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IMPROVING THE METHODOLOGY FOR ASSESSING THE FINANCIAL STABILITY OF BANKS

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Abstract: The financial stability of banks is a crucial factor ensuring the resilience of the overall banking system. This study examines key indicators such as capital adequacy, credit risk, liquidity, market risk, and profitability, which enable timely identification of potential threats to individual credit institutions. By synthesizing these metrics into a comprehensive financial stability ratio, the study proposes a refined methodology for assessing the financial soundness of banks. Empirical analysis using data from a specific period underpins the proposed approach. The findings contribute to the development of more effective tools for safeguarding systemic banking stability.

Key words: Financial stability ratio, capital adequacy, return on assets, return on equity, problem loans, liquidity ratio, risk assessment.

Annotatsiya: Banklarning moliyaviy barqarorligi butun bank tizimining mustahkamligini ta’minlovchi muhim omildir. Ushbu tadqiqotda kapital yetarliligi, kredit xavfi, likvidlilik, bozor xavfi va rentabellik kabi asosiy ko‘rsatkichlar tahlil qilinib, alohida kredit muassasalarining moliyaviy xatarlarini erta aniqlash imkoniyati baholanadi. Ko‘rsatkichlarning umumlashtirilgan nisbati asosida banklar moliyaviy barqarorligini baholashning takomillashtirilgan metodologiyasi taklif etiladi. Muayyan davr ma’lumotlari asosida olib borilgan empirik tahlil taklif etilgan yondashuvning samaradorligini ko‘rsatadi. Natijalar bank tizimi barqarorligini ta’minlashga xizmat qiluvchi samarali vositalarni ishlab chiqishga asos bo‘ladi.

Kalit so‘zlar: Moliyaviy barqarorlik koeffitsienti, kapital yetarliligi, aktivlar rentabelligi, kapital rentabelligi, muammoli kreditlar ulushi, likvidlilik koeffitsienti, xatarlarni baholash.

Аннотация: Финансовая устойчивость банков представляет собой важнейший элемент стабильности банковской системы в целом. В настоящем исследовании рассматриваются ключевые показатели, такие как достаточность капитала, уровень кредитного риска, ликвидность, рыночный риск и рентабельность, которые позволяют своевременно выявлять потенциальные угрозы для отдельных кредитных учреждений. На основе обобщающего коэффициента финансовой устойчивости предложена усовершенствованная методика оценки финансовой устойчивости банков. Представлены результаты эмпирического анализа за соответствующий период, подтверждающие эффективность предлагаемого подхода. Полученные выводы способствуют разработке инструментов для повышения устойчивости банковской системы.

Ключевые слова: Коэффициент финансовой устойчивости, достаточность капитала, рентабельность активов, рентабельность капитала, проблемные кредиты, коэффициент ликвидности, оценка рисков.

INTRODUCTION

The assessment of the development and stability of the banking system plays a crucial role in ensuring macroeconomic sustainability. In international practice, the evaluation of banking system stability is often conducted by analyzing trends in key financial indicators relative to a country’s gross domestic product (GDP). While many countries demonstrate growth in gross banking assets or an increase in bank capital compared to previous periods, there are also frequent instances where these indicators decline when measured against national GDP. Such discrepancies highlight potential imbalances and underline the importance of continuous monitoring.

Despite maintaining the stability of national currencies, many countries still face challenges in achieving comprehensive financial stability within their banking systems. This underscores the necessity of improving tools and methodologies for assessing financial soundness.

In the Republic of Uzbekistan, one of the priority directions within the national strategy for banking system reform is to enhance the financial stability of commercial banks. This includes improving corporate governance practices based on international standards, ensuring a balanced and sustainable expansion of credit activity, enhancing the quality of loan portfolios, and strengthening risk management and internal control mechanisms in banks [1].

In this context, the development and consistent application of a comprehensive methodology for assessing financial stability – particularly through the introduction and monitoring of a financial stability coefficient – is essential. Such measures enable timely identification of systemic risks, foster transparency in banking operations, and contribute to the early prevention of potential financial crises.

LITERATURE REVIEW ON THE SUBJECT

The issues related to the specifics of financial stability in the banking sector and the mechanisms for its assessment have been studied by a number of economists, who have made significant contributions to evaluating the stability of the banking system. In particular, economists Laven and Mainoni argue that banks which create sufficient reserves to strengthen financial stability during periods of economic growth are better positioned to minimize the negative effects of economic downturns and to maintain a high level of credit supply [2].

Based on her research, K. Surovneva concludes that a bank's financial condition directly affects all aspects of its operations, including its overall financial stability. According to her, the financial stability of a bank is inextricably linked with its liquidity [3].

