ETHIOPIAN INTERNATIONAL JOURNAL OF MULTIDISCIPLINARY RESEARCH

eISSN: 2349-5715 pISSN: 2349-5707

Volume: 11, Issue 11, November-2024 SJIF 2019: 4.702 2020: 4.737 2021: 5.071 2022: 4.919 2023: 6.980 2024: 7,662

The reasons for the emergence of problematic assets of commercial banks and the need to reduce them

Andijan Institute of Construction and Economics, 2nd year Faculty of Economics

Khalimova Nilufar Umidjon qizi

Andijan Institute of Economics and Construction,

Deputy Dean of the Faculty of Economics for Spiritual and Educational Affairs

Mitillaev Ibrahimjon Tursunpolatovich

COMMERCIAL BANKING THEORETICAL PRINCIPLES OF ASSETS AND THEIR REDUCTION FOREIGN EXPERIENCE

ABSTRACT:The theoretical principles of asset management and their reduction in commercial banking are vital for maintaining financial stability, ensuring liquidity, and optimizing returns while mitigating risks. These principles encompass the trade-off between risk and return, the management of liquidity, capital adequacy, and asset diversification. Commercial banks often face the challenge of managing large portfolios of assets, including loans, investments, and cash reserves, and must reduce their asset base in times of financial stress. The reduction methods—such as asset sales, loan write-offs, securitization, and loan restructuring—play crucial roles in stabilizing the balance sheet and improving financial health. Foreign experiences, such as those from the United States, Japan, the European Union, China, and India, illustrate various strategies employed to manage non-performing assets (NPAs) and restore financial stability. These global case studies provide valuable insights into the practical application of asset reduction strategies, highlighting the importance of effective governance, regulation, and the use of specialized financial institutions like asset management companies (AMCs) in managing distressed assets. This paper explores the theoretical principles underpinning asset management in commercial banking and examines foreign experiences that offer valuable lessons for improving asset management and reduction practices in different banking environments.

Key words: Commercial banking, asset management, asset reduction, risk and return, liquidity, capital adequacy, asset diversification, non-performing assets (NPAs), securitization, loan write-offs, foreign experiences, asset management companies (AMCs), financial stability, global banking practices, Basel III.

In commercial banking, the management of assets is a critical component of ensuring financial stability and profitability. Banks hold a variety of assets, including loans, securities, and real estate, which must be carefully managed and, when necessary, reduced to maintain a healthy balance sheet. The reduction of assets typically arises when loans or investments become non-performing, or when the bank needs to improve its liquidity or capital position. This can be achieved through methods such as asset sales, write-offs, or securitization. The theoretical principles behind asset management and reduction are universal, yet their practical applications can vary across different global banking systems. This paper examines the theoretical principles guiding asset management in commercial banking, discusses asset reduction techniques, and explores the experiences of foreign banking systems in managing and reducing their asset bases during times of financial stress.

eISSN: 2349-5715 pISSN: 2349-5707

Volume: 11, Issue 11, November-2024 SJIF 2019: 4.702 2020: 4.737 2021: 5.071 2022: 4.919 2023: 6.980 2024: 7,662

Risk and Return Balance: Commercial banks must manage a delicate balance between risk and return. High-risk assets, such as corporate loans, can offer high returns but also carry the risk of defaults. Conversely, low-risk assets, such as government bonds, offer lower returns but provide financial stability. Banks are expected to maximize returns on their assets while managing the risk of defaults, which could threaten their solvency.

Liquidity Management**:** Liquidity is a key consideration for any commercial bank, as it must maintain sufficient cash or liquid assets to meet daily financial obligations, including customer withdrawals and short-term liabilities. Liquidity management involves maintaining an adequate amount of easily accessible assets, such as cash, short-term investments, and government bonds, to avoid liquidity crises.

Capital Adequacy: Capital adequacy ensures that a bank has enough capital to cover potential losses from its assets. This is governed by the Basel Accords**,** which set international standards for capital requirements. Commercial banks must maintain an appropriate capital-to-asset ratio to mitigate the risk of insolvency, particularly when holding riskier assets.

Asset Diversification**:** Diversification helps reduce the risks associated with any single asset class. By spreading investments across different types of assets (e.g., loans, securities, real estate), banks can reduce exposure to market fluctuations or sector-specific downturns. This reduces the bank's overall risk profile and contributes to financial stability.

Asset Liability Management (ALM)**:** ALM focuses on the management of a bank's assets and liabilities in a way that ensures it can meet its obligations while optimizing its financial returns. ALM strategies involve matching the maturity profiles of assets and liabilities and managing interest rate risk through financial instruments such as A common method of reducing assets is through the sale of non-performing or underperforming assets. For example, banks may sell distressed loans, non-core business assets, or real estate holdings to improve their liquidity and capital position. Asset sales are often used when banks want to offload assets that are no longer profitable or when they need to raise funds quicklwaps and futures.

