

UNDERLYING CAUSES OF NON-PERFORMING LOANS AND APPROACHES TO MINIMIZE THEM

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Abstract

The article examines the phenomenon whereby an increase in the ability of commercial banks to extend credit to various economic sectors and the general population is accompanied by a rise in the proportion of non-performing loans. It analyzes the causes of non-performing loans, their impact on banking operations, and provides conclusions and recommendations for reducing their share.

Keywords: Loan, problem loan, Basel Committee, overdue loans, overdue interest, lending process, loan portfolio quality, credit monitoring.

Introduction

As in international practice, one of the main indicators affecting the performance and financial stability of commercial banks in our country is the timely repayment of loans issued by the bank and the prevention of their transformation into problem loans. In recent years, along with the growing capacity of banks to extend credit to various sectors of the economy and the population, there has also been an increase in the volume of non-performing loans. Throughout 2023, the total loan portfolio of commercial banks increased by 81.4 trillion UZS, reaching 471.4 trillion UZS by the end of the year. Compared to the beginning of the year (13.99 trillion UZS), the amount of problem loans increased by 2.63 trillion UZS. As of January 1, 2024, the volume of non-performing loans of commercial banks amounted to 16.62 trillion UZS, of which 13.26 trillion UZS fell on commercial banks with state participation.

Literature Review

The main activity of commercial banks — issuing loans — is inherently associated with high risks, while at the same time it creates an opportunity for generating significant income. The higher a bank's income, the more effectively it utilizes attracted funds and invests them in low-risk assets to obtain high returns. However, the practice of commercial banks shows that, despite their attempts to minimize risks when issuing loans, problematic loans still arise in their operations. In many cases, problematic loans result from the clients themselves. These include failure to meet loan agreement terms on time, misuse of the loan for other purposes, the deterioration of the client's financial condition, weaknesses in collateral, and other factors. These lead to the emergence of problematic loans, which are considered costly for the bank.



In international practice, the concept of "non-performing loan" is closely linked with the IMF's document "Working with Non-Performing Loans," where a non-performing loan (NPL) is defined as a loan on which payments of principal and/or interest are overdue by 90 days or more, or where interest payments overdue for 90 days or more have been capitalized, refinanced, or delayed by agreement. Additionally, delays may also be due to other reasons, such as the borrower being close to bankruptcy or facing a high likelihood of insolvency [1.15]. The accepted 90-day criterion is not universal because, as indicated in the second part of the definition, the mere substitution of a non-performing loan with a new one does not guarantee a reclassification.

The Basel Committee on Banking Supervision offers a similar definition of a non-performing loan. According to the committee, a problematic loan is one for which the borrower has significantly breached the repayment terms, the borrower's financial condition has substantially worsened, the quality of the loan has declined, or the loan lacks adequate collateral. A loan is considered problematic if:

1. the borrower fails to fulfill obligations and delays repayment by more than 90 days, and the bank has not taken steps to recover the loan (such as securitization, refinancing, review, or extending the repayment period) nor requested repayment enforcement;
2. the borrower's creditworthiness has declined, reducing asset quality and devaluing them;
3. regardless of how many days the repayment is overdue, if the bank has evidence that the client cannot repay the principal and interest without selling collateral, the loan is deemed problematic [2.41].

This shows that the Basel Committee's criteria for problematic loans are relatively stricter. In banking practice, even quality loans can become problematic if the basic principles of lending are violated, increasing credit risk and negatively impacting the quality indicators of the credit portfolio.

Russian scholar O. I. Lavrushin's opinion aligns with the Basel Committee's. He notes that the first signs of a problematic loan appear when a bank officer begins to doubt the client's financial condition, the financed object, or the collateral [3.89]. According to this economist, since banks generate income from loans, ensuring the full and timely repayment of loans from borrowers is one of the bank's top priorities. He states, "... as an investor, the bank does not sell capital itself, but rather the right to use it under certain conditions and with additional interest."

V.D. Nikiforova, A.V. Kovalenko, and A.A. Nikiforov emphasize that overdue and problematic loans block new lending channels, reduce the commercial bank's profitability and solvency. When a high level of non-performing loans affects a sufficient number of banks, the financial system ceases to function properly, and banks can no longer effectively fulfill their role of financing the economy [4.3].

As mentioned above, the state and quality of bank loans depend, on the one hand, on how well the bank adheres to its credit policy, and on the other hand, on the borrowers' fulfillment of their contractual obligations. In academic literature and banking practice, more attention is usually paid to the concepts of "problematic loans" or "problematic assets." In our view, since problematic loans are a part of problematic assets, particular attention should be paid to the intrinsic connection between the quality of bank assets and the quality of bank loans.



Among national scholars, Sh.Z. Abdullaeva [5.328.] evaluates loan quality based on timely fulfillment of loan contract terms and associated credit risks as the main criteria. Another scholar, U.A. Tukhtaboyev [6.9.], emphasizes the importance of time as a factor in credit relationships. F.K. Kholmamatov [7.488.] notes that commercial banks in our country face various challenges and problems in conducting lending activities.

