



REDUCING NON-PERFORMING LOANS IN COMMERCIAL BANKS: A COMPARATIVE ANALYSIS OF INTERNATIONAL EXPERIENCE AND UZBEKISTAN

Salixova Guzal
Tashkent International University
ORCID: 0009-0000-2802-7481
gozal.trad@gmail.com

ABSTRACT	KEYWORDS
<p>Problem loans, also known as non-performing loans, are one of the main challenges faced by commercial banks as they have a direct impact on efficiency and financial stability. A high level of problem loans reduces bank profitability, weakens capital adequacy, and limits the ability of banks to provide credit to the economy. In recent years, many countries have implemented effective measures to reduce the share of problem loans through regulatory reforms, improved credit risk management, and the use of special institutional mechanisms.</p>	<p>Problem loans, non-performing loans, commercial banks, credit risk management, international experience, banking reforms, financial stability.</p>

Introduction

The stability of the banking sector is a fundamental component of a country’s financial system and overall economic development [1]. Banking sector stability also plays a crucial role in ensuring the smooth functioning of financial intermediation in the economy. A stable banking system supports sustainable economic growth by efficiently allocating financial resources, facilitating investment activities, and maintaining public confidence in financial institutions. Conversely, instability in the banking sector may lead to disruptions in credit flows, loss of investor confidence, and broader macroeconomic imbalances. One of the main threats to banking stability is largely depend on the quality of its loan portfolio. Loans constitute the largest share of banks’ assets, therefore, any deterioration in their quality directly affects financial performance. Problem loans, commonly defined as loans with overdue payments exceeding 90 days, increase credit risk and require higher provisions, reducing banks’ ability to extend new credit [2]. Global economic uncertainty, including the 2008 crisis and the COVID-19 pandemic and tightening monetary conditions, has affected borrowers’ repayment capacity and increased pressure on banks’ asset quality however, many countries experienced sharp increases in problem loans due to declining incomes and business disruptions [3]. As a result, reducing NPLs has become a priority for regulators and commercial banks worldwide. Foreign experience demonstrates that effective NPL management requires a combination of sound regulation, strong internal bank practices, and supportive legal frameworks [4]. At the same time, emerging economies, including Uzbekistan, are actively reforming their banking sectors to align with

international standards and improve credit portfolio quality [5]. These reforms are aimed at strengthening risk management practices, increasing transparency in banking operations, and enhancing regulatory oversight in accordance with global financial standards. In particular, the introduction of modern credit risk assessment methods, improvement of loan monitoring systems, and the implementation of international banking regulations contribute to reducing the level of non-performing loans and ensuring the long-term stability of the banking sector. Additionally, recent data show that several banking systems managed to reverse this trend through effective regulatory and institutional reforms. In 2023–2024, advanced economies reduced average NPL ratios to historically low levels, while many emerging markets continued gradual improvement [6].

Analysis of Literature on the Topic

The issue of non-performing loans (NPLs) in commercial banks has been widely studied in academic literature and international financial reports. Many researchers emphasize that a high level of NPLs negatively affects the stability, profitability, and lending capacity of banks. Studies show that effective credit risk management, proper borrower assessment, and strong regulatory frameworks play an important role in reducing problem loans.

Several international organizations, including the International Monetary Fund and the World Bank, highlight that improving risk management systems and strengthening banking supervision are essential measures for controlling NPL levels. According to the International Monetary Fund, a banking system is considered vulnerable when the NPL (non-performing loans) ratio exceeds 5 percent, as this level significantly increases systemic risk [7].

Local scholars have also conducted extensive research on the theoretical foundations, practical approaches, and mechanisms for managing credit risk and reducing problem loans. In particular, according to the study by A. Norov, S. Shaxiddinonov, and N. Norova (2023) [8], in a period when lending activities are expanding rapidly, the timely repayment of loans and interest to commercial banks becomes critically important. Delays in loan repayment can lead to systemic credit risk, causing loans to become non-performing. This, in turn, negatively affects the bank's liquidity, profitability, and overall financial resources.

