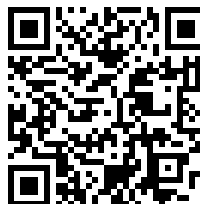
SOI: 1.1/TAS DOI: 10.15863/TAS
International Scientific Journal
Theoretical & Applied Science

p-ISSN: 2308-4944 (print) e-ISSN: 2409-0085 (online)

Year: 2022 Issue: 04 Volume: 108

Published: 08.04.2022 http://T-Science.org

Issue Article



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LEGAL BASIS AND FOREIGN EXPERIENCE IN ASSESSING THE CAPITAL OF COMMERCIAL BANKS

***Abstract**: The paper studies the legal framework for assessing the capital of commercial banks and foreign experience, as well as the analysis of the current legislation of the country where the bank operates and how each country should conduct monetary policy based on its political and economic goals comments given.*

***Key words**: commercial bank, capital, monetary, foreign experience, licensing, shareholder, currency.*
***Language**: English*
***Citation**:* Ergashev, A. (2022). Legal basis and foreign experience in assessing the capital of commercial banks. *ISJ Theoretical & Applied Science, 04 (108),* 82-86.
***Soi**:* http://s-o-i.org/1.1/TAS-04-108-17 ***Doi**:* https://dx.doi.org/10.15863/TAS.2022.04.108.17
***Scopus ASCC**: 2000.*

Introduction

When analyzing bank activities, it is critical to consider the current state of the country in which the bank operates. Each state formulates its monetary policy in accordance with its political and economic objectives. Additionally, the necessary knowledge and experience must be acquired through study of foreign experience in this field. Due to the topic's importance, this section analyzes the legal framework and international experience with commercial bank capital valuation. Today, the Republic of Uzbekistan's banking system and banking activities are regulated by a new edition of the Law "On Banks and Banking," which was adopted on November 5, 2019 by the Law of the Republic of Uzbekistan. The Republic of Uzbekistan's banking system is two-tiered, consisting of the Central Bank and commercial banks. The Central Bank of the Republic of Uzbekistan is a state-owned institution that regulates the banking sector and has licensing, regulatory, and prudential supervisory powers. The requirements for the bank's authorized capital are set out in the preceding law, which stipulates that the bank's authorized capital must be at least one hundred billion soums.

The bank's authorized capital is denominated in the Republic of Uzbekistan's national currency and is comprised of funds contributed by the bank's founders and shareholders or government securities, except in the following circumstances: - payment of the bank's shares by allocating them among the bank's creditors, taking into account any rights (claims) of the bank on monetary obligations to creditors;

- the exchange of securities for bank shares;
- the exchange of one type of bank's placed shares for another type of bank's placed shares.

Credit, collateral, and other mandatory funds cannot be used to establish the bank's authorized capital.

The bank's founders must enter the minimum amount of authorized capital prior to submitting the bank's application for state registration and licensing. Contributions to the authorized capital are deposited in a bank savings account.

In the event of a systemic financial crisis, the Ministry of Finance of the Republic of Uzbekistan may purchase bank shares in lieu of government securities.

The Central Bank is the state-level banking supervisor, establishing mandatory regulations that commercial banks must follow in the course of their operations in the interests of bank customers and the economy.

The main part

In order to ensure the financial stability of banks and protect the interests of depositors and creditors,

banks and banking groups must comply with prudential standards set by the Central Bank.

Prudential standards include:

capital adequacy ratios;

the maximum amount of risk per borrower or group of related borrowers;

maximum amount of major credit risks and investments;

coefficients of concentration by sectors;

liquidity ratios;

the maximum amount of risk for the bank's related parties;

maximum amount of unsecured loans (trust-based loans);

requirements for the classification of the bank's assets and assessment of their quality, the formation of reserves against possible losses on bank assets on the basis of asset classification;

requirements for accrual of interest on bank assets and their inclusion in the bank's income account;

the maximum amount of shares and shares to be purchased in the charter funds (authorized capital) of legal entities;

requirements for the acquisition and possession of real estate and other property;

open currency position limits;

other prudential standards set by the Central Bank in accordance with generally accepted international practice.

Banks need to adequately maintain their capital and liquid resources in order to reduce the risk of asset losses, build up reserves against potential asset losses based on asset classification, and ensure the diversification of their assets.

The central bank has the right to set additional premiums for banks, groups of banks and banks of sufficient liquidity and capital adequacy ratios to compensate for possible losses in the event of the greatest changes in risk factors specific to the bank, system of banks and groups of banks.Future changes to prudential regulations will be officially announced by the Central Bank at least one month before these changes are made.One of these prudential standards is the capital requirements of these commercial banks. This normative document is the Regulation "On requirements to the capital adequacy of commercial banks", registered by the Ministry of Justice of the Republic of Uzbekistan on July 6, 2015 No 2693. The requirements of the Regulation "On the requirements for the capital adequacy of commercial banks" determine the minimum level of capital of commercial banks, based on international experience.

