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Article

The Nature of Risks in Commercial Banks and The Reasons for Their a Rise

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Abstract: The article provides a detailed description of the economic nature of risks and the risks that arise in commercial banks. At the same time, the types of risks that arise in commercial banks, their economic nature and significance, and the need to assess and manage them are highlighted. The discussion focused on the existing risk management capabilities of banks and the feasibility of further increasing them. It was also noted that the risks that arise in commercial banks affect the financial stability of the bank. The most important factor is the correct implementation of risk management by the bank itself to improve financial stability and achieve higher profits. Also, the continuous and accurate assessment of risks by banks directly depends on the independence of bank management.

Keywords: Risk, Banking Risks, Credit Risks, Market Risks, Interest Rate Risks, Currency Risks, Liquidity Risk, Operational Risks, Risk Management, Internal Audit, Risk Assessment and Management

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1. Introduction

Today, an analysis of the current state of the banking sector in our country shows the existence of a number of problems in the sector, including a high level of state involvement in the banking sector, insufficient quality of management and risk management in state-owned banks [1].

Risk is considered an economic category. Therefore, the level and value of risk can be influenced both through financial mechanisms. Such influences are implemented through financial management technical assistance and a specific strategy. Therefore, risk management is considered a part of financial management [2].

These situations require scientific research of both theoretical and practical importance to assess and manage risks in banks.

Analysis of relevant literature.

The term risk has been defined in various ways by different scholars in various literatures. For example, according to Russian scholar Anatoly Petrovich Algin, "risk is such a generalized phenomenon that it is inextricably linked with the development of man in the process of civilization."

J.P.Morgan defines risk as the degree of uncertainty relative to future net income. Some economists express risk as "risk", "danger", for example, Professor A. Olmasov defined it as “business risk, which is the possibility of the firm being separated from its own profit and even capital” [3].

Y. Abdullayev and T. Bobokulov defined interest rate risk as the risk of loss as a result of changes in the level and movement of interest rates [4].

Some scientists define risk as "riskiness", "uncertainty", "vulnerability", "danger". For example, Sh. Shodmonov, R. Alimov, T. Jo'rayev defined entrepreneurship as “Entrepreneurship (entrepreneurial activity) is an economic activity carried out by legal and physical persons under property responsibility, within the framework of existing laws, with the aim of obtaining income (profit), and with risk” [5], while A. Olmasov, in the same definition, M. Sharifhodjayev describes risk as risk-taking.

Risk assessment helps to optimize an organization's organizational structure, financial resources, operations, and management. This is one of the important processes aimed at ensuring the continuous development of the organization and minimizing potential losses.

Bank risk management, as an integral part of bank management, involves managing the risks that arise in each bank operation. It is appropriate to view bank risk management as a system, since risk management involves a number of interrelated elements.

The banking risk management system includes a set of measures and methods to identify risks before they arise, prevent situations arising due to risks, or reduce their impact [6]. It is clear from this that banking risk management is carried out in several stages.

2. Materials and Methods

The article presents independent opinions based on the scientific conclusions of scientific research conducted by foreign and domestic scientists and the practical experience of the authors on the study of aspects that should be taken into account when identifying, assessing, managing and analyzing risks in commercial banks. At the same time, methods such as logical, analytical comparison and grouping were used.

At the same time, the study also used statistical methods, in which the main indicators were formed based on the financial results of local banks. This statistical analysis also included comparative analyses of local banks. This will directly help identify the strengths and weaknesses of local banks.

3. Results and Discussion

The stages of bank risk management proposed by Sh.Z. Abdullayeva include risk identification, analysis, assessment, decision-making, methods of influence, study of the results of the measures taken, and other similar stages.

The main tasks of bank risk management are as follows:

to create an integrated risk management process as an element of managing and improving the bank's activities based on a single standardized approach to risk management methods and procedures; to create an effective complex risk management system in the bank; using advanced international practices and standards, including bringing the risk management system closer to Basel II and Basel III standards;

To form a system for monitoring bank risks and its individual business processes, which will allow for ongoing risk control; To provide timely information to the Bank's Management Bodies on the level of risk in the bank's activities; To prevent crisis situations and ensure the normal functioning of the bank in the event of a crisis; Comprehensive monitoring of the functioning of the risk management system at all levels and within all business processes of the bank.