Furthermore, recent studies suggest that early identification of credit risk, regular monitoring of loan portfolios, and timely restructuring of distressed loans are effective tools for preventing the growth of NPLs. In the context of Uzbekistan, researchers also emphasize the importance of adopting international best practices and strengthening institutional frameworks to improve the quality of bank loan portfolios.

Research Methodology

This study examines the issue of reducing non-performing loans in commercial banks by analyzing international experience and the banking practices of Uzbekistan. In the research process, methods such as comparative analysis, statistical analysis, and a systematic approach were applied. Based on international practices and academic sources, the factors influencing the formation of non-performing loans were analyzed. In addition, available data on the structure of commercial banks' loan portfolios and the level of non-performing loans were reviewed. The results of the study provide several recommendations aimed at reducing non-performing loans and improving the effectiveness of credit risk management in commercial banks.

Analysis and Discussion of Results

Problem loans emerge due to both macroeconomic and bank-specific factors, including economic downturns, weak borrower assessment, and poor credit monitoring systems. Research conducted by the World Bank shows that rapid credit expansion without adequate risk control significantly increases NPL ratios in commercial banks [9]. Many developed countries have addressed this issue by strengthening prudential regulation and supervisory oversight. For instance, the European Union introduced stricter capital adequacy and loan provisioning requirements under Basel III to ensure early recognition of credit losses. The adoption of the Expected Credit Loss (ECL) model under IFRS 9 has further improved transparency by requiring banks to provision for potential losses before loans become non-performing [10]. Under IFRS 9, loans are classified into three stages (Stage 1, Stage 2, and Stage 3) based on the level of credit risk. Stage 1 includes financial assets for which no significant increase in credit risk has been observed since initial recognition. Stage 2 represents assets where credit risk has increased significantly. Stage 3 includes loans that are already in default. In this classification, Stage 2 can serve as an early warning indicator prior to the formation of non-performing loans.

Research shows that an increase in the share of Stage 2 loans may lead to a future rise in the level of non-performing loans (NPLs). Therefore, the Expected Credit Loss (ECL) model introduced under IFRS 9 should not be considered merely as an accounting calculation mechanism, but also as a proactive credit risk management tool that helps banks reduce problem loans.

As a result, in European Union the average non-performing loan ratio declined from more than 6 percent in 2014 to approximately 1.8 percent in 2023 [11]. Furthermore, these regulatory and accounting reforms have significantly improved the resilience of banking systems in developed economies. By encouraging banks to recognize credit risks at an earlier stage and maintain sufficient capital buffers, regulators have been able to reduce the likelihood of systemic banking crises. As a result, banks in the European Union have strengthened their balance sheets, improved risk management practices, and increased their capacity to support sustainable economic growth even during periods of financial uncertainty.

