



WAYS TO IMPROVE PRUDENTIAL REGULATION IN ENSURING THE FINANCIAL STABILITY OF THE BANKING SECTOR

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Abstract: This study examines the current state of prudential regulation in ensuring the financial stability of the banking system of Uzbekistan, identifies existing deficiencies in the regulatory framework, and presents scientifically grounded recommendations for their elimination. Drawing on the CAMELS methodology, Basel III standards, and international best practices, the study delineates pathways for improving prudential supervision.

The research findings demonstrate that, while the banking system of Uzbekistan broadly conforms to international capital adequacy standards, further improvements are required in the areas of macroprudential supervision, stress-testing methodology, and the management of banking risks in the context of ongoing digitalization.

Introduction

The transformations occurring in the global financial system, driven by the forces of globalization and digital transformation, expose the banking sector to unprecedented threats and vulnerabilities. In particular, the global financial crisis of 2008–2009 and the economic consequences of the COVID-19 pandemic of 2020 underscored the critical importance of maintaining a high level of resilience within banking systems worldwide.

Prudential regulation of banking activity occupies a position of particular significance as a regulatory mechanism designed to preserve the financial stability of commercial banks, safeguard the interests of depositors, and prevent systemic risks. The effectiveness of this regulatory framework largely determines the overall stability of the banking system.

Conceptual Framework and International Standards

Prudential regulation (from Latin *prudencia* — foresight) constitutes a system of requirements, standards, and restrictions established by the state with the objective of ensuring the stable operation of banking institutions. Contemporary banking literature distinguishes two principal levels of prudential supervision:

1. Micro prudential supervision — directed at ensuring the financial soundness of individual banking institutions.
2. Macroprudential supervision — aimed at preserving the stability of the banking system and the financial sector as a whole.

The second level of supervision gained particular prominence following the financial crisis of 2008, as empirical evidence demonstrated that systemic instability could emerge at the aggregate level even when individual banks remained individually sound, with the potential to trigger a chain-reaction collapse of the entire system.

The international framework for prudential banking regulation has been developed by the Basel Committee on Banking Supervision (BCBS). This framework evolved through three successive stages:

- Basel I (1988) — the first international standard on bank capital ratios, establishing a minimum Capital Adequacy Ratio (CAR) of 8%;
- Basel II (2004) — a three-pillar framework encompassing minimum capital requirements, supervisory review processes, and market discipline;
- Basel III (2010–2017) — enhanced capital and liquidity requirements, along with systemic risk buffers.

Table 1. Comparative Analysis of Basel II, Basel III Standards and the Practice of Uzbekistan

Requirement	Basel II	Basel III	Uzbekistan (as of 2024)
Minimum CAR (%)	8%	10.5%	13%
Tier 1 Capital (%)	4%	8.5%	10%
Capital Conservation Buffer	None	2.5%	Being implemented
LCR (Liquidity)	Not required	100%	100%
NSFR (Stable Funding)	Not required	100%	100%
Countercyclical Buffer	None	0–2.5%	Under development

** Compiled by the author based on research findings.*

The foregoing table clearly illustrates the degree of compliance of the Uzbekistan banking system with international capital adequacy standards. With respect to capital requirements, Uzbekistan maintains a position exceeding Basel III thresholds. Whereas Basel III requires a Capital Adequacy Ratio (CAR) of 10.5%, the corresponding requirement in Uzbekistan stands at 13%. Similarly, Tier 1 capital requirements are set at 10% domestically, compared to the international benchmark of 8.5%. This reflects a regulatory approach grounded in the precautionary principle and serves to reinforce the resilience of the banking system to adverse shocks.

With regard to liquidity requirements, the situation is somewhat different. The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) have been fully implemented at the Basel III-prescribed level of 100%. However, the capital conservation buffer and the countercyclical capital buffer have not yet been fully operationalized.

Current State of the Banking System of Uzbekistan

The banking system of Uzbekistan has demonstrated considerable growth as a result of the reforms implemented since 2017. The privatization of state-owned banks has been initiated, the share of private banks has increased, and the participation of foreign investors has expanded.