Risks directly or indirectly affect the activities of commercial banks. Most economists recognize the following as the main types of risks inherent in the activities of commercial banks:

1. Credit risk.
2. Interest rate risk.
3. Currency risk.
4. Operational risk.
5. Liquidity risk.
6. Market risk [7].

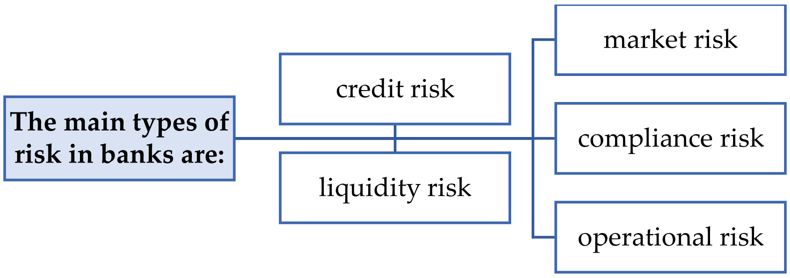

Figure 1. Types of risk in banks.

Based on our national legislation, in the Regulation of the Central Bank of the Republic of Uzbekistan dated April 18, 2023 No. 3427 "On Requirements for the Risk Management System of Banks and Banking Groups", risks are divided into 5 large groups. This division is presented in Figure 1.

Given that lending is one of the main sources of income for commercial banks, credit risk is one of the most important risks that banks face. Therefore, managing this credit risk affects the profitability of banks.

Credit risk is the risk that a lender will lose money when it lends money to a borrower. Credit risk is the possibility of financial loss as a result of a borrower's failure to repay the loan. Failure to accurately assess credit risk exposes the lender to the risk of not being able to collect the principal and interest payments, which can lead to cash flow disruptions and increased collection costs.

Granaturov MV defined credit risk as the risk of default, that is, the borrower's failure to pay the principal and interest in accordance with the terms of the loan agreement [8].

In the legislation, "credit risk is defined as the possibility of incurring losses (losses) and (or) not receiving the planned income as a result of the failure (inadequate fulfillment) of the debtor's obligations to the bank within the period and (or) under the conditions specified in the contract or legislative documents" [9].

Another risk is market risk. According to the legislation, market risk is the possibility of incurring losses and (or) not receiving the planned income as a result of changes in exchange rates, interest rates, and prices of financial instruments.

Market risk faced by the bank includes the following risks:

interest rate risk arising in the bank's investment portfolio due to unexpected changes in the value of securities or other financial instruments that yield a fixed income, market interest rates;

currency risk arising from fluctuations in foreign exchange rates that affect the value of a bank's assets, liabilities and off-balance sheet items;

commodity risk arising from fluctuations in the market value of precious metals, stones and coins;

Stock market risk, which arises due to changes in the current (fair) price of securities due to the issuer's activities or fluctuations in the securities market.

Along with credit risk management, interest rate risk management is also one of the main strategic directions of any commercial bank. Interest rate risk is the financial losses of a bank that arise as a result of changes in interest rates.

Peter S. Rose defined interest rate risk as "the risk that a bank's profit and, at the same time, its capital will decrease as a result of an unexpected negative change in interest rates" [10].

Changes in interest rates affect a bank's income, which in turn affects the bank's net interest income by changing interest income and expenses.

According to G. Akhmadeev and D. Shakirov, commercial banks are constantly exposed to interest rate risk, since there is no way to constantly balance the loans they issue. This highlights the need to improve interest rate risk management.

