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Article

Prospects for Assessing the Stability of Commercial Banking Activities

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Abstract: *This article discusses the issues of assessing the financial stability of commercial banks in the Republic of Uzbekistan. In particular, the capital adequacy, asset quality, management efficiency, profitability, and liquidity levels of commercial banks are analyzed based on the CAMEL rating system, which is widely used in international practice. As part of the study, using the example of Agrobank, the bank's capital adequacy, asset quality, and overall risk were assessed.*

Keywords: *commercial banks, financial stability, Camel rating system, capital adequacy, liquidity, asset quality, risk management.*

1. Introduction

An analysis of the financial condition of commercial banks is of particular importance in enhancing the stability and efficiency of the country's financial system. The CAMEL rating system, which is widely used in international practice, is considered one of the key criteria for assessing the reliability and liquidity level of the banking sector. This system enables a comprehensive analysis of commercial banks in terms of capital adequacy, asset quality, management efficiency, profitability, and liquidity. The financial stability of commercial banks in the Republic of Uzbekistan is assessed on the basis of the CAMEL rating system.[1]

In particular, using the example of JSCB Agrobank, the study examines the level of bank capital adequacy, asset quality, overall risk exposure, and liquidity level. This analysis serves to provide a deeper understanding of the current state of the banking system and to develop relevant recommendations for its further improvement. The results are also of great importance in making strategic decisions aimed at ensuring the stability of commercial banks.[2]

2. Literature Review

In his book The Rise and Fall of the US Mortgage and Credit Markets, published in 2009, James Barth emphasized that capital adequacy and asset quality are important factors for ensuring the stability of the banking system. In 2013, in Guardians of Finance: Making Regulators Work for Us, he noted that a decline in the asset quality of commercial banks may lead to a loss of liquidity and financial instability.[3]

Levine discussed the relationship between the banking sector and economic development in his 1997 article Financial Development and Economic Growth: Views and Agenda. In 2005, in Finance and Growth: Theory and Evidence, he argued that management efficiency in the banking system may be an even more important factor than capital adequacy. In 2018, in the article Banking Regulation and Supervision: What Works Best?, he noted that strengthening financial regulation can contribute to improving the stability of banks.[4]

Mishkin examined the causes of financial crises and the role of commercial banks in his 1996 book Understanding Financial Crises: A Developing Country Perspective. In the updated edition of The Economics of Money, Banking and Financial Markets, published in 2007, he discussed issues related to banks' capital adequacy and liquidity. In 2020, in Monetary Policy Strategy, he wrote about the long-term negative consequences of financial support provided to banks by the government.[5]

Stiglitz discussed the role of the banking system in economic growth in his 1993 work Financial Markets and Development. In 2010, in his book Freefall: America, Free Markets, and the Sinking of the World Economy, he analyzed how instability in financial markets can lead to economic crises. In 2023, in People, Power, and Profits, he emphasized that regulation of the banking sector is necessary for sustainable economic development.[6]

3. Research Results

The Table 1. Basel Committee on Banking Supervision and its recommendations play an important role in assessing the stability level of the banking system. One of the most recent requirements in this regard relates to the Basel Committee's standards on the liquidity coverage ratio and the net stable funding ratio for commercial banks. Based on the data presented in the following table, we examine the extent to which selected commercial banks in our country comply with these regulatory standards.[7]

Table 1

Compliance of Commercial Banks of the Republic of Uzbekistan with the Liquidity Coverage Ratio and Net Stable Funding Ratio Requirements [8]

No.	Banks	Liquidity Coverage Ratio as of January 1, 2023 (min = 0.80)	Net Stable Funding Ratio as of January 1, 2023	Liquidity Coverage Ratio as of January 1, 2024 (min = 0.90)	Net Stable Funding Ratio as of January 1, 2024
1	Asaka Bank	1.001	0.697	1.307	0.856
2	Uzsanoatqurilishbank	2.259	1.200	1.829	1.035
3	Xalq Bank	1.262	1.207	1.067	1.202
4	Ipotekabank	1.320	0.772	1.246	0.985
5	Mikrokreditbank	1.784	1.074	1.618	0.914
6	Ipak Yo'li Bank	2.066	1.060	2.161	1.182
7	Turon Bank	1.279	0.756	1.952	0.989

Certainly, continuous monitoring of these indicators makes it possible to develop urgent measures when necessary and to prevent various potential problems that may arise in the activities of commercial banks.

The Central Bank of the Republic of Uzbekistan assesses the financial condition of commercial banks on the basis of the "Criteria for Assessing the Financial Condition and Determining the Rating of Commercial Banks According to the International CAMEL Rating

System." The overall rating of the financial condition of commercial banks is determined by the head of the working group conducting inspections at commercial banks.[9]

The CAMEL rating system implies the assessment of capital adequacy, asset quality, management, bank income, expenses and profitability, as well as liquidity. The assessment criterion ranges from 1 to 5 points, where 1 indicates a strong condition, while 5 indicates an unsatisfactory condition. The overall rating of a bank is assessed on the basis of the rating criteria for all relevant components, summarized, and then divided by the number of components. Accordingly, the overall scores are as follows:

If the score ranges from 1.0 to 1.4, the bank should be assigned a rating of 1;

if the score ranges from 1.5 to 2.4, the bank should be assigned a rating of 2;

if the score ranges from 2.5 to 3.4, the bank should be assigned a rating of 3;

if the score ranges from 3.5 to 4.4, the bank should be assigned a rating of 4;

if the score ranges from 4.5 to 5.0, the bank should be assigned a rating of 5.[10]

Below, using the example of JSCB Agrobank, one of the largest commercial banks in the Republic, we examine the practice of assessing the stability of commercial banks' activities based on the CAMEL rating system.

