

# Methods for Qualitative Exploitation of Banking Sector Assets in The Euro Area

Tursunov Rafigali Burgutovich

Head teacher, Andijan State Technical Institute, "Accounting and Management", Uzbekistan

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**Abstract:** This article analyzes the ways to ensure and manage asset quality in the banking sector in the Eurozone area. The study looked at modern approaches such as credit risk reduction, NPL level control, Basel III requirements and stress tests. The experience of the eurozone member states is analyzed and practical approaches to improving the stability of banking assets are identified. In addition, a brief comparison with the banking sector of Uzbekistan was made, recommendations were given on the application of best practices in the national system.

**Keywords:** Banking sector, eurozone, asset quality, credit risk, NPL (non-performing assets), Basel III, banking supervision.

**Introduction:** In recent years, changes in the global financial system have further increased the demand for stability and reliability in the banking sector. The efficiency and safety of the banking system, especially in the euro area, are important drivers of economic growth. The quality of a bank's assets plays a key role in this process. High-quality assets strengthen the financial position of banks, reduce risks and expand lending opportunities.

The standards and procedures developed by the European Central Bank (ECB) and the European Banking Authority (EBA) ensure that banks are subject to stricter supervision. The article analyzes asset quality assurance methods, strategies for dealing with problem assets, and modern approaches used by banks in the region. The article also considers the possibilities of applying the Eurozone experience to the banking sector of Uzbekistan.

Assessment of the quality of bank assets, along with assessment of capital adequacy and liquidity, is one of the important tools for obtaining comprehensive information about the current real state of the bank and assessing its future viability. In most countries, including the Republic of Uzbekistan, such an assessment is carried out during routine supervision (off-site supervision and inspection), but, as a rule, it is carried out not by the measurement method, but by a

selective method. The European Central Bank (ECB) has introduced a systematic approach to assessing the quality of bank assets. In connection with the transfer of the powers of the Single Supervisory Authority to the Single Supervisory Authority over financial market participants of the European Union member states.

The financial crises that have occurred in the European banking sector in recent years have prompted regulators to introduce new and more robust supervisory systems. In particular, the European Central Bank has developed mechanisms to identify and mitigate threats to financial stability [3].

Analyzing and managing the risks taken by banks is crucial for their stability. Basel III standards are aimed at this very purpose and serve to increase banks' resilience to shocks [1].

As Mishkin noted, banks should make decisions taking into account not only internal risks, but also macroeconomic factors [5]. Such an approach ensures the overall stability of the banking system. The role of corporate governance in assessing risks is also of particular importance [8]. The idea that "reforms increase the resilience of the banking sector to shocks" [1, p. 3] is seen as the basis of current regulatory policy. Temporary reduction of capital buffers for banks and establishment of profit distribution rules Done How we are solving As a result of sanctions, banks have faced

difficulties, including limited access to foreign financial markets, blocking of assets, and currency revaluation. For some banks, this may lead to non-compliance with capital adequacy buffers, as well as a decrease in interbank transactions ("stigma effect"). Temporary reduction of buffers will allow banks to gradually recognize the damage caused by sanctions and use the freed up resources for lending. As for profit distribution rules, we see our task in forming additional mechanisms to increase the interest of bank management in maintaining financial stability in times of stress. We have temporarily reduced the capital adequacy buffer and the structural importance buffer of credit institutions and banking groups to zero.

### Relevance of the topic

Today, global economic stability directly affects the functioning of the banking system. In particular, in the context of the financial risks faced by banks in the euro area, the growth of non-performing assets in loan portfolios and market turmoil, the quality management of bank assets has become an urgent issue. The 2008 financial crisis and the COVID-19 pandemic in 2020 served as important lessons for banks in the Eurozone and highlighted the importance of the issue of bank asset quality.

The stability of the banking system, confidence in the economy, and the investment climate largely depend on the quality of assets. Therefore, there is a great need to study the best practices of the Eurozone and apply them to other countries, especially in the banking sector of Uzbekistan. The study of this topic is of practical importance in terms of minimizing bank risks, improving the loan portfolio, and increasing the efficiency of banking activities.

### The main purpose of the study

To analyze the most effective methods and quality of asset management in the Eurozone banking sector, determine their economic efficiency, and assess the possibility of applying this experience in the banking sector of Uzbekistan.

### scientific research tasks

Study the structure and mechanism of the banking system in the Eurozone, understand the quality of bank assets and the factors affecting it, analyze methods and mechanisms aimed at improving asset quality (NPL, Basel III, stress tests), compare and analyze the experience of various Eurozone member states, show differences and similarities based on comparison with the banking sector of Uzbekistan, and develop recommendations for the implementation of advanced international experience in the national banking system.