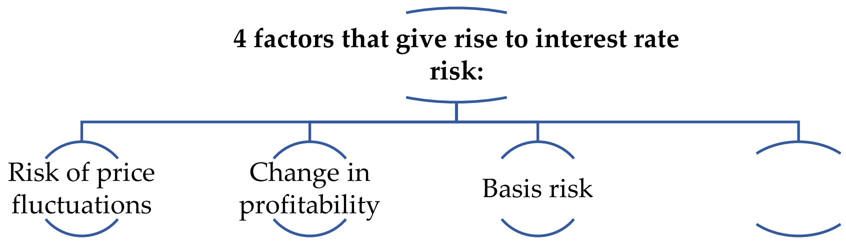

Figure 2. Factors that give rise to interest rate risk.

The Basel Committee's 1997 document "Principles for Managing Interest Rate Risk" outlines the factors that give rise to interest rate risk. This division is presented in Figure 2.

The main element of market risk is currency risk. The main losses incurred by banks from currency risk arise through the revaluation of their currency positions.

Currency position is an indicator expressing the relationship between a bank's claims and liabilities in foreign currency, which arises as a result of changes in the amount of claims and liabilities in foreign currency as a result of the bank's foreign currency purchase and sale operations and other operations [11].

Liquidity risk in banks is understood as the possibility of incurring losses (losses) and/or not receiving planned income as a result of the bank's inability to meet its obligations when due.

Based on legislative requirements, a bank must implement a liquidity risk management system that serves to identify, assess, monitor, control, and mitigate liquidity risk.

Bank liquidity is a necessary category in ensuring their solvency and reliability. An increase in bank liquidity risk weakens their solvency and reduces confidence in them. Therefore, banks should attach special importance to liquidity and constantly monitor the risk related to it. Banks are forced to maintain liquidity, even at the cost of their own profits, in order not to lose confidence in themselves [12].

We can distinguish 2 main areas of liquidity risk management:

1. policy of constant control of reserves
2. a policy of encouraging the maintenance of reserves at a constant level.

The policy of constant control over reserves - the bank should not allow the growth of non-performing assets.

The policy of maintaining a certain level of reserves is the mandatory reserve policy at the central bank, which is supported by funds from the deposits of banks attracted by depositors.

It is known from banking practice that the lack of sufficient liquidity leads to serious shortcomings in the activities of the bank. The emergence of such a situation usually leads to the loss of deposits in the bank, which in turn leads to a decrease in cash and the sale of highly liquid securities in the bank's assets. The bank's liquidity can also be satisfied at the expense of loans from other banks. However, other banks offer loans at high interest rates, which reduces the bank's income [13].

Banks typically take the following actions to manage risks:

Risk identification – the bank conducts a comprehensive risk inventory to identify potential risks. This includes various types of risks, such as credit risk, market risk, liquidity risk, and operational risk [14].

Risk measurement – the bank measures the magnitude and impact of identified risks. This is done by assessing the likelihood and impact of the risk. Risk measurement is often done using statistical models and mathematical techniques.

Risk assessment: The bank assesses the significance of the identified risks and determines their priority. This is done taking into account the impact of the risks and the bank's capital structure [15].

Risk management – the bank develops appropriate strategies and policies to manage risks. This includes steps such as reducing or transferring risk, implementing appropriate controls, and protecting against risks. Risk management is an ongoing process and is reviewed regularly.

Monitoring and reporting – the bank establishes risk monitoring and reporting systems. This is achieved through risk monitoring, the use of early warning systems and the preparation of risk reports. This ensures effective risk management and, where necessary, the implementation of interventions [16].

Proper risk management directly helps prevent the growth of a bank's problem assets. Today, there are about 40 banks operating in the Uzbek economy, and their non-performing asset (NPL) ratios are constantly fluctuating.