Table 2. Dynamics of Key Indicators of the Banking System of Uzbekistan (2020–2024)

Indicator	31.12.20	31.12.21	31.12.22	31.12.23	31.12.24
Number of Banks	32	33	34	35	37
Total Assets (trillion UZS)	366.1	444.9	556.7	652.2	769.3
Capital Adequacy Ratio (CAR, %)	18.4	17.5	17.8	17.5	17.4
Non-Performing Loans (NPL, %)	2.1	5.2	3.6	3.5	4.0
Liquidity Coverage Ratio (LCR, %)	224.5	189.6	211.6	164.8	193.8
Return on Assets (ROA, %)	2.2	1.3	2.5	2.6	1.4
Return on Equity (ROE, %)	10.3	6.1	13.3	14.2	6.6

** Compiled by the author based on official statistical data of the Central Bank of the Republic of Uzbekistan and research findings.*

The data presented in Table 2 indicate that total assets of the banking system grew from UZS 366.1 trillion to UZS 769.3 trillion over the period 2020–2024, representing a 2.1-fold increase. The Capital Adequacy Ratio (CAR) remained stable within the range of 17.4%–18.4%, substantially exceeding the minimum prudential requirement of 13% established for banks.

The share of non-performing loans (NPL) increased by 1.9 percentage points relative to the 2020 level of 2.1%. The Liquidity Coverage Ratio (LCR) remained well above the 100% threshold throughout all reporting years, reaching 193.7% by end-2024.

The Central Bank of the Republic of Uzbekistan, as the principal prudential supervisory authority and regulatory body, has established the following core prudential standards: a minimum Capital Adequacy Ratio (CAR) of 13%; a minimum Tier 1 capital ratio of 10%; a minimum Liquidity Coverage Ratio (LCR) of 100%; and a concentration limit on large credit exposures not exceeding 25% of capital per single borrower.

Identified Deficiencies in the Prudential Regulatory Framework

An analysis of compliance with prudential supervisory requirements in the Republic of Uzbekistan has identified a number of areas requiring further improvement:

- The macroprudential supervisory framework remains incompletely formed, and no specific prudential standards exist for systemically important banks;

- The countercyclical capital buffer mechanism has not yet been operationalized;
- No dedicated prudential requirements exist to address the risks associated with banks' digital services and operations;
- Excessive reliance on manual processes in the collection and analysis of data related to banking operations.

Recommendations for Strengthening Prudential Regulation

Drawing lessons from the global financial crisis is of paramount importance for enhancing the role of macroprudential supervision in ensuring systemic stability within the banking system of Uzbekistan. The following measures are recommended to strengthen macroprudential policy under Uzbekistan's conditions:

1. Establishment of a Register of Systemically Important Banks

Introduction of a system for identifying systemically important banks based on their asset size, degree of interconnectedness, and substitutability. Banks designated as systemically important shall be required to maintain an additional capital buffer of 1.0%–2.0%.

2. Implementation of the Countercyclical Capital Buffer Mechanism

Imposing a requirement on banks to accumulate additional capital in the amount of 0%–2.5% during periods of economic expansion, while permitting the drawdown of this buffer during periods of financial distress, would mitigate risks to the banking system.

3. Digital Transformation of Prudential Supervision

Digital technologies offer the potential to fundamentally transform the effectiveness of prudential supervision. International experience increasingly demonstrates the application of RegTech (regulatory technology automating compliance by banks) and SupTech (supervisory technology enabling real-time monitoring by regulatory authorities) solutions.

4. Strengthening Corporate Governance and Transparency

International experience demonstrates that the quality of corporate governance within banks plays a critical role as a structural component of prudential supervision. The following measures are recommended:

- Increasing the proportion of independent directors on bank boards to at least 40% of total board members;
- Mandating the establishment of independent risk management committees within banks;
- Full implementation of financial reporting in accordance with International Financial Reporting Standards (IFRS);
- Expanding the public disclosure of financial data by banks.

Conclusion

The implementation of the recommendations derived from this research would enhance the financial stability of the banking system of Uzbekistan, increase its attractiveness to international investors, and broaden the capacity to prevent systemic financial risks. The findings confirm that while Uzbekistan has made significant strides in aligning its prudential regulatory framework with international standards, targeted reforms in macroprudential supervision, countercyclical buffer mechanisms, and

digital regulatory infrastructure remain essential for achieving a resilient and internationally integrated banking system.

References

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