A. Abdullayev emphasizes the importance of ensuring the financial stability of the banking system through the application of systematic methods for assessing the liquidity levels of commercial banks [4].

RESEARCH METHODOLOGY

The main purpose of the study is to develop scientific conclusions based on an analysis of the effectiveness of the measures undertaken in this field, considering the relevance of improving the methodology for assessing the financial stability of banks. The theoretical and methodological foundation of this article is based on general economic literature, scientific articles, expert assessments, and research conducted by economists on the financial stability of banks. The study also relies on a systematic approach to economic phenomena and processes, incorporating monitoring of ongoing developments, and forming conclusions, suggestions, and recommendations within the scope of the identified issues.

During the research process, in addition to general economic methods, specific approaches for data systematization were employed. These include comparative analysis, mathematical and statistical techniques, as well as generalization of theoretical and practical materials through system analysis.

ANALYSIS AND RESULTS

For the Central Bank, key indicators such as capital adequacy, credit risk assessment, liquidity evaluation, market risk, and profitability contribute to the timely identification of risks within individual credit institutions.

In the following analysis, we aim to assess the financial stability of the banking system using a generalizing coefficient. To determine this coefficient, we utilize the primary indicators presented in Table 1. These indicators help identify the overall level of financial stability across the banking sector. When developing the financial stability coefficient, it is advisable to evaluate credit risk, the level of overdue loans within the loan portfolio, profitability, liquidity, and capital adequacy.

In assessing the financial stability of a bank, it is essential to evaluate the quality of the loan portfolio, considering that lending to the economy is the core function of commercial banks. Therefore, this study includes the indicator of overdue loans as a key metric. Additionally, since the bank's lending capacity is under analysis, it is important to consider that its credit potential is largely determined by the deposit base. Based on this premise, the share of deposits in loans is included as one of the important indicators of the bank's financial stability.

Using these indicators, we can develop a financial stability coefficient and analyze the results based on the benchmarks established by the International Monetary Fund for evaluating banks' financial activities, as well as the regulatory standards set by the Central Bank of the Republic of Uzbekistan.

Although there are no formally established thresholds for the return on assets (ROA) indicator, based on comparative analysis, it is considered appropriate to set a minimum benchmark of 1.5%. Similarly, while no explicit requirement exists for the return on equity (ROE), comparative assessment suggests a minimum threshold of 10%. Furthermore, the share of the loan portfolio in total assets is assumed to be no less than 45%, while the share of deposits in loans is recommended to remain at or below a maximum of 100%.

Based on these criteria, the financial stability coefficient of banks reflects more stringent requirements for the evaluated indicators. A commercial bank's failure to comply with the mandatory standards established by the Central Bank may result in the revocation of its banking license and the imposition of various penalties and fines.(Table 1)

Table 1. Indicators for evaluating the financial stability of banks.

№	Indicator	Description	Limit indicator
1	2	3	4
1.	Ratio of regulatory capital to total assets, taking into account risk	The ratio of the bank's own funds to its total assets, taking into account risk.	min 13% [5]
2.	The ratio of tier 1 capital to the total amount of risk-weighted assets	The ratio of tier 1 capital to the total amount of risk-weighted assets	min 10% [6]
3.	The share of the loan portfolio in assets	One of the most fundamental functions of the banking system is crediting. Non-compliance with the threshold value of this indicator means that preference is given to operations specific to speculative instruments or stock market instruments, the risk of which is relatively high in banking.	min 45%
4.	The share of deposits in loans	The share of deposits in loans. The lowest level (about 100%) means that the banking business model is stable in the long term.	max 100 %
5.	The share of problem loans (NPL) in the total volume of loans issued, %	This indicator is determined by the ratio of the volume of overdue loans and interest debts to the total loan portfolio. This indicator is considered an indicator that asset management is performed unsatisfactorily.	max 5%
6.	Return on assets (ROA)	Return on assets is a profitability ratio that provides how much profit a bank can generate from its assets. In other words, return on assets (ROA) measures how efficient a commercial bank's management is in earning a profit from their assets on their balance sheet.	min 1,5%
7.	Return on equity (ROE)	Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity.	min 10%
8.	Instant liquidity - H2	The ratio of highly liquid assets to demand liabilities. This indicator regulates the bank's liquidity losses per day.	min 25% [7]
9.	Ratio of liquid assets to total assets	Highly liquid assets are financial assets that may be in demand on the next calendar day.	min 10%[7]
10.	Regulatory liquidity compensation ratio	The ratio of highly liquid assets to the total net outflow over the next 30 days. Regulates the risk of loss of the bank's creditworthiness in the next 30 days.	min 100%[7]

In table 1, the main ten indicators for determining the financial stability coefficient of banks were identified, as well as the limit indicators for them were determined. Based on this, the dynamics of changes in exactly ten of these indicators in Uzbekistan during 2017-2022 was investigated (Table 2).