The first component of the CAMEL rating system is capital adequacy. The Table 2. capital adequacy indicator of commercial banks is regarded as the most fundamental and primary indicator. This is because the minimum requirements for other banking indicators are also developed on the basis of this standard.

Table 2

The Level of Adequacy of Total Capital and Tier 1 Capital in JSCB Agrobank [11]

Indicators	2018	2019	2020	2021	2022	2023	2024
Total capital of the bank, billion UZS	236.7	297.8	371.4	411.1	469.7	398.7	1,272.3
Tier 1 capital of the bank, billion UZS	217.3	262.6	345.4	382.6	414.9	387.0	1,266.1
Risk-weighted assets of the bank, billion UZS	1,388.9	1,788.3	2,265.8	2,573.5	3,312.5	4,087.4	4,527.7
Total capital adequacy ratio, % (1:3 × 100%)	13.3	13.6	13.7	13.3	12.8	9.8	28.1
Tier 1 capital adequacy ratio, % (2:3 × 100%)	15.4	14.7	15.2	14.9	12.5	9.5	27.9

The data presented in Table 2 show that, in JSCB Agrobank, the levels of total capital adequacy and Tier 1 capital adequacy during 2018–2024 were generally above the regulatory level established under the CAMEL rating system.

However, the fact that these indicators fell below the required level in 2023 is considered a negative factor in terms of ensuring the bank's stability. Therefore, as a result of the bank's capitalization in 2024, these indicators improved significantly, which can be regarded as a positive development from the perspective of financial stability. This is because capital adequacy indicators are among the key indicators characterizing the solvency of commercial banks. For this reason, both the Basel Committee and international rating agencies pay particular attention to the analysis of capital adequacy ratios when assessing the stability of commercial banks.[12]

Next, we analyze the second component of the CAMEL rating system — asset quality.

As is known, in the CAMEL rating system, the main indicator characterizing asset quality is the level of total risk exposure. The Table 3. level of total risk exposure is calculated using the following formula:

URMD = [URM : (K1 + KYQZ)] x 100%

Where:

URMD – the level of total risk exposure;

URM – total risk exposure;

K1 – Tier 1 capital;

KYQZ – loan loss provision reserve.

In turn, total risk exposure is determined using the following formula:

URM= SA x 0,2 + ShA x 0,5 + UA x 1,0

Where:

URM – the level of total risk exposure;

SA – substandard assets;

ShA – doubtful assets;

UA – loss assets.

Below, we examine the total risk exposure in JSCB Agrobank.

Table 3

Total Risk Exposure in JSCB Agrobank, million UZS

Indicators	2018	2019	2020	2021	2022	2023	2024
Substandard assets	16,200	14,462	9,437	3,255	1,009	24,444	41,651
Doubtful assets	9,357	4,359	1,970	1,118	757	1,491	7,679
Loss assets	5,699	4,630	986	1,476	300	3,644	145,399
Total risk exposure	13,617	9,701	3,858	2,686	880	9,278	157,568

The data presented in Table 3 show that, in JSCB Agrobank, total risk exposure demonstrated a downward trend during 2018–2022, decreasing by 6.4 times over this period. However, in 2023 and 2024, an upward trend in total risk exposure was observed.[13]

In our view, this Figure 1. increase may be explained by the growth of risk exposure associated with the write-off of existing problematic, particularly loss, assets from the bank's balance sheet as a result of the bank's capitalization process.

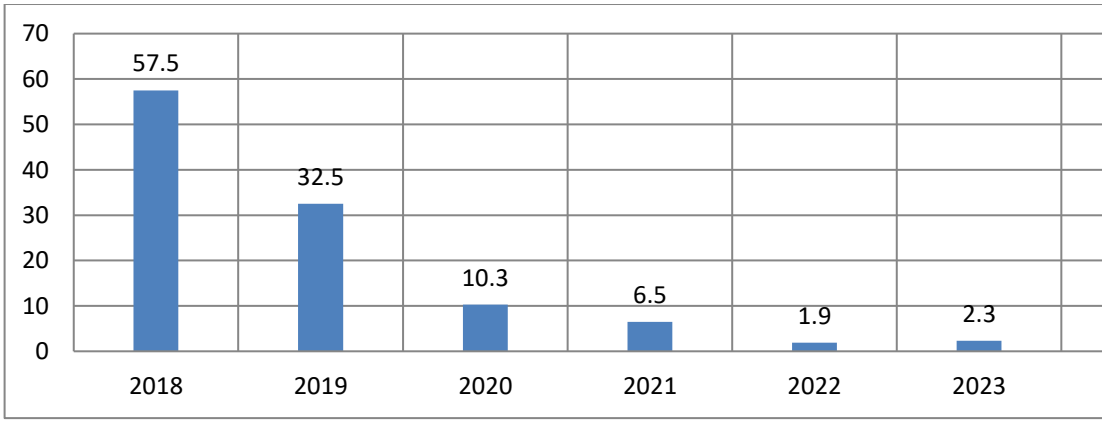


Figure 1. The Level of Total Risk Exposure in JSCB Agrobank, percent [4]

