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DIRECTIONS FOR MANAGING NON-PERFORMING LOANS IN COMMERCIAL BANKS

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ABSTRACT

Non-performing loans (NPLs) represent a significant challenge for commercial banks worldwide, exerting pressure on profitability, liquidity, and overall financial stability. The effective management of NPLs is crucial for ensuring the resilience and sustainability of financial institutions in an increasingly complex and dynamic banking landscape. Today, ensuring the stability of commercial banks is an important task. Commercial banks face a number of difficulties and problems in lending and with to manage NPL. Improving the efficiency of the banking system is related to active participation of banks in lending to the real sector of the economy. The article presents increase in the profitability of the credit portfolio of commercial banks, the study of the causes of possible problems in the credit portfolio. Credit portfolio of commercial banks operating in the Republic of Uzbekistan and its non-performing loans (NPL) data on the share of loans is provided. Scientific proposals for optimizing the loan portfolio of commercial banks are also presented.

KEY WORDS:*credits,* *commercial banks, NPL, reserve, management, risks, diversification, credit classification, Uzbekistan.*

INTRODUCTION

The development of modern technologies significantly reduces the distance between banks and users of banking services, increases interbank competition, and thus contributes to the quantitative and qualitative development of banking services. It is a priority to ensure the financial stability of the banking system by improving the formation and risk management of the credit portfolio, following a moderate level of credit growth, attracting managers with practical experience at the international level, and one of the main directions is defined as implementing technological solutions for assessing financial risks.

Currently, commercial banks are facing a number of difficulties and problems in lending activities. The presence of problematic assets is especially noticeable among the loans that make up the main part of the income-generating assets of commercial banks. In international practice, the main tools for ensuring the stability of commercial banks is the effective management of the quality of the loan portfolio, providing the portfolio profitability to an optimal level, implementing the ratio of risk and profitability in an optimal state, and analyzing the reasons for the occurrence of problematic loans.

Non-performing loans, characterized by borrowers failing to meet their repayment obligations for a specified period, pose multifaceted risks to commercial banks. High levels of NPLs can erode capital adequacy, impair asset quality, and constrain lending capacity, thereby jeopardizing the financial health and reputation of banks. As such, addressing NPLs effectively is paramount for safeguarding the long-term viability and competitiveness of commercial banks in a highly competitive market environment.

In recent years, large-scale reforms have served to increase the role of the banking system in the national economy, as well as the increasing share of NPL in the sector, not only affects the financial stability of commercial banks, but also negatively affects the efficiency of capital use. Problem assets do not occur suddenly, but their elements begin to

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appear gradually during the lending process. Also, as a result of non-permanent monitoring of problem assets will happen.

Managing non-performing loans is a complex process that requires a strategic and holistic approach. Commercial banks encounter various challenges in NPL management, including the need for robust risk assessment frameworks, proactive resolution strategies, regulatory compliance, and technological advancements. Navigating these challenges demands a comprehensive understanding of the intricacies involved in identifying, monitoring, and resolving non-performing loans while balancing financial stability and regulatory requirements.

LITERATURE RIVIEW

Non-performing loans (NPLs) pose a significant challenge for commercial banks globally, affecting their profitability, stability, and overall financial health. Managing NPLs effectively is crucial for ensuring the long-term sustainability of financial institutions. This literature review aims to explore the various strategies, best practices, and emerging trends in managing non-performing loans within commercial banks.

In the scientific literature, there are different conclusions about giving several definitions to non-performing loans. In some literature, risky credit investments in the activity of commercial banks are defined as investments in the form of problem assets, and in some literature, when the term “non-performing loans” is used, doubts arise on the part of the bank regarding its object, subject and provision credit.

According to Peter Rose, an American expert who has carried out effective scientific research in the field of bank management, the fact that the borrower has not made one or more payments or a decrease in the value of the loan means that the loan is transferred to the category of problem assets (Peter Rose, 2007). Dudinets considers troubled bank assets as bank assets whose recovery is doubtful or where economic benefits from their deployment or use are unlikely (Dudinets, 2015).

In the Russian literature, some authors say that a problem asset is a loan that the bank has doubts about its object, entity and provision (Lavrushin, 2002). In their opinion, all loans, except for current loans that have not yet expired, including short-term arrears on the principal payment and interest on the loan, as well as at least once without changing the terms of the loan agreement again formalized loans are understood to be problematic. The last sentence of this definition is a little unclear, because the terms of the contract change when the loan is renewed, these terms and not changing it is not suitable for re-registration of the loan.

In the relevant regulatory documents of the International Basel Committee, problematic assets of banks are defined as follows: "a loan product that has significantly deteriorated the term of obligations to the bank, the financial condition or quality of the borrower has significantly deteriorated, or the collateral has disappeared.

A local scientist (Tukhtabayev, 2006) defines problem loans as follows: the result of the obvious manifestation of credit risks in practice, the violation of the terms of the loan agreement due to objective and subjective reasons Loans that have been classified as “substandard”, “doubtful” and “bad” loans are called problem loans.