Table 2. Dynamics of indicators that determine the financial stability of banking activities, %[9].

№	Indicator	Limit indicator	2017	2018	2019	2020	2021	2022
1.	Ratio of regulatory capital to total assets, taking into account risk	min 13%	18,8	15,6	23,5	18,4	17,5	17,8
2.	The ratio of tier 1 capital to the total amount of risk-weighted assets	min 10%	16,5	14,3	19,6	15,2	14,6	14,5
3.	The share of the loan portfolio in assets	min 45%	62,5	78,1	77,6	75,6	73,4	70,1
4.	The share of deposits in loans	max 100 %	53,8	41,8	43,0	41,4	47,8	55,6
5.	The share of problem loans (NPL) in the total volume of loans issued, %	max 5%	*	*	*	2,1	5,2	3,6
6.	Return on assets (ROA)	min 1,5%	1,9	2	2,2	2,2	1,3	2,5
7.	Return on equity (ROE)	min 10%	17,1	16,2	16,7	10,3	6,1	13,3

8.	Instant liquidity - H2	min 25%	40,1	30,9	47,8	67,4	99,3	110,1
9.	Ratio of liquid assets to total assets	min 10%	23,6	13,6	13,9	15,4	18,6	21,5
10.	Regulatory liquidity compensation ratio	min 100%	225,2	170,7	208,5	224,5	189,6	211,6

As can be seen from the data in Table 2, one of the key indicators of the solvency of banks is the capital adequacy ratio. This ratio averaged 17–18% during the period 2017–2022, indicating stable capitalization. According to Basel III standards, the recommended total capital adequacy ratio of a bank should be at least 8% of risk-weighted assets. In addition, Basel III introduces supplementary capital requirements, including a capital conservation buffer of 2.5%, a countercyclical capital buffer ranging from 0–2.5%, and a capital surcharge for banks of local and global systemic importance, although the latter does not have a fixed upper limit.

Considering both the current state of the banking system in Uzbekistan and the additional capital requirements recommended by Basel III, the capital adequacy ratio for commercial banks has been set at 13%. Based on performance indicators from the last six years, it can be concluded that Uzbekistan's commercial banks have fully met the Central Bank's minimum capital requirements. The banking sector maintains sufficient capital to absorb potential losses.

Furthermore, the minimum requirement for the Tier I capital ratio, which compares Tier I capital to total risk-weighted assets, is set at 10%. Commercial banks have generally demonstrated compliance with this requirement. However, a decline in this ratio – from 16.5% in 2017 to 14.5% by the end of 2022 – indicates a relative decrease in Tier I capital's share against total risk-weighted assets.

The share of the loan portfolio in total assets increased from 62.5% in 2017 to 70.1% by the end of 2022, reflecting an expansion in banks' lending activities.

According to the analysis over the past six years, the average ratio of deposits to loans stood at around 50%, reaching 55.6% by the end of 2022. This suggests a growing but still moderate reliance on deposit-based funding for credit expansion.

As of 1 January 2023, the share of non-performing loans (NPLs) in the total loan portfolio of the banking system amounted to 3.6% (14 trillion soums), which is 1.6 percentage points lower than the same period in the previous year. The NPL ratio was 3.9% in banks with state ownership and 2.1% in other banks. Among state-owned banks, the highest NPL ratios were observed in:

Uzagroexportbank – 96.3%

People's Bank – 11.9%

Microcredit Bank – 4.8% [8].

The Return on Assets (ROA) increased from 1.9% in 2017 to 2.5% by the end of 2022, which is a positive dynamic. Figure 1 below illustrates the six-year trend in ROA and Return on Equity (ROE). Given that the average return on investment during this period was around 2–2.5%, and that this exceeds the minimum threshold of 1.5%, the ROA can be evaluated favorably. It is important to note that growth in ROA is one of the principal indicators of a bank's financial stability. The expansion of services through innovative digital technologies in the banking sector can reduce operating costs and increase net profit, thereby contributing to a further increase in ROA.

Conversely, the ROE experienced a sharp decline from 17.1% in 2017 to 6.1% by the end of 2021, before rebounding to 13.3% by the end of 2022 (see Figure 1). This recovery suggests improved profitability and capital efficiency in the most recent year.