This normative document defines the following components and requirements related to capital adequacy:

minimum capital requirements;

capital structure;

risk-taking assets;

off-balance sheet funds;

derivative means;

calculation of capital similarity;

final rules and applications.

Analysis and results

The capital adequacy requirements of commercial banks are based on the requirements of the International Basel Committee on Banking Supervision.

Table 1. Basic requirements of Basel III normative standards and differences from Basel I and II.

Elements	Basel I / II Requirements	New requirements (Basel III)
Minimum capital requirements	Tier 1 fixed capital / risk amount (RM) ≥ 2%; Tier 1 capital / RM ≥ 4% Total capital / RM ≥ 8%	Tier 1 fixed capital / risk amount (RM) ≥ 4.5%; Tier 1 capital / RM ≥ 6% Total capital / RM ≥ 8%
Innovative instruments	tier 1 capital (but not more than 15% of tier 1 capital)	Gradual deduction
Tier 3 capital	should not exceed 250% of Tier 1 capital intended to cover market risks	Canceled
Restrictions	Tier 2 capital ≤ Tier 1 capital; Subordinate debt obligations ≤ 50% of tier 1 capital Canceled	Canceled
Adjustments / discounts (excluding goodwill,	50% of Tier 1 capital and 50% of Tier 2 capital,	100% of Tier 1 fixed capital
Conservation buffer	Not available	4.5% in addition to Tier 1 fixed capital / RM in the amount of 2.5%
Contrast-enhancing buffer	Not available	In the amount of 0-2.5% of RM

The normative norms of the International Basel Committee on Banking Supervision are determined by the trend of economic changes around the world. As a major change from Basel III to Basel II, prudential requirements for capital and prudential requirements for liquidity were included in the capital account of banks.

The main directions offered by Basel III are:

the introduction of new requirements for the minimum level of fixed capital and its components, fixed capital, the gradual reduction of the recognition of hybrid instruments in capital, the list of regulatory deductions from capital;

tightening of capital requirements for banks and introduction of new liquidity standards - short-term (Liquidity Coverage Ratio - LCR) and long-term (Net Stable Funding Ratio - NSFR), application of the Leverage indicator.

As well as the introduction of additional capital buffers: the Capital Conservation Buffer and the Countercyclical Buffer.

Hence, Basel III envisaged the formation of two buffer capitals: a conservation buffer and a contra cyclic buffer. The main purpose of the formation of the conservation buffer is a "simple" addition to the minimum requirements to maintain the level of capital adequacy to cover the losses of the bank in times of systemic recession. In order to provide a conservation buffer, banks will have to limit the distribution of profits. Commercial banks of the Republic of Uzbekistan comply with the regulatory requirements of both the International Basel Committee and the Central Bank of the Republic of Uzbekistan. The capital adequacy, liquidity ratios and many other ratios of commercial banks are calculated and reported to the Central Bank.

The following table shows the dynamics over the years of the minimum amount of capital of commercial banks and the corresponding coefficients in accordance with the rules and requirements of Basel III.

Table 2. Requirements to the capital of commercial banks of the Republic of Uzbekistan based on the basic requirements of the Basel III normative standards

Indicators	Effective date				
	01.09.2015	**2016**	**2017**	**2018**	**2019**
Regulatory capital, (K1)	10%	11,5%	12,5%	13,5%	14,5%
1 level capital, (K2)	7,5%	8,5%	9,5%	10,5%	11%
1 level basic capital	6%	7%	7,5%	8,5%	9,5%
Leverage coefficient, (K3)	6%	6%	6%	6%	6%
Current liquidity ratio, (JLK)	30%	30%	30%	30%	30%
Liquidity Coverage Ratio, (LQMC))	-	80%	90%	100%	100%
Net Sustainable Financing Ratio, (SBMMK)	-	-	-	100%	100%

The normative requirements and minimum standards given in the table above are mandatory for all commercial banks in the country. It should be noted that the state has a share in the shares of a number of commercial banks in the Republic of Uzbekistan. This increases their financial capacity compared to private commercial banks and may lead to a violation of the principle of fair competition. The analysis of this situation in the following sections of the scientific work confirms how true or false this theoretical view is.

According to the norms of the International Basel Committee, the adequacy of bank capital is determined by the ratio of bank capital to rickshaws in total active operations.

Another system for assessing the adequacy of bank capital and the requirements for it is the CAMELS system for assessing the adequacy of banking capital used in the United States.