**Research object.** The department maintains the activities of commercial banks in the euro area (Eurozone) and the structure, quality and management system of their asset portfolios.

**Research topic.** It includes a set of methods, mechanisms and strategies aimed at ensuring and improving the quality of assets by banks in the euro area, including credit risk management, non-performing assets (NPL), [1]: Basel III regulations aim to stabilize the banking system (Basel Committee on Banking Supervision, 2011) [1].

Basel III requirements and other control mechanisms have been introduced.

### Methods used in the scientific article

This study used several scientific and methodological approaches to analyze and assess the quality of banking sector assets. In particular, the following methods were used:

1. Analytical method - an in-depth analysis was conducted based on the asset portfolio, credit quality, risk and other financial indicators of eurozone banks.
2. Comparative method - approaches to the banking system of various Eurozone countries (Germany, Italy, France, Spain, etc.) were compared with the experience of Uzbekistan;
3. Statistical methods – bank asset quality statistics and financial statements were analyzed based on ECB and European Union data;
4. Expert evaluation - assessment of the implementation of scientific articles, reports of international organizations and expert opinions;
5. Inductive-deductive approach - based on general theoretical principles, specific situations are analyzed, conclusions are drawn, and proposals are developed.

### Literature study

researches Researches of Uzbek scientists; [Fattokhova, 2023]: "Asset and liability management by modern banks of Uzbekistan": Eurasian Research Bulletin, 23, 23-30. This article examines the importance and methods of asset and liability management in state commercial banks of Uzbekistan. The author has developed proposals for increasing the liquidity level of banks and reducing risks.

Bank-specific determinants of state-owned bank profitability in Uzbekistan (2023)

Source: International Journal of Research Publication and Reviews, Vol 4, No 8, pp 268-272. The study examines the factors affecting the profitability of state-owned banks. The results show that the increase in the level of non-performing loans (NPL) is negatively

affecting the profitability of banks. The Central Bank's 2022 Financial Stability Report Source: Central Bank of the Republic of Uzbekistan. The report analyzes stress and credit market conditions in the banking system. Recommendations are provided to improve credit quality and ensure capital adequacy.

**Research by foreign scholars and international organizations. Fitch Ratings, 2023:**

"Uzbekistan's Banking Sector: Gradual Transformation Amid Structural Challenges and New Risks". The study analyzes new risks and changes in the Uzbek banking system. In particular, it examines the rapid growth of retail lending and its impact on credit quality. [CERR 2023]: "Rating of banks in Uzbekistan in 2023": The study assesses the key performance indicators and asset quality of banks. It is noted that the share of non-performing loans in the total loan portfolio was 3.8%. Daryo.uz (2023): "Uzbekistan's banking sector: 3.6% problem loans, focus on state-owned banks and the best performers." The study analyzed the level of non-performing loans in state-owned banks and their share in the loan portfolio. It was noted that the NPL rate in some banks reached 8.9%.

The general state of the banking system in the euro area. Banking in the euro area plays an important role in the economic stability of the European Union. The territory of Uzbekistan is united by 20 member states, and financial policy is based on a single currency - the euro. The European Central Bank (ECB) acts as the main regulator and monitors the liquidity, capital adequacy and risk management mechanisms of banks. Although economic growth in the euro area slowed down in 2022-2023, the banking system remained relatively stable. During this period, a sharp increase in inflation and rising interest rates created new challenges for banks. At the same time, the increase in interest rates served to increase profitability in the short term, and banks' net interest income (NII - Net interest income) increased.

More than 100 large banks are directly supervised by the ECB through the Single Supervisory Mechanism

(SSM), an important feature of the European banking system. Other small and medium-sized banks are supervised by national supervisors, but in agreement with the ECB. The stability of the banking sector in the euro area is based mainly on compliance with Basel III standards, the reduction of non-performing loans and the continuous monitoring of liquidity. At the same time, the level of non-performing assets (NPL) is being recorded as a positive development, as the NPL ratio has decreased from 6% in 2015 to an average of 1.8% by 2023.