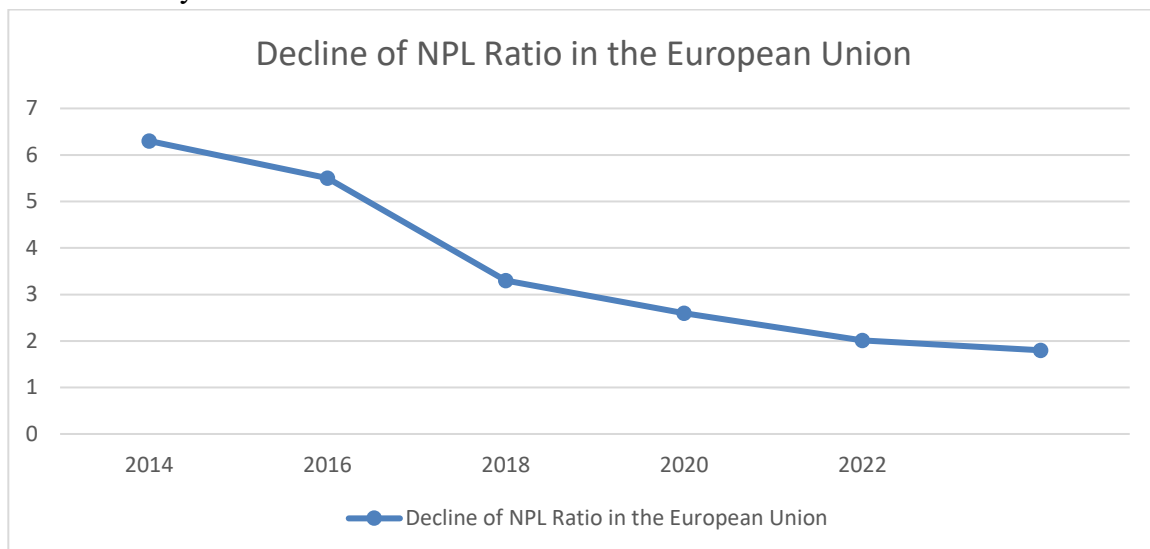


Figure 1. Decline of Non-Performing Loan Ratio in the European Union (2014-2023)

Source: European Central Bank Statistics [12].

International experience shows that central banks play a crucial role in monitoring asset quality through stress testing and regular inspections. Countries with independent and well-resourced supervisory

authorities tend to maintain lower NPL ratios compared to those with weak enforcement mechanisms. These regulatory measures create incentives for banks to improve internal risk management and reduce excessive risk-taking [13]. In contrast, many emerging economies continue to record higher NPL ratios due to weaker enforcement mechanisms and less developed legal systems. According to World Bank data, the average NPL ratio in developing countries remained close to 4–5 percent in 2023. This difference highlights the importance of strong supervisory institutions and transparent reporting standards [14].

Practical Foreign Mechanisms and Comparative Analysis

In many countries, strategies to reduce NPLs often involve a mix of credit risk management improvements, asset resolution frameworks, and institutional mechanisms such as Asset Management Companies (AMCs). AMCs are designed to purchase non-performing assets from banks and manage them through specialized processes, thereby helping to “clean up” bank balance sheets [15]. Research by international financial institutions suggests that the implementation of AMCs, especially when combined with secondary markets for distressed debt, is associated with significant annual reductions in NPL stocks—often around 15 % or more per year in extended reform periods.

Secondary markets for NPLs also play an important role. By enabling the sale and transfer of distressed loans to investors and specialist servicers, these markets improve price discovery and mobilize private capital to absorb bad assets, complementing AMC activities.

In addition to regulation, foreign experience emphasizes practical mechanisms used by commercial banks to reduce existing problem loans. One widely used approach is loan restructuring, which allows borrowers to adjust repayment schedules instead of defaulting. International studies show that timely restructuring significantly improves loan recovery rates and reduces losses for banks [16].

Table 1. Comparative Analysis of Approaches to Reducing Non-Performing Loans [17].

Indicator	International Experience (EU / Developed Countries)	Uzbekistan
Regulatory framework	Strong prudential regulation and strict supervisory requirements under Basel III	Banking regulation is gradually improving under the supervision of the Central Bank of Uzbekistan
Credit risk assessment	Advanced credit scoring models and comprehensive borrower analysis	Traditional financial analysis is mainly used, with gradual introduction of modern risk assessment tools
Accounting standards	Full implementation of IFRS 9 and the Expected Credit Loss model	IFRS 9 standards are being gradually implemented in commercial banks
Early warning systems	Active use of early warning indicators and continuous monitoring of loan portfolios	Monitoring systems exist but require further strengthening and digitalization
Problem loan resolution	Loan restructuring, asset management companies, and secondary markets for distressed assets	Loan restructuring and regulatory measures are used, but the distressed asset market is still developing
Risk management practices	Integrated risk management systems and regular stress testing	Risk management systems are developing, but their effectiveness varies across banks