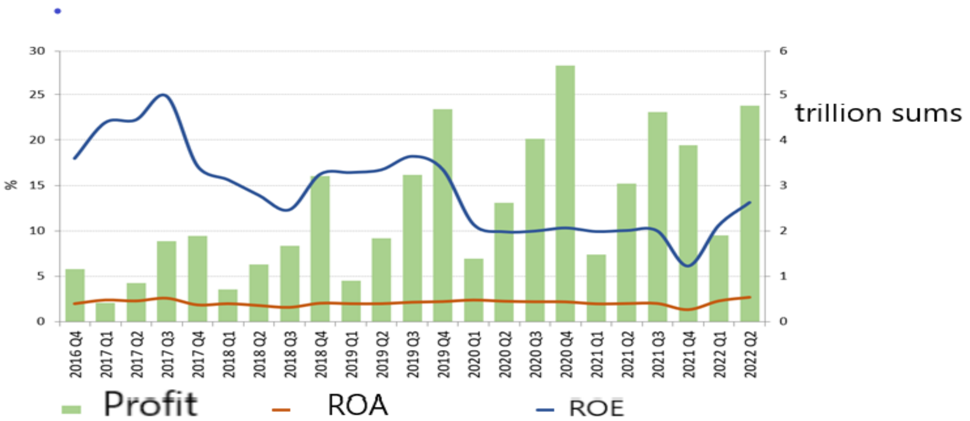

Figure 1. Profitability of the banking sector [9].

Based on the above data, an analysis of the gross indicators of the banking system was carried out. As of January 1, 2023, the analysis of the capital liquidity indicator, the return on assets indicator and the return on capital indicator in the context of banks with various assets was carried out (Table 3).

Table 3. As of January 1, 2023, the share of financial stability indicators in the context of banks with different amounts of assets, % [10].

Indicators	Total	Banks with assets up to 3 trillion soums	Banks with assets from 3 trillion soums to 10 trillion soums	Banks with assets from 10 trillion soums to 30 trillion soums	Banks with assets of more than 30 trillion soums
Ratio of regulatory capital to total assets (as a percentage)	17,8%	22,6%	18,4%	15,9%	18,4%
(ROA) (as a percentage)	2,5%	3,2%	5,0%	3,7%	1,8%
(ROE) (as a percentage)	13,3%	8,2%	27,2%	20,1%	9,8%

Based on the data in Tables 1 and 2, basing on the analysis carried out, we will elaborate the coefficient of financial stability of the suggested banks. The financial stability coefficient is taken into account based on the analysis of indicators (Table 2) obtained from the statistical bulletins of the Central Bank of Uzbekistan. A comparative analysis of the marginal value and the actual value of the indicators is carried out. The difference of the financial stability indicator from the limit value is calculated. In the stability assessment model , the formula for determining differentiation will have the following form:

$$O_i = 1 - P_i / F_i \qquad (1)$$

in this case, I - is an indicator in the Financial Stability Assessment System, P_i is the limit value of the indicator, F_i is the actual value of the indicator. If the level of O_i – differentiation has a positive value, then stability is maintained according to the calculated indicator, if the level of O_i - differentiation approaches zero, then the calculated indicator is kept at the required level, if the level of O_i – differentiation has a negative value, this means that the financial stability of the banking system is under threat.

determining the sum of the differences over the same period for all ten indicators, we determine the coefficient of financial stability – K_n The formula for calculating the financial stability coefficient will be as follows:

$$K_n = \Sigma\, O_i(n) \qquad (2)$$

in this case, O_i is the value of the difference in n year according to indicator i, K_n is the financial stability coefficient, n is the reporting period (year).

According to the indicator of financial stability of banks, the calculation is made by the amount of the difference (Oi), determined from the limit value of a specific indicator. The financial stability indicator allows you to assess the level of risk to the stability of the banking system. The higher the indicator of financial stability, the more stable the stability of the bank is calculated according to the selected indicator. If the financial stability indicator has a negative value, it means that there are risks associated with the stability of the bank, and in order to avoid a banking crisis, it is necessary to take the necessary measures to maintain stability. This coefficient reflects the average value of the difference of all I indicators from the norm in the period n.

Based on the algorithm formulated by the financial stability coefficient, the calculation of the difference of all ten indicators from the limit value in Table 4 for the study period was carried out. Based on the results of determining the degree of differentiation from the limit value, the coefficient of financial stability of banks for 2017-2022 was determined.

Based on the data obtained, Kn determines the level of financial stability of the banking system as a whole for the corresponding years.

Table 4. The degree of divergence of financial stability indicators from the limit value.