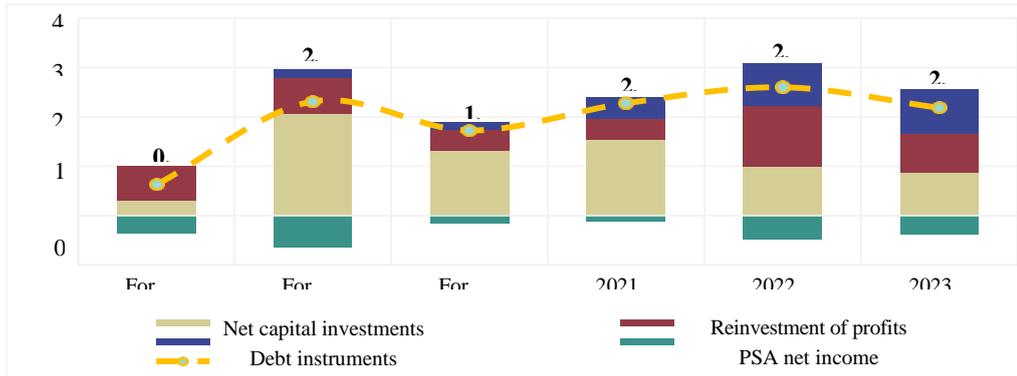
The penetration of digital technologies, ecological finance trends, and increasing interbank competition determine the modern development directions of the banking system in the Eurozone.

In 2023, work continued on aligning the Central Bank's methodology for calculating the capital adequacy ratio with the standards of the Basel Committee. In order to improve the role of microfinance services in the development of entrepreneurship during the reporting years, regulatory and legal documents regulating the activities of non-bank credit organizations were improved, and relevant resolutions of the President of the Republic of Uzbekistan were adopted. According to the resolutions, the main tasks for the period 2024-2026 are to increase the volume of the microfinance market and services, increase the share of individuals in the resource base of microfinance organizations, as well as increase the level of coverage of the population and business entities on the basis of supporting self-employment and business development.

In 2023, the negative balance of portfolio investments amounted to \$995.4 million due to the attraction of foreign portfolio investments in the capital of non-financial institutions, as well as international bonds issued by the government, commercial banks and other enterprises, as well as interest accrued on green Eurobonds.

Meanwhile, debt remains the main source of financing the current account deficit, with revenues growing 57 percent year-on-year to \$7.1 billion in 2022.

**Figure 1**  
**Changes in the composition of foreign direct investment\***



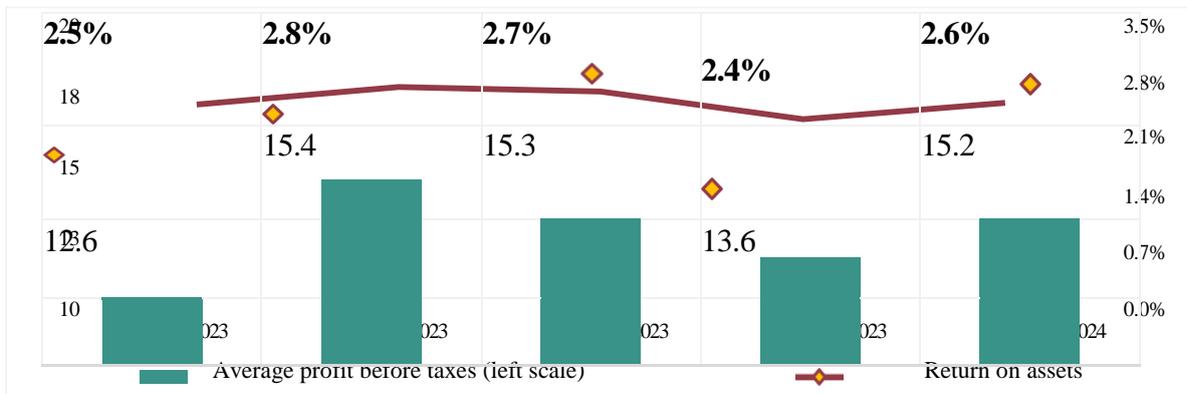
\* Source: Central Bank data

By the end of 2023, the net international investment position of the Republic of Uzbekistan decreased. "Net creditor." In 2023, the volume of total foreign assets increased by 3% to \$84.9 billion, and the total volume of external liabilities increased by 14% to \$72.5 billion. As of January 1, 2024, the country's net international investment position amounted to \$12.4 billion.

In 2023, the net profit of the banking system increased

by 24% compared to 2022 and amounted to 12.4 trillion soums. At the same time, the amount of gross income amounted to 128.7 trillion soums, and the amount of expenses amounted to 116.4 trillion soums. Interest income accounted for 67% of the total income of banks, and non-interest income accounted for 33%. 88.3% of interest income came from loans and obligations of customers, 6.2% from funds placed with other banks, and 5.5% from funds received from securities.