Among Russian researchers, O.I. Lavrushin [8.147.] focuses on how delays in repayment of loans and interest, and emerging credit risks, lead to deteriorating loan quality. Meanwhile, S.E. Zaychenko, Yu.Yu. Platonova, and E.N. Rubleva [9.28–36.] point out the wide range of factors that can increase the probability of a borrower not repaying the loan in full or on time.

Analysis and Results

According to data from the Central Bank of the Republic of Uzbekistan, the total loan portfolio of commercial banks increased by 81.4 trillion UZS during 2023, amounting to 471.4 trillion UZS by the end of the year. The volume of non-performing loans grew by 2.63 trillion UZS compared to the beginning of the year (13.99 trillion UZS). As of January 1, 2024, the total volume of non-performing loans stood at 16.62 trillion UZS, of which 13.26 trillion UZS were concentrated in commercial banks with state participation, and the remaining 3.35 trillion UZS — in other banks. In relative terms, the NPL ratio was 3.5% across all commercial banks, 4.0% for state-owned banks, and 2.4% for private banks. In October 2024, the total loan portfolio increased by 5.38 trillion UZS, exceeding 521 trillion UZS. State-owned banks' portfolios rose by 3.4 trillion UZS, and private banks by 1.957 trillion UZS. Notably, in 8 banks — especially Ipoteka Bank (–708 billion UZS) — the outstanding loan balance declined.

Table 1: Non-performing loans of state-owned commercial banks (as of 01.01.2024, in billion UZS)

Bank Name	Loan Portfolio	Non-performing Loans (NPL)	NPL Share (%)
Total (All banks)	471,406	16,621	3.5%
State-owned banks total	333,298	13,267	4.0%
Uzmilliybank	99,423	3,098	3.1%
Uzsanoatqurilishbank	57,124	1,283	2.2%
Agrobank	54,483	2,071	3.8%
Asaka Bank	39,213	1,731	4.4%
Halk Bank	24,549	1,855	7.6%
Business Development Bank	21,801	1,935	8.9%
Microcreditbank	14,437	865	6.0%
Turonbank	11,894	271	2.3%
Aloqabank	10,294	157	1.5%
Poytakht Bank	79	2	2.3%



The data shows that 70.7% of the total loan portfolio is held by state-owned commercial banks, which is proportional to their larger share in NPLs — 79.8%. The Business Development Bank has the highest NPL ratio at 8.9%, followed by Halk Bank (7.6%) and Microcreditbank (6.0%).

Table 2: Non-performing loans of private commercial banks (as of 01.01.2024, in billion UZS)

Bank Name	Loan Portfolio	Non-performing Loans (NPL)	NPL Share (%)
Total (All banks)	471,406	16,621	3.5%
Other banks total	138,107	3,354	2.4%
Ipoteka Bank	37,264	1,733	4.7%
Kapital Bank	26,586	375	1.4%
Hamkorbank	15,854	99	0.6%
Ipak Yuli Bank	11,701	251	2.1%
Orient Finance Bank	8,448	25	0.3%
Invest Finance Bank	6,431	68	1.1%
Davr Bank	5,004	32	0.6%
Trust Bank	4,947	101	2.0%
Tenge Bank	4,208	109	2.6%
TBC Bank	3,730	73	1.9%
Asia Alliance Bank	3,712	55	1.5%
Anor Bank	3,169	64	2.0%
Ziraat Bank	1,595	36	2.2%
Universal Bank	1,162	35	3.0%
Garant Bank	922	43	4.7%
Madad Invest Bank	292	39	13.2%
Oktobank	249	212	85.2%
Bank Saderat Iran	22	4	17.6%

These statistics indicate that private commercial banks account for 29.3% of total loans but only 20.2% of non-performing loans. This shows a more cautious credit policy compared to state-owned institutions. However, banks such as Oktobank and Bank Saderat Iran exhibit alarmingly high NPL ratios, 85.2% and 17.6% respectively, indicating potential solvency issues.

Conclusion

The increase in non-performing loans began during the pandemic, when many borrowers were granted payment deferrals and grace periods. As a result, the NPL ratio rose from 1.5–1.8% in 2020 to up to 6% in the following years. Unfortunately, some borrowers misused these privileges, leading to a rapid increase in bad loans across the banking system.

Other contributing factors include the issuance of subsidized loans, low financial literacy of clients, misuse of funds, lack of experience in managing credit, and poor contractual terms.



Inadequate analysis of client creditworthiness, weak collateral structures, and lack of post-disbursement control further exacerbated the problem.

To reduce the share of non-performing loans, the following measures are recommended:

- develop a comprehensive credit policy that includes options for one-time loan restructuring and temporary deferrals;
- deeply analyze clients' credit histories and solvency, and apply risk-sensitive loan classification models;
- liberalize interest rates and ensure credit amounts are appropriate to the borrower's competence and market conditions;
- reduce the burden of social lending programs on private banks by establishing a state bank and insurance company specialized in managing subsidized and high-risk loans.

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