As can be seen from the data presented in Figure 1, during 2018–2024, Agrobank demonstrated a downward trend in the level of total risk exposure. However, the fact that this indicator was very high at the beginning of the analyzed period is considered a negative situation. The developments observed in 2024 also confirm the validity of the above-mentioned considerations.

The next element of the CAMEL rating system is profitability.

In the CAMEL rating system, the profitability ratio (PR) is used for the quantitative assessment of a bank's profitability.[14]

The Figure 2. profitability ratio (PR) is determined using the following formula:

Dk = SF / BAO'S

Where:

SF – net profit of the commercial bank;

BAO'S – average amount of bank assets.

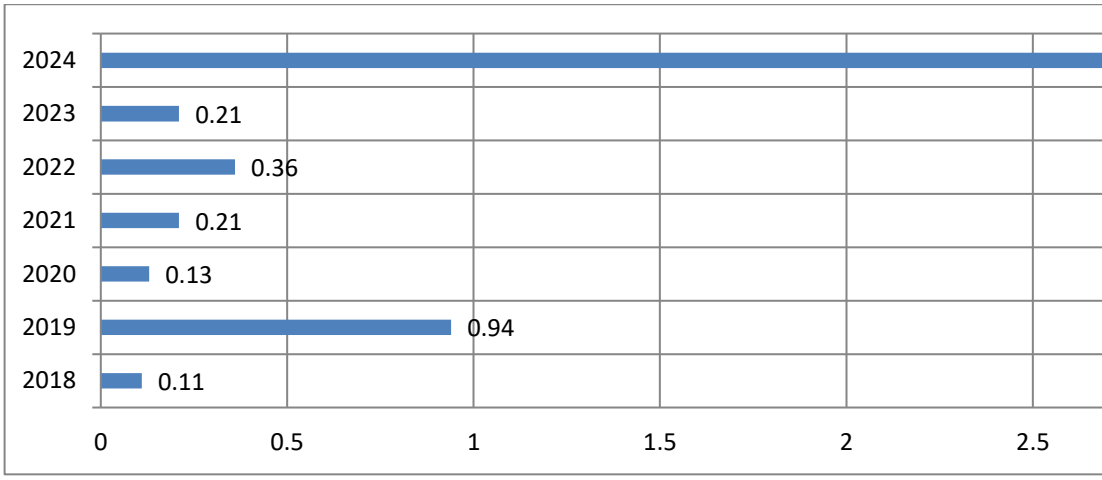


Figure 2. The Level of the Profitability Ratio in JSCB Agrobank, percent [5]

The data presented in Figure 2 show that, in 2018, the level of the profitability ratio in Agrobank was very low. Moreover, in 2020, this ratio declined significantly compared to 2019. This is considered a negative factor from the perspective of ensuring the stability of Agrobank's operations. However, from 2021 onward, this indicator gradually demonstrated an upward trend again, which can be regarded as a positive development in terms of ensuring the bank's stability.

The next element of the CAMEL rating system is liquidity. Within this system, it is recommended to use several indicators when assessing the liquidity of a commercial bank. However, no fixed threshold criteria have been established for these indicators; therefore, scores are assigned based on the actual situation. In this regard, the regulatory level of the current liquidity ratio applied by the Central Bank of the Republic of Uzbekistan in assessing the liquidity of commercial banks may be used as a baseline indicator.[15]

4. Conclusion

The financial stability of commercial banks is one of the key factors ensuring the strength and development of a country's economic system. In this article, the financial condition of commercial banks in the Republic of Uzbekistan was assessed on the basis of the CAMEL rating system, which is widely used in international practice.

Within the framework of the study, the main financial indicators, such as capital adequacy, asset quality, profitability, and liquidity, were analyzed using the example of JSCB Agrobank.

The results obtained show that capital adequacy and asset quality are among the decisive factors in ensuring financial stability. The increase in total risk exposure observed in some commercial banks in 2023 had a negative impact on their financial soundness. However, the improvement in capital adequacy and liquidity indicators in 2024 indicates the existence of positive trends in ensuring the financial stability of commercial banks.

In addition, based on international practice, the article puts forward a number of recommendations aimed at improving the stability of the banking sector. In particular, the importance of continuous monitoring of bank capital adequacy, improving asset quality, and ensuring effective risk management is emphasized. In conclusion, it can be stated that the introduction of financial monitoring and management mechanisms that comply with international standards remains one of the urgent tasks for ensuring the financial stability of commercial banks.

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