**Figure 2**  
**Analysis of the dynamics of return on assets (ROA) in the banking sector**

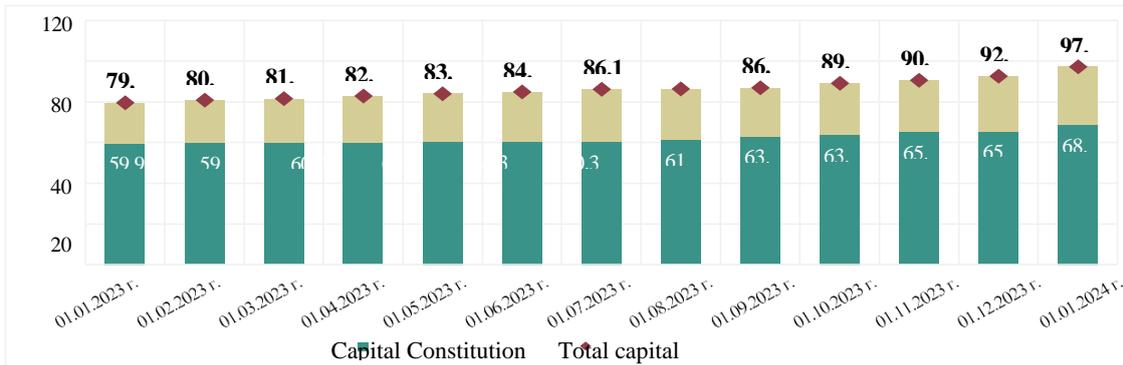


\* Source: Central Bank data.

In 2023, positive changes were observed in the profitability indicators of the banking system. At the end of the reporting year, the profitability of the banking system's assets increased by 0.1 percentage points compared to 2022, to 2.6 percent, and the return on equity increased by 0.9 percentage points to 14.2 percent by the end of the day. In the third quarter of 2023, a decrease in the profitability of the banking

system's assets was observed, which is explained by the creation of additional reserves by some banks in case of possible loss of assets. Mushroom et al. 2019: Money markets and the banking system are closely linked [5]. In 2023 The operational efficiency ratio (CIR) increased by 1 point compared to 2022 and amounted to 34% (the optimal level of this indicator is 50%, its decrease is considered positive).

**Figure 3**  
**\* Analysis of the level of capitalization of the banking sector \***



\* Source: Central Bank data

The increase in CIR compared to the beginning of the year is due to an increase in consulting (digital banking) costs related to the repair and maintenance of some bank buildings and facilities, and insurance of banking services.

In the reporting year, the total capital of banks increased by 22%, amounting to 97 trillion soums at the end of the year, while the authorized capital increased by 15%, amounting to almost 69 trillion soums.

Also, at the end of 2023, the regulatory capital in the banking system amounted to 106 trillion soums, the volume of risk-weighted assets was 604 trillion soums, and the capital adequacy ratio was 17.5% (minimum requirement 13%).

The gross non-performing loan (NPL) ratio of eurozone banks declined further in the first half of 2021, mainly due to the elimination of old NPLs. The gross NPL ratio stood at 2.4% at the end of the second quarter of 2021, down 31 basis points from the end of the previous year, confirming a downward trend observed since 2014. Central banks benefit when they get rid of reserves, 48 total NPL ratios were 3.0%. Greek and Cypriot banks have reduced their NPL ratios by more than 8 percentage points since the start of the pandemic, while in all other euro area countries the change in NPL ratios was still far from pre-pandemic levels (see Special Feature C and Table 3, (See Panel B). At the sector level, NPL ratios remain highest in the corporate portfolio – 4.6% in the second quarter of 2021, driven largely by loans to small and medium-sized enterprises.

Relationship between CIR (Cost-to-Income Ratio) and Bank Buildings. CIR (Cost-to-Income Ratio) is a ratio that measures a bank's operating expenses relative to

its income. It can be calculated with the following formula:

$$CIR = (Costs / Revenue) \times 100 \quad (1)$$

If a bank's CIR index is growing, this means the following:

1. Increased costs – such as maintaining bank buildings, opening new branches, or modernizing technological infrastructure.
2. Higher expenses than revenue growth negatively impact a bank's profitability.

The growth of bank buildings and the increase in CIR can certainly increase the overall costs of the bank. If the bank starts opening new branches or offices:

- Construction and infrastructure costs: Building new buildings, maintaining and modernizing facilities add to the bank's costs. And these costs drive up the CIR.
- Improving service: New buildings can improve a bank's service levels, but this may result in increased temporary costs.

