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THE IMPORTANCE OF THE REQUIREMENTS OF BASEL III IN PROVIDING THE STABILITY OF THE BANKING SYSTEM OF UZBEKISTAN

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Abstract. In the article explained the importance of the requirements of Basel III which helps to improve banking system and keeps it stable. As we see from the article Basel III has extra requirements than previous standards of Basel Committee. Explaining the main features of the banking system of Uzbekistan there were an illustrations of demandable indexes of Basel III for the national practice of commercial banks. Implementation of such kind of new demands for banking system for the first time would difficult for many of participants of banking sphere. However in the future after launching it completely we can see efficiency and beneficial sides of Basel III. Also article shows key of Basel III standard illustrating it by diagrams, charts and tables.
Keywords: Bank, Basel III, indicators, index, Basel Committee, credit, commercial bank, total capital, measurements, liquid asset, national economy, risk, common shares, Buffer Capital, capital of special reserves.

During independence years two-tier banking system has been formed, and being developed regularly in Uzbekistan. For any country to provide the stability banking system is one of the most important objectives. There are several suggestions offered by Basel Committee to regulate banking system, and they are being amended year by year.

In September 2010 Basel Committee launched new more comprehensive standards for bank capital and for its liquidity, and in November the new standards were approved by the Presidents of G-20 countries, in Seoul Summit. These new standards of Basel III are supposed to strengthen the minimum requirements for capital sufficiency in banks step by step. It was expected that banking systems of G-20 countries would start implementing the new standards from 2013, and would meet all changed requirements for capital sufficiency and liquidity norms and would adjust to the new standards proposed by Basel III. A variety of new terms, such as “Buffer Capital” which is used generally for other two terms: conservative and counter-cyclical buffer capital, were introduced in the Basel III requirements for bank capital.

We can find important information about main requirements that are supposed to be applied into practice completely until 2019 in the following table 1. Based on the information given in the table above, we can find out that minimum requirements for Tier 1 capital reach from de facto 4 % to 4.5 % on January 1, 2013, and to 6 % on 1 January, 2019. Moreover, minimum requirement for the predominant form of Tier 1 capital (common shares+ and retained earnings) is 3.5 % in 2013, and from 2015 on this rate is arranged to be 4.5 %. For emergency cases, Capital Conservation Buffer is formed, and its normal is expected to be 2.5 % for 2019. Taking national conditions into consideration, countercyclical capital buffer will be as much as 2.5 % of the predominant form of Tier 1 capital in 2019.

Moreover, according to Basel III banks are allowed to invest in common shares of financial institutions which are unconsolidated at the amount no more than 15 percentage of the capital.

From 2018 on, the remaining part of the 15 percent of investments given above will be discounted up to 100 percent out of capital. According to new suggestions of Basel III, new the requirements for commercial banks’ liquidity are also proposed:

1. **From 1 January, 2015 Liquidity Coverage Ratio (LCR) –**

LCR = High-quality liquid assets/ total net cash outflows over 30 days $\geq$ 100 %

Table 1

The implementation dates of requirements of Basel III for capital sufficiency in banks (valid for related fiscal year, January 1**)**

Indicators	2013	2014	2015	2016	2017	2018	2019
Minimum requirement for the predominant form of Tier 1 capital (common shares+ and retained earnings)	**3,5%**	**4,0%**	**4,5%**	**4,5%**	**4,5%**	**4,5%**	**4,5%**
Capital of special reserves	**-**	**-**	**-**	**0,625%**	**1,25%**	**1,875%**	**2,50%**
Minimum requirement for the predominant form of Tier 1 capital	**3,5%**	**4,0%**	**4,5%**	**5,125%**	**5,75%**	**6,375%**	**7,0%**
Minimum requirement for Tier 1 capital	**4,5%**	**5,5%**	**6,0%**	**6,0%**	**6,0%**	**6,0%**	**6,0%**
Minimum requirement for total capital	**8,0%**	**8,0%**	**8,0%**	**8,0%**	**8,0%**	**8,0%**	**8,0%**
Minimum requirement for total capital+ Capital of special reserves	**8,0%**	**8,0%**	**8,0%**	**8,625%**	**9,25%**	**9,875%**	**10,5%**

2. The Net Stable Funding Ratio(NSFR) from 1 January, 2018

NSFR = the available amount of stable funding / the required amount of stable funding ≥ 100%

Applying the requirements given above into banking system, the following problems may appear:

- By emitting more stocks the amount of common shares increases, attracting investors and causes to decrease the value of stocks because of the accretion in the quantity of stocks.
- Possible contradictions among shareholders for privilege to increase the quantity of retained earnings increase.
- Profitability in the implementation of the new liquidity requirement decreases.
- Crediting capacity (providing loans) of banks decreases.