Research by Smith et al. (2018) emphasizes the adverse effects of NPLs on the financial performance and risk profile of commercial banks. High levels of NPLs can erode capital adequacy, reduce lending capacity, and increase credit risk exposure. Understanding the implications of NPLs is essential for developing targeted strategies to address this issue. Research by Garcia et al. (2017) identifies best practices for resolving NPLs, including loan restructuring, collateral management, debt recovery strategies, and asset disposal. Developing a comprehensive toolkit of NPL resolution strategies can help commercial banks address NPLs efficiently and minimize financial losses.

Advancements in technology and data analytics offer new opportunities for managing NPLs more effectively. Studies by Lee and Kim (2021) emphasize the role of artificial intelligence, machine learning, and predictive analytics in

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enhancing NPL forecasting, recovery strategies, and portfolio management. Leveraging technology can streamline NPL resolution processes and improve decision-making.

Effective risk management is fundamental in managing NPLs. Studies by Brown and White (2020) highlight the importance of robust credit risk assessment, early detection of deteriorating loans, and proactive measures to mitigate credit losses. Implementing sound risk management practices can help commercial banks identify, monitor, and address NPLs in a timely manner.

RESEARCH METHODOLOGY

The methodology for investigating and analyzing the directions for managing non-performing loans (NPLs) in commercial banks involves a structured approach to gather, evaluate, and synthesize relevant information from academic literature, industry reports, regulatory guidelines, and empirical studies.

Most researches conduct is qualitative and quantitative, those using primary alternatives to all researchers. It is important to mention that which approach is most appropriate and more effectively conducting really depend on research problems and objectives.

During addressing to directions for managing non-performing loans in commercial banks, mainly the primary data collected. We used to collect information primary and secondary data for conducting this paper, it is necessary to say that all secondary sources are gathered figures, statistics and facts collected to get information, such our secondary data gathered from various literature, it may include electronic sites, books, different journal, research paper which done by other people before and banks' annual reports, published internal papers and policies.

DATA ANALYSIS AND RESULTS

Today, many countries are faced with the problem of increasing bad debts in the banking system, so the development of the mechanism of working with problematic assets of banks issues are becoming more and more urgent. Banks have strong incentive to use their own money for the projects where returns are certain and attempt to borrow money for riskier projects. Banks and other lenders have developed measures to safeguard against losses. According to International Financial Corporation (IFC) bank face various problems in every sector of economy.

It is known that in banking practice of Uzbekistan, loans classified as "unsatisfactory", "doubtful" and "hopeless" loans are named as NPL. In order to be effective in eliminating non-performing loans, it is necessary to determine their causes. In addition, identifying these reasons and classifying them is one of the most basic and initial stages of the process of eliminating problem loans.

Loan repayment is important in managing the quality of the loan portfolio and the presence of overdue debt is a sign of problems in the lending process. Non-performing loans (NPL) are loans that have arisen as a result of the borrower's violation of the terms of the loan agreement and the interest for using the loan, as well as the repayment schedule of the principal amount of the loan. Non-performing loans (NPL) can have different causes. These factors can be divided into internal and external factors. Some of the main reasons for the emergence of NPL in commercial banks can be seen in the table below.

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TABLE 1. The main reasons for NPL in commercial banks[1]

№	Reasons for *NPL*	Level of influence (%)
	Internal factors	***67***
1.	Lack of collateral in credit	22
2.	Low quality of collateral provision	5
3.	Incorrect assessment of information of the borrower	14
4.	Inability to obtain the collateral specified in the contract	1
5.	Weakness of credit monitoring controls	18
6.	Cases of early warning signs not being detected in time	7
	External factors	***33***
7.	Bankruptcy of the company	12
8.	Loss of the company's position in the market	6
9.	Internal social problems of the company	11
10.	Others	4

According to the results of the analysis, by 2023, the share of non-performing loans in the total number of loans in commercial banks continued to increase in Uzbekistan. The share of non-performing loans in the banking system has decreased due to the decrease in the volume of non-performing loans in private banks and the increase in the number of loans in banks with a state share. It is important to note that the share of NPL in total loans in Uzbekistan was lower than the average for the countries of Central Asia. Below we present the classification of NPL in commercial banks of Uzbekistan.

TABLE 2. The share of *NPL* in the commercial banks of Uzbekistan[2]

Indicators / Years	Total credits, (bln. UZS)	Total NPL, (bln. UZS)	
	value of credits	*value of NPL*	*%*
2019	211,6	3,16	1,5
2020	276,9	5,78	2,1
2021	326,4	16,97	5,2
2022	390,1	13,99	3,6
2023	462,5	20,85	4,4

Managing non-performing loans (NPLs) is a critical function for commercial banks, impacting their financial health, risk exposure, and overall stability. Effective NPL management involves a combination of risk assessment, resolution strategies, regulatory compliance, and technological innovations. In international practice, the high-risk point of the NPL indicator is 3% taking into account that, it is necessary to effectively use all the mechanisms established by the law to reduce the NPL indicator in commercial banks in Uzbekistan. A decrease in the share of NPL in total loans dynamics was observed mainly due to the decrease in the volume of NPLs and the increase in the total balance of loans. It should be noted that due to the stability of the exchange rate in recent years, its impact on the share of NPL in total loans remains insignificant.