Furthermore, digital technologies and early warning systems are increasingly used to detect credit deterioration at an early stage. International evidence indicates that banks using automated credit scoring and real-time monitoring tools experience lower growth in problem loans compared to traditional banks. These practices enhance decision-making and allow banks to intervene before loans become non-performing [18]. Another effective mechanism is the establishment of Asset Management Companies (AMCs). China provides a clear example of this approach. In the late 1990s, the NPL ratio in Chinese banks exceeded 30 percent, but after the creation of AMCs, the ratio declined to below 5 percent by the mid-2000s. This allowed banks to clean their balance sheets and resume lending activity [19]. European countries applied similar but market-based solutions. Spain reduced its NPL ratio from 13.6 percent in 2013 to around 3 percent in 2023 through loan sales, restructuring, and legal reforms. Italy achieved a reduction from 17 percent to below 4 percent over the same period using state-backed guarantees and secondary loan markets [20]. At the same time, Uzbekistan’s banking sector has undergone significant reforms in recent years aimed at improving financial stability and reducing problem loans. According to data from the Central Bank of the Republic of Uzbekistan, the share of non-performing loans declined from 4.2 percent in 2022 to approximately 3.0 percent by the end of 2024, indicating a gradual improvement in loan portfolio quality [21].

Table 2. Comparison of NPL Ratios: Foreign Experience and Uzbekistan (%)

Indicator	EU (2024)	Emerging markets average	Uzbekistan (2024)
NPL Ratio	1.8	5.5	3.0

Source: ECB; Central Bank of the Republic of Uzbekistan [22].

Compared to developed economies, Uzbekistan’s NPL ratio remains higher; however, it is significantly below the average level observed in many emerging markets. This suggests that recent reforms have had a positive impact, although further improvements are needed.

The legal basis for credit risk management in Uzbekistan is defined by the Law of the Republic of Uzbekistan “On Banks and Banking Activity”, which establishes banks’ responsibility for maintaining loan quality and managing risks. In addition, the Law “On the Central Bank of the Republic of Uzbekistan” strengthens supervisory oversight and prudential regulation [23]. These legal norms align with international standards and support the gradual reduction of problem loans. In recent official policy statements, the President of the Republic of Uzbekistan has emphasized the importance of strengthening financial discipline, improving credit allocation, and reducing problem loans as priorities of banking sector reform [24]. In response, commercial banks have expanded the use of credit history databases, digital monitoring systems, and internal risk assessment tools.

