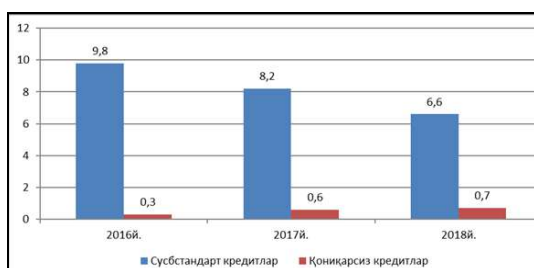
One of the indicators characterizing the practice of managing credit risks of commercial banks is a change in the structure of classified loans.

It is noteworthy that allocation of reserves are made for all categories of loans classified by commercial banks of the Republic of Uzbekistan:

- \* standard loans - 1%;
- \* subprime loans - 10%;
- \* substandard loans - 25%;
- \* doubtful loans - 50%
- \* bad loans - 100%.

Taking into account that only three categories of loans classified in the Basel standard (low-quality loans, doubtful and bad loans), make allocation of reserves.

The following figure shows the changes in the structure of classified loans of commercial banks in our country.



**Fig 2:** Change in the share of subprime loans and substandard loans in the total volume of classified loans of commercial banks of the Republic of Uzbekistan, in percent [8]

The data presented in fig. 2, show that in 2016-2018, the share of subprime loans in the total volume of classified loans decreased, and the share of substandard loans increased. This indicates that the structure of classified loans is deteriorating.

### Conclusions and offers

In our opinion, to improve the practice of managing credit risk in commercial banks, the following measures should be taken:

1. An important element of an integrated credit risk management system is the creation of an effective system for managing the structure of the loan portfolio.

The focus of this management system should be the introduction of a bank lending model that allows a balance between the level of credit risk and profitability.

2. It is necessary to improve the methodology for determining credit limits based on international best practices.

In the banking practice of the Republic of Uzbekistan, network credit limits are not applied. In addition, there are no regulatory requirements for the level of diversification of the loan portfolio.

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