CAMELS is a methodology for analyzing the activities of banks, introduced in 1978 by the US regulators after the decision to standardize the systems

of analysis of the financial condition of commercial banks and other credit institutions.

CAMELS is an abbreviation of the initial letters of the components being analyzed.

C – capital adequacy, It is a set of standardized requirements that define the minimum capital values of banks and other credit institutions and how much they should be. These requirements are designed to protect banks themselves, their customers and the country's economy by setting rules and principles that must ensure the safety and efficiency of banking activities that can withstand any potential challenges.

The following two important coefficients should be calculated:

1) the ratio of total capital to the sum of assets and off-balance sheet items involved in the degree of risk;

2) the ratio of fixed capital to the amount of involved assets and off-balance sheet items on the level of risk.

A – asset quality, . Asset quality is linked to the left side of the bank balance sheet. The bank's management should monitor the quality of bank loans, as the income of commercial banks depends on the loans disbursed. The quality of loans and assets are basically two conditions that have the same meaning. The analysis of asset quality analyzes the increase in credit risk, the impact of problem loans on banking activities.

At this stage of the analysis, assets are divided into the following three groups: non-standard assets, doubtful assets and losses. In addition, a total weighted classification is performed that includes assets classified as 20% non-standard, 50% doubtful and 100% loss.

The ratio of the total weighted classification to total capital is a key indicator of asset quality.

M – management, . The quality of bank management is determined on the basis of the assessment of compliance with the laws and regulations adopted by the control system.

In assessing the quality of management, the following is analyzed:

efficiency of bank management;

the impact of objective and subjective factors, such as capital adequacy, asset quality and profitability;

professionalism of management staff;

the existence of internal procedures of the bank and the level of compliance with it;

the degree of preparation for future changes in banking activities, their planning and mitigation of existing risks.

E – earnings, In assessing the efficiency of the bank's activities, the bank's future development is forecasted by analyzing the sources of the bank's profits and increasing profits. In assessing the bank's income, the structure and composition of income is analyzed based on the return on bank assets for the last three years.

Return on bank assets = Net income / Average total assets

L - liquidity, In the CAMELS system, the liquidity of banks is analyzed in terms of timely fulfillment of bank obligations. Bank liquidity is the ability to meet obligations without incurring excessive losses. Liquidity management is a day-to-day process that requires bankers to control cash flows. At the same time, it is very important to maintain a balance between short-term assets and short-term liabilities.

Banks' liquidity is assessed on a scale of 1 to 5, and at this stage the following is analyzed: deposit volatility, level of dependence on credit resources, sensitivity to changes in interest rates, availability of liquid assets, access to money markets, efficiency of asset and liability management, etc.

S - sensitivity to risk. At this stage, the dependence of the bank's financial condition on changes in interest rates is analyzed. As a result of these analyzes, the effectiveness and flexibility of the CAMELS system of banking system evaluation has been proven.

FIMS system of analysis of banking activities. As the CAMELS system justified itself, the mechanisms for analyzing the performance of banks became increasingly sophisticated. The FIMS method of monitoring the financial stability of banks has been developed and put into practice. The purpose of this system is to constantly monitor the activities of the bank on the basis of its reports. As a result, deficiencies identified as a result of various inspections are eliminated in advance.

This system involves the calculation of two complementary ratings: the FIMS rating and the FIMS risk category.

The FIMS rating is an assessment of the bank's current condition based on changes in a number of financial indicators over the past quarter and an analysis of the results of field inspections. The CAMELS methodology is used in this rating and the bank's position is assessed by a rating score of 1 to 5.

The FIMS rating includes the following ratios relative to the bank's assets: capital adequacy, net income, reserves, liquid assets, fixed deposits, loans, etc.

FIMS risk analysis analyzes the possibility of realization of forecasts for the next period of banking activities, the impact of risks affecting banking activities.

RATE system of analysis of banking activities. The RATE system has been used by the Bank of England since 1997 to assess the financial stability of banks. This system consists of three interrelated blocks: Risk Assessment - risk assessment (risk assessment), Tools - control tools, Evaluation - evaluation of the effectiveness of the use of control tools.

The RATE analysis system used in the banking business conducts analysis in 9 areas. During the analysis, it is important to study the importance of the following factors: capital, assets, market risk, profitability, liabilities, and business.

The analysis of these factors is based on the financial statements of banks.

Conclusions and suggestions

There are many other ways to effectively analyze the activities of banks, which are determined by the requirements of the banking system of the country. It can be said that in today's era of developed international economic relations, the economic situation and assets of banks will be the main focus not only of domestic market participants, but also of foreign economic entities. This, in turn, requires the effective organization of banking activities, reducing the risks affecting its activities, increasing the bank's capital and profits, developing and implementing a reliable and effective system of supervision of banking activities.

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