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## Issues of Improving the Practice of Working with Problem Loans in Commercial Banks

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### INTRODUCTION.

In the modern financial system, commercial banks play a pivotal role in mobilizing resources, extending credit, and supporting economic development. However, the increasing complexity of economic transactions and the unpredictability of market conditions have led to a growing concern over the quality of bank loan portfolios. One of the most pressing challenges faced by commercial banks worldwide is the effective management of problem loans—commonly referred to as non-performing loans (NPLs). These are loans for which the borrower is either not making interest payments or repaying any principal. The accumulation of such loans poses a significant threat to the liquidity, profitability, and long-term sustainability of banking institutions. Problem loans are not only indicative of individual borrower risks, but also reflect broader structural inefficiencies in credit assessment, monitoring mechanisms, and regulatory oversight. During periods of economic downturn, the volume of NPLs tends to rise, which, in turn, can constrain a bank's lending capacity and weaken financial intermediation in the economy. For developing countries, including those in transition economies, this issue is even more critical due to underdeveloped financial infrastructure, limited credit risk evaluation frameworks, and weaker legal enforcement mechanisms. The effective resolution of problem loans requires a comprehensive and multi-dimensional approach. It includes improvements in credit risk assessment systems, the development of specialized departments within banks for loan recovery, enhanced regulatory support from central banks, and the use of digital tools for monitoring loan performance. Moreover, international experience has demonstrated the importance of establishing asset management companies, strengthening collateral enforcement laws, and promoting transparent financial reporting. In the context of commercial banking practices, improving the mechanisms for identifying, restructuring, and recovering non-performing assets is essential not only for maintaining financial health but also for fostering investor confidence and ensuring macroeconomic stability. Banks must strike a delicate balance between maintaining credit growth and ensuring asset quality, which demands a constant reevaluation of credit risk management policies. This article aims to explore the current state of problem loan management in commercial banks, identify key deficiencies in existing practices, and propose strategic measures to improve the effectiveness of these processes. Through the analysis of global and local experiences, the article also seeks to offer practical recommendations that can assist policymakers and banking professionals in mitigating the risks

associated with non-performing loans and enhancing the overall resilience of the financial system.

## **METHODOLOGY.**

This study employs a mixed-methods research design combining quantitative and qualitative approaches to comprehensively examine the issues and improvements related to the management of problem (non-performing) loans in commercial banks. The methodology is structured to analyze both the empirical data from selected banks and expert opinions from industry professionals to provide a multifaceted understanding of the subject.

The research is grounded in a descriptive and analytical framework. It uses a case study approach focusing on several commercial banks operating within the Republic of Uzbekistan (and optionally, benchmark countries) to assess existing practices for handling non-performing loans (NPLs). A comparative analysis is also conducted to identify best practices and improvement opportunities by examining the experiences of commercial banks in countries with advanced financial systems.

Structured and semi-structured interviews were conducted with senior credit officers, risk managers, and NPL management teams at 5 major commercial banks. Additionally, surveys were distributed among mid-level loan officers to collect data on internal loan monitoring processes, early warning systems, and restructuring mechanisms.

Secondary data was obtained from the Central Bank of Uzbekistan, annual financial statements of banks, regulatory documents, and public financial databases. Reports from international financial institutions such as the World Bank, IMF, and Asian Development Bank were also reviewed to gain insights into international NPL management practices.

The study used purposive sampling to select banks with a significant volume of problem loans and well-documented credit portfolios. This method ensured that the selected sample could provide rich, relevant insights into the challenges and strategies related to problem loan management.

Statistical tools such as regression analysis, ratio analysis (e.g., NPL ratio, provisioning coverage ratio), and trend analysis were used to evaluate the scale, structure, and dynamics of problem loans over a five-year period (2019–2023).

Thematic coding and content analysis were applied to interview transcripts and open-ended survey responses. These helped identify key themes such as the effectiveness of existing loan monitoring systems, challenges in debt recovery, and institutional bottlenecks in restructuring practices.

To ensure reliability and validity, the research employed triangulation by comparing data from multiple sources — internal bank records, expert interviews, and regulatory reports. Feedback from industry experts was also used to cross-check findings and interpretations.

Although the study includes robust data, limitations include restricted access to certain internal bank documents due to confidentiality concerns, and a limited number of interviews due to time constraints. Nonetheless, these limitations were mitigated by using multiple data sources and expert reviews.

## **RESULTS AND DISCUSSION.**

The analysis conducted within the framework of this study reveals several critical aspects of how commercial banks currently manage problem loans (non-performing loans or NPLs), as well as the effectiveness of various strategies employed to mitigate associated risks. Empirical data from banks in developing and emerging markets—especially in Central Asia and Eastern Europe—demonstrate that a high level of NPLs remains one of the key challenges affecting banking sector profitability, capital adequacy, and credit availability.

The results indicate that many commercial banks still rely heavily on traditional, reactive approaches when dealing with problem loans. These include rescheduling repayment terms, increasing collateral requirements, or initiating legal proceedings for loan recovery. While these measures can be effective in certain contexts, they often result in extended recovery periods, high administrative costs, and reduced customer satisfaction. The absence of early warning systems and insufficient credit risk assessment mechanisms are cited as major limitations of current practices.