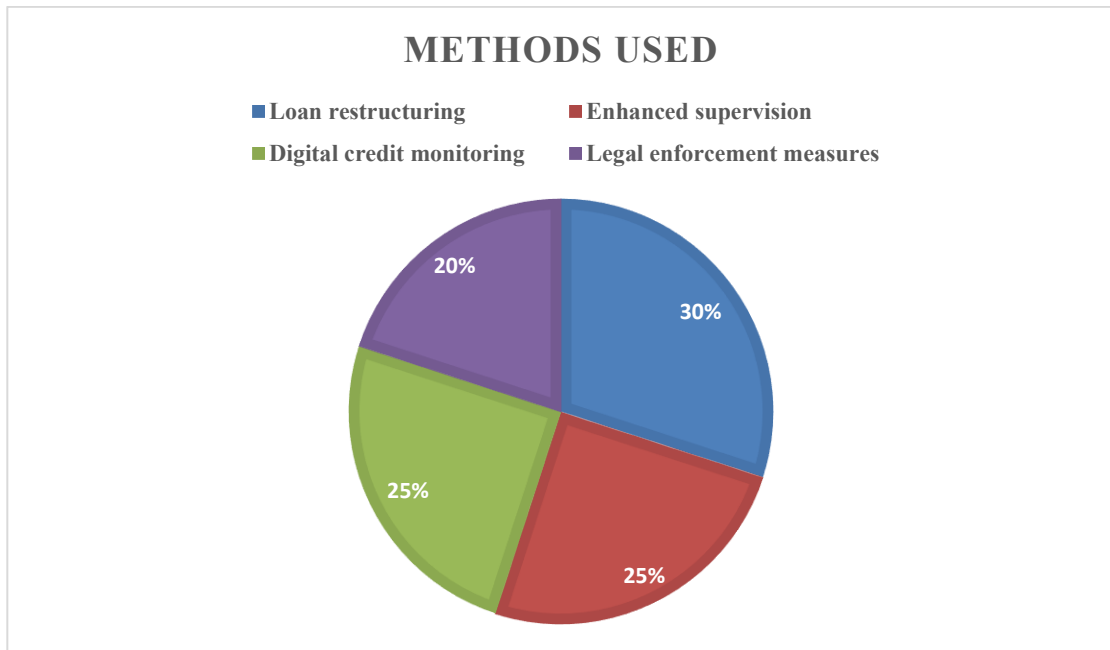


Figure 2. Main Approaches to Reducing Problem Loans in Uzbekistan

Source: Compiled by the reports of the Central Bank of the Republic of Uzbekistan [25].

The pie chart illustrates the distribution of methods employed by banks and regulatory authorities to mitigate non-performing loans (NPLs), highlighting four key strategies: loan restructuring, enhanced supervision, digital credit monitoring, and legal enforcement measures. Loan restructuring accounts for the largest share at 30%, indicating that banks prioritize reorganizing debt repayment schedules, renegotiating terms, or providing temporary relief to borrowers to allow them to resume timely payments and improve asset quality. This prominence underscores the effectiveness of restructuring in directly addressing borrowers’ repayment capacity without resorting to punitive measures. Enhanced supervision represents 25% of the methods used, reflecting stricter oversight of bank lending practices, regular inspections, and continuous monitoring of loan portfolios. By identifying high-risk loans early, banks can take proactive measures to prevent the growth of NPLs. Digital credit monitoring also accounts for 25%, showing the increasing reliance on technology-driven solutions such as automated systems, credit scoring algorithms, and real-time tracking, which enable timely interventions and align with international trends in digital credit risk management. Legal enforcement measures, comprising the smallest share at 20%, include litigation, collateral repossession, or government-backed recovery mechanisms, which, while necessary in some cases, are more reactive and time-consuming compared to proactive strategies like restructuring and monitoring. Overall, the chart demonstrates a balanced approach to NPL reduction, emphasizing preventive and rehabilitative measures over purely punitive actions, and suggests that banks, including those in Uzbekistan, could further reduce NPL levels efficiently by expanding digital monitoring tools, structured loan restructuring programs, and strengthening supervisory frameworks.

The figure demonstrates that Uzbekistan places greater emphasis on preventive and supervisory measures compared to some foreign countries, where large-scale asset sales are more common. This approach reflects national economic conditions and the current stage of financial sector development.

Conclusion

Foreign experience confirms that sustainable reduction of problem loans requires a comprehensive approach combining regulation, supervision, and effective credit risk management. Countries that introduced early recognition of credit risk and institutional mechanisms for resolving distressed assets achieved long-term improvements in banking stability. The comparison with Uzbekistan shows that recent reforms and legal measures are generally consistent with international best practices. The decline in non-performing loan ratios indicates positive progress; however, continued efforts are necessary to further strengthen asset quality and approach the levels observed in advanced banking systems. Overall, adapting foreign experience to national conditions remains a key factor in ensuring financial stability and supporting economic growth.

In comparison, Uzbekistan has made notable strides in recent years by strengthening banking regulation, enhancing legal measures for asset quality management, and gradually implementing international standards. The observed decline in NPL ratios indicates positive progress. However, further targeted measures are necessary to bring the banking sector in line with international best practices.