CIR and the digital transformation of banks

Nowadays, many banks are implementing digital technologies, thereby reducing the need for bank buildings. If a bank focuses on developing digital services, it will:

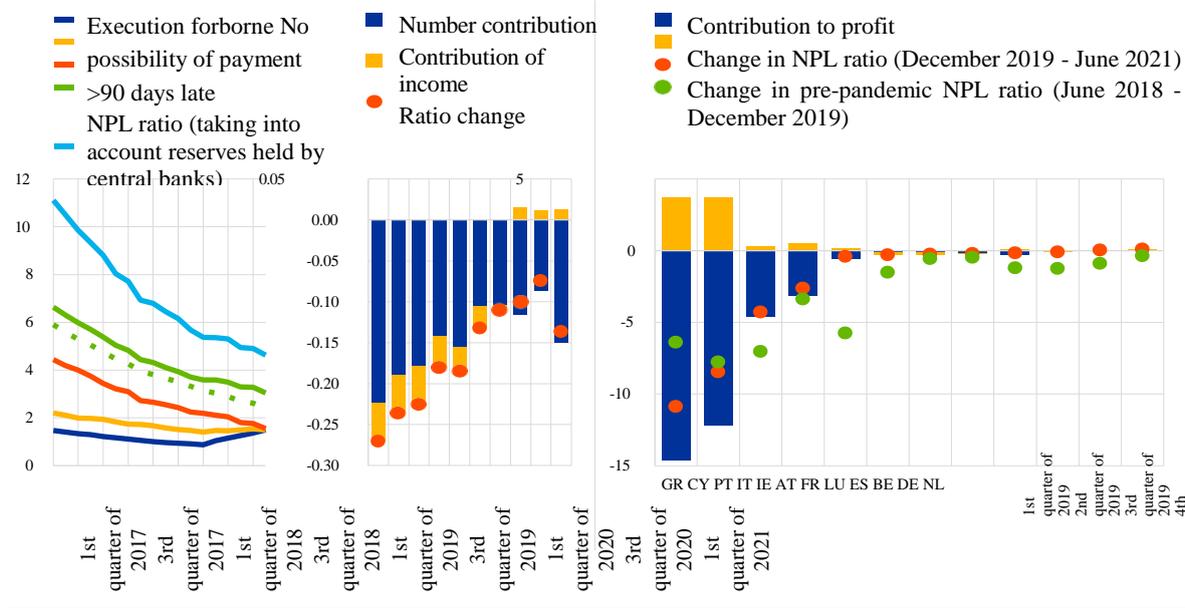
- Reduces costs. Banks can reduce the cost of maintaining branches and buildings.
- Improves CIR. If digital services are expanded, banks will improve customer service efficiency, thereby reducing CIR.

Table 3

Analysis of the Eurozone's overall NPL ratio\*

a) Evolution of Eurozone bank lending  
 b) Performance of NPL ratios over the last four quarters and their contribution to changes across countries in the previous four quarters and the four-quarter ratio After the pandemic began

(left table: 1st quarter 2017-2021, percentage of total loans; (Q2 2018-Q2 2021, percentage points)



Sources: ECB supervisory data and ECB calculations.

Forward-looking credit risk indicators point to a decline in asset quality deterioration in the first half of 2021, albeit heterogeneous across sectors. Following an increase at the start of the pandemic, the increase in implicit credit risk, as measured by net credit flows into Tier 2 asset classes, was greater in the second quarter of 2021 .

CONCLUSION

Reforms in the European banking system have played a significant role in improving the stability of the banking system following the financial crisis. In particular, the introduction of Basel III standards and the establishment of strong supervisory mechanisms by the European Central Bank and the supervisory institutions of the European Bank for Reconstruction and Development have helped to reduce risks and restore confidence. Banks now need to take into account not only the adequacy of capital, but also macroeconomic factors and institutional risks.

Also, effective corporate governance and internal control systems remain important factors in assessing risks. These analyses have once again proven that economic growth and stability of the banking system are interconnected.

Suggestions

1. Expanding unified control standards- It is recommended to develop and implement uniform and strict standards for all financial institutions in the euro area.
2. Strengthening banks' readiness for digital risks- Specific guidelines should be developed to address cybersecurity, AI-based systems, and technological risks.
3. Strengthening risk identification systems- Implementing monitoring systems based on advanced indicators will allow for timely detection of threats.
4. Maintaining a balance between micro and macro control- While banks are monitored at the micro level, approaches to overall stability for the entire financial system are important.
5. Drawing from the experience of Uzbekistan opportunities - based on European experience, it is advisable to gradually introduce Basel III elements into the banking system of Uzbekistan.

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