Securitization involves converting loans or other illiquid assets into tradable securities. These securities are sold to investors, allowing the bank to offload the risk and reduce the size of its balance sheet. **Mortgage-backed securities (MBS)** and asset-backed securities (ABS) are common examples of securitization in commercial banking. Securitization provides liquidity to banks and allows them to focus on new lending while transferring the risk to investors. In cases where borrowers are facing temporary financial difficulties, banks may opt for loan restructuring rather than an outright write-off. This involves modifying the terms of the loan to make it more manageable for the borrower, such as reducing the interest rate, extending the loan term, or even forgiving part of the debt. **Loan restructuring** helps preserve the value of the asset while reducing the risk of default.

Some banks engage in off-balance-sheet financing by using special purpose vehicles **(SPVs)** or other legal entities to hold certain assets or liabilities outside the main bank's balance sheet. This helps banks reduce the perceived size of their balance sheets while still retaining exposure to the underlying assets. While this technique can improve financial ratios, it has raised concerns about transparency and the true financial health of banks.

In international practice, two approaches to the management of problem assets are mainly used: centralized and decentralized. The first approach involves the creation of a special corporation by the

eISSN: 2349-5715 pISSN: 2349-5707

Volume: 11, Issue 11, November-2024 SJIF 2019: 4.702 2020: 4.737 2021: 5.071 2022: 4.919 2023: 6.980 2024: 7,662

state to purchase and manage problem assets of the entire banking system. The main goal of such a structure is to isolate and withdraw problem loans of commercial banks. The purchased loans are exchanged for debt obligations or shares of the corporation, or directly for debt obligations of the government. The advantage of this approach is the possibility of quickly isolating problem assets, while the disadvantage is the additional costs of forming a separate structure and the long duration of the restructuring process. An analysis of foreign experience in the restructuring of problem assets shows that this method of restructuring is preferable in cases where there are a large number of banks with problem loans in their loan portfolios and a certain degree of similarity of the purchased assets.

The essence of the decentralized approach is to create an appropriate structure for managing non-performing assets within or outside the bank. When the number of banks experiencing difficulties is not large, as was the case in Sweden and Poland, the use of a decentralized approach is more effective. The advantage of this approach is that banks can have high skills in managing problem loans. Along with the positive aspects of this model, banks are not able to change their activities without external intervention. There are also negative aspects, such as the fact that they continue to lend to customers with overdue debts. In Japan and Sweden, both approaches are used to deal with problem loans. The process of purchasing problem loans from banks can be carried out not only by the Central Bank (in Chile, Hungary, Poland), but also by a restructuring agency (in the Czech Republic, the USA, Mexico, South Korea).

The theoretical principles of asset management in commercial banking are essential for maintaining financial stability and profitability. Managing risk, ensuring liquidity, and adhering to capital adequacy requirements are central to successful asset management. When assets become distressed or non-performing, various methods such as asset sales, loan write-offs, and securitization are employed to reduce the size of the asset base and improve the financial health of banks. International experiences, particularly in the U.S., Japan, Europe, China, and India, provide valuable lessons on the strategies for handling distressed assets and highlight the importance of effective regulatory frameworks, specialized asset management entities, and timely intervention to address financial challenges.

Used literature:

1. Basel Committee on Banking Supervision. (2011). Basel III: A global regulatory framework for more resilient banks and banking systems. Bank for International Settlements.
2. Calomiris, C. W. (1994). The Political Lessons of the Savings and Loan Debacle. Journal of Financial Services Research, 8(1), 5-28.
3. Hoshi, T., & Kashyap, A. K. (2004). Japan's Financial Crisis and Economic Stagnation. Journal of Economic Perspectives, 18(1), 3-26.
4. 4.European Commission. (2014). Bank Recovery and Resolution Directive (BRRD). European Union.
5. 5 Bacon, Kenneth H. "Banks' Declining Role in the Economy Worries Fed, May Hurt Firms," Wall Street Journal, June 9, 1993, p. A 1, col. 6.
6. 6.Barth, James R., R. Dan Bmmbaugh, Jr., and Robert E. Litan. The Future ofAmerican Banking. Armonk, New York: M.E. Sharpe, Inc., 1992. , and Philip Bartholomew. "The Thrift Industry Crisis: Revealed Weaknesses in the Federal Deposit Insurance System," in The Reform of Federal Deposit Insurance by James R. Barth and R. Dan Bmmbaugh, Jr.. eds., Harper Collins Publishers Inc., 1992.

eISSN: 2349-5715 pISSN: 2349-5707

Volume: 11, Issue 11, November-2024 SJIF 2019: 4.702 2020: 4.737 2021: 5.071 2022: 4.919 2023: 6.980 2024: 7,662

7. 7.Becketti, Sean, and Charles Morris. "Are Bank Loans Still Special?" Economic Review, Federal Reserve Bank of Kansas City, Third Quarter, 1992, pp. 71-84.

8. 8. Black, Bernard S. "The Value of Institutional Investor Monitoring: The Empirical Evidence," UCL4 Law Review, vol. 39, no. 4, 1992, pp. 859-939. . "Agents Watching Agents: The Promise of Institutional Investor Voice," UCLA Law Review, vol. 39, no. 3, 1992, pp. 813- Black, F. "Bank Funds Management in an Efficient Market," Journal of Financial Economics, VOI. 2, 1975, pp. 323-39.