Table 1. Information on non-performing loans of commercial banks as of February 1, 2025.

billion UZS

No.	Bank name	Total loan portfolio	NPL	share in % of loans
	Banking System	**533,989**	**23,768**	**4.5%**
	State-owned banks	**366,860**	**16,820**	**4.6%**
1	NBU	107,499	3 778	3.5%
2	Uzpromstroybank	65,354	2,996	4.6%
3	Agrobank	59,605	2,890	4.8%
4	Asaka Bank	39,212	1,857	4.7%
5	People's Bank	28,759	1 252	4.4%
6	Business development bank	22,735	2,085	9.2%
7	Microcredit bank	17,737	1 216	6.9%
8	Contact bank	13,500	343	2.5%
9	Turan Bank	12,458	402	3.2%
	Other banks	**167 129**	**6,949**	**4.2%**
10	Mortgage bank	34,862	3 511	10.1%
11	Capital Bank	31,444	1 464	4.7%

12	Hamkorbank	19 183	326	1.7%
13	Ipak Yuli Bank	14,092	219	1.6%
14	Orient Finance Bank	12,746	105	0.8%
15	TBC Bank	8,094	161	2.0%
16	Invest Finance bank	8,019	120	1.5%
17	Period bank	7 178	144	2.0%
18	Aron Bank	7 157	182	2.5%
19	Trust Bank	5,617	201	3.6%
20	Tenge bank	4 246	96	2.3%
21	Asia Alliance Bank	3,718	80	2.1%
22	KDB Bank Uzbekistan	3 420	0	0.0%
23	Ziraat Bank Uzbekistan	1,919	65	3.4%
24	Universal bank	1,713	16	0.9%
25	Life Bank	1,314	2	0.2%
26	Guarantor Bank	798	149	18.6%
27	AVO bank	339	41	12.2%
28	Poytakht Bank	304	0	0.0%
29	Madad Invest Bank	297	58	19.5%
30	Octobank	180	0	0.0%
31	Apex Bank	167	0	0.0%
32	Grape bank	123	0	0.0%
33	New bank	110	8	7.1%
34	Smart bank	68	0	0.0%
35	Iranian Saderat Bank in Tashkent	20	1	6.7%
36	Eurasian Bank	0	0	0.0%

If we look at the official statistics of the Central Bank of the Republic of Uzbekistan, the balance of problem loans in banks with a state share remains constant. We can say that this is a direct result of the constant intervention of the state in the banking system policy and the policy being pursued.

We can explain this as follows: Uzbekistan is now one of the developing countries, and the main priority is to pursue a policy aimed at social protection of the country's population. In this case, banks with a state share are obliged to avoid risk situations inherent in the country's social policy and to conduct a credit policy aimed at ensuring the implementation of the state's policy. From this we can conclude that it is natural that state banks will face a number of restrictions on the independent issuance of financial and credit decisions.

If we look at the table 1 by bank, the highest share Madad Invest Bank (19.5%) and Garant Bank (18.6%) accounted for the largest share. Business Development Bank, which has a state share, generated 9.2% of problem assets. Today, Business Development Bank is the main bank implementing state policy aimed at developing small business and private entrepreneurship in the country.

In addition to the above, we can also mention a number of advantages in risk management by state-owned banks. In particular, state guarantees, that is, state-owned banks are usually supported by the government, which can increase their stability even during financial crises. State-owned banks also usually have access to cheap resources from the central bank, which helps reduce liquidity problems.

4. Conclusion

As a result of the above research, we can draw the following conclusions: risk assessment in banks should be clear and objective, that is, based on reliable information, and conclusions and recommendations on improving the quality of the credit portfolio should be based on analytical reports.

Among the various risks faced by commercial banks, operational risk stands out. Operational risk has its own characteristics and requires systematic development and justification of methodological approaches to its identification. Operational risks are the risks that lead to losses due to external factors, as well as internal factors, whether intentional or unintentional, as well as due to improper operation of internal systems.

Risk management in banks is essential for the sound operation of the bank and ensuring its financial stability. Risks represent the potential losses that the bank may face. Therefore, proper risk assessment and management is of great importance.

Today, it is the demand of the times for banks to promote ESG policies aimed at sustainable economic development when implementing risk policies. Proper implementation of ESG policies is one of the main reasons for directly contributing to the financial stability of the bank, customer trust, and increasing its reputation in the international arena.

In short, it is necessary to ensure the participation of each employee in risk assessment and management, and to listen to their opinions. Because no one knows better than them the risks that may arise in their activities.

In addition, along with risk management, it is necessary to increase the responsibility of internal audit for assessing and managing risks.

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