Based on these findings, the following recommendations can be proposed for commercial banks in Uzbekistan:

- 1. Strengthen early warning systems:** Expand the use of predictive indicators and advanced credit scoring models to identify loans at risk before they become non-performing.
- 2. Enhance credit risk management frameworks:** Develop integrated risk management systems that combine ICAAP, stress testing, and ECL calculations for proactive decision-making.
- 3. Implement timely loan restructuring mechanisms:** Establish clear procedures for restructuring distressed loans, including flexible repayment plans and legal safeguards.
- 4. Promote institutional capacity building:** Train bank staff in modern risk management practices and ensure that specialized units handle problem loans efficiently.
- 5. Adopt digital monitoring tools:** Leverage technology to continuously monitor loan portfolios, detect early signs of credit deterioration, and streamline reporting to regulators.
- 6. Align with international best practices:** Regularly benchmark domestic banking practices against global standards to ensure ongoing improvements in asset quality and financial stability.

By combining these measures with continued regulatory reforms and careful adaptation of foreign experience to national conditions, Uzbekistan's banking sector can achieve a sustainable reduction in NPLs, strengthen financial stability, and support long-term economic growth.

References:

1. International Monetary Fund (2023). Global Financial Stability Report.
2. World Bank (2022). Non-Performing Loans and Financial Stability.
3. BIS (2022). Annual Economic Report.
4. Basel Committee on Banking Supervision (2021). Basel III Reforms.
5. World Bank (2023). Emerging Market Banking Systems.
6. IMF (2024). Global Banking Trends.
7. IMF (2021). Financial Soundness Indicators Compilation Guide.

8. Norov, A., Shaxiddinonov, S., & Norova, N. (2023). Mechanisms for reducing the risks of loans issued by commercial banks. In *Priority Directions, Modern Trends and Prospects for the Development of the Financial Market* (pp. 134–135).
9. World Bank. *Global Financial Development Report 2019/2020: Bank Regulation and Supervision a Decade after the Global Financial Crisis*. Washington, DC: World Bank, 2019.
10. International Accounting Standards Board (IASB). *IFRS 9 Financial Instruments*. London: IFRS Foundation, 2018.
11. European Central Bank. *Financial Stability Review*. Frankfurt am Main: ECB, 2024.
12. European Central Bank Statistics
13. Basel Committee on Banking Supervision. *Principles for Supervisory Stress Testing*. Basel: Bank for International Settlements, 2022.
14. World Bank. *World Development Indicators: Bank Nonperforming Loans (% of total gross loans)*. World Bank Database, 2023.
15. *Asset Management Companies and NPL Resolution*. <https://ipafasia.org/uploads/Activities-Public-Docs/2021-1st%20-ADB-NPL-Virtual-Training/Week-3/Session%2012%20-%20AMCs.pdf>
16. International Monetary Fund. *Resolving Nonperforming Loans: Policies and Practices*. IMF Staff Discussion Note. Washington, DC, 2017.
17. Author's compilation.
18. McKinsey & Company. *Global Banking Annual Review*. McKinsey Global Institute, 2022.
19. World Bank. *China: Asset Management Companies and Nonperforming Loan Resolution*. Policy Research Working Paper. Washington, DC, 2006.
20. European Banking Authority. *Risk Assessment of the European Banking System*. Paris: EBA, 2024.
21. Central Bank of the Republic of Uzbekistan. *Financial Stability Review*. Tashkent, 2024.
22. ECB; Central Bank of the Republic of Uzbekistan
23. Law of the Republic of Uzbekistan “On Banks and Banking Activity”. Lex.uz.
24. President of the Republic of Uzbekistan. *Address to the Oliy Majlis on Banking Sector Reform*. Official website of the President of Uzbekistan, 2023–2024.
25. Compiled by the reports of the Central Bank of the Republic of Uzbekistan