Undoubtedly, different initiatives are being fulfilled in order to apply the requirements of Basel III into our national banking system, but at first, we intend to emphasize some crucial indicators of the banking system of Uzbekistan.

In particular, capital sufficiency rate in the banking system of Uzbekistan adds up to 24 %, and this percentage is three times as much as the rate (8 %) required by international banking regulation requirements of Basel Committee, and as for January 1, 2014 bank capital in Uzbekistan has amounted to over 6.5 trillion UZS (Fig. 1). (Karimov, 2014)

In the last years, the amount of total capital of commercial banks in Uzbekistan has been dramatically increasing. This, in turn, indicates that bank's liquid assets also soar during the given period.

Since 2013 bank assets have risen up to 30 %, and as for January 1, 2014 they added up to more than 43.8 trillion UZS (Fig. 2).

In 2012, commercial banks of Uzbekistan carried out extensive measures to improve the competitiveness of national economy, to encourage production branches and contemporary enterprises with high technological potential.

As a result, in 2012 total amount credits directed to real sector of economy tripled compared to 2011 and its amount reached almost 26.5 trillion UZS in 2014 (Fig. 3).

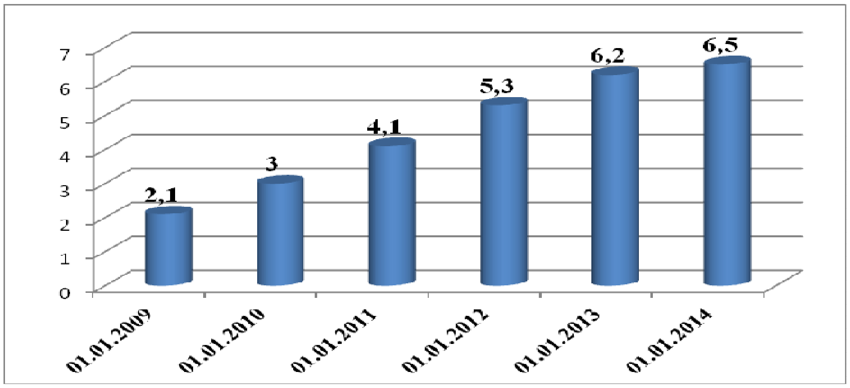

Fig. 1. Dynamics of total capital of banks in Uzbekistan

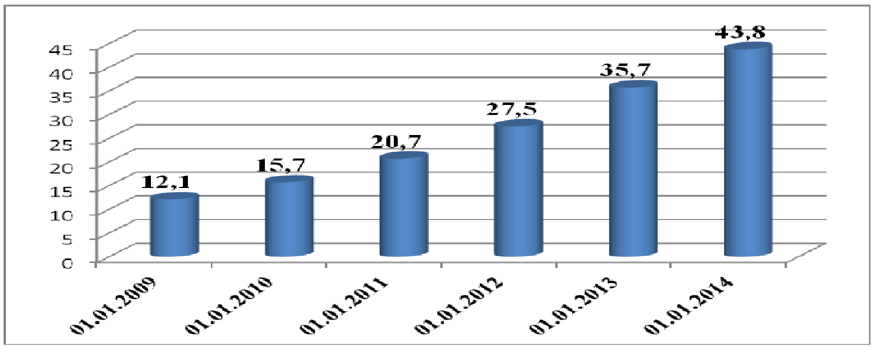

Fig. 2. Dynamics of total bank assets (trillion UZS)

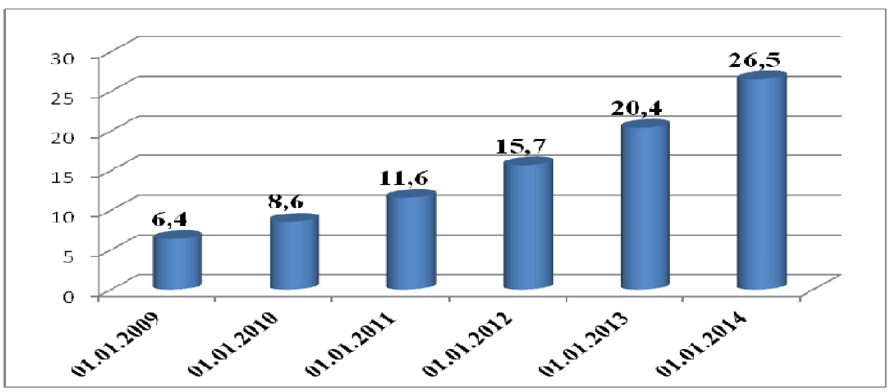

Fig. 3. The dynamics of directed credit to real sector of economy (trillion UZS)