№	Indicator	The degree of divergence of financial stability indicators from the limit value					
		2017	2018	2019	2020	2021	2022
1.	Ratio of regulatory capital to total assets, taking into account risk	0,31	0,16	0,44	0,29	0,26	0,27
2.	The ratio of tier 1 capital to the total amount of risk-weighted assets	0,39	0,30	0,49	0,34	0,32	0,31

3.	The share of the loan portfolio in assets	0,28	0,42	0,42	0,40	0,39	0,36
4.	The share of deposits in loans	0,46	0,58	0,57	0,59	0,52	0,44
5.	The share of problem loans (NPL) in the total volume of loans issued, %	*	*	*	0,58	-0,04	0,28
6.	Return on assets (ROA)	0,21	0,25	0,32	0,32	-0,15	0,40
7.	Return on equity (ROE)	0,42	0,38	0,38	0,03	-0,63	0,25
8.	Instant liquidity - H2	0,38	0,19	0,47	0,63	0,75	0,77
9.	Ratio of liquid assets to total assets	0,58	0,26	0,28	0,35	0,46	0,53
10.	Regulatory liquidity compensation ratio	0,55	0,41	0,52	0,55	0,47	0,53
	FINANCIAL STABILITY COEFFICIENT	3,58	2,95	3,89	4,08	2,35	4,14

It should be noted that changes in the activities of economic entities after the pandemic, by the end of 2021, led to a significant drop in the indicator of financial stability of banks (2.35). In particular, it can be observed that the share of problem loans (NPL) in the total volume of loans issued, indicators of return on assets, return on capital have a negative value in the reporting period.

In 2022, this indicator was recorded as growing (4.14). In particular, the share of non-performing loans (NPL) in the total volume of loans issued decreased, and the indicators of return on assets, return on capital received positive indicators.

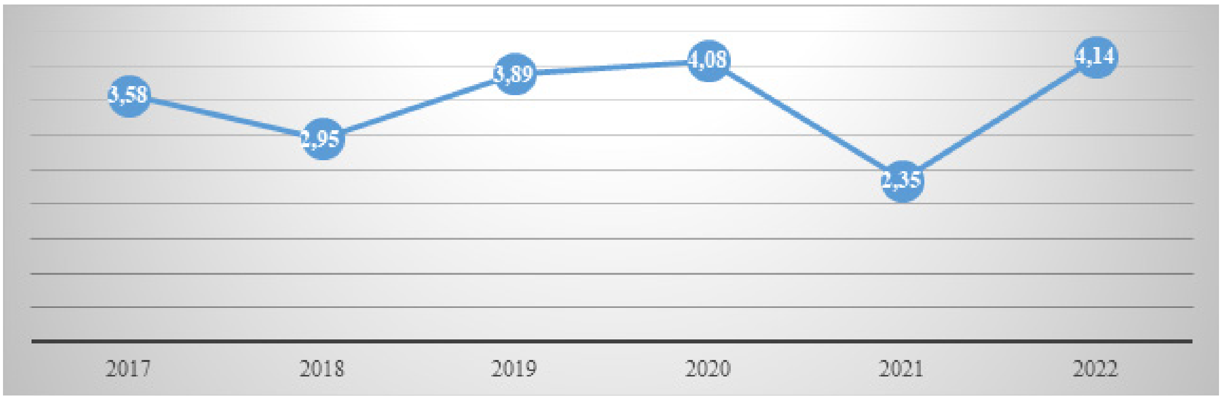

Figure 2. Dynamics of the financial stability coefficient of banks.

The necessity of the proposed model lies in the fact that it enables the evaluation of banks' financial stability through a single, generalized coefficient. In practical terms, the use of this indicator facilitates the identification of situations where the coefficient yields a negative value when analyzing a bank's financial stability. This, in turn, enables the timely implementation of corrective measures to mitigate potential risks in the banking sector.

CONCLUSION AND SUGGESTIONS

Based on the observation and analysis of the dynamics of the aforementioned indicators determining banks' financial stability, the following conclusions can be drawn:

- There are numerous indicators that influence the financial stability of banks. In this context, changes in additional indicators recommended by the Central Bank of the Republic of Uzbekistan and the International Monetary Fund have also been analyzed;
- Particular attention must be paid to assessing the financial stability of commercial banks during the ongoing transition to a digital economy and under conditions of increasing globalization. In this regard, the development and application of a generalized financial stability coefficient, along with its continuous monitoring, can serve as an early warning mechanism to prevent adverse outcomes in banking activities;
- Financial stability indicators typically reflect average values across the entire banking system. Therefore, it is advisable to conduct these evaluations at the level of individual credit institutions to ensure more accurate and targeted policy responses.

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