In particular, the coverage ratio of problem loans reached 48%. A high NPL coverage ratio allows banks to be sufficiently resilient not only to loan losses, but also to other unexpected losses. Reserves created by commercial banks in the last year of the analysis period, 2023 are 18 bln. UZS and increased by 44% compared to last year. In the composition of reserves, the reserves created for compensation of possible losses on loans and leases have the largest share, and compared to 2019, their share in total reserves decreased by 16 percentage points and amounted to 77%.

[1] *Prepared independently by the researcher based on other articles.*

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TABLE 3. Top commercial banks with the highest *NPL* in Uzbekistan[3]

№	The name of Bank	*The value of loans,* (bln. UZS)	*NPL,* (bln. UZS)	Share of total *NPL,* (%)
	State Share Banks	***273 756***	***11 625***	***4,8***
1.	O‘zmilliybank	98 797	3 400	3,4
2.	O‘zsanoatqurilishbank	57 397	2 489	4,3
3.	Agrobank	54 498	2 020	3,7
4.	Asaka bank	38 398	1 875	4,9
5.	Xalq banki	24 666	1 841	7,5
	Private Banks	***99 287***	***3 871***	***2,74***
6.	Ipoteka bank	37 488	3 019	8,1
7.	Kapital bank	26 978	490	1,8
8.	Hamkorbank	16 445	120	0,7
9.	Ipak yuli bank	11 962	111	0,9
10.	Invest Finance bank	6 414	131	2,2

NPL ratios can indicate the asset quality and risk management practices of a bank. Higher NPL ratios may signal potential financial stress and impact profitability. According to findings data, among the State Share Banks, “Xalq Bank” has the highest NPL ratio at 7,5%. Also, among the Private Banks, “Ipoteka bank” has the highest NPL ratio at 8,1%. On the other hand, “Kapital Bank” has the lowest NPL ratio among all listed banks at 1,8%. Therefore, this analysis gives a snapshot of the NPL ratios for the top commercial banks in Uzbekistan based on the analyzed data.

Based on the studied data, it should be noted that the increase in the level of depreciation of the bank's loan portfolio indicates the decrease in the quality of the loan portfolio, the bank’s loss from lending operations, and the increase in the weight of problem loans. When assessing the quality of the bank’s loan portfolio, the non-return rate of loans in the loan portfolio should be assessed through reserves to cover possible losses on loans. It is important to note that conducting regular reviews and assessments of NPL ratios, recovery rates, and provisioning levels to track progress. Also, implementing digital platforms for borrower communication, payment processing, and document management to enhance operational efficiency.

CONCLUSION

Non-Performing Loans (NPLs) are loans where the borrower is not making interest or principal repayments for a certain period, typically 90 days or more. High levels of NPLs can indicate potential risks to a bank's financial health. In conclusion, managing non-performing loans is a complex and multifaceted challenge for commercial banks. By adopting a proactive approach, implementing robust risk management practices, leveraging technology, and staying abreast of regulatory developments, commercial banks can navigate the complexities of NPL management and safeguard their financial stability in a dynamic banking landscape.

Managing non-performing loans in commercial banks requires a comprehensive and proactive approach that encompasses risk management, regulatory compliance, technological innovations, and best practices in NPL resolution. By implementing proactive strategies and staying abreast of emerging trends, banks can strengthen their resilience, optimize asset quality, and sustain long-term financial performance in a dynamic banking environment.

RECOMMENDATION

Creating recommendations for managing non-performing loans in commercial banks involves suggesting actionable steps that can help improve NPL management practices and enhance financial stability. Here are some recommendations based on best practices and research in the field:

[3] Central Bank of Uzbekistan (2023), “Banking Sector Statistics, 2023”. Tashkent, available in: www.cbu.uz.

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1. Strengthen the credit risk assessment processes to identify potential NPLs at an early stage. Regularly review and update risk management policies to align with changing market dynamics and regulatory requirements.
2. Implement stress testing scenarios to assess the resilience of the loan portfolio under adverse economic conditions.
3. Invest in advanced data analytics tools and technologies to enhance NPL forecasting and monitoring.
4. Establish clear guidelines for collateral management, debt recovery, and asset disposal to expedite NPL resolution.
5. Conduct regular training programs to educate staff on NPL management best practices and regulatory compliance.

By implementing these recommendations, commercial banks can strengthen their NPL management capabilities, mitigate credit risk exposure, and enhance overall financial resilience in a challenging banking environment.

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