The proportion of credits administered from internal resources amounted to 85.8 % of total credit portfolio of commercial banks. Long-term credits which are given for longer periods than three years reached 30.9 % increase whereas it constituted around 76.8 % of aggregate credit portfolio. In order to improve small business and private entrepreneurship, there have been various efforts to supervise the implementation of president decrees and initiatives dedicated to creating favorable business condition giving more freedom to entrepreneurs.

1. The Central bank of the Republic of Uzbekistan implemented an array of reforms in order to adopt up-to-date bank requirements worked out by Basel Committee. For instance, No. 36 / 1 decree were adopted to include changes and annexes to the 2012 year central bank chart- “requirements of commercial bank liquidity”. On the basis of new suggestions of Basel Committee on banking supervision several changes and annexes were included to above mentioned decree. They are believed to operate step by step in the near future. (URMB)

According to the decrees the following new requirement on the liquidity of commercial banks (BIS):

1. Liquidity Coverage Ratio(LCR) – From January 2015:

R(LC) = High liquidity asset/ liabilities(Dateless and under 30 days)≥ 100%

According to this equation the ratio of high liquidity assets (Dateless and under 30 days) should not be less than 100 percent.

2. The Net Stable Funding Ratio(NSFR) – from 2018:

R(NSF) = Real stable financing funding / Required stable financing capital ≥ 100%

According to this ratio of Real stable financing funding to required stable financing capital should not be less than 100 %. Moreover, new decree No. 36 / 2 was adopted by Board of Directors of Central bank to make possible changes and annexes to the chart called requirement adequacy on capital of commercial banks.

On the basis of new suggestions of Basel Committee on banking supervision changes and annexes were included in above shown chart, they are said to be adopted in banking system of Uzbekistan step by step. In particular, according to new standards, degree of bank balance assets is divided into 5 groups. They are 0, 20, 50, 10, and 150 percentage risk coefficient. In other words, 150 % risk degree is implemented to unlevied assets and which are within cord process.

According to new requirements, from 2015, minimum requirements for bank capital adequacy with bank credit risk amount operational and market risks of banks are also taken into account.

Operational and market risk sums are determined in the following way:

Operational risk = 10 (the average amount of final three year gross revenue of bank* 15%)

Here the gross revenue = percentage revenue – Percentage expenditure + other revenues

From January, 2016 the minimum degree of regulatory capital adequacy coefficient is 0.015(11.5%)

Capital adequacy requirement = Regulatory capital / Risk weighted assets ≥ 11.5%

In addition from January, 2016 the coefficient of Tier I capital adequacy is said to be 0.075 (7.5%) which is the minimum degree of Tier II capital.

Tier I capital adequacy coefficient = Tier I capital / risk weighted assets (credit risk + market risk + operational risk ≥ 7.5%

From 2019 commercials should provide at the 0.145 (14.5%) taking into account capital conservative buffer which is 3% of risk assets of Tier 1 capital minimum degree.

Capital adequacy coefficient= regulatory capital / risk weighted assets (credit risk + operational risk + market risk) ≥ 14.5%

Capital conservative buffer is considered to be additional reserve which is 3.0% of asset risk. The main reason to create such a reserve is to guarantee the losses through applying capital reserve.

The adoption of these new changes brought the development of bank supervision legislative documents on the base of international standards. But it is important to understand other side of the coin as well. During the calculation of risk weighted assets, extra risk may cause bank capital adequacy indices to fall. Because, in most cases, the amount of operation of risk weighted assets may constitute huge amounts of money.

Applying Basel III requirements into the Banking system of Uzbekistan step by step will result in the implementation of the new requirements by domestic commercial banks, avoiding rapid reduction of capital sufficiency indicators, and meeting norms of current liquidity stagnantly by banks.

In sum, this initiative will help our country to stabilize the banking system of Uzbekistan further.

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