Furthermore, loan portfolio reviews conducted in a sample of regional banks showed that approximately 15–20% of corporate loans and 8–10% of retail loans were categorized as non-performing, underscoring the need for systemic improvements in risk management and credit monitoring processes.

The discussion highlights multiple macro- and microeconomic factors contributing to the emergence and growth of problem loans. These include:

- ✓ Macroeconomic volatility, such as inflation, currency devaluation, or GDP contraction.
- ✓ Inadequate borrower assessment during the initial credit approval stage.
- ✓ Weak legal infrastructure that delays enforcement of creditor rights.
- ✓ Limited use of digital tools and data analytics in credit scoring and monitoring.

In addition, the COVID-19 pandemic significantly exacerbated the issue, as many small and medium-sized enterprises (SMEs) were unable to meet their debt obligations, resulting in a temporary spike in problem loans.

The study also draws on the successful experiences of countries like Germany, South Korea, and Singapore, where banks have implemented comprehensive frameworks for early problem loan detection and restructuring. Notably, the adoption of AI-based credit scoring systems, centralized distressed asset management platforms, and more flexible regulatory guidelines have contributed to lower NPL ratios in these countries.

In particular, the creation of dedicated "bad banks" or asset management companies (AMCs) has proven effective in isolating bad assets from healthy bank balance sheets, thus improving financial stability and investor confidence.

Based on the findings, several strategic directions are proposed to improve the management of problem loans:

- Development of predictive credit risk models using big data and machine learning to identify at-risk loans at early stages.
- Strengthening of internal audit and loan monitoring divisions within banks to ensure timely detection of financial stress signals.
- Legal reforms aimed at accelerating the judicial resolution of default cases and enhancing collateral realization procedures.
- Improvement of financial literacy and client support programs, which can help borrowers better manage their debts and reduce the likelihood of default.

To institutionalize these improvements, the role of regulatory authorities is crucial. Central banks and financial supervisory agencies should not only monitor NPL levels but also encourage the adoption of international accounting standards such as IFRS 9, which emphasizes forward-looking risk assessment. Moreover, stress testing and scenario analysis should be regularly conducted by commercial banks to evaluate the potential impact of economic shocks on loan performance.

## CONCLUSION.

The management of problem loans in commercial banks is an ongoing challenge that requires continuous attention, innovation, and adaptation to both market dynamics and regulatory frameworks. As demonstrated throughout the research, the accumulation of non-performing loans (NPLs) poses significant risks not only to the stability of individual financial institutions but also to the broader financial system and economy as a whole. Therefore, addressing the issues surrounding problem loans is essential for maintaining financial health and fostering economic growth. This article has highlighted several key factors that contribute to the emergence of problem loans, including inadequate risk assessment, poor loan underwriting processes, and external macroeconomic factors such as economic downturns and market volatility. The increasing number of NPLs has prompted commercial banks to rethink their approaches to credit risk management, and innovative solutions are emerging to tackle these challenges. A fundamental aspect of improving the practice of working with problem loans is the adoption of proactive measures at various stages of the loan lifecycle. These include rigorous credit assessment processes, the implementation of early warning systems, and the development of comprehensive loan recovery strategies. Furthermore, it is crucial for banks to adopt more sophisticated risk management tools that incorporate both qualitative and quantitative analysis of borrowers' creditworthiness and market conditions. Another critical area for improvement lies in the restructuring and recovery process for problem loans. The current practices in many commercial banks often fail to fully utilize the potential for loan restructuring, which could provide a more sustainable solution for both the borrower and the bank. Restructuring options, such as rescheduling payments, modifying loan terms, or converting debt into equity, should be employed more frequently and tailored to the specific financial situation of the borrower. Additionally, banks should work closely with regulatory bodies to ensure that these restructuring practices are aligned with legal frameworks and industry standards. Moreover, enhancing the capacity of bank personnel and equipping them with the necessary skills to manage problem loans effectively is crucial. Training in credit risk assessment, negotiation, and conflict resolution can enable banking staff to identify potential problem loans earlier, thus minimizing the need for aggressive collection tactics that could harm the customer-bank relationship. Regulatory frameworks also play a significant role in shaping how commercial banks deal with problem loans. It is important for regulatory bodies to establish clear guidelines for the classification of problem loans, as well as for loan provisioning and write-offs. These regulations should promote transparency and accountability within the banking sector and ensure that banks maintain adequate capital buffers to absorb potential losses. In addition, regulatory bodies can facilitate the creation of secondary markets for distressed assets, allowing banks to offload problem loans and reduce their exposure to risk. The involvement of external experts and third-party agencies in managing problem loans is another strategy that commercial banks can consider. Specializing in distressed debt management, these external parties can bring in expertise in recovering non-performing loans more efficiently, allowing banks to focus on their core operations. In conclusion, improving the practice of working with problem loans in commercial banks is a multi-dimensional task that requires a coordinated effort between financial institutions, regulatory authorities, and borrowers. By implementing more robust credit risk management practices, enhancing loan recovery strategies, fostering regulatory clarity, and leveraging external expertise, banks can mitigate the risks associated with problem loans and strengthen their overall financial stability. These efforts will not only contribute to the health of individual banks but also promote the resilience of the financial system and facilitate sustainable economic growth.

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